IFRS compared to US GAAP
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A changing focus

Both the FASB and the IASB believe that the era of sweeping accounting change has come to an end, for now, and both are committed to helping companies implement the new major standards.

Although they will continue to make incremental changes to their respective GAAPs, convergence is not a continuing priority, and there are no formal joint FASB-IASB projects currently planned. Instead, there’s a change in focus to enhancing transparency through better communication between companies and the users of their financial statements, such as investors and analysts.

This is clearly visible in the IASB’s ‘Better communication in financial reporting’ initiative, which focuses on principles for more transparent and to-the-point disclosures, a balanced use of non-GAAP measures and a fresh look at performance reporting overall. The IASB also wants to expand its reach beyond the four corners of the financial statements by working to promote a stronger link between financial statements and financial disclosures outside those statements as part of a new project on ‘Wider corporate reporting’.

Against this backdrop, we are pleased to publish this 2017 edition of our comparison of IFRS and US GAAP, which highlights the key differences between the two frameworks. If you’re a preparer, it may help you to identify areas to emphasise in the financial statements; if you’re a user, it may help you spot areas to focus on in your dialogue with preparers.

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About this publication

**Purpose**

The purpose of this publication is to help you understand the significant differences between IFRS and US GAAP. Although it does not discuss every possible difference, this publication provides a summary of those differences that we have encountered most frequently, resulting from either a difference in emphasis, specific application guidance or practice. The focus of this publication is primarily on recognition, measurement and presentation. However, areas that are disclosure-based, such as segment reporting and the assessment of going concern, are also covered.

**Scope**

This publication highlights the main differences of principle, emphasis or application between IFRS and US GAAP. It does not address the requirements of the IFRS for Small and Medium-sized Entities or the initiative of the FASB and the Private Company Council in determining accounting alternatives for private companies under US GAAP. It also does not address the requirements of IAS 26 Accounting and Reporting by Retirement Benefit Plans or the equivalent US GAAP. Otherwise, this publication addresses the types of businesses and activities that IFRS addresses. So, for example, biological assets are included, but accounting by not-for-profit entities is not. In addition, this publication focuses on consolidated financial statements – separate (i.e. unconsolidated) financial statements are not addressed.

Lastly, the requirements of IFRS are discussed on the basis that the entity has adopted IFRS already and therefore the following are excluded from this publication: IFRS 1 First-time Adoption of IFRS and IFRS 14 Regulatory Deferral Accounts. The special transition requirements that apply in the period in which an entity changes its GAAP to IFRS, including the implications for an entity in the scope of IFRS 14, are discussed in our publication Insights into IFRS, KPMG’s practical guide to International Financial Reporting Standards – find out more at kpmg.com/ifrs.

**Organisation of the text**

This publication is largely organised consistently with Insights into IFRS. It summarises the requirements of IFRS in the left-hand column. In the right-hand column, it compares US GAAP to IFRS, highlighting similarities and differences. At the start of each chapter is a brief summary of the key requirements of IFRS, contrasted with the parallel requirements of US GAAP. The summary provides a quick overview for easy reference, but is not detailed enough to allow a full understanding of the significant differences.

Although we have highlighted what we regard as significant differences, we recognise that the significance of any difference will vary by entity. Some differences that appear major may not be relevant to your business; by contrast, a seemingly minor difference may cause you significant additional work. One way to obtain an appreciation of the differences that may affect your business is to browse through the summary at the start of each chapter.

In certain cases, this publication includes the specific views that we have developed in the absence of explicit guidance under IFRS or US GAAP. In some cases, we note what we would expect in practice, and in other cases we simply note that practice varies or may vary.

Our commentary is referenced to current IFRS literature and the US Accounting Standards Codification (FASB ASC or Codification) as follows.

- In respect of IFRS, references in square brackets identify any relevant paragraphs of the standards or other literature – e.g. IAS 1.54 is paragraph 54 of IAS 1; IAS 18.1E1 is paragraph 1 of the IAS 18 illustrative examples. References to IFRS Interpretations Committee decisions, addressed in its
publication IFRIC Update, are also indicated – e.g. IU 01-13 is IFRIC Update January 2013.

– In respect of US GAAP, references in square brackets identify any relevant paragraphs of the Codification – e.g. 220-10-45-3 is paragraph 45-3 of ASC Subtopic 220-10; TPA 1300.15 is paragraph 15 of TPA 1300. References to SEC Regulations S-X or S-K are also indicated.

The references at the start of each chapter indicate the main literature related to that topic, based on currently effective requirements.

**Effective dates**

Generally, the standards and interpretations included in this publication are those that are mandatory for an annual reporting period beginning on 1 January 2017 – i.e. ignoring standards and interpretations that might be adopted before their effective dates. New standards and interpretations published by 1 December 2017, but not effective for an annual reporting period beginning on 1 January 2017, are briefly mentioned at the end of the relevant chapter (as forthcoming requirements) to the extent that we believe them significant to an understanding of the differences between IFRS and US GAAP. As an exception, the following forthcoming requirements are the subject of separate chapters: 4.2A ‘Revenue from contracts with customers’ and 5.1A ‘Leases’. These chapters do not discuss transition requirements. See below for information on how we have approached financial instruments and insurance.

New standards and interpretations issued by the IASB have a single effective date. In contrast, those issued by the FASB usually have at least two effective dates: one for public business entities and one for other entities. This may be further nuanced by including certain other entities (e.g. employee benefit plans that file their financial statements with the SEC) with public business entities, and in some cases the effective date for public business entities is further split between SEC filers and non-SEC filers. This means that the effective date of a pronouncement can be spread over two or even three years. The appendix provides a table of effective dates under US GAAP to help you navigate the new requirements included in forthcoming requirements that are not yet (fully) effective. For effective dates under IFRS, see [Newly effective standards](#).

**Financial instruments and insurance**

IFRS 9 [*Financial Instruments*](#), which replaces the currently effective standard, IAS 39 [*Financial Instruments: Recognition and Measurement*](#), is effective for annual periods beginning on or after 1 January 2018. The equivalent new standards under US GAAP have various effective dates: 2018 (recognition and measurement), 2019 (hedging) and 2020 (credit impairment); see appendix.

IFRS 17 [*Insurance Contracts*](#) is effective for annual periods beginning on or after 1 January 2021, and the FASB continues its work to make targeted improvements to the accounting for long-duration insurance contracts. This edition of our GAAP Comparison focuses only on currently effective requirements under both IFRS and US GAAP.

**Reporting date and reporting period**

Throughout this publication, we refer to the ‘reporting date’ and ‘end of the reporting period’. Similarly, we refer to the ‘reporting period’ rather than to the fiscal year.

Occasionally we refer to the ‘annual reporting date’ or the ‘annual reporting period’ to emphasise the annual nature of the underlying requirement; for example, under IFRS we refer to the residual value of intangible assets with finite lives being reviewed at least at each annual reporting date. However, this is not meant to imply that other references should be interpreted as applying to both the annual and the interim reporting date or period. The requirements for interim financial reporting are discussed in chapter 5.9 ‘Interim financial reporting’, and there we refer to the ‘interim reporting date’ and the ‘interim reporting period’.
1 Background

1.1 Introduction

(IfRS Foundation Constitution, IASB and IFRS Interpretations Committee Due Process Handbooks, Preface to IFRSs, IAS 1)

Overview

- ‘IFRS’ is the term used to indicate the whole body of IASB authoritative literature.

- Individual standards and interpretations are developed and maintained by the IASB and the IFRS Interpretations Committee.

- IFRS is designed for use by profit-oriented entities.

- Any entity claiming compliance with IFRS complies with all standards and interpretations, including disclosure requirements, and makes an explicit and unreserved statement of compliance with IFRS.

- The overriding requirement of IFRS is for the financial statements to give a fair presentation (or a true and fair view).

1.1 Introduction

(Topic 105, Master Glossary, SEC Rules and Regulations, AICPA Code of Professional Conduct)

Overview

- ‘US GAAP’ is the term used to indicate the body of authoritative literature that comprises accounting and reporting standards in the US. Rules and interpretative releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants.

- Authoritative US GAAP is primarily developed and maintained by the FASB, with the assistance of the Emerging Issues Task Force and the Private Company Council.

- Unlike IFRS, US GAAP is designed for use by both profit-oriented and not-for-profit entities, with additional Codification topics that apply specifically to not-for-profit entities.

- Like IFRS, any entity claiming compliance with US GAAP complies with all applicable sections of the Codification, including disclosure requirements. However, unlike IFRS, an explicit and unreserved statement of compliance with US GAAP is not required.

- The objective of financial statements is fair presentation in accordance with US GAAP, which is similar to the overriding requirement of IFRS.
International Financial Reporting Standards

‘International Financial Reporting Standards’ (IFRS) is the term used to indicate the whole body of authoritative literature of the IASB. IFRS includes:

– standards issued by the IASB;
– International Accounting Standards (IAS) issued by the IASB’s predecessor, the International Accounting Standards Committee (IASC), or revisions thereof issued by the IASB;
– interpretations of IFRS and IAS developed by the IFRS Interpretations Committee and approved for issue by the IASB; and
– interpretations developed by the IFRS Interpretations Committee’s predecessor, the Standing Interpretations Committee (SIC) and approved for issue by the IASB or the IASC. [P5]

The term ‘IFRS’ is used in this publication to indicate any of the above material.

IFRS is designed for use by profit-oriented entities, although its use by not-for-profit entities is not prohibited. [P9]

If it is permitted in a particular jurisdiction, then small and medium-sized entities (SMEs) that have no public accountability (as defined) may prepare their financial statements in accordance with the IFRS for SMEs rather than full IFRS.

US Generally Accepted Accounting Principles

All authoritative US GAAP is contained in the FASB’s Accounting Standards Codification®. Codified US GAAP comprises authoritative GAAP as of 30 June 2009, which was carried forward into the Codification, and subsequent Accounting Standards Updates (ASUs) issued by the FASB. The FASB’s Emerging Issues Task Force (EITF) considers interpretive issues, and final consensus are approved for issue by the FASB as an ASU.

Relevant portions of content issued by the SEC and selected SEC interpretations and administrative guidance are included in the Codification for reference purposes; however, the original source remains authoritative for SEC registrants.

Accounting and financial reporting practices not included in the Codification are non-authoritative and include, for example, FASB Concepts Statements, Issues Papers and Technical Practice Aids issued by the American Institute of Certified Public Accountants, and IFRS as issued by the IASB.

The term ‘US GAAP’ is used in this publication to indicate any material that is contained in the Codification and some of the material contained in SEC rules, regulations and Staff guidance as well as other non-authoritative guidance.

Unlike IFRS, US GAAP is developed for use by profit-oriented and not-for-profit entities, with additional Codification topics that apply specifically to not-for-profit entities. Separate standards exist for government entities. [105-10-05-1, 05-4]

US private entities may prepare their financial statements in accordance with US GAAP, full IFRS as issued by the IASB or the IFRS for SMEs if they have no public accountability.

In addition, the FASB and the Private Company Council (PCC) issued a Framework that acts as a guide for the FASB and the PCC in determining when accounting alternatives should be considered for private companies. The Framework addresses factors that differentiate private companies from public companies and notes that these differences could support differences in the recognition and measurement, presentation, disclosure, effective date and transition requirements for private vs public companies. The FASB uses a single definition for a public business entity (see Appendix) that is used to identify the types of business entities that are not eligible to use the private company exceptions and alternatives issued or to be issued by the FASB.
Financial statements prepared in accordance with the IFRS for SMEs are not in compliance with IFRS.

The IFRS for SMEs is outside the scope of this publication.

There are no special standards or exemptions for SMEs that apply full IFRS. However, EPS and segment information are not required for non-public entities.

IFRS is not limited to a particular legal framework. Therefore, financial statements prepared under IFRS often contain supplementary information required by local statute or listing requirements.

IFRS comprises a series of bold and plain-type paragraphs. Generally, the bold paragraphs outline the main principle, and the plain-type paragraphs provide further explanation. Bold and plain-type paragraphs have equal authority. Some IFRSs contain appendices; a statement at the top of each appendix specifies its status. The bases for conclusions that accompany standards are not an integral part of those standards and do not have the same level of authority. [P.13]

IFRS sometimes includes optional accounting treatments. For each choice of accounting treatment, an entity applies that policy consistently (see chapter 2.8). [IAS 8.13]

Standards and interpretations issued by the IASB have a single effective date that applies to all entities. New requirements apply in interim periods within the annual period in which they are adopted, unless the transitional requirements of the standard permit or require a different transition (see chapter 5.9). [IAS 34.43]

Financial statements prepared by private companies in accordance with the FASB’s private company alternatives are in compliance with US GAAP, which is a different approach from IFRS.

The private company regime is outside the scope of this publication.

Unlike IFRS, there are special standards or exemptions from some recognition and/or measurement requirements for non-public entities that apply full US GAAP from the requirements that apply to public business entities. Additionally, certain presentations (e.g. EPS and segment information) and a variety of disclosures are not required for non-public entities, which is broader than the disclosure exemptions under IFRS.

Unlike IFRS, entities asserting compliance with US GAAP that are subject to SEC regulations apply the formal and informal presentation, interpretative and disclosure requirements of the SEC, including those found in Regulations S-X and S-K. As a result, there are some differences between US GAAP as applied by public entities and US GAAP as applied by non-public entities – e.g. the presentation of certain redeemable securities (see chapter 7.3). [105-10-05-1, 05-4]

Like IFRS, all paragraphs in the Codification have equal authority. The main principle is contained in the main body of the guidance and further explanation is included in implementation guidance. Only the material appearing in the Codification is authoritative. The bases for conclusions are not included in the Codification. [105-10-05-1]

Like IFRS, US GAAP sometimes includes optional accounting treatments. If an option is available, unless preferability is specifically indicated (e.g. the successful-efforts method for oil and gas producers – see chapter 5.11), then each one is considered equally acceptable; however, one of the options may be considered preferable by the entity and its auditors in its own specific situation. Like IFRS, for each choice of accounting treatment, an entity applies the chosen policy consistently (see chapter 2.8). [250-10-45-11 – 45-13]

ASUs issued by the FASB usually have at least two effective dates:
- an effective date for public business entities, which may be further separated into an effective date for SEC filers and an effective date (a year later) for public business entities that are not SEC filers; and
- an effective date for other entities, which is a year later than the furthest effective date for public business entities.
Compliance with IFRS

Any entity asserting that a set of financial statements is in compliance with IFRS complies with all applicable standards and related interpretations, and makes an explicit and unreserved statement of compliance in the notes to the financial statements. Compliance with IFRS encompasses disclosure as well as recognition and measurement requirements. (IAS 1.16)

The IASB does not carry out any inquiry or enforcement role regarding the application of its standards. However, this is often undertaken by local regulators and/or stock exchanges, which includes the SEC for non-US companies.

Unlike IFRS, ‘other entities’ are often not required to apply new requirements in interim periods until the second annual period to which the new requirements apply.

Compliance with US GAAP

Like IFRS, any entity asserting that a set of financial statements is in compliance with US GAAP complies with all applicable sections of the Codification, including disclosures. However, unlike IFRS, an explicit and unreserved statement of compliance is not required.

Like IFRS, the FASB does not carry out any inquiry or enforcement role regarding the application of its guidance. In the US, this role is undertaken by the SEC for SEC registrants, whether domestic or foreign, and by federal, state and local regulators, law enforcement and stock exchanges for entities that are listed on an exchange.

The financial statements of domestic SEC registrants are prepared in accordance with US GAAP and in conformity with other SEC regulations regarding accounting and disclosures, and form part of the Annual Report on Form 10-K that is filed on public record with the SEC. (105-10-06-1, 05-4)

Most foreign SEC registrants are required to prepare and file their Annual Report on Form 20-F in accordance with either US GAAP or another comprehensive basis of accounting, in which case net income and shareholders’ equity are reconciled to US GAAP. The reconciliation is accompanied by a discussion of significant variations in accounting policies, practices and methods used in preparing the financial statements from US GAAP and Regulation S-X. However, a foreign private issuer that prepares its financial statements in accordance with IFRS as issued by the IASB is not required to present such a reconciliation or the accompanying discussion of variations from US GAAP and Regulation S-X. This exemption is permitted only if the financial statements filed with the SEC contain an explicit and unreserved statement of compliance with IFRS as issued by the IASB, which is also referred to in the auditor’s report. [SEC Release No. 33-8879]

Entities’ filings on Forms 10-K (generally used for US domestic issuers) or 20-F (generally used for foreign private issuers) are reviewed by the SEC Staff at least once every three years in accordance with the requirements of the Sarbanes-Oxley Act. The filings are reviewed for compliance with the stated basis of accounting and other relevant regulations. The review findings are communicated by comment letters from the SEC Staff to the entity.
When a foreign business is acquired by an SEC registrant, Regulation S-X allows for the inclusion of financial statements prepared in accordance with non-IASB IFRS or local GAAP (without reconciliation to US GAAP) if the acquired business is below the 30 percent level for all of the ‘significance tests’; at or above 30 percent, a reconciliation to US GAAP is included for the most recent two annual and interim periods. No US GAAP reconciliation is required for the inclusion of financial statements of an acquired foreign business if the business uses IFRS as issued by the IASB. [SEC FRM §63501, Rule 3-05(c)]

The amounts used for the 30 percent test are determined on the basis of US GAAP for issuers that file their financial statements in accordance with or provide a reconciliation to US GAAP, or IFRS as issued by the IASB for foreign private issuers, rather than based on non-IASB IFRS or local GAAP. [Reg S-X, Rule 3-05, Rule 8-04]

**XBRL**

eXtensible Business Reporting Language (XBRL) is a form of electronic communication whose main feature includes interactive electronic tagging of both financial and non-financial data. The IFRS Taxonomy is a translation of IFRS into XBRL. It classifies information presented and disclosed in IFRS financial statements and reflects presentation and disclosure requirements in IFRS Standards.

The IASB is not issuing requirements to file under the IFRS Taxonomy; the submission of IFRS financial statements in XBRL is mandated by regulators in their jurisdiction.

**Fair presentation**

The overriding requirement of IFRS is for the financial statements to give a fair presentation (or true and fair view). Compliance with IFRS, with additional disclosure when necessary, is presumed to result in a fair presentation. [IAS 1.15]

**Fair presentation in accordance with US GAAP**

The objective of US GAAP is fair presentation in accordance with US GAAP which is similar to the overriding requirement of IFRS. Like IFRS, compliance with US GAAP, with additional disclosure when necessary, is presumed to result in a fair presentation. [105-10-10-1, 15-1]
If compliance with a requirement of an IFRS would be so misleading that it would conflict with the objective of financial reporting set out in the Conceptual Framework (see chapter 1.2), then an entity departs from the required treatment to give a fair presentation, unless the relevant regulator prohibits such an override. If an override cannot be used because it is prohibited by the regulator, then additional disclosure is required in the notes. The use of a true and fair override is very rare under IFRS.

Like IFRS, when compliance with the Codification would be misleading due to unusual circumstances, an entity departs from the Codification topic so that the financial statements will not be misleading. In this case, the entity discloses the effects of the departure and why compliance would render the financial statements misleading, like IFRS. However, in our experience the use of such an override does not occur in practice.
1.2 The Conceptual Framework

(Conceptual Framework for Financial Reporting)

Overview

– The Conceptual Framework is used in developing and maintaining standards and interpretations.

– The Conceptual Framework is a point of reference for preparers of financial statements in the absence of specific guidance in IFRS.

– Transactions with shareholders in their capacity as shareholders are recognised directly in equity.

Introduction

The IASB’s Conceptual Framework for Financial Reporting (the Conceptual Framework) provides a broad discussion of the concepts that underlie the preparation and presentation of financial statements. It discusses the objective of general purpose financial reporting; the qualitative characteristics of useful financial information, such as relevance and faithful presentation; the underlying assumptions of financial statements; and the elements of financial statements.

The IASB uses the Conceptual Framework as an aid to drafting new or revised IFRSs. The Conceptual Framework also provides a point of reference for preparers of financial statements in the absence of any specific standards on a particular subject (see chapter 1.1).

Assets and liabilities

‘Assets’ are resources that are controlled by the entity as a result of past events, from which future economic benefits are expected to flow to the entity. [CF:4.4]

1.2 The Conceptual Framework


Overview

– Like IFRS, the Conceptual Framework establishes the objectives and concepts that the FASB uses in developing guidance.

– Unlike IFRS, the Conceptual Framework is non-authoritative guidance and is not referred to routinely by preparers of financial statements.

– Like IFRS, transactions with shareholders in their capacity as shareholders are recognised directly in equity.

Introduction

Like IFRS, the FASB Concepts Statements (the Conceptual Framework) establish the objectives of financial reporting, identify the qualitative characteristics of accounting information, define the elements of financial statements and discuss recognition, measurement and the presentation of a complete set of financial statements. [CON 5, 6, 8]

Like IFRS, the FASB uses its Conceptual Framework as an aid to drafting new or revised guidance. However, unlike IFRS, the Conceptual Framework is non-authoritative guidance (see chapter 1.1) and therefore is not generally used as a point of reference for preparers of financial statements.

Assets and liabilities

Like IFRS, the definition of ‘assets’ encompasses future economic benefits that are obtained or controlled by an entity as a result of past transactions or events. [CON 6.25]
‘Liabilities’ are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. [CF.4.4]

An item that meets the definition of an asset or liability is recognised when:
- it is probable that any future economic benefit associated with the item will flow to (asset) or from (liability) the entity; and
- the asset or liability has a cost or value that can be measured reliably. [CF.4.38]

The term ‘probable’ is not defined in the Conceptual Framework, although it is defined in the provisions standard as more likely than not (see chapter 3.12). [IAS 3723]

An ‘executory contract’ is one in which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. Although the rights and obligations under executory contracts generally meet the definition and recognition criteria of assets and liabilities, in our experience they are not recognised in the financial statements to the extent that the rights and obligations have equal value, or the rights have a value greater than the obligations. If a contract is onerous, then a provision is recognised (see chapter 3.12). [IAS 373, 66, 68]

The modified historical cost convention

IFRS requires financial statements to be prepared on a modified historical cost basis, with a growing emphasis on fair value. ‘Fair value’ is 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 – i.e. an exit price (see chapter 2.4). [IFRS 13.9, A]

Like IFRS, the definition of ‘liabilities’ encompasses future sacrifices of economic benefits arising from present obligations to transfer assets or provide services to other entities in the future as a result of past transactions or events. [CON 6.35]

Like IFRS, an item that meets the definition of an asset or liability is recognised when it has a cost or value that can be measured reliably. Unlike IFRS, the probability of cash inflows or outflows is part of the definition of an asset or liability and not a recognition requirement; however, the concepts are similar and we have not experienced differences in practice. [CON 5.63, 6.25, 6.35]

Unlike IFRS, the term ‘probable’ as used in the Conceptual Framework refers to that which can be reasonably expected or believed on the basis of available evidence or logic, but is neither certain nor proved. Unlike IFRS, in the Codification (see chapter 1.1) ‘probable’ is defined as when the future events are likely to occur. Therefore, differences from IFRS may result in practice and are discussed throughout this publication. [CON 6.fn18, ASC Master Glossary]

Unlike IFRS, US GAAP does not define an executory contract. However, the US Bankruptcy Code (Chapter 11) defines an executory contract and states as the standard feature that each party to the contract has duties remaining under the contract. Furthermore, the EITF has discussed the term ‘executory contract’ in broadly the same manner as under IFRS. Practice under US GAAP is not to recognise executory contracts unless a specific Codification topic/subtopic requires recognition, like IFRS. However, unlike IFRS, US GAAP does not have a general requirement to recognise onerous contracts (see chapter 3.12).

The modified historical cost convention

Like IFRS, financial statements are prepared on a modified historical cost basis with a growing emphasis on fair value. Like IFRS, ‘fair value’ is 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 – i.e. an exit price (see chapter 2.4). [B20-10-20]
The carrying amounts of the following assets and liabilities are based on fair value measurements subsequent to initial recognition.

- Derivatives, financial assets and financial liabilities classified as held-for-trading or designated as at fair value through profit or loss, and financial assets classified as available-for-sale are measured at fair value (see chapter 7.6).
- Biological assets are measured at fair value less costs to sell (see chapter 3.9).
- In general, an investment entity measures investments in subsidiaries at fair value subject to certain conditions (see chapter 3.2).
- Certain intangible assets may be revalued to fair value (see chapter 3.3).
- Investment property may be measured at fair value (see chapter 3.4).
- Inventories held by commodity broker-traders may be measured at fair value less costs to sell (see chapter 3.8).

As described below, US GAAP differs from IFRS in respect of the underlying measurement basis of some items.

- Derivatives, investments classified as held-for-trading, investments in securities classified as available-for-sale, and financial instruments for which the fair value option is elected are measured at fair value (see chapter 7.6), like IFRS; however, differences from IFRS exist on which instruments qualify for the related accounting.
- Agricultural assets are measured at historical cost until they are harvested, at which point they are measured at estimated selling price less costs of disposal (see chapter 3.9), unlike IFRS.
- In general, an investment company measures investments in subsidiaries at fair value, like IFRS (see chapter 5.6).
- The revaluation of property, plant and equipment to fair value is not permitted under US GAAP (see chapter 3.2), unlike IFRS.
- The revaluation of intangible assets to fair value is not permitted under US GAAP (see chapter 3.3), unlike IFRS.
- Investment property is not permitted to be measured at fair value under US GAAP (see chapter 3.4), unlike IFRS.
- Broker/dealers that apply the specialised industry guidance measure commodity inventories at fair value, which may result in differences from IFRS in practice.

Additionally, discounting and value-based measurements are an integral part of financial reporting under IFRS in some areas, including impairment testing (see chapter 3.10) and provisions (see chapter 3.12).

Materiality

IFRS does not apply to items that are ‘immaterial’. The term is not defined quantitatively, and depends on the facts and circumstances of a particular case; both the size and the nature of an item are relevant. Consideration of materiality is relevant to judgements about both the selection and the application of accounting policies and to the omission or disclosure of information in the financial statements, and is judged based on whether the information would influence the decisions of financial statement users. [CFQC11, BC3.18, IAS 1.7 8.5]

Like IFRS, US GAAP does not apply to items that are ‘immaterial’. Also like IFRS, materiality is not defined quantitatively, but rather is the magnitude of an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgement of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement. Entities are required to consider both the quantitative and the qualitative aspects of an error in determining whether it is material to the financial statements, like IFRS. Unlike IFRS, in assessing whether an error is quantitatively material, SEC registrants are required to use the ‘dual method’, which uses the greater of a ‘rollover’ (based on the income statement) and an ‘iron curtain’ (based on the statement of financial position) amount. [SAB Topics 1.M, 1.N]
Accounting policies selected in accordance with IFRS do not need to be applied when their effect is immaterial. [IAS 8.8]

Consideration of materiality is also relevant when making judgements about disclosure, including decisions about whether to aggregate items, and/or use additional line items, headings or subtotals. Material items that have different natures or functions cannot be aggregated. In addition, IFRS does not permit an entity to obscure material information with immaterial information. [IAS 1.30A–31]

Financial statements do not comply with IFRS if they contain either material errors, or immaterial errors that are made intentionally to achieve a particular presentation of an entity’s financial position, financial performance or cash flows. [IAS 8.8, 41]

**Transactions with equity holders**

The definitions of income and expenses exclude capital transactions with equity holders acting in that capacity. Accordingly, capital contributions from shareholders are recognised directly in equity, as are dividends paid (see chapter 7.3). However, the position is less clear when a transaction with a shareholder equally could have been with a third party. In these cases, the accounting is generally based on whether the shareholder was acting as a ‘normal’ counterparty. [CF4.25]

The share-based payment standard requires the attribution of expense for certain share-based payment transactions (see chapter 4.5). However, there is no overriding principle under IFRS that requires transactions entered into or settled by a shareholder on behalf of an entity to be attributed to the entity and reflected in its financial statements.

**Emerging from bankruptcy**

IFRS does not provide special guidance on the accounting by entities emerging from bankruptcy or a quasi-reorganisation; instead, the usual requirements of IFRS apply.

Like IFRS, accounting policies selected in accordance with US GAAP do not need to be applied when their effect is immaterial. [105-10-05-6]

Unlike IFRS, there is no specific guidance on the materiality of disclosures; instead, the general principles outlined in this chapter apply. Many entities conclude that if a Codification Topic is material, then all required disclosures within that Topic are required, which may result in differences from IFRS in practice.

Like IFRS, financial statements are not considered to comply with US GAAP if they contain material errors (including of disclosures). Also like IFRS, errors that are made intentionally to achieve a particular presentation of an entity’s financial position, financial performance or cash flows are considered to be qualitatively material. [250-10-20, SAB Topic 1.M]

**Transactions with equity holders**

Like IFRS, all transfers between an entity and its equity holders acting in that capacity, including investments by owners and distributions to owners, are recognised directly in equity (see chapter 7.3). However, because there are circumstances in which an entity evaluates whether the transaction was with the party in its role as a shareholder or on behalf of the entity, differences from IFRS may arise in practice. [CON 6.66 – 69]

Like IFRS, if a shareholder settles share-based payment expenses on behalf of the entity, then US GAAP requires the attribution of expense in the entity’s financial statements. However, unlike IFRS, similar accounting is required in other circumstances and transactions in which a principal shareholder pays an expense for the entity, unless the shareholder’s action is caused by a relationship or obligation completely unrelated to their position as a shareholder or clearly does not benefit the entity. [SAB Topic 5.T]

**Emerging from bankruptcy**

Unlike IFRS, fresh-start reporting is applied by entities emerging from bankruptcy if the reorganisation value of the assets of the emerging entity immediately before the date of confirmation is less than the total of all post-petition liabilities and allowed claims, and the holders of existing voting shares immediately before confirmation receive less than 50% of the voting shares of the emerging entity, or for a quasi-reorganisation. [852-10-45-19 – 45-21]
2 General issues

2.1 Basis of preparation of financial statements

Overview

– Financial statements are prepared on a going concern basis, unless management intends or has no realistic alternative other than to liquidate the entity or to stop trading.

– If management concludes that the entity is a going concern, but there are nonetheless material uncertainties that cast significant doubt on the entity’s ability to continue as a going concern, then the entity discloses those uncertainties.

– In carrying out its assessment of going concern, management considers all available information about the future for at least, but not limited to, 12 months from the reporting date. This assessment determines the basis of preparation of the financial statements.

– If the entity is not a going concern and the financial statements are being prepared in accordance with IFRS, then in our view there is no general dispensation from the measurement, recognition and disclosure requirements of IFRS.

US

2.1 Basis of preparation of financial statements

Overview

– Financial statements are generally prepared on a going concern basis (i.e. the usual requirements of US GAAP apply) unless liquidation is imminent. Although this wording differs from IFRS, we would not expect differences in practice.

– If management concludes that the entity is a going concern, but there is substantial doubt about the entity’s ability to continue as a going concern, then disclosures are required, like IFRS. However, the disclosures are more prescriptive than IFRS, which may lead to differences in practice. Additionally, if management’s plans mitigate the doubt, then other disclosures are required, which may give rise to differences from IFRS in practice.

– Unlike IFRS, the assessment of going concern is for a period of time of one year from the financial statements being issued (available for issue). Unlike IFRS, this assessment is for the purpose of determining whether the disclosures in the financial statements are appropriate, and the basis of preparation is not affected unless liquidation is imminent.

– Unlike IFRS, if liquidation is imminent, then there are specific requirements for the measurement, recognition and disclosures under US GAAP.
**Going concern assessment**
Financial statements are prepared on a going concern basis, unless management intends or has no realistic alternative other than to liquidate the entity or to stop trading. [IAS 1.25]

Management assesses the entity’s ability to continue as a going concern for the purpose of determining the basis of preparation of the financial statements. [IAS 1.25]

In assessing whether the going concern assumption is appropriate, management assesses all available information about the future for at least, but not limited to, 12 months from the reporting date. [IAS 1.26]

IFRS is not prescriptive about the events and conditions that should be considered as part of the going concern assessment.

**Going concern assessment**
Financial statements are prepared on a going concern basis, unless liquidation is imminent at the reporting date. Although this wording differs from IFRS, we would not expect differences in practice. [205-30-25-1]

Liquidation is ‘imminent’ when a plan for liquidation:
- has been approved by those with the authority to make such a plan effective, and the likelihood is remote that:
  - execution of the plan will be blocked by other parties (e.g. by shareholders); or
  - the entity will return from liquidation; or
- is imposed by other forces (e.g. involuntary bankruptcy) and the likelihood is remote that the entity will return from liquidation. [205-30-25-2]

Unlike IFRS, management assesses the entity’s ability to continue as a going concern for the purpose of determining the appropriate disclosures in the financial statements. There is no impact on the basis of preparation unless liquidation is imminent. [205-40-05-1]

Management assesses whether there is substantial doubt about the entity’s ability to continue as a going concern. In doing so, unlike IFRS, management considers information about whether it is probable that the entity will be unable to meet its obligations as they become due within one year of the date the financial statements are issued (or are available to be issued for non-public entities). [205-40-50-1 – 50-5]

In making this assessment, management considers both known and reasonably knowable events and conditions. The evaluation follows a two-step process.
- **Step 1.** Management’s initial assessment does not take into consideration the potential mitigating effects of management’s plans.
- **Step 2.** If Step 1 indicates that it is probable that the entity will be unable to meet its obligations when they become due, then management considers any plans to mitigate those conditions and events to determine whether there is substantial doubt about the entity’s ability to continue as a going concern. [205-40-50-3 – 50-11]

Although this two-step process is more prescriptive than IFRS, we would not expect differences in the types of events or conditions considered.
If an entity ceases to be a going concern after the reporting date but before the financial statements are authorised for issue, then the financial statements are not prepared on a going concern basis. [IAS 1.25-26, 10.14]

Disclosures about the going concern assessment
If management concludes that the entity is a going concern, but there are nonetheless material uncertainties that cast significant doubt on the entity’s ability to continue as a going concern, then the entity discloses those uncertainties. Even if there are no material uncertainties about an entity’s ability to continue as a going concern, an entity discloses any significant judgements made in reaching this conclusion (a ‘close call’ scenario). [IAS 1.25, 122, IU 07-14]

Unlike IFRS, if liquidation becomes imminent after the reporting date but before the financial statements are issued (which may be later than when the financial statements are authorised for issue), then the financial statements are prepared on a going concern basis. In this case, specific disclosures are required. [885-10-25-3 – 25-4]

Disclosures about the going concern assessment
Unlike IFRS, if there is substantial doubt about the entity’s ability to continue as a going concern, the extent of disclosures depends on whether that doubt is alleviated by management’s plans.

If that doubt is alleviated by management’s plans (i.e. substantial doubt does not exist), then the entity discloses:
- the principal conditions or events that raised substantial doubt about the entity’s ability to continue as a going concern (before consideration of management’s plans);
- management’s evaluation of the significance of those conditions or events in relation to the entity’s ability to meet its obligations; and
- management’s plans that alleviated substantial doubt about the entity’s ability to continue as a going concern. [205-40-50-12]

If that doubt is not alleviated by management’s plans (i.e. substantial doubt exists), then the entity discloses (in addition to the above) a statement that there is substantial doubt about the entity’s ability to continue as a going concern. [205-40-50-13 – 50-14]

In principle, these disclosures are similar to the types of disclosures that might be expected under IFRS. However, the more specific wording under US GAAP may lead to differences in practice – e.g. as a result of the specific definition of the term ‘substantial doubt’, the introduction of a probability threshold in determining whether the reporting entity will be unable to meet its obligations, and the two-step process used to determine the specific categories of disclosures applicable to an entity’s circumstances.
**Entity is not a going concern**
If the entity is not a going concern but the financial statements are being prepared in accordance with IFRS, then in our view there is no general dispensation from the measurement, recognition and disclosure requirements of IFRS. We believe that even if the going concern assumption is not appropriate, IFRS should be applied, with particular attention paid to the requirements for assets that are held for sale (see chapter 5.4), the classification of debt and equity instruments (see chapter 7.3), the impairment of non-financial assets (see chapter 3.10) and the recognition of provisions (see chapter 3.12).

For an entity in liquidation, all liabilities continue to be recognised and measured in accordance with the applicable standard until the obligations are discharged or cancelled or expire (see chapter 7.5).

**Subsidiary expected to be liquidated**
If a subsidiary (that is still controlled by the parent – see chapter 2.5) is expected to be liquidated and its financial statements are prepared on a non-going concern basis, but the parent is expected to continue as a going concern, then in our view the consolidated financial statements should be prepared on a going concern basis. We believe that the subsidiary should continue to be consolidated until it is liquidated or otherwise disposed of.

**Liquidation basis of accounting**
Unlike IFRS, if liquidation is imminent, then there are specific requirements for measurement, recognition and disclosures under US GAAP, including the following.
- The entity recognises previously unrecognised items (e.g. trademarks) that it expects either to sell in liquidation or to use to settle liabilities. Such items may be recognised in the aggregate.
- The entity recognises liabilities in accordance with the usual requirements of US GAAP, but also accrues the estimated costs to dispose of items that it expects to sell in liquidation. [205-30-25-4 – 25-6]

Unlike IFRS, when liquidation is imminent assets are generally measured – both initially and subsequently – at the estimated amount of consideration that the entity expects to collect in carrying out its plan for liquidation. [205-30-30-1]

In general, when liquidation is imminent liabilities are measured – both initially and subsequently – in accordance with the usual requirements of US GAAP, which differ from IFRS. In applying these requirements, an entity adjusts its liabilities to reflect changes in assumptions that are a result of its decision to liquidate (e.g. the timing of payments). However, like IFRS, an entity does not anticipate being legally released from being the primary obligor under a liability, either judicially or by the creditor. [205-30-30-2]

Unlike IFRS, as a minimum the entity prepares:
- a statement of net assets in liquidation; and
- a statement of changes in net assets in liquidation, incorporating only changes in net assets that occurred during the period since liquidation became imminent. [205-30-45-1 – 45-2]

**Liquidation of a subsidiary is imminent**
If the liquidation of a subsidiary (that is still controlled by the parent – see chapter 2.5) is imminent then, unlike IFRS, the parent’s consolidated financial statements incorporate the financial information of the subsidiary prepared on the liquidation basis of accounting. [205-30-15-1]
### Overview

- An entity with one or more subsidiaries presents consolidated financial statements unless specific criteria are met.

- The following are presented as a complete set of financial statements: a statement of financial position; a statement of profit or loss and OCI; a statement of changes in equity; a statement of cash flows; and notes, including accounting policies.

- All owner-related changes in equity are presented in the statement of changes in equity, separately from non-owner changes in equity.

- IFRS specifies minimum disclosures for material information; however, it does not prescribe specific formats.

- Comparative information is required for the preceding period only, but additional periods and information may be presented.

### US Overview

- Unlike IFRS, there are no exemptions, other than for investment companies, from preparing consolidated financial statements if an entity has one or more subsidiaries.

- Like IFRS, the following are presented as a complete set of financial statements: a statement of financial position; a statement of comprehensive income; a statement of cash flows; and notes, including accounting policies. Changes in equity may be presented either within a separate statement (like IFRS) or in the notes to the financial statements (unlike IFRS).

- Like IFRS, all owner-related changes in equity are presented separately from non-owner changes in equity.

- Like IFRS, although minimum disclosures are required, which may differ from IFRS, specific formats are not prescribed. Unlike IFRS, there are more specific format and line item presentation and disclosure requirements for SEC registrants.

- Unlike IFRS, US GAAP does not require presentation of comparative information. However, like IFRS, SEC registrants are required to present statements of financial position as at the end of the current and prior reporting periods; unlike IFRS, all other statements are presented for the three most recent reporting periods.
Overview (continued)

- In addition, a statement of financial position as at the beginning of the preceding period is presented when an entity restates comparative information following a change in accounting policy, the correction of an error, or the reclassification of items in the statement of financial position.

Consolidated financial statements

A parent entity presents consolidated financial statements unless it is an investment entity that is required to measure all of its subsidiaries at fair value through profit or loss (see chapter 5.6), or all of the following criteria are met:

- the parent is a wholly owned subsidiary, or is a partially owned subsidiary and its other owners (including those not otherwise entitled to vote) have been informed about, and do not object to, the parent not preparing consolidated financial statements;
- the parent’s debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) – see chapter 5.2;
- the parent has not filed, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
- the ultimate or any intermediate parent of the parent produces financial statements that are available for public use and comply with IFRS, such that subsidiaries are either consolidated or measured at fair value through profit or loss. [IFRS 10.4(a), 48]

IFRS does not provide specific guidance on whether an entity that disposes of its last subsidiary during the current reporting period should prepare consolidated financial statements for that period. In our view, consolidated financial statements are not required in such circumstances, although they may be required by a relevant regulator.

Reporting period

Financial statements are presented for the reporting period ending on the date of the statement of financial position (reporting date). [IAS 1.10]
The reporting date may change in certain circumstances – e.g., following a change of major shareholder. When the reporting date changes, the annual financial statements are presented for a period that is longer or shorter than a year; there is no requirement to adjust historical comparative information. [IAS 1.36]

**Components of the financial statements**

The following is presented as a complete set of financial statements:
- a statement of financial position (see chapter 3.1);
- a statement of profit or loss and OCI (see chapter 4.1);
- a statement of changes in equity (see below);
- a statement of cash flows (see chapter 2.3); and
- notes to the financial statements, comprising significant accounting policies and other explanatory information. [IAS 1.10]

An entity presents both a statement of profit or loss and OCI and a statement of changes in equity as part of a complete set of financial statements. These statements cannot be combined. [IAS 1.10]

Although IFRS specifies disclosures to be made in the financial statements, it does not prescribe formats or order of notes. However, notes need to be presented in a systematic manner, to the extent practicable. Although a number of disclosures are required to be made in the financial statements, IFRS generally allows flexibility in presenting additional line items and subtotals when such information is relevant to an understanding of the entity’s financial performance. [IAS 1.85, 113]

Disclosures that are not material need not be included in the financial statements, even if IFRS includes a specific requirement or describes it as a minimum requirement. [IAS 1.31, BC30H–BC30I]
In addition to the information required to be disclosed in the financial statements, many entities provide additional information outside the financial statements, either because of local regulations or stock exchange requirements, or voluntarily (see chapter 5.8). [IAS 1.13, 54-55A, 82-85B]

Statement of changes in equity
The following information is presented in the statement of changes in equity:
- profit or loss and total comprehensive income for the period, showing separately for profit or loss and OCI the total amounts attributable to owners of the parent and to NCI;
- for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with the standard on accounting policies, changes in estimates and errors (see chapter 2.8); and
- for each component of equity, a reconciliation between the carrying amount at the beginning and at the end of the period, separately disclosing changes resulting from:
  - profit or loss;
  - OCI; and
  - transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control. [IAS 1.106]

For each component of equity, an entity presents an itemised analysis of OCI. This analysis may be presented either in the statement of changes in equity or in the notes to the financial statements. [IAS 1.106A]

The notes to the financial statements include a separate schedule showing the effects of any changes in a parent’s ownership interest in a subsidiary that do not result in a loss of control. [IFRS 12.18]

Dividends and related per-share amounts are disclosed either in the statement of changes in equity or in the notes to the financial statements. [IAS 1.107]

Like IFRS, many entities provide additional information outside the financial statements (see chapter 5.8). Additionally, SEC registrants are required to disclose certain information outside the financial statements – e.g. management’s discussion and analysis (MD&As) of financial condition, the results of operations, and liquidity and quantitative and qualitative disclosures about market risk (see chapter 5.8).

Information on changes in equity
Like IFRS, the following information is presented in respect of changes in equity:
- net income and total comprehensive income for the period, showing separately for net income and OCI the amounts attributable to owners of the parent and to NCI;
- for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with the Codification Topic on accounting policies, changes in estimates and errors (see chapter 2.8); and
- for each component of equity, a reconciliation between the carrying amount at the beginning and at the end of the period, separately disclosing changes resulting from:
  - profit or loss;
  - OCI; and
  - transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control. [505-10-50-2, 810-10-50-1A(d)]

Like IFRS, for each component of accumulated OCI, an entity presents an itemised analysis. Like IFRS, this analysis may be presented either in the statement of changes in equity or in the notes to the financial statements. [220-10-45-14A]

Like IFRS, the notes to the financial statements include a separate schedule showing the effects of any changes in a parent’s ownership interest that do not result in a loss of control. [810-10-50-1A(d)]

Dividends and related per-share amounts are disclosed either in the statement of changes in equity or in the notes to the financial statements, like IFRS, or in the statement of financial position, unlike IFRS. [505-10-50-5]
Capital disclosure
An entity discloses information that enables users of its financial statements to evaluate the entity’s objectives, policies and processes for managing capital. [IAS 1.134]

Comparative information
Comparative information is required for the immediately preceding period only, but additional periods and information may be presented. [IAS 1.38]

A third statement of financial position is presented as at the beginning of the preceding period following a retrospective change in accounting policy, the correction of an error or a reclassification that has a material effect on the information in the statement of financial position. In our view, the third statement of financial position is required only if it is material to users of the financial statements (see chapter 1.2). [IAS 1.10(f), 40A–40D]

Unless there is a specific exemption provided in an IFRS, an entity discloses comparative information in respect of the previous period for all amounts reported in the current period’s financial statements. Generally, the previous period’s related narrative and descriptive information is required only if it is relevant for an understanding of the current period’s financial statements. [IAS 1.38]

Restatements and retrospective adjustments
Restatements and retrospective adjustments are presented as adjustments to the opening balance of retained earnings, unless an IFRS requires retrospective adjustment of another component of equity. IFRS requires disclosure in the statement of changes in equity of the total adjustment to each component of equity resulting from changes in accounting policies, and separately from corrections of errors. [IAS 1.106(b), 110]

Capital disclosure
Unlike IFRS, US GAAP does not require disclosure of the entity’s objectives, policies and processes for managing capital. However, information about the management of capital may be required by prudential regulators and SEC requirements for certain industries (e.g. banks).

Comparative information
Unlike IFRS, US GAAP does not require disclosure of the immediately preceding period only, but additional periods and information may be presented. [205-10-45-1 – 45-2]

Unlike IFRS, SEC registrants filing financial statements in accordance with US GAAP are required to present statements of earnings, statements of comprehensive income (if presented as a separate financial statement), statements of equity and statements of cash flows for each of the most recent three years (two years for ‘small business issuers’, like IFRS). Like IFRS, SEC registrants are required to present statements of financial position for each of the most recent two years (one year for ‘small business issuers’, unlike IFRS). [Reg S-X 210.3-01 – 3-04]

Unlike IFRS, a statement of financial position as at the beginning of the earliest comparative period is not required in any circumstances.

Unlike IFRS, the comparative information includes all of the previous period’s numerical, narrative and descriptive information unless a specific exception is provided.

Restatements and retrospective adjustments
Like IFRS, restatements and retrospective adjustments are presented as adjustments to the opening balance of retained earnings, unless a specific Codification topic/subtopic requires retrospective adjustment of another component of equity. Like IFRS, US GAAP requires disclosure in the statement of changes in equity of the total adjustment to each component of equity resulting from changes in accounting policies, and separately from corrections of errors. [250-10-50-1]
2.3 Statement of cash flows (IAS 7)

Overview

– ‘Cash and cash equivalents’ include certain short-term investments and, in some cases, bank overdrafts.

– The statement of cash flows presents cash flows during the period, classified by operating, investing and financing activities.

– The separate components of a single transaction are classified as operating, investing or financing.

– Cash flows from operating activities may be presented using either the direct method or the indirect method. If the indirect method is used, then an entity presents a reconciliation of profit or loss to net cash flows from operating activities; however, in our experience practice varies regarding the measure of profit or loss used.

– An entity chooses its own policy for classifying each of interest and dividends paid as operating or financing activities, and interest and dividends received as operating or investing activities.

– Income taxes paid are generally classified as operating activities.

– Foreign currency cash flows are translated at the exchange rates at the dates of the cash flows (or using averages when appropriate).

– Generally, all financing and investing cash flows are reported gross. Cash flows are offset only in limited circumstances.

2.3 Statement of cash flows (Topic 230)

Overview

– Like IFRS, ‘cash and cash equivalents’ include certain short-term investments. Unlike IFRS, bank overdrafts are classified as liabilities and included in financing activities.

– Like IFRS, the statement of cash flows presents cash flows during the period, classified by operating, investing and financing activities.

– Unlike IFRS, cash receipts and payments with attributes of more than one class of cash flows are classified based on the predominant source of the cash flows unless the underlying transaction is accounted for as having different components. See forthcoming requirements.

– Like IFRS, cash flows from operating activities may be presented using either the direct method or the indirect method. Like IFRS, if the indirect method is used, then an entity presents a reconciliation of income to net cash flows from operating activities; unlike IFRS, the starting point of the reconciliation is required to be net income.

– Unlike IFRS, interest received and paid (net of interest capitalised) and dividends received from previously undistributed earnings are required to be classified as operating activities. Also unlike IFRS, dividends paid are required to be classified as financing activities.

– Income taxes are generally required to be classified as operating activities, like IFRS.

– Like IFRS, foreign currency cash flows are translated at the exchange rates at the dates of the cash flows (or using averages when appropriate).

– Like IFRS, financing and investing cash flows are generally reported gross. Cash flows are offset only in limited circumstances, which differ from IFRS.
Cash and cash equivalents

‘Cash flows’ are movements in cash and cash equivalents. [IAS 7.6]

‘Cash’ comprises cash on hand and demand deposits. ‘Demand deposits’ are not defined in IFRS, but in our view they should have the same level of liquidity as cash and therefore should be available to be withdrawn at any time without penalty. ‘Cash equivalents’ are short-term highly liquid investments that are held for the purpose of meeting short-term cash commitments and are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value. [IAS 76–7]

‘Short-term’ is not defined, but the standard encourages a cut-off of three months’ maturity from the date of acquisition. In our view, three months is a presumption that may be rebutted only in rare cases when facts and circumstances indicate that the investment is held for the purpose of meeting short-term cash commitments and when the instrument otherwise meets the definition of a cash equivalent. [IAS 77]

An investment that is redeemable at any time is a cash equivalent only if the amount of cash that would be received is known at the time of the initial investment, subject to an insignificant risk of changes in value, and the other criteria for cash equivalents are met. The fact that an investment can be converted at the market price at any time does not necessarily mean that the ‘readily convertible to known amounts of cash’ criterion has been met. [IU 05-09]

Bank overdrafts that are repayable on demand are included in cash and cash equivalents only if they form an integral part of the entity’s cash management. [IAS 78]

Operating, investing and financing activities

The statement of cash flows presents cash flows during the period classified as operating, investing and financing activities.

– ‘Operating activities’ are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities, and generally result from transactions and events that enter into the determination of profit or loss.
– ‘Investing activities’ relate to the acquisition and disposal of long-term assets and other investments that are not included in cash equivalents.
– ‘Financing activities’ relate to transactions with shareholders in their capacity as shareholders and borrowings of the entity. [IAS 76, 10]

Cash and cash equivalents

Like IFRS, ‘cash flows’ are movements in cash and cash equivalents. [230-10-45-4]

Like IFRS, ‘cash’ comprises cash on hand and demand deposits. Although ‘demand deposits’ are not defined in US GAAP, they should have the same level of liquidity as cash, like IFRS. Like IFRS, ‘cash equivalents’ are short-term highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value. [230-10-20]

US GAAP defines ‘short-term’ which, like IFRS, is generally a remaining maturity at the time of acquisition by the entity of three months or less. [230-10-20]

An investment that is redeemable at any time could be considered a cash equivalent, but only if the amount of cash that would be received is known at the time of the initial investment and the other criteria for cash equivalents are met, like IFRS. The fact that an investment can be converted at the market price at any time does not necessarily mean that the ‘readily convertible to known amounts of cash’ criterion has been met, like IFRS.

Unlike IFRS, bank overdrafts are classified as liabilities. Bank overdrafts are considered a form of short-term financing, with changes therein classified as financing activities in the statement of cash flows. [TPA 1300.15]

Operating, investing and financing activities

Like IFRS, the statement of cash flows presents cash receipts and payments during the period classified as operating, investing and financing activities.

– Like IFRS, ‘operating activities’ are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities, and generally result from the cash effect of transactions that enter into the determination of net income.
– Like IFRS, ‘investing activities’ relate to the acquisition and disposal of long-term assets and other investments that are not included in cash equivalents.
– Like IFRS, ‘financing activities’ relate to transactions with shareholders in their capacity as shareholders and borrowings of the entity. [230-10-45-10 – 45-17]
In our view, it is the nature of the activity, rather than the classification of the related item in the statement of financial position, that determines the appropriate classification of the cash outflow. [IAS 7.10–11, IU 03-12, 07-12, 03-13]

The separate components of a single transaction are each classified as operating, investing or financing; a transaction is not classified based on its predominant characteristic. [IAS 7.12]

Non-cash investing or financing transactions (e.g. shares issued as consideration in a business combination) are not included in the statement of cash flows, but are disclosed. [IAS 7.43–44]

Net cash flows from all three categories are totalled to show the change in cash and cash equivalents during the period, which is then used to reconcile opening to closing cash and cash equivalents. [IAS 7.45]

There are specific requirements for the presentation of cash flow information for discontinued operations (see chapter 5.4). [IFRS 5.33(c)]

Direct vs indirect method
Cash flows from operating activities may be presented using either the direct method, which includes receipts from customers, payments to suppliers etc, or the indirect method, which includes net profit or loss for the period reconciled to the total net cash flow from operating activities. When using the indirect method, the reconciliation begins with profit or loss, although in our experience practice varies over whether this is net profit or loss or a different figure, e.g. profit or loss before tax. [IAS 7.18–20]

Interest and dividends
The classification of cash flows from interest and dividends received and paid is not specified, and an entity chooses its own policy for classifying each of interest and dividends paid as operating or financing activities, and interest and dividends received as operating or investing activities. As an exception, a financial institution usually classifies interest paid, and interest and dividends received, as operating cash flows. [IAS 7.31–34]

In general, it is the classification of the related item in the statement of financial position and its related accounting that determines the appropriate classification of the cash outflows, which could result in differences in practice from IFRS. [230-10-45-12 – 45-15]

If a cash receipt or payment has multiple elements that are accounted for separately (e.g. a loan repayment that comprises interest and principal repayments), then the separate components are classified as operating, investing or financing as appropriate, like IFRS. However, unlike IFRS, the separate components of a single transaction that is accounted for as a single element are not reported separately. Instead, cash receipts and payments with attributes of more than one class of cash flows are classified based on the activity that is likely to be the predominant source of the cash flows. See forthcoming requirements. [230-10-45-22 – 45-23]

Like IFRS, non-cash investing or financing transactions are disclosed rather than being included in the statement of cash flows. [230-10-45-3]

Like IFRS, net cash flows from operating, investing and financing activities are totalled to show the net effect of the cash flows on cash and cash equivalents, which is then used to reconcile opening to closing cash and cash equivalents. [230-10-45-24]

There is guidance on the presentation of cash flow information for discontinued operations, which differs from IFRS (see chapter 5.4). [230-10-45-24A]

Direct vs indirect method
Like IFRS, cash flows from operating activities may be presented using either the direct or the indirect method. Unlike IFRS, when using the indirect method, the reconciliation is required to begin with net income (net profit or loss). [230-10-45-25, 28]

Interest and dividends
Unlike IFRS, interest received and paid (net of interest capitalised) and dividends received from previously undistributed earnings are classified as operating activities. Also unlike IFRS, dividends paid are required to be classified as financing activities. [230-10-45-15 – 45-16]
IFRS does not contain specific guidance on the classification of capitalised interest. In our view, to the extent that borrowing costs are capitalised in respect of qualifying assets (see chapter 4.6), an entity should choose an accounting policy, to be applied consistently, to classify cash flows related to capitalised interest as follows:

– as cash flows from investing activities, if the other cash payments to acquire the qualifying asset are reflected as investing activities; or
– consistently with interest cash flows that are not capitalised. [IAS 7.16(a), 32-33]

**Changes in ownership interests**

The aggregate net cash flow arising from obtaining or losing control of subsidiaries or other businesses is generally presented separately as a single line item as part of investing activities. [IAS 7.39]

However, the cash flow classification of the cash payment for deferred consideration in a business combination may require judgement, taking into account the nature of the activity to which the cash outflow relates. To the extent that the amount paid reflects finance expense, classification consistent with interest paid may be appropriate (i.e. as operating or financing activities); to the extent that the amount paid reflects settlement of the fair value of the consideration recognised on initial recognition (see chapter 2.6), classification as a financing or investing activity may be appropriate.

Cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control (see chapter 2.5) are classified as financing activities. [IAS 7.42A]

**Income taxes**

Income taxes are classified as operating activities, unless it is practicable to identify them with, and therefore classify them as, financing or investing activities. IFRS does not contain guidance on the classification of tax benefits associated with share-based payments, and in our experience practice varies. [IAS 7.35-36]

Unlike IFRS, capitalised interest is classified as an investing activity. [230-10-45-13]

**Changes in ownership interests**

Like IFRS, the aggregate net cash flow arising from obtaining or losing control of subsidiaries or other businesses is presented separately as a single line item as part of investing activities. [230-10-45-13]

Unlike IFRS, the amount paid for deferred consideration in a business combination that is a finance expense is classified as an operating activity, except for payments made soon after the acquisition date (in which case the payments are classified as investing activities). The portion that represents a payment of the principal is classified as a financing activity, which may result in differences from IFRS. [230-10-45-14, 45-17]

Like IFRS, cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control (see chapter 2.5) are presented as cash flows from financing activities. [230-10-45-15]

**Income taxes**

Unlike IFRS, all income taxes, with the exception of excess tax benefits recognised in paid-in capital by non-public business entities related to share-based payments (see chapter 4.5), are required to be classified as operating activities. Cash flows related to the excess tax benefits recognised in paid-in capital for share-based payments are classified with other income tax cash flows in operating activities (public business entities) or as financing activities (other entities – see forthcoming requirements); these classifications may differ from practice under IFRS. [230-10-45-14, 45-17]

**Assets held for rental and subsequently held for sale**

All cash flows related to the manufacture or acquisition of assets that will be used for rental to others and subsequently sold are classified as operating activities. [IAS 7.14]

**Assets held for rental and subsequently held for sale**

Unlike IFRS, only cash flows from the sale or disposal of equipment that was rented to others for a short period of time before the sale or disposal are classified as operating activities, as are the cash flows related to the manufacture or acquisition of such assets. [230-10-45-22]
**Hedging instruments**

If a hedging instrument is accounted for as a hedge of an identifiable position (see chapter 7.7), then the cash flows of the hedging instrument are classified in the same manner as the cash flows of the position being hedged. [IAS 7.16]

**Factoring and reverse factoring**

There is no specific guidance in IFRS on the classification of cash flows from traditional factoring or reverse factoring arrangements.

If receivables are factored without recourse, then in our view the proceeds from the factor should be classified as part of operating activities even if the entity does not enter into such transactions regularly.

If receivables are factored with recourse and the customer remits cash directly to the factor, then in our view the following approaches are acceptable and should be applied consistently.

- **Single cash flow approach:** Present a single financing cash inflow or a single operating cash inflow for the proceeds received from the factor against receivables due from the entity’s customers. An entity applies judgement in determining the appropriate classification, based on the nature of the activity to which the cash inflow relates.

- **Gross cash flows approach:** Present a financing cash inflow for the proceeds received from the factor, followed by an operating cash inflow when the factor collects the amounts from the customer in respect of goods or services sold by the entity and a financing cash outflow for settlement of amounts due to the factor.

If receivables are factored with recourse and the customer remits cash directly to the entity, then the entity follows the gross cash flows approach.

**Hedging instruments**

Cash flows resulting from hedging instruments that are hedges of identifiable transactions are generally classified in the same cash flow category as the cash flows from the hedged items, like IFRS. However, unlike IFRS, this is an accounting policy election that should be disclosed. Unlike IFRS, if a derivative instrument used for hedge accounting contains more than an insignificant financing element at inception, then all cash inflows and outflows from that derivative are classified as financing activities. [230-10-45-27]

**Factoring and reverse factoring**

Unlike IFRS, there is specific guidance in US GAAP on the classification of cash flows from traditional factoring arrangements. Like IFRS, there is no specific guidance on reverse factoring arrangements.

If receivables are factored without recourse, then the proceeds from the factor are classified as part of operating activities, like IFRS. [230-10-45-16]

Unlike IFRS, if receivables are factored with recourse, then the single cash flow approach is not permitted. Instead, the entity follows what is the gross cash flows approach under IFRS. The entity presents a financing cash inflow for the proceeds received from the factor, followed by an operating cash inflow when the factor collects the amounts from the customer in respect of goods or services sold by the entity and a financing cash outflow for settlement of amounts due to the factor. See forthcoming requirements. [230-10-45-14 – 45-17]

Like IFRS, if receivables are factored with recourse and the customer remits cash directly to the entity, then the entity follows the gross cash flows approach. See forthcoming requirements. [230-10-45-14 – 45-17]
In a reverse factoring arrangement, a factor agrees to pay amounts to a supplier in respect of invoices owed by the supplier’s customer and receives settlement from that customer (the entity) at a later date. In our view, the following approaches to presenting cash flows are acceptable and should be applied consistently.

- **Single cash flow approach**: Present a single operating cash outflow or a single financing cash outflow for the payments made to the factor. An entity applies judgement in determining the appropriate classification, based on the nature of the activity to which cash flow relates.

- **Gross cash flows approach**: Present a financing cash inflow and an operating cash outflow when the factor makes a payment to the supplier in respect of the purchase of goods or services made by the entity, together with a financing cash outflow for settlement of amounts due to the factor.

**Foreign currency differences**

Cash flows arising from an entity’s foreign currency transactions are translated into the functional currency (see chapter 2.7) at the exchange rates at the dates of the cash flows. Cash flows of foreign operations are translated at the actual rates (or appropriate averages). The effect of exchange rate changes on the balances of cash and cash equivalents is presented as part of the reconciliation of movements therein. [IAS 7.25–28]

**Offsetting**

All financing and investing cash flows are generally reported gross. [IAS 7.21]

Receipts and payments may be netted only if the items concerned (e.g. sale and purchase of investments) turn over quickly, the amounts are large and the maturities are short; or if they are on behalf of customers and the cash flows reflect the activities of customers. [IAS 7.22–23A]

In a reverse factoring arrangement, a factor agrees to pay amounts to a supplier in respect of invoices owed by the supplier’s customer and receives settlement from that customer (the entity) at a later date. Unlike IFRS, in our view, the single cash flow approach is not permitted. Instead, we believe that the entity should follow what is the gross cash flows approach under IFRS. The entity should present a financing cash inflow and an operating cash outflow when the factor makes a payment to the supplier in respect of the purchase of goods or services made by the entity, together with a financing cash outflow for settlement of amounts due to the factor.

**Foreign currency differences**

Like IFRS, cash flows arising from foreign currency transactions are translated into the functional currency (see chapter 2.7) at the exchange rates at the dates of the cash flows. Like IFRS, cash flows of foreign operations are translated at the actual rates (or appropriate averages). The effect of exchange rate changes on cash and cash equivalents is presented as part of the reconciliation of movements therein, like IFRS. [830-230-45-1]

**Offsetting**

Like IFRS, financing and investing cash flows are generally reported gross. [230-10-45-7 – 45-9]

Under US GAAP, the items that qualify for net reporting include:

- cash receipts and payments related to investments, loans receivable and debt, provided that the original maturity of the asset or liability is three months or less; or
- cash that an entity is substantively holding or disbursing on behalf of its customers, such as demand deposits of a bank and customer accounts payable of a broker-dealer. [230-10-45-8 – 45-9]

Although the offsetting requirements of US GAAP are more specific than the general requirements under IFRS, differences in practice would not generally be expected.
Disclosures: financing activities
An entity provides disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including changes from cash flows and non-cash changes. One way to meet this requirement is to provide a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities, including:
- changes from financing cash flows;
- changes from obtaining or losing control of subsidiaries or other business;
- the effect of changes in foreign exchange rates;
- changes in fair values; and
- other changes. [IAS 7.44B–44D]

This disclosure requirement also applies to changes in financial assets (e.g. assets that hedge liabilities arising from financing activities) if cash flows from those financial assets were, or future cash flows will be, included in cash flows from financing activities. [IAS 7.44C]

Reporting cash flows for financial institutions
Cash advances and loans made by financial institutions are usually classified as operating activities because they relate to the main revenue-producing activities of that entity. [IAS 7.18]

Deposits from banks and customers are usually classified as operating activities. [IAS 7.1EB]

A financial institution may report on a net basis certain advances, deposits and repayments thereof that form part of its operating activities. [IAS 7.24]

Forthcoming requirements
Cash and cash equivalents
There are no forthcoming requirements under IFRS regarding the definition of cash and cash equivalents.

IFRS does not provide specific guidance on ‘restricted’ amounts; however, to meet the definition of cash and cash equivalents, amongst other criteria (see above) the amounts should be either held on hand, or be available to be withdrawn at any time without penalty or be readily convertible to known amounts of cash. [IAS 7.6–7]

Disclosures: financing activities
Unlike IFRS, disclosures related to changes in liabilities from financing activities, and related financial assets, are not required.

Reporting cash flows for financial institutions
Unlike IFRS, cash advances and loans made by financial institutions are usually classified as investing activities, unless the cash advances and loans were originated or purchased specifically for resale. [230-10-45-11–45-13]

Unlike IFRS, increases or decreases in net deposits from banks and customers are classified as financing activities. [AAG-DEP6.21]

Like IFRS, a financial institution may report on a net basis certain advances, deposits and repayments thereof that form part of its operating activities. [942-230-45-1–45-2]

Forthcoming requirements
Cash, cash equivalents, restricted cash and restricted cash equivalents
Amendments to the statement of cash flows Codification Topic are effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted. [ASU 2016-18]

Cash and cash equivalents may include amounts generally described as ‘restricted’. Although restricted, such amounts are included in cash and cash equivalents (with the title changed to indicate that it includes restricted items); and the nature of the restrictions is disclosed. [230-10-45-4, 50-7]
Classification of cash flows: Income taxes
There are no forthcoming requirements under IFRS regarding the classification of cash flows related to income taxes.

Income taxes are classified as operating activities, unless it is practicable to identify them with, and therefore classify them as, financing or investing activities. IFRS does not contain guidance on the classification of tax benefits associated with share-based payments, and in our experience practice varies. [IAS 7.35–36]

Classification of cash flows: Other
There are no forthcoming requirements under IFRS regarding the classification of other cash flows.

There is limited prescriptive guidance on the classification of specific cash flows. In our view, it is the nature of the activity, rather than the classification of the related item in the statement of financial position, that determines the appropriate classification of the cash outflow. [IAS 7.10–11, IU 03-12, 07-12, 03-13]

Judgement is required to determine the appropriate cash flow classification of a cash payment made after a business combination to settle a contingent consideration liability taking into account the nature of the activity to which the cash outflow relates. To the extent that the amount paid reflects the settlement of the fair value of the consideration recognised on initial recognition, classification as a financing or investing activity may be appropriate. Classification of any excess paid as an operating activity, or consistent with the policy election for interest paid (see above), may be appropriate.

Classification of cash flows: ASU 2016-09
Amendments to the statement of cash flows Codification Topic are effective for annual periods beginning after 15 December 2017 for entities other than public business entities; early adoption is permitted. [ASU 2016-09]

Unlike IFRS, all income taxes, including cash flows related to excess tax benefits on share-based payments (see chapter 4.5) are required to be classified as operating activities, which may result in differences from IFRS. [230-10-45-17]

Classification of cash flows: ASU 2016-15
Amendments to the statement of cash flows Codification Topic are effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted. [ASU 2016-15]

Unlike IFRS, US GAAP includes prescriptive guidance on the classification of certain cash flows, which may give rise to differences from IFRS in practice. The following are examples of the forthcoming requirements.

- Cash payment for debt prepayment or extinguishment costs: financing activity.
- Cash payment for the settlement of a zero-coupon bond or a bond with an insignificant interest rate: operating activity (portion attributable to accreted interest); financing activity (portion attributable to original principal).
- Proceeds from the settlement of an insurance claim: based on the nature of the loss.

Unlike IFRS, there is specific guidance that a cash payment made not soon after a business combination to settle a contingent consideration liability is classified as a financing activity up to the amount recognised as contingent consideration at the acquisition date. Any excess paid is classified as an operating activity. [230-10-45-13, 45-15, 45-17]
The separate components of a single transaction are each classified as operating, investing or financing; IFRS does not allow a transaction to be classified based on its predominant characteristic. [IAS 7:12]

There are no forthcoming requirements under IFRS on the classification of cash flows from traditional factoring arrangements.

The separate components of a single cash flow are each classified as operating, investing or financing if such a distinction can reasonably be made based on its identifiable sources and uses, like IFRS. Otherwise, unlike IFRS, classification is based on the activity that is likely to be the predominant source or use of the cash flow. [230-10-45-22 – 45-22A]

If an entity factors receivables, it presents:
- a financing cash inflow for the proceeds received from the factor, followed by:
  - when the factor collects the amounts from the customer in respect of goods or services sold by the entity:
    - an investing cash inflow to the extent that the cash inflow relates to a beneficial interest in the receivables retained by the entity; and
    - an operating cash inflow for the balance; and
  - a financing cash outflow for settlement of amounts due to the factor. [230-10-45-12, 45-16]
Overview

- The fair value measurement standard applies to most fair value measurements and disclosures (including measurements based on fair value) that are required or permitted by other standards.

- ‘Fair value’ is 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.

- What is being measured – e.g. a stand-alone asset or a group of assets and/or liabilities – generally depends on the unit of account, which is established under the relevant standard.

- Fair value is based on assumptions that market participants would use in pricing the asset or liability. ‘Market participants’ are independent of each other, they are knowledgeable and have a reasonable understanding of the asset or liability, and they are willing and able to transact.

- Fair value measurement assumes that a transaction takes place in the principal market for the asset or liability or, in the absence of a principal market, in the most advantageous market for the asset or liability.

- In measuring the fair value of an asset or a liability, an entity selects those valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value. The technique used should maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

Like IFRS, the fair value measurement Codification Topic applies to most fair value measurements and disclosures (including measurements based on fair value) that are required or permitted by other Codification topics/subtopics. However, the scope exemptions differ in some respects from IFRS because of differences from IFRS in the underlying Codification topics/subtopics with which the fair value measurement Codification Topic interacts.

Like IFRS, ‘fair value’ is 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.

Like IFRS, what is being measured – e.g. a stand-alone asset or a group of assets and/or liabilities – generally depends on the unit of account, which is established under the relevant Codification topics/subtopics. However, these differ in some respects from IFRS.

Like IFRS, fair value is based on assumptions that market participants would use in pricing the asset or liability. Like IFRS, ‘market participants’ are independent of each other, they are knowledgeable and have a reasonable understanding of the asset or liability, and they are willing and able to transact.

Like IFRS, fair value measurement assumes that a transaction takes place in the principal market for the asset or liability or, in the absence of a principal market, in the most advantageous market for the asset or liability.

Like IFRS, in measuring the fair value of an asset or a liability, an entity selects those valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value. The technique used should maximise the use of relevant observable inputs and minimise the use of unobservable inputs, like IFRS.
Overview (continued)

- A fair value hierarchy is used to categorise fair value measurements for disclosure purposes. Fair value measurements are categorised in their entirety based on the lowest level input that is significant to the entire measurement.

- A day one gain or loss arises when the transaction price for an asset or liability differs from the fair value used to measure it on initial recognition. Such gain or loss is recognised in profit or loss, unless the standard that requires or permits fair value measurement specifies otherwise.

- A fair value measurement of a non-financial asset considers a market participant’s ability to generate economic benefits by using the asset in its highest and best use, or by selling it to another market participant who will use the asset in its highest and best use.

- If certain conditions are met, then an entity is permitted to measure the fair value of a group of financial assets and financial liabilities with offsetting risk positions on the basis of its net exposure (portfolio measurement exception).

- There is no practical expedient that allows entities to measure the fair value of certain investments at net asset value.

- The fair value measurement standard contains a comprehensive disclosure framework.

Overview (continued)

- Like IFRS, a fair value hierarchy is used to categorise fair value measurements for disclosure purposes. Like IFRS, fair value measurements are categorised in their entirety based on the lowest level input that is significant to the entire measurement.

- Like IFRS, a day one gain or loss arises when the transaction price for an asset or liability differs from the fair value used to measure it on initial recognition. Like IFRS, such gain or loss is recognised in profit or loss, unless the Codification topic/subtopic that requires or permits fair value measurement specifies otherwise. However, the instances in which recognition is prohibited are less restrictive than IFRS.

- Like IFRS, a fair value measurement of a non-financial asset considers a market participant’s ability to generate economic benefits by using the asset in its highest and best use, or by selling it to another market participant who will use the asset in its highest and best use.

- Like IFRS, if certain conditions are met, then an entity is permitted to measure the fair value of a group of financial assets and financial liabilities with offsetting risk positions on the basis of its net exposure (portfolio measurement exception).

- Unlike IFRS, a practical expedient allows entities to measure the fair value of certain investments at net asset value.

- The fair value measurement Codification Topic contains a comprehensive disclosure framework, which differs in certain respects from IFRS.

This chapter highlights only the key differences between the IFRS and US GAAP requirements. For further discussion, see KPMG’s publication Fair Value Measurement: Questions and Answers.
General principles

The fair value measurement standard defines fair value, establishes a framework for measuring fair value and sets out related disclosure requirements. It does not give rise to any requirements on when fair value measurements are required, but instead provides guidance on how fair value should be measured and disclosed when it is required or permitted under other standards.

‘Fair value’ is 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 – i.e. it is an ‘exit price’. [IFRS 13.9, A]

Scope

The fair value measurement standard applies to:
- fair value measurements (both initial and subsequent) that are required or permitted by other standards;
- fair value measurements that are required or permitted to be disclosed by other standards, but which are not included in the statement of financial position; and
- measurements based on fair value, or disclosures about those measurements. [IFRS 13.5–8, BC25]

The fair value measurement standard has the following specific exclusions in respect of measurement and disclosure:
- share-based payment transactions (see chapter 4.5);
- leasing transactions (see chapter 5.1); and
- measurements that are similar to fair value but that are not fair value – e.g. net realisable value in measuring inventories (see chapter 3.8). [IFRS 13.6]

IFRS does not include practical expedients that override the requirements of the fair value measurement standard.
The fair value measurement standard has the following specific exclusions in respect of disclosure only:

- plan assets measured at fair value (see chapter 4.4);
- retirement benefit plan investments measured at fair value (outside the scope of this publication); and
- assets for which the recoverable amount is fair value less costs of disposal (see chapter 3.10). [IFRS 13.7]

**The item being measured and the unit of account**

What is being measured – e.g. a stand-alone asset or a group of assets and/or liabilities – generally depends on the unit of account. The fair value measurement standard does not generally specify the unit of account. Instead, this is established under the specific standard that requires or permits the fair value measurement or disclosure. [IFRS 13.14]

There are two exceptions included in the fair value measurement standard itself.

- In certain circumstances, an entity is required to measure non-financial assets in combination with other assets or other assets and liabilities (see below).
- The unit of account for financial instruments is generally the individual financial instrument (e.g. a share). However, an entity is permitted to measure the fair value of a group of financial assets and financial liabilities on the basis of the net risk position, if certain conditions are met (see below). [IFRS 13.27, 31–32, 48–49]

In general, IFRS contains little guidance on the unit of account and therefore there may be diversity in practice depending on the underlying item. For example, when the unit of account is an investment in a listed subsidiary, in our view the unit of valuation and therefore the measurement of fair value may be based on the fair value of the individual shares making up the investment or the investment as a whole.

**Market participants**

Fair value is based on assumptions that market participants would use in pricing the asset or liability. ‘Market participants’ are buyers and sellers in the principal (or most advantageous) market who have all of the following characteristics:

- they are independent of each other;
- they are knowledgeable;
- they are able to enter into a transaction for the asset or liability; and
- they are willing to enter into a transaction – i.e. motivated but not forced. [IFRS 13.22, A]

Like IFRS, the disclosure requirements of the fair value measurement Codification Topic do not apply to the plan assets of a defined benefit pension plan or other post-retirement plan that are accounted for under the post-retirement benefit Codification Topic (see chapter 4.4). [820-10-50-10]

Unlike IFRS, the recoverable amount of long-lived assets is not based on fair value less costs of disposal (see chapter 3.10).

**The item being measured and the unit of account**

Like IFRS, what is being measured – e.g. a stand-alone asset or a group of assets and/or liabilities – generally depends on the unit of account. The fair value measurement Codification Topic does not generally specify the unit of account, like IFRS. Instead, the unit of account is established under the specific Codification topic/subtopic that requires or permits the fair value measurement or disclosure, which may differ from IFRS. [820-10-35-2E]

Like IFRS, there are two exceptions included in the Codification Topic itself.

- In certain circumstances, an entity is required to measure non-financial assets in combination with other assets or other assets and liabilities (see below).
- The unit of account for financial instruments is generally the individual financial instrument (e.g. a share). However, an entity is permitted to measure the fair value of a group of financial assets and financial liabilities on the basis of the net risk position, if certain conditions are met (see below). [820-10-35-10A, 35-10E – 35-11A, 35-18D – 35-18E]

Unlike IFRS, in general, US GAAP is more prescriptive in respect of the unit of account, which can lead to differences from IFRS. For example, when an investment company measures the fair value of a controlling interest in a listed investee, although the unit of account is the investment as a whole, the unit of valuation is the individual share and therefore the measurement of fair value is based on the product of the share price and the number of shares held.

**Market participants**

Like IFRS, fair value is based on assumptions that market participants would use in pricing the asset or liability. Like IFRS, ‘market participants’ are buyers and sellers in the principal (or most advantageous) market who have all of the following characteristics:

- they are independent of each other;
- they are knowledgeable;
- they are able to enter into a transaction for the asset or liability; and
- they are willing to enter into a transaction – i.e. motivated but not forced. [820-10-20, 35-9]
Like IFRS, fair value takes into account characteristics of the asset or liability that would be considered by market participants and is not based on the entity’s specific use or plans. Such characteristics may include the condition and location of an asset or restrictions on an asset’s sale or use. [IFRS 13.11]

**Principal and most advantageous markets**

Like IFRS, an entity values assets, liabilities and its own equity instruments assuming a transaction in the principal market for the asset or liability – i.e. the market with the greatest volume and level of activity. In the absence of a principal market, it is assumed that the transaction would occur in the most advantageous market. The ‘most advantageous market’ is the market that would either maximise the amount that would be received to sell an asset or minimise the amount that would be paid to transfer a liability, after taking into account transport and transaction costs. [IFRS 13.16–17, A]

In the absence of evidence to the contrary, the market in which the entity would normally sell the asset or transfer the liability is assumed to be the principal (or most advantageous) market. [IFRS 13.17]

The price used to measure fair value is not adjusted for transaction costs, although they are considered in determining the most advantageous market. ‘Transaction costs’ do not include transport costs. If location is a characteristic of an asset, then the price in the principal (or most advantageous) market is adjusted for transport costs. [IFRS 13.25–26, A]

**Valuation approaches and techniques**

Like IFRS, valuation techniques used to measure fair value fall into three approaches: market approach; income approach; and cost approach. [IFRS 13.62]

Like IFRS, inputs to valuation techniques are the assumptions that market participants would use in pricing the asset or liability. [IFRS A]

Like IFRS, fair value takes into account characteristics of the asset or liability that would be considered by market participants and is not based on the entity’s specific use or plans. Such characteristics may include the condition and location of an asset or restrictions on an asset’s sale or use, like IFRS. [820-10-35-28]

**Principal and most advantageous markets**

Like IFRS, an entity values assets, liabilities and its own equity instruments assuming a transaction in the principal market for the asset or liability – i.e. the market with the greatest volume and level of activity. In the absence of a principal market, it is assumed that the transaction would occur in the most advantageous market, like IFRS. The ‘most advantageous market’ is the market that would either maximise the amount that would be received to sell an asset or minimise the amount that would be paid to transfer a liability, after taking into account transport and transaction costs, like IFRS. [820-10-20, 35-5 – 35-5A]

Like IFRS, in the absence of evidence to the contrary, the market in which the entity would normally sell the asset or transfer the liability is assumed to be the principal (or most advantageous) market. [820-10-35-5A]

Like IFRS, the price used to measure fair value is not adjusted for transaction costs, although they are considered in determining the most advantageous market. ‘Transaction costs’ do not include transport costs, like IFRS. If location is a characteristic of an asset, then the price in the principal (or most advantageous) market is adjusted for transport costs, like IFRS. [820-10-35-9B – 35-9C]

**Valuation approaches and techniques**

Like IFRS, in measuring the fair value of an asset or a liability, an entity selects those valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value. The technique used should maximise the use of relevant observable inputs and minimise the use of unobservable inputs, like IFRS. [820-10-35-24, 35-36]

Like IFRS, valuation techniques used to measure fair value fall into three approaches: market approach; income approach; and cost approach. [820-10-35-24A]

**Inputs to valuation techniques**

Like IFRS, inputs to valuation techniques are the assumptions that market participants would use in pricing the asset or liability. [820-10-20]
Inputs are categorised into three levels.

- **Level 1 inputs**: Unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.
- **Level 2 inputs**: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- **Level 3 inputs**: Unobservable inputs for the asset or liability. [IFRS 13.76, 81, 86, A]

These inputs include assumptions about risk, such as the risk inherent in a particular valuation technique used to measure fair value and the risk inherent in the inputs to the valuation technique. [IFRS 13.88, A]

The most reliable evidence of fair value is a quoted price in an active market. If this is not available, then an entity uses a valuation technique to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. [IFRS 13.61, 67, 77]

In measuring fair value, a premium or discount should not be applied if:

- it is inconsistent with the relevant unit of account;
- it reflects size as a characteristic of the entity’s holding – e.g. a blockage factor;
- the characteristic is already reflected in the preliminary value indication; or
- there is a quoted price in an active market for an identical asset or liability – i.e. a Level 1 input. [IFRS 13.69]

A blockage factor is a discount that reflects the number of instruments as a characteristic of the entity’s holding rather than a characteristic of the asset or liability. An entity is prohibited from applying a blockage factor for a fair value measurement for all three levels of the fair value hierarchy. [IFRS 13.69, 80]

A control premium is not applied in measuring the fair value of financial instruments if the unit of account is the individual instrument and the individual instrument does not convey control; this is regardless of the level in the fair value hierarchy. [IFRS 13.69]

If assets or liabilities have a bid and an ask price, then an entity uses the price within the bid-ask spread that is most representative of fair value in the circumstances. The use of bid prices for long positions and ask prices for short positions is permitted but not required. [IFRS 13.70]

Like IFRS, inputs are categorised into three levels.

- **Level 1 inputs**: Unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.
- **Level 2 inputs**: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- **Level 3 inputs**: Unobservable inputs for the asset or liability. [IFRS 13.69, 80, 820-10-20, 35-40, 35-47, 35-52]

Like IFRS, these inputs include assumptions about risk, such as the risk inherent in a particular valuation technique used to measure fair value and the risk inherent in the inputs to the valuation technique. [IFRS 13.820-10-20, 35-54]

Like IFRS, the most reliable evidence of fair value is a quoted price in an active market. If this is not available, then an entity uses a valuation technique to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs, like IFRS. [IFRS 13.820-10-35-24, 35-36, 35-41]

Like IFRS, in measuring fair value, a premium or discount should not be applied if:

- it is inconsistent with the relevant unit of account – however, see above for differences from IFRS in the unit of account;
- it reflects size as a characteristic of the entity’s holding – e.g. a blockage factor;
- the characteristic is already reflected in the preliminary value indication; or
- there is a quoted price in an active market for an identical asset or liability – i.e. a Level 1 input. [IFRS 13.820-10-35-36B]

Like IFRS, a blockage factor is a discount that reflects the number of instruments as a characteristic of the entity’s holding rather than a characteristic of the asset or liability. Like IFRS, an entity is prohibited from applying a blockage factor for a fair value measurement for all three levels of the fair value hierarchy. [IFRS 13.820-10-35-36B, 35-44]

Like IFRS, a control premium is not applied in measuring the fair value of financial instruments if the unit of account is the individual instrument and the individual instrument does not convey control; this is regardless of the level in the fair value hierarchy. However, differences from IFRS may arise because US GAAP is more restrictive in specifying the unit of account (see above). [IFRS 13.820-10-35-36B]

Like IFRS, if assets or liabilities have a bid and an ask price, then an entity uses the price within the bid-ask spread that is most representative of fair value in the circumstances. The use of bid prices for long positions and ask prices for short positions is permitted but not required. [IFRS 13.820-10-35-36C]
Fair value hierarchy
The fair value measurement standard includes a fair value hierarchy based on the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs). [IFRS 13.72]

Fair value measurements are categorised in their entirety based on the lowest level input that is significant to the entire measurement. [IFRS 13.73]

The resulting categorisation is relevant for disclosure purposes. [IFRS 13.72]

Fair value at initial recognition
Normally, the transaction price equals fair value; however, there may be situations in which the transaction price and initial fair value differ. This could be due to factors such as transactions between related parties, transactions taking place under duress etc. [IFRS 13.58, B4]

A day one gain or loss arises when the transaction price for an asset and/or liability differs from the fair value used to measure it on initial recognition. The fair value measurement standard requires day one gains or losses to be recognised in profit or loss, unless the standard that requires or permits the fair value measurement specifies otherwise. [IFRS 13.60]

The financial instruments standards prohibit the immediate recognition of a day one gain or loss unless fair value is evidenced by a quoted price in an active market for an identical financial asset or liability, or is based on a valuation technique whose variables include only data from observable markets. [IAS 39.AG76] If the entity determines that the fair value on initial recognition differs from the transaction price but is not evidenced by a valuation technique that uses only data from observable markets, then the carrying amount of the financial asset or financial liability on initial recognition is adjusted to defer the difference between the fair value measurement and the transaction price. This deferred difference is subsequently recognised as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability. [IAS 39.AG76-76A]

Fair value hierarchy
Like IFRS, the fair value measurement Codification Topic includes a fair value hierarchy based on the inputs to valuation techniques used to measure fair value. Like IFRS, the fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs). [820-10-35-37]

Like IFRS, fair value measurements are categorised in their entirety based on the lowest level input that is significant to the entire measurement. [820-10-35-37A]

Like IFRS, the resulting categorisation is relevant for disclosure purposes. [820-10-35-37]

Fair value at initial recognition
Normally, the transaction price equals fair value; however, like IFRS, there may be situations in which the transaction price and initial fair value differ. This could be due to factors such as transactions between related parties, transactions taking place under duress etc. [820-10-30-3 – 30-3A]

Like IFRS, a day one gain or loss arises when the transaction price for an asset and/or liability differs from the fair value used to measure it on initial recognition. Like IFRS, the fair value measurement Codification Topic requires day one gains or losses to be recognised in profit or loss unless the relevant Codification topic/subtopic that requires or permits the fair value measurement specifies otherwise. However, the instances in which recognition of a day one gain or loss is prohibited by other Codification topics/subtopics are less restrictive than IFRS (see below). [820-10-30-6]

Unlike IFRS, the financial instruments Codification Topics do not prohibit the immediate recognition of a day one gain or loss for fair value measurements at all three levels of the fair value hierarchy. [820-10-30-6]

Unlike IFRS, a day one gain or loss in respect of a financial instrument is always recognised in profit or loss. [820-10-30-6]
Highest and best use
A fair value measurement of a non-financial asset considers a market participant’s ability to generate economic benefits by using the asset at its highest and best use or by selling it to another market participant who will use the asset in its highest and best use. In the absence of evidence to the contrary, the entity’s current use of an asset is assumed to be its highest and best use. [IFRS 13.27, 29]

A fair value measurement of a non-financial asset is based on its use either:
- in combination with other assets as a group or in combination with other assets and liabilities; or
- on a stand-alone basis. [IFRS 13.31]

Liabilities and own equity instruments
In measuring the fair value of a liability or an own equity instrument, it is assumed that the item is transferred to a market participant at the measurement date – e.g. the liability remains outstanding and the market participant transferee would be required to fulfil it. [IFRS 13.34]

If there is no quoted price for the transfer of an identical or a similar liability or an entity’s own equity instruments, and another market participant holds the identical item as an asset, then the entity measures the item’s fair value from the perspective of such a market participant. [IFRS 13.37]

In other cases, an entity uses a valuation technique to measure the fair value of the item from the perspective of a market participant that owes the liability or that issued the equity instrument. [IFRS 13.40]

The fair value of a liability reflects the effect of ‘non-performance risk’ – i.e. the risk that an entity will not fulfil an obligation. Non-performance risk includes, but may not be limited to, an entity’s own credit risk. [IFRS 13.42, A]

The issuer of a liability with an inseparable third party credit enhancement excludes the enhancement in measuring the fair value of the liability, if the liability and the enhancement are separate units of account. IFRS does not contain explicit guidance about the unit of account for liabilities issued with inseparable credit enhancements. [IFRS 13.44]

Highest and best use
Like IFRS, a fair value measurement of a non-financial asset considers a market participant’s ability to generate economic benefits by using the asset at its highest and best use or by selling it to another market participant who will use the asset in its highest and best use. In the absence of evidence to the contrary, the entity’s current use of an asset is assumed to be its highest and best use, like IFRS. [820-10-35-10A, 35-10C]

Like IFRS, a fair value measurement of a non-financial asset is based on its use either:
- in combination with other assets as a group or in combination with other assets and liabilities; or
- on a stand-alone basis. [820-10-35-10E]

Liabilities and own equity instruments
Like IFRS, in measuring the fair value of a liability or an own equity instrument, it is assumed that the item is transferred to a market participant at the measurement date – e.g. the liability remains outstanding and the market participant transferee would be required to fulfil it. [820-10-35-16]

Like IFRS, if there is no quoted price for the transfer of an identical or a similar liability or an entity’s own equity instruments, and another market participant holds the identical item as an asset, then the entity measures the item’s fair value from the perspective of such a market participant. [820-10-35-16B]

In other cases, like IFRS, an entity uses a valuation technique to measure the fair value of the item from the perspective of a market participant that owes the liability or that issued the equity instrument. [820-10-35-16H]

Like IFRS, the fair value of a liability reflects the effect of ‘non-performance risk’ – i.e. the risk that an entity will not fulfil an obligation. Non-performance risk includes, but may not be limited to, an entity’s own credit risk, like IFRS. [820-10-20, 35-17]

Like IFRS, the issuer of a liability with an inseparable third party credit enhancement excludes the enhancement in measuring the fair value of the liability, if the liability and the enhancement are separate units of account. However, unlike IFRS, US GAAP includes specific guidance that separation is generally required except when the enhancement is granted to the issuer of the liability, such as deposit insurance provided by a government or government agency, or is provided between a parent and a subsidiary or between entities under common control. [820-10-35-18A, 825-10-25-13]
The fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid. [IFRS 13.47]

**Portfolio measurement exception**

An entity that holds a group of financial assets and financial liabilities is exposed to market risks (i.e. interest rate risk, currency risk and other price risk) and to the credit risk of each of the counterparties. If certain conditions are met, then an entity is permitted (but not required) to measure the fair value of a group of financial assets and financial liabilities with offsetting risk positions on the basis of its net exposure (portfolio measurement exception). [IFRS 13.48–49]

Under the exception, the fair value of the group is measured on the basis of the price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure in an orderly transaction between market participants at the measurement date. [IFRS 13.48]

If the entity is permitted to use the exception, then it chooses an accounting policy, to be applied consistently, for a particular portfolio. [IFRS 13.51]

**Net asset value**

IFRS does not include an exception that allows the use of net asset value (NAV) as a practical expedient. An entity may only measure investments on the basis of NAV when NAV is representative of fair value.

**Inactive markets**

In an active market, transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. [IFRS 13.A]

An orderly transaction assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities. [IFRS 13.A]
A fair value measurement may be affected if there has been a significant decrease in the volume or level of activity for that item compared with normal market activity for that item. Judgement may be required in determining whether, based on the evidence available, there has been such a significant decrease. [IFRS 13.B37, B42]

If an entity concludes that the volume or level of activity for an asset or liability has significantly decreased, then further analysis of the transactions or quoted prices is required. A decrease in the volume or level of activity on its own might not indicate that a transaction or a quoted price is not representative of fair value, or that a transaction in that market is not orderly. [IFRS 13.B38]

Disclosures
The fair value measurement standard contains a comprehensive disclosure framework. Fair value disclosures are based on the level within which a measurement falls in the fair value hierarchy. [IFRS 13.91]

The disclosures differentiate fair value measurements that are recurring from those that are non-recurring. More extensive disclosures are required for Level 3 measurements. Disclosure of quantitative sensitivity analysis is required for recurring fair value measurements of financial assets and financial liabilities categorised within Level 3 of the fair value hierarchy. [IFRS 13.93]

There are no disclosure exemptions for non-public entities under IFRS.

Like IFRS, a fair value measurement may be affected if there has been a significant decrease in the volume or level of activity for that item compared with normal market activity for that item. Judgement may be required in determining whether, based on the evidence available, there has been such a significant decrease, like IFRS. [820-10-35-54C, 35-54H]

Like IFRS, if an entity concludes that the volume or level of activity for an asset or liability has significantly decreased, then further analysis of the transactions or quoted prices is required. A decrease in the volume or level of activity on its own might not indicate that a transaction or a quoted price is not representative of fair value, or that a transaction in that market is not orderly. [820-10-35-54D]

Disclosures
Like IFRS, the fair value measurement Codification Topic contains a comprehensive disclosure framework. Like IFRS, fair value disclosures are based on the level within which a measurement falls in the fair value hierarchy. However, unlike IFRS, there is no requirement for entities to categorise investments measured using the NAV practical expedient (see above) in the hierarchy, and simplified disclosures apply. [820-10-35-54B, 50-1, 50-6A]

Like IFRS, the disclosures differentiate fair value measurements that are recurring from those that are non-recurring. Like IFRS, more extensive disclosures are required for Level 3 measurements. Unlike IFRS, there is no requirement for a quantitative sensitivity analysis for Level 3 financial assets and financial liabilities. [820-10-50-2]

Unlike IFRS, US GAAP exempts non-public entities from certain of the disclosure requirements. [820-10-50-2F]
Overview

- Subsidiaries are generally consolidated. As an exception, investment entities generally account for investments in subsidiaries at fair value.

- Consolidation is based on what can be referred to as a ‘power-to-direct’ model. An investor ‘controls’ an investee if it is exposed to (has rights to) variable returns from its involvement with the investee, and has the ability to affect those returns through its power over the investee. Although there is a practical distinction between structured and non-structured entities, the same control model applies to both.

- For a structured entity, voting rights are not the dominant factor in assessing whether the investor has power over the investee.

- Control is assessed on a continuous basis.

- Control is usually assessed over a legal entity, but can also be assessed over only specified assets and liabilities of an entity (a ‘silo’) if certain conditions are met.

Overview

- Subsidiaries are generally consolidated, like IFRS. As an exception, investment companies generally account for investments in subsidiaries at fair value, like IFRS. However, unlike IFRS, there are additional exceptions for certain other specialised industries.

- Unlike IFRS, consolidation is based on a controlling financial interest model, which differs in certain respects from IFRS.
  - For non-variable interest entities, ‘control’ is the continuing power to govern the financial and operating policies of an entity.
  - For variable interest entities (VIEs), control is the power to direct the activities that most significantly impact the VIE’s economic performance and either the obligation to absorb losses of the VIE, or rights to receive benefits from the VIE, that could potentially be significant to the VIE.

- A VIE is an entity for which the amount of equity investment at risk is insufficient for the entity to finance its own operations without additional subordinated financial support, or the equity investment at risk lacks one of a number of specified characteristics of a controlling financial interest. A VIE may or may not be a structured entity under IFRS.

- Like IFRS, control of a VIE is assessed on a continuous basis. Unlike IFRS, control of a non-VIE is reassessed only when there is a change in voting interests in the investee.

- Like IFRS, control is usually assessed over a legal entity and, in the case of VIEs, can also be assessed over only specified assets and liabilities of an entity (a ‘silo’) if certain conditions are met. Unlike IFRS, control is assessed over only legal entities in the voting interest model.
Overview (continued)

– In assessing control, an investor considers both substantive rights that it holds and substantive rights held by others. To be ‘substantive’, rights need to be exercisable when decisions about the relevant activities are required to be made, and the holder needs to have a practical ability to exercise those rights.

– Power is assessed with reference to the investee’s relevant activities, which are the activities that most significantly affect the returns of the investee. As part of its analysis, the investor considers the purpose and design of the investee, how decisions about the activities of the investee are made, and who has the current ability to direct those activities.

– The assessment of power over an investee includes considering the following factors:
  - determining the purpose and design of the investee;
  - identifying the population of relevant activities;
  - considering evidence that the investor has the practical ability to direct the relevant activities, special relationships, and the size of the investor’s exposure to the variability of returns of the investee.

– In assessing whether the investor is exposed to the variability of returns of the investee, ‘returns’ are broadly defined and include:
  - distributions of economic benefits;
  - changes in the value of the investment; and
  - fees, remunerations, tax benefits, economies of scale, cost savings and other synergies.

– An investor that has decision-making power over an investee and exposure to variability in returns determines whether it acts as a principal or as an agent to determine whether there is a link between power and returns. If the decision maker is an agent, then the link between power and returns is absent and the decision maker’s delegated power is treated as if it were held by its principal(s).

Overview (continued)

– In assessing control, an investor considers ‘substantive’ kick-out rights held by others, which is narrower than the guidance under IFRS. For non-VIEs, kick-out rights can be substantive if they are exercisable by a simple majority of the investors, like IFRS. For VIEs, unlike IFRS, kick-out rights that are not exercisable by a single investor or related party group (unilateral kick-out rights) are not considered substantive.

– Power is assessed with reference to the activities of the VIE that most significantly affect its financial performance, like IFRS. As part of its analysis, the investor considers the purpose and design of the VIE, and the nature of the VIE’s activities and operations, broadly like IFRS. However, unlike IFRS, for non-VIEs, power is derived through either voting or contractual control of the financial and operating policies of the investee.

– In assessing control over a VIE investee, the explicit factors to consider are more extensive than those noted under IFRS. Such factors are not relevant for non-VIEs, unlike IFRS.

– Unlike IFRS, US GAAP does not define returns for the purpose of determining whether an investor has control over a VIE. Nevertheless, the decision maker must have the obligation to absorb losses of the VIE, or rights to receive benefits from the VIE, that could potentially be significant to the VIE.

– Unlike IFRS, the VIE consolidation model does not have a separate test to assess the link between power and obligations/benefits. For non-VIEs, the investor with a controlling financial interest consolidates its investee without a principal/agent evaluation.
Overview (continued)

- A parent and its subsidiaries generally use the same reporting date when preparing consolidated financial statements. If this is impracticable, then the difference between the reporting date of a parent and its subsidiary cannot be more than three months. Adjustments are made for the effects of significant transactions and events between the two dates.

- Uniform accounting policies are used throughout the group.

- The acquirer in a business combination can elect, on a transaction-by-transaction basis, to measure ‘ordinary’ NCI at fair value, or at their proportionate interest in the net assets of the acquiree, at the date of acquisition. ‘Ordinary NCI’ are present ownership interests that entitle their holders to a proportionate share of the entity’s net assets in the event of liquidation. Other NCI are generally measured at fair value.

- An entity recognises a liability for the present value of the exercise price of put options held by NCI, but there is no detailed guidance on the accounting for such put options.

- Losses in a subsidiary may create a deficit balance in NCI.

- NCI in the statement of financial position are classified as equity but are presented separately from the parent shareholders’ equity.

- Profit or loss and comprehensive income for the period are allocated between shareholders of the parent and NCI.

- Intra-group transactions are eliminated in full.

Overview (continued)

- Like IFRS, the difference between the reporting date of a parent and its subsidiary cannot be more than about three months. However, unlike IFRS, use of the same reporting date need not be impracticable; adjustments may be made for the effects of significant transactions and events between these dates, or disclosures regarding those effects are provided.

- Unlike IFRS, uniform accounting policies within the group are not required.

- Unlike IFRS, NCI are generally measured initially at fair value.

- Unlike IFRS, there is specific guidance on the accounting for put options held by NCI, which results in a liability recognised at fair value or redemption amount, or the presentation of NCI as ‘temporary equity’, depending on the terms of the arrangement and whether the entity is an SEC registrant.

- Like IFRS, losses in a subsidiary may create a deficit balance in NCI.

- Like IFRS, non-redeemable NCI in the statement of financial position are classified as equity but are presented separately from the parent shareholders’ equity.

- Like IFRS, profit or loss and comprehensive income for the period are allocated between shareholders of the parent and NCI.

- Intra-group transactions are generally eliminated in full, like IFRS. However, for a consolidated VIE, the effect of eliminations on the consolidated results of operations is attributed entirely to the primary beneficiary, unlike IFRS.
Overview (continued)

– On the loss of control of a subsidiary, the assets and liabilities of the subsidiary and the carrying amount of the NCI are derecognised. The consideration received and any retained interest (measured at fair value) are recognised. Amounts recognised in OCI are reclassified as required by other IFRSs. Any resulting gain or loss is recognised in profit or loss.

– Pro rata spin-offs (demergers) are generally accounted for on the basis of fair values, and a gain or loss is recognised in profit or loss. In our view, non-pro rata spin-offs may be accounted for on the basis of fair values (gain or loss recognised in profit or loss) or book values (no gain or loss recognised).

– Changes in the parent’s ownership interest in a subsidiary without a loss of control are accounted for as equity transactions and no gain or loss is recognised.

Entities included in the consolidated financial statements

Except for the following, there are no exceptions from the requirement for an entity to consolidate all subsidiaries.

– With limited exceptions, investment entities (as defined) account for investments in subsidiaries at fair value through profit or loss; the consolidation exception for investment entities is the subject of chapter 5.6.

– An entity does not consolidate post-employment benefit plans or other long-term employee benefit plans in the scope of the employee benefits standard (see chapter 4.4). [IFRS 10.4A, 31–33]

Subsidiaries are consolidated even if they are held exclusively with a view to subsequent disposal (see chapter 5.4).

Structured vs non-structured entities

Consolidation is based on what can be referred to as a ‘power-to-direct’ model.

Entities included in the consolidated financial statements

Except for the following, there are no exceptions from the requirement for an entity to consolidate all subsidiaries.

– Like IFRS, investment companies account for investments in subsidiaries at fair value through profit or loss, with limited exceptions; the consolidation exception for investment companies is the subject of chapter 5.6.

– An entity does not consolidate employee benefit plans, like IFRS (see chapter 4.4).

– Unlike IFRS, an entity does not consolidate registered money market funds under the Investment Company Act of 1940, or similar entities. [810-10-15-10]

Like IFRS, subsidiaries are consolidated even if they are held exclusively with a view to subsequent disposal (see chapter 5.4).

Variable interest vs non-variable interest entities

Consolidation is based on a controlling financial interest model, which differs in certain respects from IFRS.
Although there is no distinction between different types of entities in determining whether one entity controls another, there is a ‘gating’ question in the analysis that distinguishes between entities for which:

– voting rights are the dominant factor in assessing whether the investor has power over the investee – i.e. the investee is controlled by voting instruments; and

– voting rights are not the dominant factor in assessing whether the investor has power over the investee – i.e. the investee is controlled by means of other rights. [IFRS 10.86]

Therefore, for practical purposes, this chapter considers entities for which voting rights are relevant (typically referred to as ‘non-structured entities’) separately from those for which voting rights are not relevant (typically referred to as ‘structured entities’).

Non-structured entities
An investor ‘controls’ an investee if the investor is exposed to (has rights to) variable returns from its involvement with the investee, and has the ability to affect those returns through its power over the investee. ‘Control’ involves power, exposure to variability of returns and a link between the two. [IFRS 10.6–7, A, B2]

If the investee is controlled by equity instruments, with associated and proportionate voting rights, then the assessment of power focuses on which investor, if any, has sufficient voting rights to direct the investee’s relevant activities; this is in the absence of any additional arrangements that alter the decision making. In the most straightforward cases, the investor holding the majority of the voting rights has power over (and controls) the investee. [IFRS 10.11, B6]

An investor considers both substantive rights that it holds and substantive rights held by others. To be ‘substantive’, rights need to be exercisable when decisions about the relevant activities are required to be made, and the holder needs to have a practical ability to exercise those rights. [IFRS 10.B22, B24]

Protective rights are related to fundamental changes in the activities of an investee, or are rights that apply only in exceptional circumstances. As such, they cannot give the holder power or prevent other parties from having power and therefore control over an investee. [IFRS 10.14, B26–B28]

Unlike IFRS, US GAAP distinguishes between variable interest entities (VIEs) and non-VIEs and applies the controlling financial interest model differently to each category of investees. This distinction between VIEs and non-VIEs is not necessarily the same as the distinction between structured entities and non-structured entities under IFRS.

Non-variable interest entities
Consolidation is based on ‘control’, which is the continuing power to govern the financial and operating policies of an entity, which differs from IFRS in certain respects. [810-10-15-8, 810-10-25]

Like IFRS, if the investee is controlled by means of equity instruments, with associated and proportionate voting rights, then the assessment of power focuses on which investor, if any, has sufficient voting rights to direct the investee’s relevant activities; this is in the absence of any additional arrangements that alter the decision making. Like IFRS, in the most straightforward cases the investor holding the majority of the voting rights has power over (and controls) the investee. [810-10-15-8]

An investor considers ‘substantive’ kick-out rights held by others, which is narrower than the guidance under IFRS. Kick-out rights can be substantive if they are exercisable by a simple majority of the investors. [810-10-25-10, 25-38C]

Like IFRS, under the non-VIE model, protective rights are related to fundamental changes in the activities of an investee, or are rights that apply only in exceptional circumstances. As such, they cannot give the holder power or prevent other parties from having power and therefore control over the investee, like IFRS. [810-10-25-10, 25-38C]
In assessing control, an investor considers its potential voting rights – e.g. a call option over shares of the investee – as well as potential voting rights held by other parties, to determine whether it has power. Potential voting rights are considered only if they are substantive (see above). [IFRS 10.B47]

Even without potential voting rights or other contractual rights, if the investor holds significantly more voting rights than any other vote holder or organised group of vote holders, then this may be sufficient evidence of power (de facto power). In other situations, the size of the investor’s holding of voting rights relative to the size and dispersion of the holdings of other vote holders may provide sufficient evidence that the investor does not have power – e.g. if there is a concentration of other voting interests among a small group of vote holders. [IFRS 10.B38, B43–B45]

The assessment of control is performed on a continuous basis and an investor reassesses whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the elements of the control model. [IFRS 10.8, B80–B85]

The factors discussed below in respect of structured entities apply equally to non-structured entities. However, in practice, they are more likely to be relevant to structured entities.

**Structured entities**

**Definition**

IFRS has no concept of variable interest entities. Instead, ‘structured entities’ are entities designed such that voting or similar rights are not the dominant factor in assessing control. [IFRS 12.A]

Unlike IFRS, the control model does not incorporate the assessment of potential voting rights; therefore, such rights are not considered.

Unlike IFRS, the control model does not incorporate the concept of de facto power.

Unlike IFRS, control of a non-VIE is assessed only when there is a change in voting interests in the investee.

Unlike IFRS, the factors discussed below for VIEs do not apply to non-VIE investees.

**Variable interest entities**

**Definition**

US GAAP has no concept of structured entities. Instead, a VIE is an entity that has any of the following characteristics:
- the amount of equity investment at risk is insufficient for the entity to finance its own operations without additional subordinated financial support;
- the equity investment at risk lacks one of the following characteristics of a controlling financial interest:
  - the power, through voting or similar rights, to direct the activities that most significantly impact the entity’s economic performance;
  - the obligation to absorb the entity’s economic risks; or
  - the right to receive the entity’s economic rewards; or
- substantially all of the entity’s activities either involve or are conducted on behalf of an equity investor (and its related parties) that has disproportionately few voting rights in relation to its economic interests. [S10-10-05-B-A, A-14]
Many entities that are VIEs under US GAAP will meet the definition of a structured entity under IFRS. However, some VIEs under US GAAP will not be structured entities under IFRS and some entities that are not VIEs under US GAAP may be structured entities under IFRS. Additionally, aspects of the controlling financial interest model that applies to VIEs differ from the control model that applies to structured entities under IFRS.

Like IFRS, control is usually assessed over a legal entity, but for a VIE can also be assessed over only specified assets (and any related credit enhancements, unlike IFRS) and liabilities of the entity (a ‘silo’) if the following criteria are met:

- the specified assets of the investee are essentially the only source of payment for specified liabilities of, or specified other interests in, an investee; and
- parties other than those with the specified liability have no rights or obligations in respect of the assets related to that liability (specified assets) or to residual cash flows from those assets. [IFRS 10.B76–B78]

The controlling party

Like the analysis for non-structured entities, an investor ‘controls’ an investee if the investor is exposed to (has rights to) variable returns from its involvement with the investee, and has the ability to affect those returns through its power over the investee. Control involves power, exposure to variability of returns and a link between the two. [IFRS 10.6–7 A, B2]

As for non-structured entities, a structured entity is not expected to have more than one controlling party at any given time. If no single investor, or group of investors acting collectively, has control, then no controlling party is identified and the entity is not consolidated. [IFRS 10.9]

As for non-structured entities, the assessment of control is performed on a continuous basis and an investor reassesses whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the elements of the control model. [IFRS 10.8, B80–B85]

Other than in respect of disclosure, the distinction between structured and non-structured entities is practical rather than being a feature of the control model itself. Therefore, there is no need for an entity to reconsider whether an investee is a structured entity when changes in facts and circumstances occur, although this might change the factors considered in assessing control.

Unlike IFRS, reporting entities need to explicitly determine whether an entity is a VIE and to reconsider whether it is a VIE when changes in facts and circumstances occur. [810-10-35-4]
There are no exceptions from the requirement to identify a controlling party.

Unlike IFRS, the primary beneficiary VIE consolidation requirements do not apply to reporting entities’ interests in entities that either have all of the characteristics of investment companies or for which it is industry practice to apply measurement principles for financial reporting purposes consistent with those that apply to investment companies, if other conditions are met. The primary beneficiary VIE consolidation requirements do not apply to reporting entities’ interests in all registered money market funds and other entities that comply with requirements similar to the money market fund rules of the Investment Company Act of 1940. For such entities that are not subject to the primary beneficiary VIE consolidation requirements, VIE consolidation requirements that are primarily based on an evaluation of the reporting entity’s exposure to the entity’s economic risks and rewards apply along with the disclosure requirements applicable to all VIEs. [810-10-65-2aa]

Power over relevant activities

Power is based on an assessment of who directs the relevant activities of an investee, i.e. the activities that most significantly affect the investee’s returns. [IFRS 10.10]

The investor needs to have a variable interest in the investee (see below), but its power does not necessarily need to be conveyed through a variable interest. Power may be derived through a management or servicing agreement, or through other agreements.

The assessment of power over a structured entity includes considering the following factors:
- determining the purpose and design of the investee, including:
  - the risk(s) that the investee was designed to create;
  - the risk(s) that the investee was designed to pass on to parties involved with the investee; and
  - the investor’s role in the purpose and design of the investee;
- identifying the population of relevant activities; and
- considering evidence that the investor has the practical ability to direct the relevant activities, special relationships, and the size of the investor’s exposure to the variability of returns of the investee (see below). [IFRS 10.B3, B7-B8]

Power over activities that most significantly impact economic performance

Power is based on an assessment of who directs the activities that most significantly impact the economic performance of a VIE. Although the precise wording of US GAAP differs from IFRS, the overall concept is generally the same. [810-10-25-38]

A primary beneficiary must have a variable interest in the VIE (which differs in certain respects from IFRS – see below), but its power does not necessarily need to be conveyed through a variable interest, like IFRS. Power may be conveyed through voting equity interests (unlike a structured entity under IFRS), by a management or servicing agreement, or through other agreements, like IFRS. [810-10-25-38]

The assessment of power over a VIE includes considering the following factors:
- whether a single reporting entity has the unilateral ability to exercise kick-out rights or participating rights;
- the purpose and design of the VIE;
- the risk(s) that the VIE was designed to create and pass through to its variable interest holders; and
- the terms of the contractual arrangements with variable interest holders. [810-10-25-38]

Although the precise wording of US GAAP differs from IFRS, we expect that similar factors will often be considered in the assessment.
For a leasing vehicle that is a structured entity created to lease a single asset to a single lessee, the lessee’s right to use the leased asset for a period of time does not, in isolation, typically give the lessee decision-making rights over the relevant activities of the vehicle (e.g. managing the credit risk on rentals, and/or managing the leased asset at the end of the lease term) and therefore the lessee does not typically have power over the vehicle; this is regardless of whether the lease is a finance or an operating lease. [IU 06-15]

As for non-structured entities, an investor considers both substantive rights that it holds and substantive rights held by others. To be ‘substantive’, rights need to be exercisable when decisions about the relevant activities are required to be made, and the holder needs to have a practical ability to exercise those rights. In the context of structured entities, kick-out rights are an example of rights that are potentially substantive. [IFRS 10.B22, B24]

Fund managers apply the general guidance for their analysis of whether there is a link between power and returns (see below).

For a VIE that is a lessee, most operating leases do not absorb variability in the fair value of a VIE’s net assets if the lease terms are consistent with market terms at the inception of the lease and do not contain residual value guarantees or fixed price purchase options. Therefore, we expect for ‘plain vanilla’ operating leases a similar outcome under US GAAP as under IFRS – i.e. non-consolidation of such vehicles. However, features such as residual value guarantees or fixed price purchase options may result in a different conclusion for operating leases under US GAAP than under IFRS. [810-10-55-39]

An investor considers substantive kick-out rights held by others, which is narrower than the guidance under IFRS. Unlike IFRS, kick-out rights that are not exercisable by a single investor or related party group (unilateral kick-out rights) are not considered substantive. [810-10-25, 10-38C, 810-20-25]

Unlike IFRS, for an entity that is the general partner in a limited partnership or similar entity, there is specific guidance on the power assessment.

– A limited partnership or similar entity is not a VIE only if substantive kick-out rights are exercisable by either a single limited partner or a simple majority of all limited partner voting interests (excluding those held by the general partner, entities under common control with the general partner, and other parties acting on behalf of the general partner). In that case, the limited partnership or similar entity is assessed for consolidation under the non-VIE model (see above). [810-10-15-14(b)(1)(i)]

– Other entities that have a decision maker whose fee is a variable interest may qualify to be assessed for consolidation under the non-VIE model (see above) even if substantive kick-out rights are not exercisable by either a single limited partner or a simple majority of all limited partner voting interests (excluding those held by the general partner, entities under common control with the general partner, and other parties acting on behalf of the general partner). [810-10-15-14(c)(2)]

Determining whether participating rights are substantive requires judgement. However, unlike IFRS, factors to consider include:

– the ability to select, terminate or set the compensation of management responsible for implementing the investee’s policies and procedures; and

– establishing operating and capital decisions of the investee, including budgets, in the ordinary course of business. [810-10-25-11]
Exposure to variability in returns
To have control over an investee, an investor needs to be exposed to (have rights to) variable returns from its involvement with the investee. Returns might be only positive, only negative, or either positive or negative. Sources of returns include:
- dividends or other economic benefits, such as interest from debt securities and changes in the value of the investor’s investment in the investee;
- remuneration for servicing an investee’s assets or liabilities, fees and exposure to loss from providing credit or liquidity support;
- tax benefits;
- residual interests in the investee’s assets and liabilities on liquidation; and/or
- returns that are not available to other interest holders, such as the investor’s ability to use the investee’s assets in combination with its own to achieve economies of scale, cost savings or other synergies. [IFRS 10.15, B55–B57]

There is no specific guidance on fees paid to a decision maker in determining the variability of returns. Instead, guidance that is particularly relevant to fund managers is included in the assessment of the link between power and returns (see below).

Obligation to absorb losses or rights to receive benefits
Unlike IFRS, ‘expected losses’ and ‘expected residual returns’ are defined as the expected variability in the fair value of net assets exclusive of variable interests. Factors to consider include:
- the purpose, design and structure of the VIE, including the terms of the VIE’s variable interests and nature of its variability;
- whether any of the entity’s or VIE’s exposure to losses or benefits is capped;
- the nature of the VIE’s capital structure, including where in the structure the entity’s interest resides;
- the magnitude of the VIE’s variable interests held by the reporting entity; and
- the rationale for the entity holding a variable interest in the VIE. For example, holding an interest for reputational reasons may indicate that the reporting entity is exposed to losses or benefits that may be significant to the VIE. [810-10-55-61, 55-64, 55-67, 55-70, 55-74, 55-77, 55-80, 55-83 – 55-84]

Unlike IFRS, an entity’s fees paid to a decision maker or service provider are not variable interests (and therefore the decision maker or service provider will not consolidate) if:
- they are commensurate with the level of effort required to provide the services;
- the decision maker or service provider does not hold other interests that would absorb (receive) more than an insignificant amount of the VIE’s expected losses (returns); and
- the service arrangement has terms and conditions consistent with an arm’s length arrangement. [810-10-55-37]

Unlike IFRS, when the guidance on fees is being applied, interests held by a related party of the decision maker or service provider are considered as follows.
- The interests of the related party are considered on a proportionate basis if the decision maker or service provider holds an economic interest in the related party and the related party:
  - is not an employee or employee benefit plan of the decision maker; or
  - is an employee or employee benefit plan of the decision maker that is being used to circumvent the VIE consolidation requirements.
- If the group of entities under common control has an obligation to absorb losses that could potentially be significant to the entity, or it has the right to receive benefits from the entity but no individual entity with the group does, then the entity within the common control group that is most closely associated with the entity’s activities is the primary beneficiary. [810-10-55-37D]
Link between power and returns

To have control, in addition to power and exposure to variable returns from its involvement with the investee, an investor needs the ability to use its power over the investee to affect its returns. If the investor is an agent, then this linkage element is missing. [IFRS 10.17]

The following is a summary.
- If the decision maker has the power to direct the activities of the investee that it manages to generate returns for itself, then it is a principal.
- If the decision maker is engaged to act on behalf and for the benefit of another party or parties, then it is an agent and does not control the investee when exercising its decision-making authority. However, a decision maker is not an agent simply because other parties can benefit from the decisions that it makes. [IFRS 10.18, B58]

This analysis is often particularly relevant for fund managers. In applying the guidance, two tests are determinative.
- If a single party holds substantive kick-out rights (i.e. the decision maker can be removed without cause), then the decision maker is an agent. In that case, the linkage test is failed and the decision maker does not consolidate the investee. This is regardless of the level of remuneration.
- If the decision maker’s remuneration is not commensurate with the services provided, or the terms and conditions are not on an arm’s length basis, then the decision maker is the principal. In that case, the linkage test is met and the decision maker consolidates the investee. [IFRS 10.B65, B69-B70]

Subsidiaries’ accounting periods and policies

If the reporting dates of the parent and subsidiary are different, then additional financial statements of the subsidiary are prepared as at the parent’s reporting date, unless it is impracticable to do so. In any case, the difference between the reporting dates of the parent and subsidiary should not be greater than three months and adjustments are made for the effects of significant transactions and events between these dates. [IFRS 10.B92-B93]
IFRS does not provide specific guidance on a change in a subsidiary’s reporting date, or the elimination of an existing lag period between the reporting dates of a parent and its subsidiary. In our view, when a subsidiary’s reporting date changes, the consolidated financial statements for the current period should include the results of the parent for the 12 months and the results of the subsidiary for a longer or shorter period, unless the parent has already adjusted its consolidated financial statements in the previous period for the effects of the difference.

For the purposes of consolidation, the financial information of all subsidiaries is prepared on the basis of IFRS. Additionally, uniform accounting policies are used throughout the group for like transactions and events. [IFRS 10.19, B87]

**Non-controlling interests**

NCI represent the equity in a subsidiary that is not attributable directly or indirectly to the parent. [IFRS 10.22, A]

NCI are generally recognised in the consolidated financial statements of the parent, even if the non-wholly owned subsidiary does not constitute a business, because there is no exception from the general requirements of the standard. [IFRS 10.A, 22]

The acquirer in a business combination can elect, on a transaction-by-transaction basis, to measure NCI that are present ownership interests and entitle their holders to a proportionate share of the acquiree’s net assets in liquidation (‘ordinary’ NCI) at fair value or at the holders’ proportionate interest in the recognised amount of the identifiable net assets of the acquiree at the date of acquisition. Other components of NCI are initially measured at fair value, unless a different measurement basis is required by other IFRSs. [IFRS 3.19]

Even though control of an entity takes into account potential voting rights that are substantive, the calculation of NCI is generally based on current ownership interests. In our view, the returns associated with an ownership interest, and hence the NCI proportion, do not refer to the wider returns, such as synergistic benefits due to economies of scale and cost savings, that are part of the test of control (see above). [IFRS 10.B89]

Losses that are attributable to NCI are allocated to the NCI even if doing so causes the NCI to have a deficit balance. [IFRS 10.B94]

Unlike IFRS, a parent reflects the effect of a change in a subsidiary’s reporting date, or the elimination of an existing lag period between the reporting dates of the parent and the subsidiary, by including 12 months’ results for the subsidiary for the current period and revising comparative information unless it is impracticable to do so. [810-10-45-13]

For the purposes of consolidation, the financial information of all subsidiaries is prepared on the basis of US GAAP which is equivalent to the IFRS requirement. However, unlike IFRS, uniform accounting policies within the group are not required. Also unlike IFRS, specialised accounting at the subsidiary level is required to be retained in the consolidated financial statements of the parent in certain circumstances. [810-10-25-15]

**Non-controlling interests**

Like IFRS, NCI represent the equity in a subsidiary that is not attributable directly or indirectly to the parent. [810-10-45-15]

Like IFRS, NCI are generally recognised in the consolidated financial statements of the parent, even if the non-wholly owned subsidiary does not constitute a business, because there is no exception from the general requirements of the consolidation Codification Topic. [810-10-15-3]

Unlike IFRS, the acquirer in a business combination measures NCI at fair value at the date of acquisition, with the exception of share-based payments held as NCI, which are measured using the fair value-based measurement requirements of the share-based payments Codification Topic. [805-20-30-1]

Unlike IFRS, control of an entity does not take into account potential voting rights. Like IFRS, the calculation of NCI is generally based on current ownership interests unless the subsidiary is a VIE. [323-10-15-9, 810-10-25-1]

Like IFRS, losses that are attributable to NCI are allocated to the NCI even if doing so causes the NCI to have a deficit balance. [810-10-45-21]
If an entity writes a put option or enters into a forward purchase agreement (that provides for settlement in cash or in another financial asset of the entity) with the NCI in an existing subsidiary on their shares in that subsidiary, then the entity recognises a financial liability for the present value of the exercise price of the option or of the forward price. In our view, the accounting for the NCI depends in part on whether the NCI have present access to the returns associated with the underlying ownership benefits. [IAS 32.23]

Unlike IFRS, there is specific guidance on accounting for a put option or forward held by a non-controlling shareholder, which may give rise to differences from IFRS in practice. The following are examples.

- If the put option is issued as a single freestanding instrument for a fixed exercise price, then it is accounted for at fair value as a derivative liability and the NCI continue to be recognised.
- If the put option is embedded in the non-controlling shares and there is also an offsetting embedded mirror call option held by the parent, then the parent recognises no NCI and accounts for the arrangement as a financing of the parent’s acquisition of NCI.
- If the put option is embedded in the non-controlling shares and there is no offsetting embedded call option held by the parent, then:
  - if the exercise price of the put option is at fair value or a formula intended to approximate fair value, then NCI should generally be reported outside equity and measured at the greater of the carrying amount and fair value; or
  - if the exercise price of the put option is not intended to reflect fair value (e.g. a fixed exercise price), then NCI would generally be reported outside equity and accreted to the redemption amount.

In the consolidated statement of financial position, NCI are classified as equity but are presented separately from the parent shareholders’ equity. If the NCI are redeemable, then the terms of the instrument determine whether the NCI should be classified as equity or as a liability (see chapter 7.3). [IAS 1.54]

Like IFRS, in the consolidated statement of financial position, NCI are classified as equity but are presented separately from the parent shareholders’ equity. However, if the NCI are redeemable upon events outside the control of the issuer, then SEC registrants are required to present NCI outside ‘permanent’ equity and doing so changes the measurement of NCI, which may give rise to differences from IFRS in practice. [480-10-45-16]

Like IFRS, profit or loss and each component of OCI are attributed to the owners of the parent and to the NCI. [IFRS 10.B94]

**Intra-group transactions**

Intra-group balances and transactions, and resulting profits, are eliminated in full regardless of whether the unearned profit is in the parent or the subsidiary. Intra-group losses are eliminated in full, except to the extent that the underlying asset is impaired. [IFRS 10.B86(c)]

The requirements for the elimination of intra-group balances and transactions apply equally to all subsidiaries. [IFRS 10.B86(c)]

Like IFRS, profit or loss and each component of OCI are attributed to the owners of the parent and to the NCI. [810-10-45-20]

**Intra-group transactions**

Intra-group balances and transactions, and resulting profits, are generally eliminated in full regardless of whether the unearned profit is in the parent or the subsidiary, like IFRS. Like IFRS, intra-group losses are eliminated in full, except to the extent that the underlying asset is impaired. [810-10-45-1]

Unlike IFRS, the elimination of fees or other sources of income or expense between a primary beneficiary and a consolidated VIE is attributed entirely to the primary beneficiary, rather than being allocated between the primary beneficiary and NCI holders. [810-10-35-3]
Changes in ownership interests while retaining control
Changes in ownership interests without gaining or losing control (i.e., increases and decreases in NCI) are accounted for as transactions with equity holders in their capacity as equity holders. As a result, no gain or loss on such changes is recognised in profit or loss. [IFRS 10.23]

The interests of the parent and NCI are adjusted to reflect the relative change in their interests in the subsidiary’s equity. Any difference between the amount by which the NCI are adjusted and the fair value of the consideration paid or received, if there is any, is recognised directly in equity and attributed to the owners of the parent. [IFRS 10.B96, IU 01-13]

When NCI are initially measured based on their proportionate interest in the recognised amount of the identifiable net assets of the acquiree, there is no specific guidance in IFRS on the calculation to reflect the relative change in their interests in the subsidiary’s equity, and practice varies.

In our view, when NCI were initially measured at fair value, the adjustment of NCI on purchases or sales of equity interests in the subsidiary when control of the subsidiary by the parent exists before and after the transaction should include a portion of goodwill. 

Loss of control
A subsidiary is consolidated until the date on which control ceases. When a parent loses control of a subsidiary other than in a spin-off (see below), it:
- derecognises the assets (including goodwill), liabilities and NCI in the subsidiary, including any components of OCI attributable to them;
- recognises the fair value of the consideration received, if there is any;
- recognises any non-controlling equity investment retained at fair value; and

Like IFRS, a subsidiary is consolidated until the date on which control ceases. When a parent loses control of a subsidiary that is a business, other than a subsidiary that is in-substance real estate or oil- and gas-producing activities (unlike IFRS), other than in a spin-off (see below), it:
- derecognises the assets (including goodwill), liabilities and NCI in the subsidiary, including any components of accumulated OCI attributable to them, like IFRS;
- reclassifies to profit or loss, or transfers directly to retained earnings, amounts recognised in OCI in relation to the subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities. [IFRS 10.25, B95–B99]

When control of a subsidiary is lost other than in a spin-off (see below), any resulting gain or loss is recognised in profit or loss, and is measured as the difference between:
- the sum of:
  - the fair value of the consideration received, if there is any;
  - the fair value of any retained non-controlling equity investment; and
  - the carrying amount of the NCI in the former subsidiary, including amounts recognised in OCI (e.g. foreign exchange differences – see chapter 2.7) attributable to the NCI; and
- the carrying amount of the former subsidiary’s net assets. [IFRS 10.25(c), B98(d)]

The gain or loss recognised in profit or loss comprises a ‘realised’ gain or loss on the interest disposed of, and an ‘unrealised’ gain or loss from remeasurement to fair value of any retained non-controlling equity investment in the former subsidiary. [IFRS 10.25(c), B98(d)]

The above accounting applies to subsidiaries. Practice may vary in terms of the accounting treatment applied to a group of assets that constitutes a business.

Because the above accounting applies to subsidiaries, no distinction is made for subsidiaries that do not constitute a business.

If a parent loses control of a subsidiary by contributing it to an equity-accounted investee, then IFRS is unclear on how the gain or loss on the loss of control should be calculated. In our view, the entity should choose an accounting policy, to be applied consistently, either to recognise the gain or loss in full (as described above) or to eliminate that portion of the gain or loss related to the entity’s continuing interest in the investee.

- recognises the fair value of the consideration received, if there is any, like IFRS;
- recognises any non-controlling equity investment retained at fair value, like IFRS; and
- reclassifies to profit or loss amounts recognised in accumulated OCI in relation to the subsidiary, which may differ from IFRS depending on the nature of the underlying item. [810-10-40-5]

Like IFRS, when control of a subsidiary that is a business, other than a subsidiary that is in-substance real estate or oil- and gas-producing activities (unlike IFRS), is lost other than in a spin-off (see below), any resulting gain or loss is recognised in profit or loss, and is measured as the difference between:
- the sum of:
  - the fair value of the consideration received, if there is any;
  - the fair value of any retained non-controlling equity investment; and
  - the carrying amount of the NCI in the former subsidiary, including accumulated OCI attributable to the NCI; and
- the carrying amount of the former subsidiary’s net assets. [810-10-40-5]

Like IFRS, the gain or loss recognised in profit or loss comprises a ‘realised’ gain or loss on the interest disposed of (unless, unlike IFRS, the portion is disposed of through a non-reciprocal pro rata transfer to owners), and an ‘unrealised’ gain or loss from remeasurement to fair value of any retained non-controlling equity investment in the former subsidiary. [810-10-40-6]

Unlike IFRS, the above accounting also applies to a group of assets that constitutes a business when control is lost. [810-10-40-5]

Unlike IFRS, if the subsidiary is not a business or is in-substance real estate or an oil- and gas-producing activity, then other US GAAP is applied on losing control, which may result in partial step-up and partial gain recognition. [810-10-40-5]

Unlike IFRS, if a parent loses control of a subsidiary by contributing it to an equity-method investee, then the above accounting applies if the subsidiary is a business, other than in-substance real estate or oil- and gas-producing activities, and the gain or loss is recognised in full. Unlike IFRS, if the subsidiary does not constitute a business, then whether the portion of the gain or loss related to the entity’s continuing interest in the investee is eliminated depends on the nature of the asset group. See forthcoming requirements. [810-10-40-5]
Any retained non-controlling equity investment in the former subsidiary is remeasured to its fair value at the date on which control is lost. From the date that control is lost, the remaining interest is accounted for as:
- an associate (see chapter 3.5);
- a joint arrangement (see chapter 3.6); or
- a financial asset (see chapter 7.4).

Like IFRS, any retained non-controlling equity investment in the former subsidiary that is a business is remeasured to its fair value at the date on which control is lost, unless control is lost through a spin-off (see below). Unlike IFRS, any retained non-controlling equity investment in a former subsidiary that is not a business is measured at its existing carrying amount. From the date that control is lost, the remaining interest is accounted for as either:
- an equity-method investee (see chapter 3.5), like IFRS;
- an investment classified as trading or available-for-sale if the security is currently traded in an organised market (see chapter 7.4), like IFRS; or
- a cost-method investment or at fair value through profit or loss if the security is not currently traded in an organised market (see chapter 7.4), unlike IFRS.

Based on facts and circumstances, an entity accounts for two or more transactions or arrangements that result in the loss of control of a subsidiary as a single transaction. Judgement is required in making this determination, and IFRS provides the following indicators to consider:
- the transactions or arrangements are entered into at the same time or in contemplation of one another;
- the transactions or arrangements form a single arrangement that achieves, or is designed to achieve, an overall commercial effect;
- the occurrence of one transaction or arrangement is dependent on the other transaction(s) or arrangement(s) occurring; and/or
- one or more of the transactions or arrangements considered on their own is not justified economically, but they are justified economically when considered together. [IFRS 10.B97]

A spin-off, in which operations are distributed to owners on a pro rata basis, is accounted for on a fair value basis (see chapter 7.3), with a gain or loss recognised in profit or loss. However, if the spin-off is a common control transaction (i.e. the operations are controlled by the same party before and after the transaction – see chapter 5.13), then there is no specific guidance in IFRS. In this case, in our view an entity should choose an accounting policy, to be applied consistently, of fair value or book value (i.e. with no gain or loss recognised). [IFRIC 17.S, 11, 14]

In a non-pro rata spin-off, operations are distributed to owners on a non-pro rata basis. In this case, in our view an entity should choose an accounting policy, to be applied consistently, of fair value (with a gain or loss recognised in profit or loss) or book value (no gain or loss recognised). Unlike IFRS, under US GAAP spin-offs are accounted for on the basis of book values (with no gain or loss recognised) if there is a pro rata distribution to owners (see chapter 7.3). [ASU 2010-30-10]

Unlike IFRS, a non-pro rata spin-off, in which operations are distributed to owners on a non-pro rata basis, is required to be accounted for on the basis of fair values (with a gain or loss recognised in profit or loss). [ASU 2010-30-10]
Forthcoming requirements

Amendments to the consolidation suite of standards were originally meant to be effective for annual periods beginning on or after 1 January 2016. In December 2015, the IASB decided to postpone the effective date of these amendments indefinitely pending the outcome of its research project on the equity method of accounting.

If a parent loses control of a subsidiary by contributing it to an equity-accounted investee, then the recognition of any gain or loss depends on whether the subsidiary meets the definition of a business (see chapter 2.6).

- If the former subsidiary is a business, then the parent recognises the full gain or loss on the loss of control.
- If the former subsidiary is not a business, then the parent recognises a gain or loss on the loss of control only to the extent of the unrelated investors’ interests in the equity-accounted investee. [IFRS 10.B99A, IAS 28.28, 30, 31A]

Forthcoming requirements

Amendments to the consolidation Codification Topic as a result of the new revenue Codification Topic (see chapter 4.2A) are effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted but not before annual periods beginning after 15 December 2016.

If a parent loses control of a subsidiary by contributing it to an equity-method investee, then the recognition of any gain or loss generally depends on whether the subsidiary meets the definition of a business (see chapter 2.6) or is in-substance non-financial assets.

- If the former subsidiary is a business, then the parent recognises a full gain or loss on the loss of control, like IFRS.
- If the former subsidiary is in-substance non-financial assets (whether or not it is also a business), then the parent recognises a gain or loss on the loss of control using the recognition and measurement requirements of the revenue Codification Topic (see chapter 4.2A), unlike IFRS.
- If the former subsidiary is neither a business nor in-substance non-financial assets, the gain or loss is accounted for using other Codification topics which may result in differences from IFRS. [620-10-15-4, 810-10-40-3A, 40-5]
2.6 Business combinations 

Overview

- Business combinations are accounted for under the acquisition method, with limited exceptions.

- A ‘business combination’ is a transaction or other event in which an acquirer obtains control of one or more businesses.

- The acquirer in a business combination is the combining entity that obtains control of the other combining business or businesses.

- In some cases, the legal acquiree is identified as the acquirer for accounting purposes (reverse acquisition).

- The ‘date of acquisition’ is the date on which the acquirer obtains control of the acquiree.

- Consideration transferred by the acquirer, which is generally measured at fair value at the date of acquisition, may include assets transferred, liabilities incurred by the acquirer to the previous owners of the acquiree and equity interests issued by the acquirer.

- Contingent consideration transferred is initially recognised at fair value. Contingent consideration classified as a liability or an asset is remeasured to fair value each period until settlement, with changes recognised in profit or loss. Contingent consideration classified as equity is not remeasured.

- Any items that are not part of the business combination transaction are accounted for outside the acquisition accounting.

Like IFRS, business combinations are accounted for under the acquisition method, with limited exceptions.

- Like IFRS, a ‘business combination’ is a transaction or other event in which an acquirer obtains control of one or more businesses. However, the US GAAP guidance on control differs from IFRS.

- Like IFRS, the acquirer in a business combination is the combining entity that obtains control of the other combining business or businesses.

- Like IFRS, in some cases the legal acquiree is identified as the acquirer for accounting purposes (reverse acquisition).

- Like IFRS, the ‘date of acquisition’ is the date on which the acquirer obtains control of the acquiree.

- Like IFRS, consideration transferred by the acquirer, which is generally measured at fair value at the date of acquisition, may include assets transferred, liabilities incurred by the acquirer to the previous owners of the acquiree and equity interests issued by the acquirer.

- Like IFRS, contingent consideration transferred is initially recognised at fair value. Like IFRS, contingent consideration classified as a liability or an asset is remeasured to fair value each period until settlement, with changes recognised in profit or loss. Contingent consideration classified as equity is not remeasured, like IFRS. However, the guidance on debt vs equity classification differs from IFRS.

- Like IFRS, any items that are not part of the business combination transaction are accounted for outside the acquisition accounting.
Overview (continued)

- The identifiable assets acquired and liabilities assumed are recognised separately from goodwill at the date of acquisition if they meet the definition of assets and liabilities and are exchanged as part of the business combination.

- The identifiable assets acquired and liabilities assumed as part of a business combination are generally measured at the date of acquisition at their fair values.

- There are limited exceptions to the recognition and/or measurement principles for contingent liabilities, deferred tax assets and liabilities, indemnification assets, employee benefits, reacquired rights, share-based payment awards and assets held for sale.

- Goodwill is measured as a residual and is recognised as an asset. If the residual is a deficit (gain on bargain purchase), then it is recognised in profit or loss after reassessing the values used in the acquisition accounting.

- Adjustments to the acquisition accounting during the ‘measurement period’ reflect additional information about facts and circumstances that existed at the date of acquisition. Such adjustments are made by retrospective application to the period in which the acquisition occurred and any subsequent periods.

- ‘Ordinary’ NCI are measured at fair value, or at their proportionate interest in the net assets of the acquiree, at the date of acquisition. ‘Other’ NCI are generally measured at fair value.

- If a business combination is achieved in stages (step acquisition), then the acquirer’s previously held non-controlling equity interest in the acquiree is remeasured to fair value at the date of acquisition, with any resulting gain or loss recognised in profit or loss.

Overview (continued)

- Like IFRS, the identifiable assets acquired and liabilities assumed are recognised separately from goodwill at the date of acquisition if they meet the definition of assets and liabilities and are exchanged as part of the business combination.

- Like IFRS, the identifiable assets acquired and liabilities assumed as part of a business combination are generally measured at the date of acquisition at their fair values.

- Like IFRS, there are limited exceptions to the recognition and measurement principles for contingent liabilities, deferred tax assets and liabilities, indemnification assets, employee benefits, reacquired rights, share-based payment awards and assets held for sale, although the accounting for some of these items differs from IFRS. However, unlike IFRS, there is also specific guidance on the recognition and measurement of uncertain tax positions.

- Like IFRS, goodwill is measured as a residual and is recognised as an asset. Like IFRS, if the residual is a deficit (gain on bargain purchase), then it is recognised in profit or loss after reassessing the values used in the acquisition accounting.

- Like IFRS, adjustments to the acquisition accounting during the ‘measurement period’ reflect additional information about facts and circumstances that existed at the date of acquisition. Unlike IFRS, such adjustments are made in the current period.

- Unlike IFRS, the acquirer in a business combination generally measures NCI at fair value at the date of acquisition.

- Like IFRS, if a business combination is achieved in stages (step acquisition), then the acquirer’s previously held non-controlling equity interest in the acquiree is remeasured to fair value at the date of acquisition, with any resulting gain or loss recognised in profit or loss.
Overview (continued)

– In general, items recognised in the acquisition accounting are measured and accounted for in accordance with the relevant IFRS subsequent to the business combination. However, as an exception, there is specific guidance for certain items – e.g. contingent liabilities and indemnification assets.

– ‘Push-down’ accounting, whereby fair value adjustments are recognised in the financial statements of the acquiree, is not permitted under IFRS.

– The acquisition of a collection of assets that does not constitute a business is not a business combination. In such cases, the entity allocates the cost of acquisition to the assets acquired and liabilities assumed based on their relative fair values at the date of acquisition. No goodwill is recognised.

Scope

The business combinations standard does not apply to:

– the formation of a joint arrangement in the financial statements of the joint arrangement itself;
– the acquisition of an asset or a group of assets that does not meet the definition of a business (see below);
– a combination of entities or businesses under common control (see chapter 5.13); and
– the acquisition by an investment entity of an investment in a subsidiary that is required to be measured at fair value through profit or loss (see chapter 5.6).  
[IFRS 3.2–2A]

Overview (continued)

– Like IFRS, in general, items recognised in the acquisition accounting are measured and accounted for in accordance with the relevant US GAAP subsequent to the business combination. However, like IFRS, there is specific guidance for certain items, although the guidance differs in some respects from IFRS.

– Unlike IFRS, ‘push-down’ accounting, whereby fair value adjustments are recognised in the financial statements of the acquiree, is permitted.

– Like IFRS, the acquisition of a collection of assets that does not constitute a business is not a business combination. Like IFRS, the entity allocates the cost of acquisition to the assets acquired and liabilities assumed based on their relative fair values at the date of acquisition, and no goodwill is recognised.

Scope

The business combinations Codification Topic does not apply to:

– the formation of a joint venture in the financial statements of the joint venture itself, like IFRS. US GAAP does not define a joint arrangement other than a joint venture; however, in practice they are understood to arise from an arrangement that is carried on with assets that are controlled jointly, but not through a separate entity, which may differ from IFRS (see chapter 3.6);
– the acquisition of an asset or a group of assets that does not meet the definition of a business (see below), like IFRS;
– a combination of entities or businesses under common control, like IFRS. However, unlike IFRS, US GAAP includes guidance on the accounting for a combination of entities or businesses under common control (see chapter 5.13);
– financial assets and financial liabilities of a consolidated variable interest entity that is a collateralised financing entity, when the entity chooses to measure both the assets and liabilities using the more observable of the fair value of the financial assets and the fair value of the financial liabilities, unlike IFRS; and
– the acquisition by an investment company of an investment in a subsidiary that is required to be measured at fair value through profit or loss, which differs from the exception under IFRS in some respects (see chapter 5.6).  
[805-10-15-4, 30-10 – 30-15, 946-810-45-3]
The scope of the standard includes business combinations between mutual entities, and business combinations in which separate entities are brought together by contract alone without obtaining an ownership interest. [IFRS 3.33, 43]

A not-for-profit organisation that chooses to apply IFRS also complies with the accounting for business combinations. [P9]

**Identifying a business combination**

A ‘business combination’ is a transaction or other event in which an acquirer obtains control of one or more businesses. [IFRS 3.3, A, B5]

Business combinations are accounted for under the acquisition method, with limited exceptions. [IFRS 3.4]

For a transaction or event to be a business combination, the activities and assets over which the acquirer has obtained control are required to constitute a business. [IFRS 3.3, B5]

The structure of a transaction or event does not affect the determination of whether it is a business combination; whether an acquirer obtains control of one or more businesses is determinative. [IFRS 3.B6]

A ‘business’ is an integrated set of activities and assets that is capable of being conducted and managed to provide a return to investors (or other owners, members or participants) by way of dividends, lower costs or other economic benefits. [IFRS 3.A]

A business generally consists of inputs, processes applied to those inputs and the ability to create outputs. [IFRS 3.B7]

An entity in its development stage can meet the definition of a business. [IFRS 3.B10]

Like IFRS, the scope of the Codification Topic includes business combinations between mutual entities, and business combinations in which separate entities are brought together by contract alone without obtaining an ownership interest. [805-10-15-4]

Unlike IFRS, business combinations between not-for-profit organisations and the acquisition of a for-profit business by a non-profit organisation are excluded from the scope of the business combinations Codification Topic and a separate Codification topic applies. [805-10-15-4, 994-805, 958-805]

**Identifying a business combination**

Like IFRS, a ‘business combination’ is a transaction or other event in which an acquirer obtains control of one or more businesses. However, because the US GAAP guidance on control differs from IFRS (see chapter 2.5), differences may arise in practice. [805-10-20]

Like IFRS, business combinations are accounted for under the acquisition method, with limited exceptions. However, the application of the acquisition method under US GAAP differs from IFRS for certain financial statement elements (see below). [805-10-25-1]

Like IFRS, for a transaction or event to be a business combination, the activities and assets over which the acquirer has obtained control are required to constitute a business. [805-10-15]

Like IFRS, the structure of a transaction or event does not affect the determination of whether it is a business combination; whether an acquirer obtains control of one or more businesses is determinative. However, the determination of control under US GAAP differs from IFRS (see chapter 2.5) and differences may arise in practice.

Like IFRS, a ‘business’ is an integrated set of activities and assets that is capable of being conducted and managed to provide a return to investors (or other owners, members or participants) by way of dividends, lower costs or other economic benefits. [805-10-20]

Like IFRS, a business generally consists of inputs, processes applied to those inputs and the ability to create outputs. [805-10-65-4]

Like IFRS, an entity in its development stage can meet the definition of a business. [805-10-55-6]

See forthcoming requirements.
Identifying the acquirer

The ‘acquirer’ is the combining entity that obtains control of the other combining business or businesses. An acquirer is identified for each business combination. [IFRS 3.6, A]

The concept of ‘control’ is discussed in chapter 2.5.

The business combinations standard refers to the consolidation standard in the first instance for the factors to consider in determining control (see chapter 2.5). [IFRS 3.7, B13–B18, 10.5–18]

If a new entity is created to issue equity instruments to effect a business combination, then one of the combining entities that existed before the combination is identified as the acquirer. However, if a newly created entity transfers cash or other assets or incurs liabilities as consideration, then it might be the acquirer. [IFRS 3.B18]

In a reverse acquisition, the legal acquiree becomes the acquirer for accounting purposes in the consolidated financial statements, and the legal acquirer becomes the acquiree for accounting purposes (see below). [IFRS 3.B19]

Determining the date of acquisition

The ‘date of acquisition’ is the date on which the acquirer obtains control of the acquiree. [IFRS 3.A, 8]

It is not permissible to designate, for convenience, an effective date of acquisition other than the actual date on which control is obtained, or to consolidate a subsidiary as of the beginning of the period in which it was acquired. [IFRS 3.9]

Identifying the acquirer

Like IFRS, the ‘acquirer’ is the combining entity that obtains control of the other combining business or businesses. An acquirer is identified for each business combination, like IFRS. However, the determination of control under US GAAP differs from IFRS and differences may arise in practice. In particular, unlike IFRS, if a variable interest entity is the acquiree, then the primary beneficiary is always the acquirer (see chapter 2.5). [805-10-25-4]

The concept of ‘control’ is discussed in chapter 2.5.

Like IFRS, the business combinations Codification Topic refers to the consolidation Codification Topic in the first instance for the factors to consider in determining control (see chapter 2.5). Because the determination of control under US GAAP differs from IFRS, differences may arise in practice. [805-10-25-5, 810-10]

Like IFRS, if a new entity is created to issue equity instruments to effect a business combination, then one of the combining entities that existed before the combination is identified as the acquirer. However, like IFRS, if a newly created entity transfers cash or other assets or incurs liabilities as consideration, then it might be the acquirer. [805-10-55-15]

Like IFRS, in a reverse acquisition the legal acquiree becomes the acquirer for accounting purposes in the consolidated financial statements, and the legal acquirer becomes the acquiree for accounting purposes (see below). [805-10-55-12, 805-40-20]

Determining the date of acquisition

Like IFRS, the ‘date of acquisition’ is the date on which the acquirer obtains control of the acquiree. However, the determination of control under US GAAP differs from IFRS (see chapter 2.5) and differences may arise in practice. [805-10-25-6]

Like IFRS, it is not permissible to designate, for convenience, an effective date of acquisition other than the actual date on which control is obtained, or to consolidate a subsidiary as of the beginning of the period in which it was acquired. [SFAS 141R.B108, 805-10-25-7]
Consideration transferred and determining what is part of the business combination

**General principles**

The acquirer recognises and measures the consideration transferred, the assets acquired and liabilities assumed, NCI and goodwill at the date of acquisition. [IFRS 3.10]

Consideration transferred by the acquirer may include assets transferred, liabilities incurred by the acquirer to the previous owners of the acquiree, and equity interests issued by the acquirer. [IFRS 3.37]

Consideration transferred is measured at fair value at the date of acquisition except for replacement share-based payment awards treated as part of consideration transferred, which are measured in accordance with the guidance on share-based payments (see below). [IFRS 3.37]

Contingent consideration that is part of the consideration transferred is classified as equity or a liability in accordance with the guidance on the presentation of financial instruments (see chapter 7.3). [IFRS 3.39–40]

There is no specific guidance on the treatment of an acquiree’s contingent consideration from a previous acquisition, and practice may vary.

A business combination can occur without the acquirer transferring consideration. Acquisition accounting is applied using the fair value of the acquirer’s interest in the acquiree instead of the fair value of the consideration transferred in such business combinations. [IFRS 3.33, B46]

The acquirer is required to identify any items that are not part of the business combination transaction and account for them separately from the business combination. [IFRS 3.51–52]

Consideration transferred and determining what is part of the business combination

**General principles**

Like IFRS, the acquirer recognises and measures the consideration transferred, the assets acquired and liabilities assumed, NCI and goodwill at the date of acquisition. (805-30-30)

Like IFRS, consideration transferred by the acquirer may include assets transferred, liabilities incurred by the acquirer to the previous owners of the acquiree, and equity interests issued by the acquirer. [805-20-25, 805-30-30-7]

Like IFRS, consideration transferred is measured at fair value at the date of acquisition except for replacement share-based payment awards treated as part of consideration transferred, which are measured in accordance with the guidance on share-based payments (see below). [805-30-30]

Like IFRS, contingent consideration that is part of the consideration transferred is classified as equity or a liability in accordance with the guidance on the presentation of financial instruments (see chapter 7.3). However, these requirements differ from IFRS in certain respects. (805-30-25-5)

Unlike IFRS, there is specific guidance on the acquiree’s contingent consideration from a previous acquisition. Such contingent consideration is measured in the same manner as any contingent consideration agreed to between the acquirer and the acquiree, but is treated as a liability assumed in the acquisition rather than as consideration transferred. [805-20-30-9A]

Like IFRS, a business combination can occur without the acquirer transferring consideration. Acquisition accounting is applied using the fair value of the acquirer’s interest in the acquiree instead of the fair value of the consideration transferred in such business combinations, like IFRS. (805-10-25-11 – 25-12)

Like IFRS, the acquirer is required to identify any items that are not part of the business combination transaction and account for them separately from the business combination. (805-10-25-20)
Restructuring liabilities are recognised as part of the acquisition accounting only if they represent a liability recognised by the acquiree at the date of acquisition (see chapter 3.12). An acquiree’s restructuring plan that is conditional on it being acquired is not, immediately before the business combination, a present obligation of the acquiree. [IFRS 3.11]

Like IFRS, restructuring liabilities are recognised as part of the acquisition accounting only if they represent a liability recognised by the acquiree at the date of acquisition; however, the guidance on restructuring liabilities differs in some respects from IFRS and differences may arise in practice (see chapter 3.12). Like IFRS, an acquiree’s restructuring plan that is conditional on it being acquired is not, immediately before the business combination, a present obligation of the acquiree or a contingent liability. [805-20-25-2]

Pre-existing relationships
The settlement of a pre-existing relationship between the acquirer and the acquiree is an example of a transaction that is not part of the business combination. [IFRS 3.52]

The settlement of pre-existing relationships is recognised in profit or loss. The measurement of such settlements is based on:
– for a non-contractual relationship, fair value (e.g. a lawsuit); and
– for a contractual relationship, the lesser of the amount by which the pre-existing relationship is off-market from the acquirer’s perspective and any cancellation clause that is exercisable by the party to which the relationship is unfavourable. [IFRS 3.852]

An entity may, as part of settling a pre-existing relationship, reacquire a right that it had previously granted to the acquiree. Such reacquired rights are recognised as intangible assets and are measured based on the remaining contractual term. [IFRS 3.835]

Like IFRS, an entity may, as part of settling a pre-existing relationship, reacquire a right that it had previously granted to the acquiree. Such reacquired rights are recognised as intangible assets and are measured based on the remaining contractual term, like IFRS. [805-20-25-14]

Payments to employees or former owners of the acquiree
An arrangement that remunerates employees or former owners of the acquiree for future services is an example of a transaction that is not part of the business combination. [IFRS 3.52]

Contingent payment arrangements that potentially benefit employees or former owners of an acquiree are evaluated to determine whether they constitute contingent consideration issued in the business combination or are separate transactions. The automatic forfeiture of payments when employment is terminated always leads to the conclusion that the contingent payments represent compensation for post-combination services. [IFRS 3.855, IU 01-13]

Like IFRS, contingent payment arrangements that potentially benefit employees or former owners of an acquiree are evaluated to determine whether they constitute contingent consideration issued in the business combination or are separate transactions. The automatic forfeiture of payments when employment is terminated always leads to the conclusion that the contingent payments represent compensation for post-combination services, like IFRS. [805-10-55-25]
Acquirer share-based payment awards exchanged for awards held by employees of the acquiree

If the acquirer issues share-based payment awards (replacement awards) to employees of an acquiree in exchange for share-based payment awards issued previously by the acquiree (acquiree awards), then all or a portion of the amount of the acquiree’s replacement awards is included in measuring the consideration transferred in the business combination. [IFRS 3.B56]

To the extent that the replacement awards relate to past service, they are included in the consideration transferred. To the extent that they require future service, they are not part of the consideration transferred and instead are treated as post-combination remuneration cost. If they relate to both past and future services, then the market-based measure is allocated between consideration transferred and post-combination remuneration cost. [IFRS 3.B56–B58]

However, if acquiree awards expire when a business combination occurs and the acquirer voluntarily issues replacement awards, then all of the market-based measure of the replacement awards is recognised as post-combination remuneration cost. [IFRS 3.B56]

In our view, an entity should choose an accounting policy, to be applied consistently, to account for the recognition of the remuneration cost in post-combination periods using the new grant approach (under which the replacement award is treated as a new grant), or the modification approach (under which the modification accounting principles of the share-based payments standard are applied). However, the cumulative amount recognised should be the same under the two approaches.

The market-based measures of both the acquiree awards and the replacement awards are determined at the date of acquisition. [IFRS 3.30]

If the market-based measure of the replacement awards is greater than the market-based measure of the acquiree awards (determined at the date of acquisition), then the excess amount is recognised as post-combination compensation cost by the acquirer. [IFRS 3.B57–B59]

Acquirer share-based payment awards exchanged for awards held by employees of the acquiree

Like IFRS, if the acquirer is obliged to issue share-based payment awards (replacement awards) to employees of an acquiree in exchange for share-based payment awards issued previously by the acquiree (acquiree awards), then all or a portion of the amount of the acquiree’s replacement awards is included in measuring the consideration transferred in the business combination. [805-30-30-9]

Like IFRS, to the extent that the replacement awards relate to past service, they are included in the consideration transferred. Like IFRS, to the extent that they require future service, they are not part of the consideration transferred and instead are treated as post-combination remuneration cost. If they relate to both past and future services, then the market-based measure is allocated between consideration transferred and post-combination remuneration cost, like IFRS. [805-30-30-11, 55-7]

Like IFRS, if acquiree awards expire when a business combination occurs and the acquirer voluntarily issues replacement awards, then all of the market-based measure of the replacement awards is recognised as post-combination remuneration cost. [805-30-30-10]

Unlike IFRS, an entity applies the modification guidance of the share-based payment Codification Topic. [718-20-35]

Like IFRS, the market-based measures of both the acquiree awards and the replacement awards are determined at the date of acquisition. [805-30-30-11]

Like IFRS, if the market-based measure of the replacement awards is greater than the market-based measure of the acquiree awards (determined at the date of acquisition), then the excess amount is recognised as post-combination compensation cost by the acquirer. [805-30-30-12, 55-10]
Subsequent changes in the number of replacement awards that are expected to vest due to service and non-market performance conditions are reflected as an adjustment to post-combination remuneration cost, not to the consideration transferred for the business combination. [IFRS 3.860]

Like IFRS, subsequent changes in the number of replacement awards that are expected to vest due to service and performance conditions (non-market performance conditions under IFRS) are reflected as an adjustment to post-combination remuneration cost, not to the consideration transferred for the business combination. However, there are differences between IFRS and US GAAP with respect to service and non-market performance conditions (see chapter 4.5). [805-30-55]

Market conditions and non-vesting conditions are reflected in the market-based measure at the date of acquisition. There is no true-up if the expected and actual outcomes differ because of these conditions for equity-settled transactions.

Like IFRS, market conditions are reflected in the market-based measure at the date of acquisition. Likewise, post-vesting restrictions are reflected in the market-based measure at the date of acquisition. There is no true-up if the expected and actual outcomes differ because of these conditions for equity-classified transactions, like IFRS. However, there are differences between IFRS and US GAAP with respect to non-vesting conditions and post-vesting restrictions (see chapter 4.5). [805-30-55-6 – 55-13]

For cash-settled transactions, an entity recognises the liability incurred. The liability is remeasured, until settlement date, for subsequent changes in its market-based measure even if the amount of the liability that is recognised for services attributed to pre-combination service remains in goodwill. [IFRS 2.33, 3.861]

For cash-settled transactions, an entity recognises the liability incurred, like IFRS. The liability is remeasured, until settlement date, for subsequent changes in its market-based measure, like IFRS. However, the classification of an award under US GAAP as equity or a liability differs in certain respects from IFRS (see chapter 4.5). [805-30-55-6 – 55-13]

Acquisition-related costs are expensed as they are incurred, except for costs related to the issue of debt or equity instruments (see chapter 7.5). [IFRS 3.53]

Like IFRS, acquisition-related costs are expensed as they are incurred, except for costs related to the issue of debt or equity instruments. However, the accounting for costs related to the issue of debt or equity instruments may differ from IFRS (see chapter 7.5). [805-10-25-23]

Assets and liabilities transferred as part of the consideration for a business combination that remain under the control of the acquirer continue to be recognised based on their existing carrying amounts. [IFRS 3.38]

Like IFRS, assets and liabilities transferred as part of the consideration for a business combination that remain under the control of the acquirer continue to be recognised based on their existing carrying amounts.

The identifiable assets acquired and liabilities assumed as part of a business combination are recognised separately from goodwill at the date of acquisition if they meet the definition of assets and liabilities and are exchanged as part of the business combination. [IFRS 3.11–12]

Like IFRS, the identifiable assets acquired and liabilities assumed as part of a business combination are recognised separately from goodwill at the date of acquisition if they meet the definition of assets and liabilities and are exchanged as part of the business combination. [805-20-25]
The identifiable assets acquired and liabilities assumed as part of a business combination are measured at the date of acquisition at their fair values, with limited exceptions. [IFRS 3.18]

The following are exceptions to the recognition and measurement principles.

- Exception to the recognition principle:
  - Contingent liabilities are included in the acquisition accounting only to the extent that they represent ‘present’ obligations.

- Exceptions to the recognition and measurement principles:
  - Deferred tax assets and liabilities are recognised and measured in accordance with relevant income tax guidance (see chapter 3.13).
  - Indemnification assets are recognised and measured consistently with the underlying item that has been indemnified, subject to adjustments for collectibility.
  - Employee benefits are recognised and measured in accordance with relevant employee benefits guidance (see chapter 4.4). [IFRS 3.22–28]

- Exceptions to the measurement principle:
  - Reacquired rights are measured without taking into account potential renewals.
  - Share-based payment awards are measured in accordance with relevant share-based payments guidance (see chapter 4.5).
  - Assets that are held for sale are measured at fair value less costs to sell (see chapter 5.4). [IFRS 3.29–31]

At the date of acquisition, the acquirer classifies and designates the identifiable assets acquired and liabilities assumed as necessary to apply other IFRSs subsequently. Those classifications are made based on the contractual terms, economic conditions, acquirer’s operating or accounting policies and other relevant conditions at the date of acquisition. There are exceptions to this principle for leases and insurance contracts. [IFRS 3.15–17]

Like IFRS, the identifiable assets acquired and liabilities assumed as part of a business combination are measured at the date of acquisition at their fair values, with limited exceptions. [805-20-25]

The following are exceptions to the recognition and measurement principles.

- Exception to the recognition principle:
  - Unlike IFRS, there are no exceptions to the recognition principle only.

- Exceptions to the recognition and measurement principles:
  - Deferred tax assets and liabilities are recognised and measured in accordance with the relevant income tax Codification Topic (see chapter 3.13), which differs in certain respects from IFRS.
  - Indemnification assets are recognised and measured consistently with the underlying item that has been indemnified, subject to adjustments for collectibility, like IFRS.
  - Employee benefits are recognised and measured in accordance with relevant guidance on employee compensation (see chapter 4.4), which differs in certain respects from IFRS.
  - Assets and liabilities that arise from contingencies are generally recognised in the acquisition accounting if they are probable and reasonably estimable, unlike IFRS.

- Exceptions to the measurement principle:
  - Reacquired rights are measured without taking into account potential renewals, like IFRS.
  - Share-based payment awards are measured in accordance with relevant share-based payments guidance (see chapter 4.5), which differs in certain respects from IFRS.
  - Assets that are held for sale are measured at fair value less costs to sell (see chapter 5.4), like IFRS. [805-20-25]

Like IFRS, at the date of acquisition the acquirer classifies and designates the identifiable assets acquired and liabilities assumed as necessary to apply other US GAAP subsequently. Those classifications are made based on the contractual terms, economic conditions, acquirer’s operating or accounting policies and other relevant conditions at the date of acquisition, like IFRS. There are exceptions to this principle for leases and contracts written by a company meeting the specialised insurance industry accounting requirements, like IFRS, although the accounting for such contracts under US GAAP differs from IFRS (see chapter 8.1). [805-20-25-6, 25-8]
Assets acquired that the acquirer intends not to use, or to use in a way that is different from how other market participants would use them, are nonetheless measured at their acquisition-date fair values based on what market participants would do with them – i.e. the specific intentions of the acquirer are ignored for the purpose of determining fair values. [IFRS 3.18]

**Intangible assets**

Identifiable intangible assets acquired in a business combination are recognised separately from goodwill. [IFRS 3. B31]

An intangible asset is ‘identifiable’ if it arises from contractual or other legal rights or if it is separable. [IAS 38.12]

Except for reacquired rights (see below), intangible assets are measured at their fair values without consideration of the intended use by the acquirer – e.g. even if the acquirer does not intend to use the intangible asset. [IAS 38.33]

**Leases**

The lessee’s classification of a lease acquired in a business combination as an operating lease or a finance lease is retained. [IFRS 3.17, IAS 17.4, IFRIC 4.6]

Lease contracts acquired in a business combination are recognised separately from goodwill at their fair value at the date of acquisition. See forthcoming requirements.

- For an operating lease acquired in which the acquiree is the lessee, an intangible asset is recognised if the terms are favourable relative to market terms and a liability is recognised if the terms are unfavourable.
- For an operating lease acquired in which the acquiree is the lessor, no separate intangible asset or liability is recognised for the lease contract. Instead, the terms of the lease are taken into account in measuring the acquisition-date fair value of the underlying asset.
- For a finance lease acquired in which the acquiree is the lessor, the acquirer recognises the fair value of both the asset held under the finance lease and the related liability. No separate intangible asset or liability is recognised for the lease contract terms, because any value inherent in the lease is reflected in the assets and liabilities recognised.

Like IFRS, assets acquired that the acquirer intends not to use, or to use in a way that is different from how other market participants would use them, are nonetheless measured at their acquisition-date fair values based on what market participants would do with them – i.e. the specific intentions of the acquirer are ignored for the purpose of determining fair values. [805-20-25]

**Intangible assets**

Like IFRS, identifiable intangible assets acquired in a business combination are recognised separately from goodwill. [805-20-25-10]

Like IFRS, an intangible asset is ‘identifiable’ if it arises from contractual or other legal rights or if it is separable. [805-20-25-10]

Like IFRS, except for reacquired rights (see below) intangible assets are measured at their fair values without consideration of the intended use by the acquirer – e.g. even if the acquirer does not intend to use the intangible asset. [805-20-30-1, 30-6]

**Leases**

Like IFRS, the lessee’s classification of a lease acquired in a business combination as an operating lease or a capital (finance) lease is retained. However, the accounting for leases under US GAAP differs from IFRS (see chapter 5.1). [840-10-25-7]

Lease contracts acquired in a business combination are recognised separately from goodwill at their fair value at the date of acquisition. See forthcoming requirements.

- For an operating lease acquired in which the acquiree is the lessee, an intangible asset is recognised if the terms are favourable relative to market terms and a liability is recognised if the terms are unfavourable, like IFRS.
- For an operating lease acquired in which the acquiree is the lessor, a separate intangible asset or liability is generally recognised for the lease contract if the terms are favourable or unfavourable, respectively, to market terms, unlike IFRS.
- For a finance (capital) lease acquired in which the acquiree is the lessee, the acquirer recognises the fair value of both the asset held under the capital lease and the related liability, like IFRS. No separate intangible asset or liability is recognised for the lease contract terms, because any value inherent in the lease is reflected in the assets and liabilities recognised, like IFRS.
– For a finance lease acquired in which the acquiree is the lessor, the acquirer recognises a receivable for the net investment in the finance lease at its acquisition-date fair value. In our view, the acquirer should not separately recognise an additional asset or liability related to favourable or unfavourable contracts, because measurement of the fair value of the lease receivables and the unguaranteed residual values at fair value would consider all of the terms of the lease contracts. [IFRS 3.B28–B29, B42]

In addition to recognising the lease contract, there may be other identifiable intangible assets associated with the lease to be recognised separately from goodwill – e.g. a relationship intangible asset with the lessor/lessee would be recognised at its fair value at the date of acquisition because the contractual-legal criterion is satisfied. [IFRS 3.B30]

Non-controlling interests
The acquirer in a business combination can elect, on a transaction-by-transaction basis, to measure NCI that are present ownership interests and entitle their holders to a proportionate share of the entity’s net assets in liquidation (‘ordinary’ NCI) at fair value or at the holders’ proportionate interest in the recognised amount of the identifiable net assets of the acquiree at the date of acquisition. Other components of NCI are measured at fair value, unless a different measurement basis is required by other IFRSs. [IFRS 3.19]

If share-based payment awards of the acquiree are not replaced with share-based payment awards of the acquirer, then the market-based measure of the unreplaced acquiree awards that are vested at the date of acquisition is part of NCI in the acquiree. The market-based measure of the unreplaced acquiree awards that are not vested at the date of acquisition is allocated between NCI and post-combination remuneration cost. [IFRS 3.B62A–B62B]

Goodwill or a gain on a bargain purchase

Goodwill
Goodwill arising in a business combination is recognised as an asset. [IFRS 3.32]

– For a capital lease acquired in which the acquiree is the lessor, the acquirer recognises a receivable for the net investment in the capital lease at its acquisition-date fair value, like IFRS. The acquirer does not separately recognise an additional asset or liability related to favourable or unfavourable contracts, because measurement of the fair value of the lease receivables and the unguaranteed residual values at fair value would consider all of the terms of the lease contracts, like IFRS. [805-20-25-11 – 25-12, 30-5]

Like IFRS, in addition to recognising the lease contract, there may be other identifiable intangible assets associated with the lease to be recognised separately from goodwill – e.g. a relationship intangible asset with the lessor/lessee would be recognised at its fair value at the date of acquisition because the contractual-legal criterion is satisfied. [805-20-25-13]

Non-controlling interests
Unlike IFRS, the acquirer in a business combination measures NCI at fair value at the date of acquisition with the exception of share-based payments held as NCI, which are measured using the market-based measurement requirements of the share-based payments Codification Topic. [805-20-30-1]

Like IFRS, if share-based payment awards of the acquiree are not replaced with share-based payment awards of the acquirer, then the market-based measure of the unreplaced acquiree awards that are vested at the date of acquisition is part of NCI in the acquiree. The market-based measure of the unreplaced acquiree awards that are not vested at the date of acquisition is allocated between equity and post-combination remuneration cost; however, practice varies over whether the equity portion is classified as NCI before vesting, unlike IFRS. [805-30-30-11, 810-10-20]

Goodwill or a gain on a bargain purchase

Goodwill
Like IFRS, goodwill arising in a business combination is recognised as an asset. [805-30-30]
Goodwill is measured as a residual, as the excess of (a) over (b).

a. The aggregate of:
   - consideration transferred, which is generally measured at fair value at the
date of acquisition;
   - the amount of any NCI in the acquiree; and
   - the acquisition-date fair value of any previously held equity interest in
the acquiree.

b. The net of the acquisition-date amounts of the identifiable assets acquired
and the liabilities assumed. [IFRS 3.32]

Like IFRS, goodwill is measured as a residual, as the excess of (a) over (b).

a. The aggregate of:
   - consideration transferred, which is generally measured at fair value at the
date of acquisition;
   - the amount of any NCI in the acquiree; and
   - the acquisition-date fair value of any previously held equity interest in
the acquiree.

b. The net of the acquisition-date amounts of the identifiable assets acquired
and the liabilities assumed. [805-30-30-1]

However, as discussed above, the measurement of NCI and replacement share-
based payment awards in the above calculation may differ from IFRS.

Goodwill recognised by the acquiree before the date of acquisition is not an
identifiable asset of the acquiree when accounting for the business combination.
[IFRS 3.11–12]

Like IFRS, goodwill recognised by the acquiree before the date of acquisition
is not an identifiable asset of the acquiree when accounting for the business
combination. [805-30-30]

Gain on a bargain purchase
A gain on a bargain purchase is measured as a residual, as the excess of (b) over
(a) in the above calculation. [IFRS 3.34]

Like IFRS, a gain on a bargain purchase is measured as a residual, as the excess
of (b) over (a) in the above calculation. [805-30-25-2]

If an acquirer determines that it has made a bargain purchase, then it
reassesses the procedures on which its acquisition accounting is based and
whether amounts included in the acquisition accounting have been determined
appropriately. [IFRS 3.36]

A gain on a bargain purchase is recognised in profit or loss after reassessing the
values used in the acquisition accounting. [IFRS 3.34]

Like IFRS, if an acquirer determines that it has made a bargain purchase, then
it reassesses the procedures on which its acquisition accounting is based and
whether amounts included in the acquisition accounting have been determined
appropriately. [805-30-25-4]

A gain on a bargain purchase is recognised in profit or loss after reassessing the
values used in the acquisition accounting. [805-30-25-2]

Measurement after the initial accounting for the business
combination
The measurement period
A measurement period is allowed for entities to finalise the acquisition
accounting. [IFRS 3.45]

Like IFRS, measurement-period adjustments reflect additional information about facts and
circumstances that existed at the date of acquisition. [805-10-25-13]

Measurement-period adjustments reflect additional information about facts and circumstances that existed at the date of acquisition. [805-10-25-13 – 25-15, 30-1]
Adjustments made to the acquisition accounting during the measurement period may affect the recognition and measurement of assets acquired and liabilities assumed, any NCI, consideration transferred, any pre-existing interest in the acquiree, and goodwill or any gain on a bargain purchase. [IFRS 3.46]

The measurement period is not an open period in which to make adjustments to the acquisition accounting. It ends when the acquirer obtains all of the information that is necessary to complete the acquisition accounting, or learns that more information is not available, and cannot exceed one year from the date of acquisition. [IFRS 3.45, BC392]

If the acquirer issues financial statements for a period in which the acquisition accounting is not finalised, then it discloses information about the provisional acquisition accounting. [IFRS 3.45, B67(a), IAS 34.16A(i)]

Adjustments made to the provisional acquisition accounting are reflected through retrospective application to the period in which the acquisition occurred and any subsequent periods. [IFRS 3.45, BC399]

Adjustments are made to the acquisition accounting after the end of the measurement period only for errors (see chapter 2.8) and, in our view, for certain accounting policy changes. [IFRS 3.50]

**Subsequent measurement and accounting**

In general, items recognised in the acquisition accounting are measured and accounted for in accordance with the relevant IFRS subsequent to the business combination. However, as an exception, there is specific guidance for the following.

- Reacquired rights are amortised over their contractual life, not taking into account potential contract renewals.
- When a contingent liability recognised in the acquisition accounting subsequently becomes a provision, it is recognised at the higher of the fair value recognised at the date of acquisition less amortisation (if appropriate) and the then-current provision amount (see chapter 3.12).
- Indemnification assets are measured on the same basis as the underlying item that has been indemnified, subject to adjustments for collectibility and overall contractual limitations.
- Contingent consideration that is classified as equity is not remeasured.

Like IFRS, adjustments made to the acquisition accounting during the measurement period may affect the recognition and measurement of assets acquired and liabilities assumed, any NCI, consideration transferred, any pre-existing interest in the acquiree, and goodwill or any gain on a bargain purchase. [805-10-25-13 – 25-15]

Like IFRS, the measurement period is not an open period in which to make adjustments to the acquisition accounting. It ends when the acquirer obtains all of the information that is necessary to complete the acquisition accounting, or learns that more information is not available, and cannot exceed one year from the date of acquisition, like IFRS. [805-10-25-14]

Like IFRS, if the acquirer issues financial statements for a period in which the acquisition accounting is not finalised, then it discloses information about the provisional acquisition accounting. [805-10-25-14]

Unlike IFRS, adjustments made to the provisional acquisition accounting are reflected in the current period, with disclosure of what the effects would have been on each prior period. [805-10-25-13, 25-17, 805-20-50-4A]

Adjustments are made to the acquisition accounting after the end of the measurement period only for errors (see chapter 2.8). [805-10-25-19]

**Subsequent measurement and accounting**

Like IFRS, in general, items recognised in the acquisition accounting are measured and accounted for in accordance with the relevant US GAAP subsequent to the business combination. However, as an exception, there is specific guidance for the following.

- Reacquired rights are amortised over their contractual life, not taking into account potential contract renewals.
- Unlike IFRS, US GAAP does not provide specific guidance on the subsequent accounting for a contingent liability recognised at the date of acquisition. However, in our experience entities generally apply the guidance applicable to contingencies with adjustments recognised in profit or loss (see chapter 3.12).
- Like IFRS, indemnification assets are measured on the same basis as the underlying item that has been indemnified, subject to adjustments for collectibility and overall contractual limitations.
- Equity-classified contingent consideration is not remeasured, like IFRS. However, the classification of contingent consideration as equity or a liability may differ from IFRS (see chapter 7.3).
Contingent consideration that is a liability or an asset is remeasured to fair value, with changes therein recognised in profit or loss. [IFRS 3.55–58]

Like IFRS, contingent consideration that is a liability or an asset is remeasured to fair value, with changes therein recognised in profit or loss. However, the classification of contingent consideration as equity or a liability may differ from IFRS (see chapter 7.3). [805-20-30-12 – 30-23]

**Additional guidance for applying the acquisition method to particular types of business combinations**

### Business combinations achieved in stages

A ‘business combination achieved in stages’ (step acquisition) is a business combination in which the acquirer obtains control of an acquiree in which it held a non-controlling equity interest immediately before the date of acquisition. [IFRS 3.41]

In a step acquisition:
- the previously held non-controlling equity interest is remeasured to its fair value at the date of acquisition, with any resulting gain or loss recognised in profit or loss;
- the acquirer derecognises the previously held non-controlling equity interest and recognises 100 percent of the acquiree’s identifiable assets acquired and liabilities assumed; and
- any amounts recognised in OCI related to the previously held equity interest are recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest. [IFRS 3.32(a)(ii), 42, BC384]

**Business combinations achieved without the transfer of consideration**

Examples of business combinations achieved without the transfer of consideration include an acquiree repurchasing a sufficient number of its own shares so that an existing shareholder obtains control of the acquiree; the expiry of substantive participating rights held by another equity holder; and business combinations achieved by contract alone. [IFRS 3.43]

In calculating goodwill, the acquirer substitutes the acquisition-date fair value of its interest in the acquiree for the consideration transferred. [IFRS 3.33, B46]

If the acquirer holds no equity interest in the acquiree, then 100 percent of the acquiree’s equity is attributed to the NCI. [IFRS 3.44]

Like IFRS, examples of business combinations achieved without the transfer of consideration include an acquiree repurchasing a sufficient number of its own shares so that an existing shareholder obtains control of the acquiree; the expiry of substantive participating rights held by another equity holder; and business combinations achieved by contract alone. [805-10-25-11 – 25-12]

Like IFRS, in calculating goodwill the acquirer substitutes the acquisition-date fair value of its interest in the acquiree for the consideration transferred. [805-10-25-11]

Unlike IFRS, if the acquirer obtains control over another entity without holding an equity interest, then the acquiree will be a variable interest entity and the guidance on the acquisition of variable interest entities is applied. [805-10-25-6]
A stapling arrangement is another example of a business combination in which no consideration is transferred. It is a contractual arrangement between two or more entities or their shareholders in which the equity securities of the entities or other similar instruments are ‘stapled’ together and each of these entities has the same owners. The stapled securities are quoted as a single security – i.e. the equity securities of each entity are not traded independently. For these arrangements, one of the combining entities needs to be identified as the acquirer. [IU 05-14]

**Reverse acquisitions**

A ‘reverse acquisition’ is a business combination in which the legal acquiree becomes the acquirer for accounting purposes and the legal acquirer becomes the acquiree for accounting purposes. [IFRS 3.B19]

In applying the acquisition method to a reverse acquisition, it is the identifiable assets and liabilities of the legal acquirer (accounting acquiree) that are measured at fair value. [IFRS 3.B22]

The accounting acquiree must meet the definition of a business (see above) for the transaction to be accounted for as a reverse acquisition. [IFRS 3.B19]

**Business combinations between mutual entities**

Business combinations between mutual entities are accounted for using the acquisition method. [IFRS 3.4]

If the fair value of the equity or members’ interests in the acquiree is more reliably determinable than the fair value of the members’ interests in the acquirer given as consideration, then goodwill is calculated by using the fair value of the acquiree as the consideration transferred. [IFRS 3.B47]

**Income taxes**

Income tax issues related to business combinations are discussed in chapter 3.13.

**Push-down accounting**

‘Push-down’ accounting, whereby fair value adjustments recognised in the consolidated financial statements are pushed down into the financial statements of the acquiree, is not permitted under IFRS. However, the acquiree can adopt a policy of revaluation for certain assets if this is permitted by the relevant standards (see chapters 3.2, 3.3 and 3.4).

Like IFRS, a stapling arrangement is another example of a business combination in which no consideration is transferred. There is no specific guidance on stapling arrangements under US GAAP but, following general principles, one of the combining entities would be identified as the acquirer, like IFRS.

**Reverse acquisitions**

Like IFRS, a ‘reverse acquisition’ is a business combination in which the legal acquiree becomes the acquirer for accounting purposes and the legal acquirer becomes the acquiree for accounting purposes. [805-10-55-12, 805-40-20]

Like IFRS, in applying the acquisition method to a reverse acquisition, it is the identifiable assets and liabilities of the legal acquirer (accounting acquiree) that are measured at fair value. [805-10-55-12, 805-40-20]

Like IFRS, the accounting acquiree must meet the definition of a business (see above) for the transaction to be accounted for as a reverse acquisition. [805-10-55-12, 805-40-20]

**Business combinations between mutual entities**

Like IFRS, business combinations between mutual entities are accounted for using the acquisition method. [805-30-55-3 – 55-5]

Like IFRS, if the fair value of the equity or members’ interests in the acquiree is more reliably determinable than the fair value of the members’ interests in the acquirer given as consideration, then goodwill is calculated by using the fair value of the acquiree as the consideration transferred. [805-30-55-3 – 55-5]

**Income taxes**

Income tax issues related to business combinations are discussed in chapter 3.13.

**Push-down accounting**

Unlike IFRS, ‘push-down’ accounting, whereby the effect of acquisition accounting recognised in the consolidated financial statements is pushed down into the financial statements of the acquiree, is permitted for acquisitions on or after 18 November 2014. For prior change-in-control events, push-down accounting was required for SEC registrants if an entity became ‘substantially’ wholly owned and was permitted for non-SEC registrants. [805-50-25-4 – 25-9, SAB 115]
Asset acquisitions
The acquisition of a collection of assets that does not constitute a business is not a business combination. In such cases, the acquirer allocates the cost of acquisition to the assets acquired and liabilities assumed based on their relative fair values at the date of acquisition. Such transactions do not give rise to goodwill. [IFRS 3.2]

Disclosure of pro forma information
The acquirer discloses:
– the revenue and profit or loss of the acquiree since the date of acquisition included in the consolidated statement of profit or loss and OCI for the reporting period; and
– the revenue and profit or loss of the combined entity as if the date of acquisition for all business combinations that occurred during the year had been as of the beginning of the current annual reporting period. [IFRS 3.B64(q)]

Forthcoming requirements
Identifying a business combination
There are no forthcoming requirements under IFRS.

Asset acquisitions
Like IFRS, the acquisition of a collection of assets that does not constitute a business is not a business combination. Like IFRS, the acquirer allocates the cost of acquisition to the assets acquired and liabilities assumed based on their relative fair values at the date of acquisition, and no goodwill is recognised. [805-50-05-3]

Disclosure of pro forma information
Unlike IFRS, only an acquirer that is a public company discloses:
– the revenue and earnings of the acquiree since the date of acquisition included in the consolidated income statement for the reporting period – i.e. excluding OCI, unlike IFRS; and
– the revenue and earnings of the combined entity as if the date of acquisition for all business combinations that occurred during the year had been as of the beginning of the comparative annual reporting period, unlike IFRS. Also unlike IFRS, this information is presented as supplemental information – i.e. outside the financial statements. [805-10-50-2(h)]

Unlike IFRS, public entities are required to provide a description of the nature and amount of material, non-recurring pro forma adjustments as supplemental information. [805-10-50-2(h)]

Forthcoming requirements
Identifying a business combination
Amendments to the business combinations Codification Topic are effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted. [ASU 2017-01]

Unlike IFRS, US GAAP provides a framework for determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The framework contains an initial screening test (Step 1) that reduces the population of transactions that an entity needs to analyse to determine whether there is business (Step 2).
– Step 1: Determine whether substantially all of the fair value of the gross assets acquired is concentrated in a single (group of similar) identified asset(s). If ‘yes’, then the set is not a business. If ‘no’, then go to Step 2.
– Step 2: Evaluate whether an input and a substantive process exist that together contribute to the ability to create outputs. If ‘yes’, then the set is a business. If ‘no’, then the set is not a business. [805-10-55-3A]
Leases

Amendments to the business combinations standard as a result of the new leases standard (see chapter 5.1A) are effective for annual periods beginning on or after 1 January 2019; early adoption is permitted if the new revenue standard is applied as well.

Under these amendments relating to leases in which the acquiree is the lessee, an acquirer generally recognises and measures:
- a lease liability at the present value of the remaining lease payments as if the acquired lease were a new lease at the date of acquisition; and
- a right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms. [IFRS 3.28A–28B]

Like IFRS, under these amendments relating to leases in which the acquiree is the lessee, an acquirer generally recognises and measures:
- a lease liability at the present value of the remaining lease payments as if the acquired lease were a new lease at the date of acquisition; and
- a right-of-use asset at the same amount as the lease liability, adjusted to reflect favourable or unfavourable terms of the lease when compared with market terms. [805-20-25-10A, 30-24]
2.7 Foreign currency translation

Overview

An entity measures its assets, liabilities, income and expenses in its functional currency, which is the currency of the primary economic environment in which it operates.

Transactions that are not denominated in an entity’s functional currency are foreign currency transactions, and exchange differences arising on translation are generally recognised in profit or loss.

The financial statements of foreign operations are translated for consolidation purposes as follows: assets and liabilities are translated at the closing rate; income and expenses are translated at the actual rates or appropriate averages; and in our view equity components (excluding current-year movements, which are translated at the actual rates) should be translated at historical rates.

Exchange differences arising on the translation of the financial statements of a foreign operation are recognised in OCI and accumulated in a separate component of equity. The amount attributable to any NCI is allocated to and recognised as part of NCI.

If the functional currency of a foreign operation is the currency of a hyperinflationary economy, then current purchasing power adjustments are made to its financial statements before translation into a different presentation currency; the adjustments are based on the closing rate at the end of the current period. However, if the presentation currency is not the currency of a hyperinflationary economy, then comparative amounts are not restated.
Overview (continued)

- An entity may present its financial statements in a currency other than its functional currency (presentation currency). An entity that translates its financial statements into a presentation currency other than its functional currency uses the same method as for translating the financial statements of a foreign operation.

- If an entity loses control of a subsidiary that is a foreign operation, then the cumulative exchange differences recognised in OCI are reclassified in their entirety to profit or loss. If control is not lost, then a proportionate amount of the cumulative exchange differences recognised in OCI is reclassified to NCI.

- If an entity retains neither significant influence nor joint control over a foreign operation that was an associate or joint arrangement, then the cumulative exchange differences recognised in OCI are reclassified in their entirety to profit or loss. If either significant influence or joint control is retained, then a proportionate amount of the cumulative exchange differences recognised in OCI is reclassified to profit or loss.

- An entity may present supplementary financial information in a currency other than its presentation currency if certain disclosures are made.

Functional and presentation currency

An entity measures its assets, liabilities, equity, income and expenses in its functional currency, which is the currency of the primary economic environment in which it operates. All transactions in currencies other than the functional currency are foreign currency transactions. [IAS 21.1/N7, 8, 20]

Functional and reporting currency

Like IFRS, an entity measures its assets, liabilities, equity, income and expenses in its functional currency, which is the currency of the primary economic environment in which it operates. However, the indicators used to determine the functional currency differ in some respects from IFRS (see below). Like IFRS, all transactions in currencies other than the functional currency are foreign currency transactions. [830-19-20, 45-2]
A ‘foreign operation’ of an entity is a subsidiary, associate, joint arrangement or branch whose activities are based or conducted in a country or currency other than those of the reporting entity. A division could also be a foreign operation. [IAS 21.8]

Each entity or distinct operation (e.g. a branch) in a group has its own functional currency and there is no concept of a group-wide functional currency. [IAS 21.8, 11]

The following factors, which are not exhaustive, are considered in determining an entity’s or operation’s functional currency.

Primary indicators:
– the currency that mainly influences sales prices;
– the currency of the country whose competitive forces and regulations mainly determine sales prices; and
– the currency that mainly influences labour, material and other costs. [IAS 21.9]

Secondary indicators:
– the currency in which funds from financing activities are generated; and
– the currency in which receipts from operating activities are usually retained. [IAS 21.10]

Like IFRS, a ‘foreign operation’ includes a subsidiary, division, branch, equity-method investee or a joint venture whose functional currency differs from that of the reporting entity. [830-10-20]

Like IFRS, each entity or distinct operation (e.g. a branch) in a group has its own functional currency and there is no concept of a group-wide functional currency. [830-10-45-5]

The US GAAP guidance on functional currency is based on the presumption that entities in the US have the US dollar as their functional currency. Therefore, unlike IFRS, the guidance is written from the perspective of assessing whether a foreign operation has a functional currency that is different from that of the parent (which is assumed to be the US dollar).

Unlike IFRS, in determining the functional currency of a foreign operation, the following indicators are considered (without distinguishing between primary and secondary).

– Cash flows that are generated by the assets and liabilities of the foreign operation are primarily in the foreign currency and do not directly affect the parent’s cash flows.

– Sales prices of the foreign operation’s products or services are determined more by local competition or government regulation than by worldwide competition and international prices and are not generally responsive on a short-term basis to changes in exchange rates.

– There is an active local sales market for the foreign operation’s products or services, although there might also be significant amounts of exports.

– The foreign operation uses primarily local labour, material and other costs to produce its products or render its services, even though there might also be imports from other countries.

– The financing is primarily denominated in the foreign currency and cash flows generated by the foreign operation are sufficient to service existing and anticipated financing obligations.

– The foreign operation has a low volume of inter-company transactions and no extensive inter-relationship of operations with the parent. However, the foreign operation may rely on the parent’s competitive advantages, such as patents and trademarks.

– The parent’s currency would generally be the functional currency if the foreign entity is a holding company or shell company for holding investments, obligations, intangible assets and other assets and liabilities that could readily be carried on the parent’s financial statements. [830-10-55-5]
In determining whether the functional currency of a foreign operation is the same as that of its parent, the following additional indicators are considered:

– whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy;
– whether transactions with the reporting entity are a high or a low proportion of the foreign operation’s activities;
– whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it; and
– whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity. [IAS 21.11]

If the indicators are mixed and the functional currency is not obvious, then management uses its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transaction. In exercising its judgement, management gives priority to the primary indicators before considering the secondary indicators. [IAS 21.12]

Once the functional currency is determined, it is not changed unless there is a change in the foreign operation’s underlying transactions, events and circumstances. [IAS 21.13]

If there is a change in the functional currency, then the change is reflected prospectively by translating the financial position at that date into the new functional currency using the rate current at that date. [IAS 21.35]

An entity may decide to present its financial statements in a currency other than its functional currency (presentation currency). [IAS 21.8, 38]

The above indicators are also used in assessing whether the functional currency of a foreign operation is the same as that of its parent; there are no additional indicators.

Unlike IFRS, there is no priority given to any of the above indicators if the indicators are mixed and the functional currency is not obvious. Instead, management evaluates all relevant information and exercises its judgement in determining the functional currency. Because determination of the functional currency requires the exercise of judgement, it is possible for an entity to identify different functional currencies under IFRS and US GAAP. [830-10-45-6]

Once the functional currency is determined, the functional currency is used consistently unless significant changes in economic facts and circumstances clearly indicate that the functional currency has changed. [830-10-45-7]

If there is a change in the functional currency, then generally the change is reflected prospectively, like IFRS. However, if the functional currency changes from the reporting currency to a foreign currency, then the adjustments attributable to the current-rate translation of non-monetary assets at the date of the change are recognised in OCI, unlike IFRS. [830-10-45-9 – 45-10]

Unlike IFRS, US GAAP does not address whether an entity may have more than one reporting currency. However, the SEC Staff has indicated that a foreign private issuer may select any reporting currency that the issuer deems appropriate, like IFRS. [830-10-20, SEC FRM 6610.1]

Translation of foreign currency transactions

Each foreign currency transaction is recorded in the entity’s functional currency at the rate of exchange at the date of the transaction (see forthcoming requirements). An average exchange rate for a specific period may be a suitable approximate rate for transactions during that period. However, if exchange rates fluctuate, then the use of an average rate for a period may be inappropriate. [IAS 21.21–22]

Unlike IFRS, each foreign currency transaction is recorded in the entity’s functional currency at the rate of exchange at the date of the transaction, or at an average exchange rate that approximates the rates during that period. Like IFRS, if exchange rates fluctuate, then the use of an average rate for a period may be inappropriate. [830-10-55-10, 830-20-30-1]
2.7 Foreign currency translation

At each subsequent reporting date, monetary items denominated in a foreign currency are translated at the closing exchange rate at the reporting date.

Non-monetary items measured at historical cost in a currency other than the functional currency are not retranslated into the functional currency; they remain at the exchange rate at the date of the transaction.

For a monetary item to form, in substance, part of the net investment in a foreign operation, settlement of the monetary item needs to be neither planned nor likely to occur in the foreseeable future. The entity that has the monetary item receivable from or payable to the foreign operation may be the parent and/or any subsidiaries of the group.

For the purpose of recognising foreign exchange differences, available-for-sale monetary items such as debt securities are treated as if they were measured at amortised cost in a foreign currency. Accordingly, the foreign exchange gain or loss and the remainder of the fair value change are recognised in OCI (see chapter 76).

Any derivatives related to foreign currency transactions are measured at fair value and may qualify as hedging instruments (see chapter 77).

Non-monetary items measured at historical cost in a currency other than the functional currency are not retranslated into the functional currency; they remain at the exchange rate at the date of the transaction.

Like IFRS, for available-for-sale monetary items such as debt securities, the entire change in the fair value is recognised in OCI (see chapter 76).

Any derivatives related to foreign currency transactions are measured at fair value and may qualify as hedging instruments (see chapter 77).

Unlike IFRS, foreign exchange gains and losses on monetary items are generally recognised in OCI. As exceptions, exchange gains and losses related to the following are recognised in OCI:

- monetary items that in substance form part of the net investment in a foreign operation (see below), like IFRS;
- a derivative that qualifies as a cash flow hedge (see chapter 77), which is narrower than the IFRS reference to hedging instruments;
- hedging instruments in a qualifying hedge of a net investment in a foreign operation (see chapter 77).

For a monetary item to form, in substance, part of the net investment in a foreign operation, settlement of the monetary item needs to be neither planned nor likely to occur in the foreseeable future. However, unlike IFRS, the entity, that has the monetary item receivable from or payable to the foreign operation, may be the parent and/or any subsidiaries of the group, but also equity-method investees (associates).

Like IFRS, any derivatives related to foreign currency transactions are measured at fair value and may qualify as hedging instruments (see chapter 77).

Unlike IFRS, for available-for-sale monetary items such as debt securities, the entire change in the fair value is recognised in OCI (see chapter 76).

Foreign exchange gains and losses on monetary items are generally recognised in OCI. As exceptions, exchange gains and losses related to the following are recognised in OCI:

- monetary items that in substance form part of the net investment in a foreign operation (see below), like IFRS;
- a derivative that qualifies as a cash flow hedge (see chapter 77), which is narrower than the IFRS reference to hedging instruments;
- hedging instruments in a qualifying hedge of a net investment in a foreign operation (see chapter 77).
Non-monetary items measured at fair value in a currency other than the functional currency are translated into the functional currency at the exchange rate when the fair value was determined. The resulting exchange differences are recognised in profit or loss or OCI depending on the nature of the item. [IAS 21.23, 30]

**Translation of foreign currency financial statements of a foreign operation**

The financial statements of foreign operations are translated as follows:

- assets and liabilities are translated at the closing exchange rate at the reporting date;
- items of income and expense are translated at the exchange rates at the dates of the relevant transactions, although appropriate average rates may be used;
- the resulting exchange differences are recognised in OCI and are presented within equity (generally referred to as the ‘foreign currency translation reserve’ or ‘currency translation adjustment’); and
- cash flows are translated at the exchange rates at the dates of the relevant transactions, although appropriate average rates may be used. [IAS 7.26–27, 21.39, 52]

In addition, although IFRS is not explicit on these points, in our view:

- capital transactions (e.g. dividends) should be translated at exchange rates at the dates of the relevant transactions, although appropriate average rates may be used; and
- components of equity should not be retranslated (i.e. each component of equity is translated once, at the exchange rates at the dates of the relevant transactions).

Goodwill and any fair value acquisition accounting adjustments related to the acquisition of a foreign operation (see chapter 2.6) are treated as assets and liabilities of the foreign operation and are translated at the closing rate at each reporting date. [IAS 21.47]

If a foreign operation’s reporting date is before that of the parent (see chapter 2.5), then adjustments should be made for significant movements in exchange rates up to the parent’s reporting date for consolidation purposes. [IAS 21.46]

Like IFRS, non-monetary items measured at fair value in a currency other than the functional currency are translated into the functional currency at the exchange rate when the fair value was determined. The resulting exchange differences, as well as other changes in fair value, are recognised in profit or loss or OCI, depending on the nature of the item, like IFRS. However, US GAAP guidance for items that may be measured at either cost or fair value (e.g. lower of cost and market) differs from IFRS, which could result in differences in practice from IFRS. [830-10-55-8, 830-20-35-6]

**Translation of foreign currency financial statements of a foreign operation**

The financial statements of foreign operations are translated as follows:

- assets and liabilities are translated at the closing exchange rate at the reporting date, like IFRS;
- items of income and expense are translated at the exchange rates at the dates of the relevant transactions, although appropriate average rates may be used, like IFRS;
- the resulting exchange differences are recognised in OCI, and are presented within equity, like IFRS (often referred to as a ‘cumulative translation adjustment’, which is an element of accumulated OCI);
- cash flows are translated at the exchange rates at the dates of the relevant transactions, although appropriate average rates may be used, like IFRS;
- capital transactions (e.g. dividends) are translated at the exchange rates at the dates of the relevant transactions, although appropriate average rates may be used, like IFRS; and
- components of equity are not retranslated (i.e. each component of equity is translated once at the exchange rates at the dates of the relevant transactions), like IFRS. [830-30-45-3, 45-6, 45-12, 830-230-45-1]

Like IFRS, goodwill and any fair value acquisition accounting adjustments related to the acquisition of a foreign operation (see chapter 2.6) are treated as assets and liabilities of the foreign operation and are translated at the closing rate at each reporting date. [830-30-45-11]

Unlike IFRS, if a foreign operation’s reporting date is before that of the parent (see chapter 2.5), then adjustments for significant movements in exchange rates up to the parent’s reporting date for consolidation purposes are not made, although disclosures about exchange rate movements subsequent to the reporting date of the foreign operation may be needed. [830-30-50-2]
If there are NCI in a foreign operation that is a subsidiary, then a portion of the foreign currency translation reserve is attributed to NCI. \[ \text{[IAS 21.41]} \]

If the functional currency of a foreign operation is the currency of a hyperinflationary economy, then the foreign operation’s financial statements are first restated into the measuring unit that is current at the reporting date, and then translated into the group’s presentation currency using the exchange rate at the reporting date of the current reporting period. \[ \text{[IAS 21.42–43, 29.8]} \]

IFRS is not clear on how changes in equity as a result of adjustments for hyperinflation and the translation of the adjusted balances at the closing exchange rate should be presented if the presentation currency is non-hyperinflationary. In our view, an entity may use one of the following approaches, which should be applied consistently, and present:

- the entire amount as an adjustment to equity in the statement of changes in equity;
- the entire amount in OCI; or
- the component related to hyperinflation accounting as an adjustment to equity and the component related to foreign exchange rate changes in OCI.

If the presentation currency is not the currency of a hyperinflationary economy, then comparative amounts are not restated and are those that were presented as current-year amounts in the prior year. \[ \text{[IAS 21.42(b)]} \]

The financial statements of a foreign operation can be translated from its functional currency directly into the presentation currency of the consolidated financial statements or by applying the step-by-step method of intermediate consolidation. Although the cumulative exchange differences in respect of all foreign operations recognised in equity will be the same under either method, the attribution of that difference to individual foreign operations will differ. \[ \text{[IAS 21.BC18, IFRIC 16.17]} \]

**Translation from functional to presentation currency**

If an entity presents its financial statements in a presentation currency that is different from its functional currency, then the translation procedures are the same as those for translating foreign operations (see above). \[ \text{[IAS 21.39]} \]

If an entity’s functional currency is hyperinflationary, then the translation procedures are the same as those for translating hyperinflationary foreign operations (see above). \[ \text{[IAS 21.42]} \]

Like IFRS, if there are NCI in a foreign operation that is a subsidiary, then a portion of the cumulative translation adjustment is attributed to NCI. \[ \text{[830-30-45-17]} \]

Unlike IFRS, the financial statements of a foreign operation whose functional currency is highly inflationary are remeasured for consolidation purposes as if the parent’s reporting currency were its functional currency. \[ \text{[830-10-45-11]} \]

Unlike IFRS, under US GAAP foreign operations are translated using the step-by-step method.

**Translation from functional to reporting currency**

Like IFRS, if an entity presents its financial statements in a reporting currency that is different from its functional currency, then the translation procedures are the same as those for translating foreign operations (see above). \[ \text{[830-30-45-3]} \]

Unlike IFRS, if the currency that would be the entity’s functional currency is that of a highly inflationary economy, then that currency can no longer be its functional currency. In this situation, the entity uses its parent’s functional currency as its functional currency. \[ \text{[830-10-45-11]} \]
Disposal of a foreign operation

The treatment of the foreign currency translation reserve on disposal of a foreign operation depends on the type of investee and whether a full or partial disposal has occurred.

The cumulative exchange differences related to a foreign operation that have been included in the foreign currency translation reserve are reclassified to profit or loss when the foreign operation is disposed of. A disposal may arise, for example, through sale, liquidation or repayment of share capital. [IAS 21.48–49]

If an entity loses control of a subsidiary that is a foreign operation, then the cumulative exchange differences recognised in OCI are reclassified in their entirety to profit or loss. If control is not lost, then a proportionate amount of the cumulative exchange differences recognised in OCI is reclassified to NCI. [IFRS 21.48–48A, 48C]

If an entity retains neither significant influence nor joint control over a foreign operation that was an associate or joint arrangement, then the cumulative exchange differences recognised in OCI are reclassified in their entirety to profit or loss. If either significant influence or joint control is retained, then a proportionate amount of the cumulative exchange differences recognised in OCI is reclassified to profit or loss. [IFRS 21.48–48A, 48C]

Disposal of a foreign operation

Unlike IFRS, the prior-year financial statements are not restated on a change in functional currency arising from the fact that the entity’s previous functional currency is that of a highly inflationary economy. In such cases, the cumulative translation adjustments of prior periods are not removed from equity. The exchange rate on the date of the change becomes the historical rate for subsequent remeasurement of non-monetary assets and liabilities into the new functional currency, which may differ from the policy choice under IFRS. [830-10-45-2 45-8]

Like IFRS, the prior-year financial statements are not restated on a change in functional currency arising from the fact that the entity’s previous functional currency is that of a non-hyperinflationary economy. In our view, an entity should choose an accounting policy, to be applied consistently, regarding whether it restates its comparatives in these circumstances. [IAS 21.42, 29.8]

Disposal of a foreign operation

The treatment of the foreign currency translation reserve on disposal of a foreign operation depends on the type of investee and whether a full or partial disposal has occurred.

Like IFRS, the prior-year financial statements are not restated on a change in functional currency arising from the fact that the entity’s previous functional currency is that of a highly inflationary economy. In such cases, the cumulative translation adjustments of prior periods are not removed from equity. The exchange rate on the date of the change becomes the historical rate for subsequent remeasurement of non-monetary assets and liabilities into the new functional currency, which may differ from the policy choice under IFRS. [830-10-45-2 45-8]

Like IFRS, the cumulative exchange differences arising on translation of the net investment in a foreign entity and included in the cumulative translation adjustment are reclassified to profit or loss when the foreign entity is sold or on complete or substantially complete liquidation. Disposal may take place through sale, liquidation, repayment of share capital or abandonment. [830-30-40-1 – 40-3]

Like IFRS, if an entity loses control of a subsidiary that is a foreign operation, then the exchange differences recognised in accumulated OCI are reclassified in their entirety to profit or loss. Like IFRS, if control is not lost, then a proportionate amount of the exchange differences recognised in accumulated OCI is reclassified to NCI. However, unlike IFRS, if an entity loses control of a subsidiary within a foreign entity, then the exchange differences recognised in accumulated OCI are reclassified in their entirety to profit or loss only if the investment in the subsidiary has been sold or substantially liquidated. Otherwise, none of the exchange differences recognised in accumulated OCI is reclassified to profit or loss. [830-30-40-1 – 40-1A]

If an entity loses significant influence over a foreign operation that was an equity-method investee, then the exchange differences recognised in accumulated OCI in respect of an equity-method investee are treated as follows.

- If the investee is a foreign entity that is disposed of in its entirety, then the exchange differences are reclassified in their entirety to profit or loss, like IFRS.
2.7 Foreign currency translation

- If the investee is a foreign entity that is not disposed of in its entirety, then the proportionate amount of the exchange differences is reclassified to profit or loss, unlike IFRS. Also, unlike IFRS, the remaining amount of the exchange differences is reclassified into the carrying amount of the investment unless doing so would reduce the carrying amount below zero, in which case, any excess amount is reclassified to profit or loss.

- If the investee is a foreign operation within a foreign entity, then none of the exchange differences recognised in accumulated OCI are reclassified unless the foreign entity has been sold or substantially liquidated, unlike IFRS.

When a parent loses control of a subsidiary by contributing it to an associate or joint arrangement, the amount of the foreign exchange translation reserve that is reclassified from OCI to profit or loss depends on the approach adopted by the entity to calculate the gain or loss on disposal and can be either the full related amount or a proportionate amount (see also chapter 2.5).

On partial disposal of a subsidiary that includes a foreign operation where control is retained, the entity re-attributes the proportionate share of the cumulative amount of the exchange differences recognised in OCI to the NCI in that foreign operation. In other partial disposals of a foreign operation that result in a loss of control of the subsidiary, the entity reclassifies to profit or loss the proportionate share of the cumulative amount of the exchange differences recognised in OCI. [IAS 21.48C]

A write-down of the carrying amount of a foreign operation, either because of its own losses or because of an impairment recognised by an investor, is not a partial disposal and therefore does not result in any amount of the foreign currency translation reserve being reclassified to profit or loss. In our view, a major restructuring that reduces the scale of operations of a foreign operation does not in itself trigger the reclassification to profit or loss of any amount of the foreign currency translation reserve, because the operations have not substantively ceased and the parent has not realised its investment in the foreign operation. However, in our view the substantive liquidation of a foreign operation should be treated as a disposal. [IAS 21.49]

Unlike IFRS, when a parent loses control of a subsidiary that is a foreign entity by contributing it to an equity-method investee, the full gain or loss on disposal is recognised and the full amount of the related cumulative translation adjustment balance is reclassified from accumulated OCI to profit or loss (see also chapter 2.5). Unlike IFRS, if the subsidiary is not a foreign entity, then no cumulative translation adjustment is reclassified until complete or substantially complete liquidation of the foreign entity in which it resided. [830-30-40-1 – 40-3]

Like IFRS, on partial disposal of a subsidiary that is a foreign entity while retaining control of the subsidiary, the entity re-attributes the proportionate share of the cumulative translation adjustment recognised in accumulated OCI to the NCI in that subsidiary. Unlike IFRS, for a partial disposal of a subsidiary that is a foreign entity resulting in a loss of control, the entity reclassifies the entire amount of accumulated OCI to profit or loss. [810-10-40-4A, 830-30-40-1 – 40-1A]

Like IFRS, a major restructuring that reduces the scale of operations of a foreign operation does not in itself trigger the reclassification to profit or loss of any amount of the foreign currency translation reserve, because the parent has not realised its investment in the foreign operation. Like IFRS, substantially complete liquidation of a foreign operation is treated as a disposal. [830-30-45-13]
An entity may make a loan to a foreign operation that is classified as part of its net investment, such that exchange differences on the loan are recognised in the foreign currency translation reserve. IFRS is silent about whether repayment of an inter-company loan forming part of the net investment is a partial disposal. In our view, an entity should choose an accounting policy, to be applied consistently, on whether repayment of an inter-company loan forming part of the net investment in a foreign operation is considered a partial disposal. We prefer such a repayment not to be considered a partial disposal. [IAS 21.8, 48D, BC250]

The cumulative exchange differences recorded and therefore subject to recategorisation in respect of an individual foreign operation are affected by whether the entity uses a direct or step-by-step method of consolidation (see above). However, if an entity uses the step-by-step method of consolidation, then it may adopt a policy of determining the amount to be reclassified as if it had applied the direct method of consolidation to translate the financial statements of the foreign operation into the functional currency of the ultimate parent. [IFRIC 16.17]

Disposal of a non-foreign operation

IFRS is silent on the accounting treatment for exchange differences on disposal of a non-foreign operation when the group presentation currency is not the same as the parent’s functional currency. In our view, no reclassification of these differences is required or permitted in the parent’s consolidated financial statements because the operation did not meet the definition of a foreign operation. Unlike IFRS, under US GAAP foreign operations are translated using the step-by-step method (see above) and there is no option to determine the amount to be transferred to profit or loss based on the direct method of consolidation.

Convenience translations

An entity is permitted to present financial information in a currency that is different from its functional currency or presentation currency (a ‘convenience translation’) as long as:
- the information is identified as being supplementary to the IFRS financial statements;
- the currency in which the supplementary information is presented is disclosed; and
- the entity’s functional currency and the method used to translate the financial information are disclosed. [IAS 21.8C14]

Unlike IFRS, for SEC registrants whose reporting currency is not the US dollar, a convenience translation may be presented of the most recent annual reporting period and any subsequent interim period presented using the exchange rate as at the most recent reporting date or the most recent date practicable, if this is materially different. For non-public entities, US GAAP does not provide any guidance on when it is appropriate to present consolidated financial information in a currency that is different from the parent’s reporting currency, unlike IFRS. [830-10-15-7]

Forthcoming requirements

A new interpretation about foreign currency transactions and advance consideration is effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

Unlike IFRS, exchange differences on disposal of a non-foreign operation when the group’s reporting currency is not the same as the parent’s functional currency are reclassified in the normal manner (see above).

Forthcoming requirements

There are no forthcoming requirements under US GAAP.
When foreign currency consideration is paid or received in advance of the item to which it relates (e.g. an asset, expense or income), the transaction date is the date on which the entity initially recognises the prepayment or deferred income.

Like IFRS, when foreign currency consideration is paid or received in advance of the item to which it relates (e.g. an asset, expense or income), the transaction date is the date on which the entity initially recognises the prepayment or deferred income. [830-10-45-18]
Overview

`Accounting policies’ are the specific principles, bases, conventions, rules and practices that an entity applies in preparing and presenting financial statements.

Like IFRS, ‘accounting principles’ (policies) are the specific principles, bases, conventions, rules and practices that an entity applies in preparing and presenting financial statements.

If IFRS does not cover a particular issue, then management uses its judgement based on a hierarchy of accounting literature.

If the Codification does not address an issue directly, then an entity considers other parts of the Codification that might apply by analogy and non-authoritative guidance from other sources; these sources are broader than under IFRS.

Unless a standard specifically permits otherwise (see chapter 8.1), the accounting policies adopted by an entity are applied consistently to all similar items, and accounting policies within a group are consistent for consolidation purposes.

Like IFRS, the accounting principles adopted by an entity are applied consistently to all similar items; however, unlike IFRS, US GAAP does not require uniform accounting policies be applied to similar items within a group.

An accounting policy is changed in response to a new or revised standard, or on a voluntary basis if the new policy is more appropriate.

Like IFRS, an accounting principle is changed in response to an Accounting Standards Update, or on a voluntary basis if the new principle is ‘preferable’.

Generally, accounting policy changes and corrections of prior-period errors are made by adjusting opening equity and restating comparatives unless this is impracticable.

Like IFRS, accounting principle changes are generally made by adjusting opening equity and comparatives unless this is impracticable. Errors are corrected by restating opening equity and comparatives, like IFRS; however, unlike IFRS, there is no impracticability exemption.

Changes in accounting estimates are accounted for prospectively.

Like IFRS, changes in accounting estimates are accounted for prospectively.

If it is difficult to determine whether a change is a change in accounting policy or a change in estimate, then it is treated as a change in estimate.

Like IFRS, if it is difficult to determine whether a change is a change in accounting principle or a change in estimate, then it is treated as a change in estimate. However, unlike IFRS, ‘preferability’ is required for such changes.
Overview (continued)

- If the classification or presentation of items in the financial statements is changed, then comparatives are restated unless this is impracticable.

- A statement of financial position as at the beginning of the preceding period is presented when an entity restates comparative information following a change in accounting policy, the correction of an error, or the reclassification of items in the statement of financial position.

Selection of accounting policies

‘Accounting policies’ are the specific principles, bases, conventions, rules and practices that an entity applies in preparing and presenting financial statements. [IAS 8.5]

If IFRS does not cover a particular issue, then an entity considers:

- in the first instance, the guidance and requirements in standards and interpretations dealing with similar and related issues; and then
- the IASB’s Conceptual Framework (see chapter 1.2). [IAS 8.11]

The entity may also consider the most recent pronouncements of other standard-setting bodies and accepted industry practice, to the extent that they do not conflict with the IASB’s standards, interpretations and the Conceptual Framework. [IAS 8.12]

The accounting policies adopted by an entity are applied consistently to all similar items or, if it is permitted by a standard, to all similar items within a category. An exception occurs when a standard allows the application of different methods to different categories of items. [IAS 8.13]

Accounting policies within a group are consistent for consolidation purposes (see chapter 2.5), including in respect of equity-accounted investees (see chapter 3.5). [IFRS 10.B.87 IAS 28.35]

Selection of accounting principles

Like IFRS, ‘accounting principles’ (policies) are the specific principles, bases, conventions, rules and practices that an entity applies in preparing and presenting financial statements. [250-10-20]

If the Codification (see chapter 1.1) does not address an issue directly, then US GAAP requires an entity to consider other parts of the Codification that might apply by analogy and non-authoritative guidance from other sources, which may include FASB Concept Statements and IFRS, but may also include other non-authoritative sources, which is broader than IFRS. [105-10-05-3]

Like IFRS, the accounting policies adopted by an entity are applied consistently from period to period.

Unlike IFRS, different accounting policies may be used within a group for consolidation purposes (see chapter 2.5) or by equity-method investees (see chapter 3.5).
Restatement
In our experience, the term ‘restatement’ is used more broadly than in the context of the correction of an error. Accordingly, the restatement of comparatives does not imply that the previously issued financial statements were in error.

Changes in accounting policy
A change in accounting policy is made when an entity is required to adopt a new or revised standard, or otherwise if a voluntary change will result in reliable and more relevant information. [IAS 8.14]

When a change in accounting policy arises from the adoption of a new, revised or amended standard, an entity follows the specific transitional requirements in that standard. [IAS 8.19]

The financial statements include disclosures regarding the change in accounting policy, including the reasons why applying a voluntary change in accounting policy provides reliable and more relevant information. [IAS 8.28–29]

A change in accounting policy to revalue items of property, plant and equipment (see chapter 3.2) or intangible assets (see chapter 3.3) is accounted for as a revaluation in accordance with the relevant standards. [IAS 8.17]

In other cases, an entity applies a change in accounting policy retrospectively (i.e. as if the new accounting policy had always been applied), including any income tax effect. This is done by adjusting the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented, unless this is impracticable (see below). [IAS 8.22–27]

Restatement
Unlike IFRS, in US GAAP the term ‘restatement’ is generally used in the context of the correction of an error. Accordingly, the restatement of comparatives generally means that the previously issued financial statements were in error. The term ‘retrospective adjustment’ is used to refer to other situations in which the comparatives are adjusted.

Changes in accounting principle
Like IFRS, an accounting principle is changed in response to a new Accounting Standards Update, or on a voluntary basis if the new principle is preferable. Although US GAAP refers to a new accounting principle being ‘preferable’ for a voluntary change, in general we would not expect a difference from IFRS in practice. [250-10-45-2]

Like IFRS, when a change in accounting principle arises from the adoption of a new Accounting Standards Update, an entity follows the specific transitional requirements in that Update. [250-10-45-3]

Like IFRS, the financial statements include disclosures regarding the nature of and reason for the change, including why the new principle is preferable. However, unlike IFRS, for a voluntary change domestic SEC registrants need to include as an exhibit in the first SEC Form 10-Q or 10-K filed after the date of the accounting change, a letter from the registrant’s independent accountants indicating whether the change is to an alternative principle that in their judgement is preferable under the circumstances (‘preferability letter’). [250-10-60-1(b), Reg S-X Rule 10-01(b)(6), Reg S-K 229.601(b)(18)]

Unlike IFRS, US GAAP does not permit the revaluation of property, plant and equipment (see chapter 3.2) or intangible assets (see chapter 3.3).

Like IFRS, an entity applies a change in accounting principle retrospectively (i.e. as if the new accounting principle had always been applied), including any income tax effect. This is done by adjusting the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented, unless this is impracticable (see below), like IFRS. [250-10-45-6]
Errors

‘Errors’ result from the misapplication of policies, oversight or the misinterpretation of facts and circumstances that existed at the reporting date and were made in the prior period. Examples include mathematical mistakes and fraud. Material prior-period errors are corrected by restating comparative information presented in the current-period financial statements, unless this is impracticable (see below). [IAS 8.5, 41–43]

Impracticability of retrospective adjustment

Retrospective application or restatement is done using only information that:
– would have been available in preparing the financial statements for that earlier period; and
– provides evidence of circumstances that existed on the date(s) that the transaction or event occurred. [IAS 8.82]

Other information (e.g. information that uses the benefit of hindsight) is not used. [IAS 8.50, 52–53]

The financial statements are adjusted as at the beginning of the earliest period from which retrospective adjustment is practicable. [IAS 8.23, 43]

The impracticability exemption applies in respect of both changes in accounting policy and the correction of errors. [IAS 8.5, 23, 43]

Changes in accounting estimates

Changes in estimates are accounted for in the period in which they occur, or in the current and the future period(s) if they affect more than one period. Generally, a prospective approach is applied. IFRS uses a cumulative catch-up approach for some changes in estimate and a ‘pure prospective’ approach for others. [IAS 8.36–37]

If it is difficult to determine whether a change is a change in accounting policy or a change in estimate, then the change is treated as a change in estimate and disclosure is made. Similarly, if an objective determination cannot be made of whether a change is a change in estimate or the correction of an error, then in our view it should be accounted for as a change in estimate. [IAS 8.35]

Errors

US GAAP describes an ‘error’ as an error in recognition, measurement, presentation or disclosure in financial statements resulting from mathematical mistakes, mistakes in the application of US GAAP or the oversight or misuse of facts that existed when the financial statements were prepared, like IFRS. Like IFRS, material (see chapter 1.2) prior-period errors are corrected by restating comparative information. However, unlike IFRS, there is no impracticability exemption under US GAAP. [250-10-20, 250-10-45-23, 45-27]

Impracticability of retrospective adjustment

Like IFRS, retrospective application is done using only information that:
– would have been available in preparing the financial statements for that earlier period; and
– provides evidence of circumstances that existed on the date(s) that the transaction or event occurred. [250-10-45-9C]

Like IFRS, other information (e.g. information that uses the benefit of hindsight) is not used. [250-10-45-10]

Like IFRS, the financial statements are adjusted at the beginning of the period from which retrospective adjustment is practicable. [250-10-45-6]

Unlike IFRS, the impracticability exemption applies only in respect of changes in accounting principle and does not extend to the correction of errors. [250-10-45-23]

Changes in accounting estimates

Like IFRS, changes in estimates are accounted for in the period in which they occur, or in the current and the future period(s) if they affect more than one period. Like IFRS, US GAAP uses a cumulative catch-up approach for some changes in estimate and a ‘pure prospective’ approach for others; however, the instances in which each approach is used are not necessarily consistent with IFRS. [250-10-45-17]

Like IFRS, if it is difficult to determine whether a change is a change in accounting principle or a change in estimate, then the change is treated as a change in estimate and disclosure is made; and, unlike IFRS, ‘preferability’ should be demonstrated. Unlike IFRS, an entity should determine whether an adjustment is the result of a correction of an error or some other reason (i.e. a change in estimate or a change in principle). [250-10-45-18, 45-23]
Judgements and estimation
Disclosures are required if judgements made by management in applying accounting policies have a significant effect on the recognition or measurement of items in the financial statements. Additionally, disclosures are required of the key assumptions about the future, and other sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities in the next annual reporting period. [IAS 1.122, 125]

Change in classification or presentation
In some cases, it may be appropriate to change the classification or presentation of items, even though there has been no change in accounting policy, to achieve a more appropriate presentation. In such cases, comparative information is restated unless it is impracticable to do so (see above), and appropriate explanatory disclosures are included in the notes to the financial statements. [IAS 1.41, 45–46]

If the change in classification or presentation relates to a voluntary change in accounting policy, then it should result in more relevant information (see above). [IAS 8.14]

Presentation of a third statement of financial position
A third statement of financial position is presented as at the beginning of the preceding period following a retrospective change in accounting policy, the correction of an error or a reclassification that has a material effect on the information in that statement of financial position (see chapter 2.1). [IAS 1.10(f), 40A]

Other restatements
The consolidated financial statements are not restated on the acquisition or disposal of a subsidiary, except to the extent that the disposal is a discontinued operation (see chapter 5.4). However, in our view the acquirer may elect to adjust comparatives in accounting for a common control transaction (see chapter 5.13).

Judgements and estimation
SEC registrants provide a discussion of critical accounting policies and estimates, which is like the IFRS disclosure requirements; however, unlike IFRS, such disclosure is required as part of management’s discussion and analysis, which is outside the financial statements (see chapter 5.8). Like IFRS, all entities are required to disclose information about estimates that have a reasonable possibility of changing by a significant amount in the near term; however, unlike IFRS, there is no specific disclosure requirement for non-SEC registrants in respect of significant judgements made in applying accounting policies. Non-public entities disclose the use of estimates and information about significant estimates but this information is generally not as detailed as for SEC registrants or under IFRS. [Reg S-K, 275-10-50-6 – 50-15A]

Change in classification or presentation
Like IFRS, comparatives are adjusted retrospectively if the classification or presentation of items has changed, unless this is impracticable (see above), and disclosures are included in the notes to the financial statements. [250-10-45-24]

If the change in classification or presentation relates to a voluntary change in accounting principle, then it should be justified as ‘preferable’ (see above). [250-10-45-2]

Presentation of a third statement of financial position
Unlike IFRS, a statement of financial position as at the beginning of the earliest comparative period is not required to be presented in any circumstances.

Other restatements
Like IFRS, the consolidated financial statements are not restated on the acquisition or disposal of a subsidiary, except to the extent that the disposal is a discontinued operation (see chapter 5.4). However, unlike IFRS, the acquirer is required to adjust comparatives in accounting for a common control transaction (see chapter 5.13).
IFRS is silent on what might constitute a change in the reporting entity and when it might be appropriate to adjust comparatives. However, neither a business combination accounted for using acquisition accounting (see chapter 2.6) nor the consolidation of a structured entity (see chapter 2.5) results in the adjustment of comparatives.

Unlike IFRS, prior-period financial statements are adjusted retrospectively if there is a change in the reporting entity – e.g. consolidated or combined financial statements are presented in place of the financial statements of individual entities. However, neither a business combination accounted for using acquisition accounting (see chapter 2.6) nor the consolidation of a variable interest entity (see chapter 2.5) constitutes a change in the reporting entity, like IFRS. [250-10-45-21]

Disclosure about the effects of new accounting standards

When an entity has not applied a new standard that has been issued, but is not yet effective, it discloses this fact and known or reasonably estimable information relevant to assessing the possible impact of the new standard on the entity’s financial statements, including:

- the title of the new standard;
- the nature of the impending change;
- the date by which application is required;
- the date from which it plans to apply the standard; and
- either a discussion of the effect that initial application is expected to have on the entity’s financial statements or, if the effect is not known or reasonably estimable, a statement to that effect. [IAS 8.30–31]

Like IFRS, SEC registrants disclose the expected effects of the forthcoming adoption of a new standard, which generally includes:

- a brief description of the new standard, including the date on which adoption is required and the date that the registrant plans to adopt, like IFRS;
- a discussion of the effect that adopting the standard is expected to have on the financial statements of the registrant or, if the effect is not known or reasonably estimable, a statement to that effect, like IFRS; and
- a discussion of the transition methods allowed by the standard and the method that the registrant expects to use, if it has been determined, unlike IFRS. [SAB Topic 11.M]

In addition, unlike IFRS, SEC registrants are encouraged to provide a discussion of the potential effects of other significant matters that they believe might result from adopting the standard – e.g. violation of debt covenant agreements, or planned or intended changes in business practices. [SAB Topic 11.M]
2.9 Events after the reporting date

Overview

- The financial statements are adjusted to reflect events that occur after the reporting date, but before the financial statements are authorised for issue, if those events provide evidence of conditions that existed at the reporting date.

- Financial statements are not adjusted for events that are a result of conditions that arose after the reporting date, except when the going concern assumption is no longer appropriate.

- The classification of liabilities as current or non-current is based on circumstances at the reporting date.

Comparison to US GAAP

- Like IFRS, the financial statements are adjusted to reflect events that occur after the reporting date if those events provide evidence of conditions that existed at the reporting date. However, unlike IFRS, the period to consider goes to the date on which the financial statements are issued for public entities and to the date on which the financial statements are available to be issued for certain non-public entities.

- Like IFRS, financial statements are generally not adjusted for events that are a result of conditions that arose after the reporting date. However, unlike IFRS, there is no exception for when the going concern assumption is no longer appropriate, although disclosures are required. Also, unlike IFRS, SEC registrants adjust the statement of financial position for a share dividend, share split or reverse share split occurring after the reporting date.

- The classification of liabilities as current or non-current generally reflects circumstances at the reporting date, like IFRS. However, unlike IFRS, in some circumstances liabilities are classified as non-current based on events after the reporting date.
Adjusting events
The financial statements are adjusted to reflect events that occur after the reporting date but before the financial statements are authorised for issue, if those events provide evidence of conditions that existed at the reporting date (adjusting events) or if they indicate that the going concern basis of preparation is inappropriate (see chapter 2.1). [IAS 10.3, 8, 14]

Non-adjusting events
Financial statement amounts are not adjusted for events that are a result of conditions that arose after the reporting date (non-adjusting events). An exception is when events after the reporting date indicate that the financial statements should not be prepared on a going concern basis (see chapter 2.1). [IAS 10.3, 10, 14]

The following is disclosed in respect of significant non-adjusting events: the nature of the event and an estimate of its financial effect, or a statement that an estimate cannot be made. [IAS 10.21]

Detailed information about business combinations effected after the reporting date is disclosed. [IFRS 3 59–60, B64–B66]

Recognised events
Like IFRS, the financial statements are adjusted to reflect events that occur after the reporting date if they provide evidence of conditions that existed at the reporting date (recognised events). However, unlike IFRS, events occurring up to the date on which the financial statements are issued, which may be later than when the financial statements are authorised for issue, are considered for public entities. For non-public entities whose financial statements are not widely distributed, subsequent events are considered up to the date on which the financial statements are available to be issued, unlike IFRS. Also unlike IFRS, tax uncertainties are not adjusted to reflect events that occur after the reporting date even if they provide evidence of conditions that existed at the reporting date. [855-10-25-1 – 25-2, 740-10-55-118 – 55-119]

The financial statements are issued as at the date on which they are distributed for general use and reliance in a form and format that complies with US GAAP. ‘Issuance’ is the earlier of when the financial statements are widely distributed to all shareholders and other financial statement users, and when they are filed with the SEC. The issuance of an earnings release does not constitute issuance. [855-10-20]

Non-recognised events
Like IFRS, financial statement amounts are not adjusted for events that are a result of new conditions that arose after the reporting date (non-recognised events). However, unlike IFRS, there is no specific requirement to adjust the financial statements when a subsequent event occurs indicating that the going concern basis of preparation is not appropriate; instead, disclosures are required (see chapter 2.1). [855-10-25-3 – 25-4]

Like IFRS, non-recognised events may be of such a nature and significance that disclosure is required to keep the financial statements from being misleading. Like IFRS, for such non-recognised events entities are required to disclose the event and an estimate of its effect, or a statement that such an estimate cannot be made. [855-10-50-2]

Like IFRS, detailed information about business combinations effected after the reporting date is disclosed. [805-10-50-1 – 50-3]
Specific application issues

Dividends
Cash dividends declared (i.e. the dividends are authorised and no longer at the discretion of the entity) after the reporting date are non-adjusting events that are not recognised as a liability in the financial statements, but are disclosed in the notes to the financial statements. This is because no obligation exists at the reporting date. [IAS 10.1.12–13, BC4]

Share dividends, share splits or reverse splits occurring after the reporting date are also non-adjusting events. Their impact on EPS is explained below. [IAS 10.22(f)]

Current vs non-current classification
Generally, the classification of long-term debt as current or non-current reflects circumstances at the reporting date. Refinancings, amendments, waivers etc that are agreed after the reporting date are not considered in determining the classification of debt, but are disclosed as non-adjusting events if material. However, if an entity expects, and has the discretion at the reporting date, to refinance or to reschedule payments on a long-term basis, then the debt is classified as non-current (see chapter 3.1). [IAS 1.72–76]

Earnings per share
EPS is restated to include the effect on the number of shares of certain share transactions that occur after the reporting date even though the transactions themselves are non-adjusting events (see chapter 5.3). [IAS 10.22(f), 33.64]

Dividends per share
In our experience, any dividends per share amounts disclosed might be restated to include the effect on the number of shares of certain share transactions that occur after the reporting date.

Specific application issues

Dividends
Like IFRS, cash dividends declared, proposed or approved by shareholders after the reporting date are non-recognised events that are not recognised as a liability in the financial statements because no obligation exists at the reporting date. [855-10-S99-1]

Unlike IFRS, SEC registrants are required to adjust the statement of financial position for a share dividend, share split or reverse split occurring after the reporting date but before the financial statements are issued. Their impact on EPS is explained below. [855-10-S25-2, S99-1]

Current vs non-current classification
Unlike IFRS, refinancings, amendments, waivers etc that occur after the reporting date are considered in determining the classification of debt at the reporting date. Therefore, debt that would otherwise be classified as current is classified as non-current if the intent and ability to refinance is demonstrated by a refinancing or the existence of a financing agreement that was entered into after the reporting date but before the financial statements are issued. Unlike IFRS, liabilities that are payable on demand at the reporting date due to covenant violations are classified as non-current if the lender agrees through a waiver, before the issue of the financial statements, not to demand prepayment for more than one year (or operating cycle, if it is longer) from the reporting date. Like IFRS, if an entity expects, and has the discretion at the reporting date, to refinance or to reschedule payments on a long-term basis, then the debt is classified as non-current (see chapter 3.1). [470-10-45-1, 45-4 – 45-5, 45-13 – 45-14]

Earnings per share
Like IFRS, EPS is restated to include the effect on the number of shares of certain share transactions that occur after the reporting date (see chapter 5.3). However, unlike IFRS, the transactions themselves may also be recognised events (see above). [260-10-65-12, 55-15]

Dividends per share
An entity disclosing a non-GAAP measure of dividends per share would restate to include the effect on the number of shares of certain share transactions that occur after the reporting date, like practice under IFRS. However, unlike IFRS, the transactions themselves may also be recognised events (see above).
Disclosure of the date of authorisation for issue
Disclosure is required in the financial statements of the date on which the financial statements were authorised for issue and who gave such authorisation. If the shareholders have the power to amend the financial statements after issue, then the entity discloses that fact. [IAS 10.17]

In our view, two different dates of authorisation for issue of the financial statements (‗dual dating‘) should not be disclosed, because we believe that only a single date of authorisation for issue of the financial statements complies with IFRS. [IAS 10.17, IU 05-13]

Discovery of a fraud after the reporting date
A fraud may be discovered after the financial statements have been authorised for issue. In our view, if information about the fraud could reasonably be expected to have been obtained and taken into account by an entity preparing financial statements when those financial statements were authorised for issue – e.g. in the case of a fraud within the entity itself – then subsequent discovery of such information is evidence of a prior-period error in those financial statements. [IAS 8.5, 10.9(e)]

In other circumstances, an external fraud may be discovered after the reporting date but before the financial statements are authorised for issue. In our view, in concluding whether the discovery of the fraud should be treated as an adjusting or a non-adjusting event related to reporting the fair value of financial assets in the scope of the financial instruments standards (see chapter 7.1) in financial statements that have not yet been authorised for issue, management should first identify whether there is a question of existence, valuation or both.

In our view, if the discovery of a fraud raises issues about the existence of the financial assets involved, then it should be treated as an adjusting event for financial statements that have not yet been authorised for issue. If, however, the fraud raises issues related only to the valuation of financial assets that do exist, then in our view it should be treated as a non-adjusting event for reporting the fair values of financial assets.

Discovery of a fraud after the reporting date
A fraud may be discovered after the financial statements have been authorised for issue. Like IFRS, if information about the fraud could reasonably be expected to have been obtained and taken into account by an entity preparing financial statements when those financial statements were issued or available for issuance, as appropriate (see above), then subsequent discovery of such information is evidence of a prior-period error in those financial statements. [250-10-20]

In other circumstances, a fraud may be discovered after the reporting date but before the financial statements are issued or are available for issuance, as appropriate (see above). Like IFRS, in concluding whether the discovery of a fraud should be treated as a recognised or a non-recognised event related to reporting the fair value of financial assets in the scope of the financial instruments Codification Topics (see chapter 7.1) in financial statements that have not yet been issued or are not available for issuance, an entity first identifies whether there is a question of existence, valuation or both.

Like IFRS, if the discovery of a fraud raises issues about the existence of the financial assets involved, then it should be treated as a recognised event for financial statements that have not yet been issued or are not available for issuance. If, however, the fraud raises issues related only to the valuation of financial assets that do exist, then it should be treated as a non-recognised event for reporting the fair values of financial assets, like IFRS.
In our view, if it is impracticable to separate the existence and the valuation issues, then the entire effect should be treated as an issue related to the existence of assets.

Like IFRS, if it is impracticable to separate the existence and the valuation issues, then the entire effect should be treated as an issue related to the existence of assets.
2.10 Hyperinflation

Overview

- When an entity’s functional currency is hyperinflationary, its financial statements are adjusted to state all items in the measuring unit that is current at the reporting date.

- When an entity’s functional currency becomes hyperinflationary, it makes price-level adjustments retrospectively as if the economy had always been hyperinflationary.

- When an economy ceases to be hyperinflationary, an entity stops making price-level adjustments for annual periods ending on or after the date on which the economy ceases to be hyperinflationary.

Indicators of hyperinflation

Although it is a matter of judgement as to when restatement for hyperinflation becomes necessary, IFRS provides guidance on the characteristics of a hyperinflationary economy. These characteristics include, but are not limited to, a cumulative inflation rate over three years approaching or exceeding 100 percent. [IAS 29.3]

Restating for hyperinflation

When an entity’s functional currency is hyperinflationary, its financial statements (generally including the comparatives) are adjusted to state all items in the measuring unit that is current at the reporting date. [IAS 29.8]

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2.10 Hyperinflation

Overview

- When a non-US entity that prepares US GAAP financial statements operates in an environment that is highly inflationary, it either reports price-level adjusted local currency financial statements, like IFRS, or remeasures its financial statements into a non-highly inflationary currency, unlike IFRS.

- Unlike IFRS, when an entity makes price-level adjustments prospectively.

- Unlike IFRS, when an economy ceases to be highly inflationary, an entity stops making price-level adjustments for annual periods beginning on or after the date on which the economy ceases to be highly inflationary.

Indicators of hyperinflation

Like IFRS, a highly inflationary (hyperinflationary) economy is indicated by cumulative inflation of approximately 100 percent or more over a three-year period. Historical inflation rate trends and other relevant economic factors are also considered if the cumulative inflation rate over three years is less than 100 percent, like IFRS. However, unlike IFRS, if the cumulative inflation rate over three years is higher than 100 percent, then the determination of whether an economy is highly inflationary is based solely on the cumulative inflation rate. [830-10-45-11 – 45-13]

Restating for hyperinflation

When a non-US entity that prepares US GAAP financial statements operates in an environment that is highly inflationary, it reports price-level adjusted local currency (measuring unit current at the reporting date) US GAAP financial statements as its primary financial statements, like IFRS, or it remeasures its financial statements into a non-highly inflationary currency, unlike IFRS (see chapter 2.7). [255-10-45-2 – 45-4, 830-10-45-11]
When an entity identifies that the economy of its functional currency is hyperinflationary, it makes price-level adjustments retrospectively. Comparative figures in subsequent reporting periods are restated only for changes in price for each subsequent period. [IAS 29.8, 34, IFRIC 7.3]

Comparative amounts are excluded from the restatement requirement when the presentation currency of the ultimate financial statements in which they will be included is non-hyperinflationary. For a discussion of translation into the presentation currency that is non-hyperinflationary, see chapter 2.7. [IAS 29.8, 34]

In adjusting for hyperinflation, a general price index is applied to all non-monetary items in the financial statements (including equity) and the resulting gain or loss, which is the gain or loss on the entity’s net monetary position, is recognised in profit or loss. Monetary items in the closing statement of financial position, which are defined as money held and items to be received or paid in money, are not adjusted. [IAS 29.9, 11–28, 128]

IFRS requires the use of a general price index that reflects changes in general purchasing power. Although it is not specifically mentioned in the standard, in our view, the consumer price index (CPI) is the most appropriate index to use because it is a broad-based measurement across all consumers in an economy. Some jurisdictions have multiple price indices published and further analysis and judgement may be required to determine an appropriate index that reliably reflects changes in general purchasing power. [IAS 29.37]

Non-monetary items are adjusted from the date of acquisition or contribution. However, if an asset has been revalued, then it is adjusted only from the date of the valuation; if the item is stated at fair value at the reporting date, then no adjustment is necessary. Income and expenses recognised in profit or loss are updated to reflect changes in the price index from the date on which they are initially recognised in the financial statements. Restated retained earnings are derived after all other amounts in the restated statement of financial position and statement of profit or loss and OCI are calculated. [IAS 29.14–15, 18, 24, 26]

The financial statements of a foreign operation whose functional currency is hyperinflationary are adjusted before being translated and included in the investor’s consolidated financial statements (see chapter 2.7). [IAS 21.42–43]

Unlike IFRS, when an entity’s economy becomes highly inflationary, it applies price-level adjustments on a prospective basis. Like IFRS, from that point forward comparative figures in subsequent reporting periods are restated only for changes in the inflation index for each subsequent period. [830-10-45-7]

Like IFRS, comparative amounts are excluded from the restatement requirement when the presentation currency of the ultimate financial statements in which they will be included is non-highly inflationary. For a discussion of translation into the presentation currency that is non-hyperinflationary, see chapter 2.7. [255-10-45.2–45.4, 830-10-45-11]

Like IFRS, in adjusting for a highly inflationary economy, a general price index is applied to all non-monetary items and the resulting gain or loss on the entity’s net monetary position is recognised in profit or loss. Like IFRS, monetary items in the closing statement of financial position are not adjusted. However, unlike IFRS, monetary items are defined as money or a claim to receive a sum of money, the amount of which is fixed and determinable without reference to the future prices of specific goods and services. [830-10-45.9–45.10, 45.17, 255-10-20]

In adjusting for a highly inflationary economy, the CPI is used as the general price index because it reflects changes in general purchasing power, like IFRS. [255-10-20]

Like IFRS, non-monetary items are restated from the date of acquisition or contribution. Like IFRS, if an asset has been revalued, then it is restated only from the date of the valuation; however, unlike IFRS, revaluations of non-monetary items occur only because of impairments (see chapters 3.2, 3.3, 3.4 and 3.10). Like IFRS, an item that is stated at fair value at the reporting date is not restated for inflation. Like IFRS, revenues and expenses are updated to reflect the changes in the price index using the same method as used for the related assets and liabilities. Like IFRS, restated retained earnings are derived after all other amounts in the restated statement of financial position and income statement are calculated. [830-10-45.11, 45.17]

Unlike IFRS, the financial statements of a foreign operation whose functional currency is highly inflationary are remeasured for consolidation purposes as if the parent’s reporting currency were its functional currency (see chapter 2.7). [830-10-45-11]
Ceasing to be hyperinflationary

When an economy ceases to be hyperinflationary, an entity stops preparing its financial statements in accordance with the standard on financial reporting in hyperinflationary economies for annual periods ending on or after the date on which the economy is identified as being non-hyperinflationary. Judgement is required in determining when the economy ceases to be hyperinflationary. [IAS 29.38]

Unlike IFRS, when an economy ceases to be highly inflationary, an entity stops preparing its financial statements in accordance with the Codification Subtopic on financial reporting in highly inflationary economies for annual periods beginning on or after the date on which the economy is identified as being non-highly inflationary. Judgement is required in determining when the economy ceases to be highly inflationary, like IFRS. [830-10-45-15, 55-12 – 55-14]
3 Statement of financial position

3.1 General

Overview

- Generally, an entity presents its statement of financial position classified between current and non-current assets and liabilities. An unclassified statement of financial position based on the order of liquidity is acceptable only if it provides reliable and more relevant information.

- Although IFRS requires certain line items to be presented in the statement of financial position, there is no prescribed format.

- A liability that is payable on demand because certain conditions are breached is classified as current even if the lender has agreed, after the reporting date but before the financial statements are authorised for issue, not to demand repayment.

- There is no specific guidance when an otherwise long-term debt agreement includes a subjective acceleration clause. Classification is based on whether the entity has an unconditional right to defer settlement of the liability at the reporting date.

Overview

- Unlike IFRS, US GAAP does not contain a requirement to present a classified statement of financial position. Unlike IFRS, there is no restriction on when an unclassified statement of financial position based on the order of liquidity can be presented.

- Unlike IFRS, SEC regulations prescribe the format and certain minimum line item disclosures for SEC registrants. For non-SEC registrants, there is limited guidance on the presentation of the statement of financial position, like IFRS.

- Generally, obligations that are payable on demand are classified as current, like IFRS. However, unlike IFRS, a liability is not classified as current when it is refinanced subsequent to the reporting date but before the financial statements are issued (available to be issued for certain non-public entities), or when the lender has waived after the reporting date its right to demand repayment for more than 12 months from the reporting date.

- Unlike IFRS, there is specific guidance when an otherwise long-term debt agreement includes a subjective acceleration clause. Classification is based on the likelihood that the creditor will choose to accelerate repayment of the liability, which may result in differences from IFRS.
Format of the statement of financial position

IFRS generally requires an entity to present a classified statement of financial position, which distinguishes current from non-current assets and liabilities. However, entities may present assets and liabilities broadly in order of liquidity if such a presentation provides information that is reliable and more relevant. [IAS 1.60]

The standard lists line items to be presented in the statement of financial position. An entity presents additional line items (including by disaggregating the line items listed in the standard), headings and subtotals when such presentation is relevant to an understanding of the entity’s financial position. Additional items may be presented because of their size or nature or to distinguish them from other items with differing timing, liquidity or function within the entity. An entity can aggregate immaterial line items listed in the standard. [IAS 1.29–31, 54–55, BC38A–E]

When additional subtotals are presented, those subtotals:
– comprise line items made up of amounts recognised and measured in accordance with IFRS;
– are presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable;
– are consistent from period to period; and
– are displayed with no more prominence than other subtotals and totals presented in the statement of financial position. [IAS 1.55A, BC38G]

Current vs non-current classification

An asset is classified as ‘current’ if it meets any of the following conditions:
– it is expected to be realised in, or is held for sale or consumption in, the entity’s normal operating cycle;
– it is primarily held for trading purposes;
– it is expected to be realised within 12 months of the reporting date; or
– it is cash or a cash equivalent (see chapter 2.3) that is not restricted from being exchanged or used to settle a liability for at least 12 months after the reporting date. [IAS 1.66]

Unlike IFRS, US GAAP does not require the presentation of a classified statement of financial position. Entities can elect to present assets and liabilities in descending order of liquidity (most liquid first) without demonstrating that such a presentation provides information that is reliable and more relevant than a classified statement of financial position, unlike IFRS. However, prevalent practice under US GAAP is to present a classified statement of financial position, like IFRS.

Unlike IFRS, there are no requirements for specific line items, headings and subtotals to be presented under US GAAP; therefore, differences from IFRS may arise in practice. However, SEC regulations prescribe the presentation and certain minimum line item disclosures for SEC registrants in general and by industry, which include the following and may differ from IFRS:
– general instructions for financial statements;
– commercial and industrial companies;
– insurance companies; and
– bank holding companies. [Reg S-X Art 3, 5, 7, 9]

Current vs non-current classification

Under US GAAP, ‘current assets’ are those assets that are:
– expected to be realised in cash or sold or consumed in the course of the entity’s operating cycle, like IFRS;
– items classified as trading securities, like IFRS;
– expected to be realised, sold or consumed within 12 months of the reporting date, which is like IFRS except that it excludes an asset that is to be used to retire a non-current liability; or
– cash or cash equivalents, like IFRS; under US GAAP, restricted cash is excluded from cash and cash equivalents and is classified as current or non-current as appropriate, like IFRS. [210-10-45-1 – 45-4]
A liability is classified as current if it meets any of the following conditions:
– it is expected to be settled in the entity’s normal operating cycle;
– it is primarily held for trading purposes;
– it is due to be settled within 12 months of the reporting date; or
– it is not subject to an unconditional right of the entity at the reporting date to defer settlement of the liability for at least 12 months after the reporting date. [IAS 1.69]

The terms of a liability (e.g. the liability component of a convertible instrument) that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification. [IAS 1.69(d)]

If a line item in the statement of financial position includes a combination of assets or a combination of liabilities that are expected to be settled both before and after 12 months from the reporting date, then an entity discloses the amount expected to be recovered or settled after more than 12 months. [IAS 1.61]

All assets and liabilities that do not meet the definition of current assets or liabilities are classified as non-current. [IAS 1.66, 69]

Non-current assets and assets of disposal groups classified as held-for-sale or held-for-distribution (see chapter 5.4) are classified as current in the statement of financial position. In our view, liabilities of such disposal groups should be classified as current in the statement of financial position because they are expected to be realised within 12 months of the date of classification as held-for-sale or held-for-distribution. Assets and liabilities classified as held-for-sale or held-for-distribution cannot be offset, unless the offsetting requirements explained below apply. [IFRS 5.3, BC9–BC10, IAS 1.32–33, 66]

The current portion of a non-current financial asset or liability is classified as a current asset or liability. [IAS 1.68, 71]

Under US GAAP ‘current liabilities’ are:
– debts that arise from operations directly related to the operating cycle, such as accruals for wages, salaries, commissions, rentals, royalties and income and other taxes, like IFRS;
– collections received in advance of the delivery of goods or performance of services, which may vary from IFRS;
– liabilities whose regular and ordinary liquidation is expected to occur within a relatively short period of time, usually 12 months, like IFRS;
– amounts required to be expended within one year under ‘sinking fund’ provisions, like IFRS;
– obligations that, by their terms, are due on demand or will be due on demand within one year (or the operating cycle, if longer) of the reporting date, even though liquidation may not be expected within that period, like IFRS; or
– long-term obligations that are or will be callable by the creditor, like IFRS except that there are certain exceptions (see below). [210-10-45-5 – 45-12, 470-10-45]

Unlike IFRS, US GAAP has no specific guidance on the classification of the liability component of a convertible instrument and practice may vary. [210-10-20, 470-10-45]

Unlike IFRS, if classification as current or non-current is driven by the entity’s operating cycle, then the entire amount is classified as current and disclosure of amounts receivable or payable before and after 12 months is not required. [210-10-45]

Like IFRS, all assets and liabilities that do not meet the definition of current assets or liabilities are classified as non-current. [210-10-20]

Unlike IFRS, non-current assets and related liabilities classified as held-for-sale (see chapter 5.4) are required to be segregated in the statement of financial position, but not necessarily included in current assets and current liabilities. Like IFRS, the segregated assets and segregated liabilities cannot be offset. Unlike IFRS, there is no held-for-distribution classification. [360-10-45-14 – 45-15]

Like IFRS, the current portion of a non-current financial asset or liability is classified as a current asset or liability. [210-10-45]
Deferred tax assets and liabilities are always classified as non-current (see chapter 3.13). [IAS 156]

There is no requirement to classify post-employment benefit obligations and assets into current and non-current portions, and in our experience this is not typically done. [IAS 19.133]

A liability that is due within 12 months or is payable on demand because loan conditions have been breached is classified as current even if the lender has agreed, after the reporting date but before the financial statements are authorised for issue, not to demand repayment as a result of the breach. However, if before the reporting date the lender agrees to provide a period of grace ending at least 12 months after the reporting date, then the liability is classified as non-current. [IAS 1.74–76, BC47]

The current portion of long-term debt is classified as current even if an agreement to refinance or reschedule payments on a long-term basis is completed after the reporting date but before the financial statements are authorised for issue. However, if at the reporting date an entity expects and is able, solely at its own discretion, to refinance or roll over an obligation for at least 12 months after the reporting date under an existing loan facility, then it classifies the obligation as non-current even if the loan would otherwise be current. [IAS 1.72–73]

Usually, debt is classified as current or non-current based on whether it is due to be settled within 12 months of the reporting date. However, if a liability is part of the working capital used in the entity’s normal operating cycle, then it is classified as current even if it is due to be settled more than 12 months after the reporting date. [IAS 1.70–71]

An otherwise long-term debt agreement may include a subjective acceleration clause – i.e. a clause that allows the creditor to accelerate the scheduled maturity of the debt under conditions that are not objectively determinable (e.g. if the debtor ‘fails to maintain satisfactory operations’).

Unlike IFRS, deferred tax assets and liabilities are classified as current or non-current based on the classification of the related asset or liability (see chapter 3.13). [740-10-45-4]

Unlike IFRS, a net post-retirement benefit obligation is classified as current or non-current if the entity prepares a classified statement of financial position. The current portion of the obligation is the amount of benefits expected to be paid within 12 months of the reporting date that is in excess of the plan assets. The remaining amount of the obligation is classified as non-current. If a net post-retirement benefit asset exists, then it is classified as non-current. [715-20-45-2 – 45-3]

Like IFRS, a liability that is payable on demand or will be payable on demand within 12 months (or the operating cycle, if it is longer) is classified as current even if payment is not expected within that period. Unlike IFRS, a liability that is due within 12 months or is payable on demand due to a violation of the credit agreement is not classified as current if, before the financial statements are issued or available for issue, the creditor has waived or subsequently lost the right to demand repayment for more than 12 months from the reporting date or, for long-term obligations containing a grace period within which the breach may be remedied, it is probable that the violation will be cured within that grace period. [470-10-45]

Unlike IFRS, the current portion of long-term debt is classified as non-current if an agreement to refinance or reschedule payments on a long-term basis is completed after the reporting date but before the financial statements are issued (available to be issued for certain non-public entities). Like IFRS, if at the reporting date an entity expects and is able, solely at its own discretion, to refinance or roll over an obligation for at least 12 months after the reporting date under an existing loan facility, then it classifies the obligation as non-current even if the loan would otherwise be current. [470-10-45-1 – 45-21, 470-10-55-1 – 55-36]

Like IFRS, if a liability is part of the working capital used in the entity’s operating cycle, then it is classified as current even if it is due to be settled more than 12 months after the reporting date. [210-10-45]

An otherwise long-term debt agreement may include a subjective acceleration clause – i.e. a clause that allows the creditor to accelerate the scheduled maturity of the debt under conditions that are not objectively determinable (e.g. if the debtor ‘fails to maintain satisfactory operations’).
Although subjective acceleration clauses may require greater judgement to determine whether the terms of the agreement have been breached and classification of the debt as current is required, in our view objective and subjective covenant tests should be dealt with consistently; both need to be assessed to determine whether the entity has an unconditional right to defer settlement of the liability at the reporting date. However, more judgement may be needed to determine whether a subjective clause has been breached at the reporting date. [IAS 1.74–76, BC47]

Unlike IFRS, there are specific requirements relating to subjective acceleration clauses, and classification is based on the likelihood that the creditor will choose to accelerate repayment of the liability.

- If the likelihood of acceleration is ‘remote’, then the debtor is neither required to classify the debt as a current liability nor required to disclose the existence of the subjective acceleration clause.
- If the likelihood of acceleration is ‘reasonably possible’, then the debtor evaluates the facts and circumstances to determine the proper classification of the debt and the appropriate disclosures.
- If the likelihood of acceleration is ‘probable’, then the debt is classified as current and the debtor discloses the nature and terms of the subjective acceleration clause, the amount that may be due within one year of the reporting date, and the debt’s due date assuming acceleration. [470-10-20, 10-45]

**Offsetting**

A financial asset and a financial liability are offset and reported net only if the entity has a legally enforceable right to set off and it intends to settle either simultaneously or on a net basis (see chapter 7.8). [IAS 32.42]

Like IFRS, the offsetting of financial assets and financial liabilities is permitted only if there is a legally enforceable right to set off and the intention is to settle the amounts net. Additionally, unlike IFRS, US GAAP permits the offsetting of positions under a master netting agreement (see chapter 7.8), and also provides for offsetting by entities that follow certain specialised industry guidance. [210-20-06, 20-45]

Specific offsetting requirements exist for current and deferred tax assets and liabilities (see chapter 3.13), and plan assets and obligations in a defined benefit plan (see chapter 4.4). Non-financial assets and non-financial liabilities cannot be offset under IFRS. [IAS 1.32–33]

Like IFRS, specific offsetting requirements exist for deferred tax assets and liabilities and plan assets and obligations in a defined benefit plan (see chapters 3.13 and 4.4). Like IFRS, non-financial assets and non-financial liabilities cannot be offset. Unlike IFRS, US GAAP specifically requires offsetting for other specific arrangements, including leveraged leases (see chapter 5.1).
### Overview

- Property, plant and equipment is recognised initially at cost.

- ‘Cost’ includes all expenditure that is directly attributable to bringing the asset to the location and working condition for its intended use.

- ‘Cost’ includes the estimated cost of dismantling and removing the asset and restoring the site.

- Changes to an existing decommissioning or restoration obligation are generally adjusted against the cost of the related asset.

- Property, plant and equipment is depreciated over its expected useful life.

- Estimates of useful life and residual value, and the method of depreciation, are reviewed as a minimum at each annual reporting date. Any changes are accounted for prospectively as a change in estimate.

- If an item of property, plant and equipment comprises individual components for which different depreciation methods or rates are appropriate, then each component is depreciated separately.

Like IFRS, property, plant and equipment is recognised initially at cost.

Like IFRS, ‘cost’ includes all expenditure that is directly attributable to bringing the asset to the location and working condition for its intended use.

Like IFRS, ‘cost’ includes the estimated cost of dismantling and removing the asset and certain costs of restoring the site. However, unlike IFRS, to the extent that such costs relate to environmental remediation, they are not capitalised.

Like IFRS, changes to an existing decommissioning or restoration obligation are generally adjusted against the cost of the related asset.

Like IFRS, property, plant and equipment is depreciated over its expected useful life.

Estimates of useful life and residual value, and the method of depreciation, are reviewed only when events or changes in circumstances indicate that the current estimates or depreciation method are no longer appropriate. However, in general we would not expect differences from IFRS in practice. Like IFRS, any changes are accounted for prospectively as a change in estimate.

Unlike IFRS, component accounting is permitted but not required. When component accounting is used, its application may differ from IFRS.
Overview (continued)

- Property, plant and equipment may be revalued to fair value if fair value can be measured reliably. All items in the same class are revalued at the same time and the revaluations are kept up to date.

- The gain or loss on disposal is the difference between the net proceeds received and the carrying amount of the asset.

- Compensation for the loss or impairment of property, plant and equipment is recognised in profit or loss when it is receivable.

Definition

‘Property, plant and equipment’ comprises tangible assets that are held by an entity for use in the production or supply of goods or services, for rental to others or for administrative purposes, that are expected to be used for more than one period. Property, plant and equipment also includes agricultural bearer plants.

[IAS 16.6]

Initial recognition

Property, plant and equipment is recognised initially at cost. [IAS 16.15]

A customer may supply property, plant and equipment that the entity is required to use to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services, or both. For such property, plant and equipment, cost is determined with reference to its fair value on initial recognition. See forthcoming requirements. [IFRIC 18.11]

Overview (continued)

- Unlike IFRS, the revaluation of property, plant and equipment is not permitted.

- Like IFRS, the gain or loss on disposal is the difference between the net proceeds received and the carrying amount of the asset.

- Unlike IFRS, compensation for the loss or impairment of property, plant and equipment, to the extent of losses and expenses recognised, is recognised in profit or loss when receipt is likely to occur. Compensation in excess of that amount is recognised only when it is receivable, like IFRS.

Definition

Like IFRS, ‘property, plant and equipment’ comprises tangible assets that are held by an entity for use in the production or supply of goods or services, for rental to others or for administrative purposes, that are expected to be used for more than one period. US GAAP does not use the term agricultural bearer plants, but the property, plant and equipment accounting model generally applies to such assets. [360-10-05-3, 905-360]

Initial recognition

Like IFRS, property, plant and equipment is recognised initially at cost. [360-10-30-1]

Unlike IFRS, US GAAP has no explicit general guidance on property, plant and equipment that is contributed by a customer. The entity would need to consider the ownership of the asset and the scope of the leasing Codification Topic (see chapter 5.1), and the related supply contract. In many cases, we would expect this analysis to result in a similar conclusion to IFRS and, if so, the cost of such property, plant and equipment would be determined with reference to its fair value on initial recognition, like IFRS. However, differences may arise in practice regarding either the determination of whether the entity has an asset or its initial measurement. [340-10-25-1 – 25-3, 340-10-55-2 – 55-5]
Directly attributable expenditure

‘Cost’ includes all expenditure that is directly attributable to bringing the asset to the location and condition necessary for its intended use, which means capable of operating in the manner intended by management. The costs incurred need not be external or incremental. See forthcoming requirements. [IAS 16.16–17]

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset (see chapter 4.6). [IAS 23.8–9]

The following are not included in the cost of an item of property, plant and equipment:
- training costs;
- when an item of property, plant and equipment is constructed by an entity, abnormal amounts of wasted material, labour and other resources;
- start-up and pre-operating costs unless those costs are necessary to bring the asset to its working condition; and
- losses incurred before the asset reaches its planned performance level. [IAS 16.19–20, 22]

Incidental income from operating (including testing) a new asset is part of the directly attributable cost of the asset. Income and expenses from other incidental operations are recognised in profit or loss. [IAS 16.17, 21]

Decommissioning or restoration

The cost of property, plant and equipment includes the estimated cost of dismantling and removing the asset and restoring the site (decommissioning or restoration) to the extent that such cost is recognised as a provision (see chapter 3.12). [IAS 16.16(c)]

Decommissioning costs comprise liabilities incurred during the period of use for purposes other than producing inventory. Decommissioning or restoration costs related to the production of inventory are included in the cost of inventory. [IAS 16.16(c), 18, IFRIC 1.5(a)]

Directly attributable expenditure

Like IFRS, ‘cost’ includes all expenditure that is directly attributable to bringing the asset to the location and condition necessary for its intended use, which means capable of operating in the manner intended by management. Like IFRS, the costs incurred need not be external or incremental. [360-10-30-1]

Like IFRS, interest (borrowing costs) that is directly attributable to the acquisition, construction or production of a qualifying asset forms part of the cost of that asset. However, the specific requirements differ from IFRS in certain respects (see chapter 4.6). [360-10-30-1]

Like IFRS, the following are not activities necessary to bring the asset to the condition and location necessary for its intended use and would not be included in the cost of an item of property, plant and equipment:
- training costs;
- when an item of property, plant and equipment is constructed by an entity, abnormal amounts of wasted material, labour and other resources;
- start-up and pre-operating costs unless those costs are necessary to bring the asset to its working condition; and
- losses incurred before the asset reaches its planned performance level. [360-10-30-1–30-2]

Unlike IFRS, incidental income from operating (including testing) a new asset is not part of the directly attributable cost of the asset and is recognised in profit or loss unless the property is being developed for rental or sale, in which case income (but not a loss) from incidental operations is recognised as a reduction to the cost of the asset. Like IFRS, income and expenses from other incidental operations are recognised in profit or loss. [970-340-25-12]

Asset retirement obligation

Like IFRS, the cost of property, plant and equipment includes the estimated cost of dismantling and removing the asset and restoring the site to the extent that such cost is recognised as an asset retirement obligation. Unlike IFRS, to the extent that such costs are environmental remediation obligations, they are recognised in profit or loss. For further discussion, see chapter 3.12. [410-20-35-8]

Like IFRS, asset retirement obligations include liabilities incurred during the period of use. However, unlike IFRS, asset retirement obligations incurred as a consequence of the production of inventory in a particular period are not part of the cost of inventory, but are added to the carrying amount of the item of property, plant and equipment. [410-20-35-1]
If an entity uses the cost model for the subsequent measurement of property, plant and equipment, then any changes to an existing decommissioning or restoration obligation (other than changes related to the unwinding of the discount) are added to or deducted from the cost of the related asset, and are depreciated prospectively over the asset’s useful life. However, the amount deducted from the cost of the asset cannot exceed its carrying amount; any excess is recognised immediately in profit or loss. [IFRIC 1.5]

The remeasurement of a decommissioning or restoration provision includes the effect of changes in interest rates (see chapter 3.12). [IFRIC 1.3]

Under the revaluation model, changes in a liability for decommissioning or restoration (other than changes related to the unwinding of the discount) are recognised in the same way as a revaluation (see below), unless the change would reduce the depreciated cost of the asset to below zero. [IFRIC 1.6]

Deferred payment
If payment is deferred beyond normal credit terms, then the cost of the asset is the cash price equivalent, which may be different from the cash flows discounted using a market rate of interest (see chapter 7.5). [IAS 16.23]

Depreciation
Subsequent to initial recognition, property, plant and equipment is depreciated on a systematic basis over its useful life, which should be reviewed at least at each annual reporting date. A change in the useful life is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [IAS 16.50–51]

The depreciation charge for each period is recognised as an expense in profit or loss, unless it is included in the carrying amount of another asset (e.g. inventory). [IAS 16.48]

Like IFRS, any changes to an existing decommissioning or restoration obligation (other than changes related to the unwinding of any discount) are added to or deducted from the cost of the related asset if the initial recognition of the obligation was recognised as an increase to the cost of the asset, and are depreciated prospectively over the asset’s useful life. However, the amount deducted from the cost of the asset cannot exceed its carrying amount; any excess is recognised immediately in profit or loss, like IFRS. [410-20-35-8]

Unlike IFRS, the remeasurement of an asset retirement obligation includes the effect of changes in interest rates only in respect of increases in estimates of future cash flows (see chapter 3.12). If the estimated future cash flows do not change, then the liability is not remeasured, unlike IFRS. [410-20-35-5]

Unlike IFRS, entities are not permitted to use the revaluation model under US GAAP.

Deferred payment
If payment is deferred, then the purchase price is recognised at the fair value of the consideration given, which may be measured as the present value of the future payments discounted using a market rate of interest (see chapter 7.5); however, in general we would not expect differences in measurement from IFRS in practice. [835-30-25-10]

Depreciation
Like IFRS, subsequent to initial recognition property, plant and equipment is depreciated on a systematic basis over its useful life. Under US GAAP, the useful life is reviewed only when events or changes in circumstances indicate that the current estimate of useful life is no longer appropriate; however, in general, we would not expect a difference from IFRS in practice. Like IFRS, a change in the useful life is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [360-10-35-4]

Like IFRS, the depreciation charge for each period is recognised as an expense in profit or loss, unless it is included in the carrying amount of another asset (e.g. inventory). [360-10-35-3]
An asset’s depreciable amount is its cost or revalued amount, less its residual value. ‘Residual value’ is the amount that an entity could receive from disposal of the asset at the reporting date if the asset were already of the age and in the condition that it will be in when the entity expects to dispose of it. Residual value does not include expected future inflation or expected increases or decreases in the ultimate disposal value. The residual value of an asset is reviewed at least at each annual reporting date; changes in the residual value are accounted for prospectively as a change in accounting estimate (see chapter 2.8). [IAS 16.6, 51]

No specific method of depreciation is required to be used, and suitable methods include the straight-line method, the diminishing (or reducing balance) method and the sum-of-the-units (or units-of-production) method. The method of depreciation reflects the pattern in which the benefits associated with the asset are consumed; the depreciation method applied is reviewed at least at each annual reporting date. A change in the depreciation method is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [IAS 16.60–62]

The use of a revenue-based method of depreciation is prohibited. [IAS 16.62A]

Depreciation of an asset begins when it is available or ready for use – i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. [IAS 16.55]

Component accounting

If an item of property, plant and equipment comprises individual components for which different depreciation methods or rates are appropriate, then each component is depreciated separately. A separate component may be either a physical component or a non-physical component that represents a major inspection or overhaul. [IAS 16.43–47]

Like IFRS, an asset’s depreciable amount is its cost less its salvage value (residual value). US GAAP does not define ‘salvage value’ for depreciable assets, or prescribe a method for measuring salvage value. Instead, US GAAP only requires the cost of an asset, less salvage if any, to be allocated over its estimated useful life in a systematic and rational manner. Therefore, differences from IFRS may arise in practice. Like IFRS, changes in the salvage value are accounted for prospectively as a change in accounting estimate (see chapter 2.8). [360-10-35-4]

Like IFRS, no specific method of depreciation is required to be used, and suitable methods include the straight-line method, the diminishing (or reducing balance) method and the sum-of-the-units (or units-of-production) method. Additionally, US GAAP specifies that certain tax depreciation approaches are not acceptable if the number of years specified by the tax code does not fall within a reasonable range of the asset’s useful life. Like IFRS, the method of depreciation reflects the pattern in which the benefits associated with the asset are consumed. Under US GAAP, the depreciation method applied is reviewed whenever events or changes in circumstances indicate that the current estimate is no longer appropriate; however, we would not expect differences from IFRS in practice. Like IFRS, a change in the depreciation method is accounted for prospectively as a change in accounting estimate (see chapter 2.8). However, unlike IFRS, because an accounting principle (policy) is also involved, the change needs to be justified as preferable and the disclosure requirements for a change in accounting principle apply. [250-10-45-2, 50-1, 360-10-35-7, 35-9 – 35-11]

Unlike IFRS, the use of a revenue-based method of depreciation is not prohibited. However, in our experience such a method is not typically used in practice. [360-10-35-2, 35-7, 35-9]

Like IFRS, depreciation of an asset begins when it is available for use – i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. [360-10-35-4]

Component accounting

Unlike IFRS, there is neither a requirement for, nor a prohibition from, accounting for separate components of an asset. Therefore, differences from IFRS may arise in practice.
Routine maintenance costs are expensed as they are incurred. Major inspection or overhaul costs are accounted for as a separate component of the item of property, plant and equipment if that component is used over more than one period. In our view, the cost of a major inspection or overhaul includes internal as well as external costs, and there is no requirement for the costs to be incremental. [IAS 16.12, 14]

Like IFRS, routine maintenance costs are expensed as they are incurred. Under US GAAP, an entity can elect to account for planned major maintenance using any of the following methods:

- under the **direct expense method**, all maintenance costs are expensed in the period in which they are incurred, unlike IFRS;
- under the **built-in overhaul method**, planned major maintenance costs (which may include internal as well as external costs) are accounted for as a separate component of the asset, like IFRS; and
- under the **deferral method**, although no component of the asset is attributed to planned major maintenance on initial recognition, costs (which may include internal as well as external costs) incurred for each major maintenance are capitalised and amortised over the period to the next planned major maintenance, unlike IFRS. [360-10-25-5, 45-1, 908-360-30-2 – 30-3, 908-720-25-3]

If the component is a physical component, then the initial carrying amount of the component is determined with reference to its cost. [IAS 16.15]

The remaining carrying amount of a component that is replaced by a new component is derecognised. [IAS 16.13]

If an entity uses a component approach, then the initial carrying amount of the component is normally determined using the estimated relative fair value of the components. Although this wording differs from IFRS, we would not generally expect differences in practice.

Like IFRS, if an entity uses a component approach, then the carrying amount of the component that is replaced by a new component would generally be derecognised. However, unlike IFRS, because the component approach is not required, entities may use the composite depreciation method whereby the cost of a new component is capitalised without derecognising the replaced component.

**Subsequent expenditure**

Expenditure incurred subsequent to the initial recognition of property, plant and equipment is capitalised only when it is probable that future economic benefits associated with the item will flow to the entity, or when it replaces a component that is accounted for separately. Expenditure associated with the day-to-day servicing of assets is expensed as it is incurred. [IAS 16.7, 12]

Like IFRS, expenditure incurred subsequent to the initial recognition of property, plant and equipment is capitalised only when it is probable that future economic benefits associated with the item will flow to the entity. However, unlike IFRS, component accounting is not required and replacement components may be recognised without derecognising the replaced component. Like IFRS, expenditure associated with the day-to-day servicing of assets is expensed as it is incurred. [TPA 2210.15]

The costs of relocating or reorganising part or all of an entity’s operations are not included in the carrying amount of an item of property, plant and equipment. [IAS 16.20]

The costs of relocating or reorganising property, plant and equipment, including part or all of an entity’s operations, are generally expensed as they are incurred, like IFRS. [CON 6.149]
Revaluations

Property, plant and equipment may be revalued to fair value if fair value can be measured reliably (see chapter 2.4). Any surplus arising on revaluation is recognised in OCI except to the extent that the surplus reverses a previous revaluation deficit on the same asset recognised in profit or loss, in which case the credit to that extent is recognised in profit or loss. Any deficit on revaluation is charged in profit or loss except to the extent that it reverses a previous revaluation surplus on the same asset, in which case the debit to that extent is recognised in OCI. Therefore, revaluation increases and decreases cannot be offset, even within a class of assets. [IAS 16.31, 36, 39–40]

If an asset is revalued, then all property, plant and equipment of the same class is revalued at the same time and these revaluations are kept up to date. A ‘class of assets’ is a grouping of items that have a similar nature and use in an entity’s operations. [IAS 16.31, 36–38]

The revaluation surplus may be transferred directly to retained earnings as the surplus is realised. ‘Realisation’ of the surplus may occur either by the use (and depreciation) of the asset or its disposal (see below). [IAS 16.41]

If an entity changes its accounting policy from cost to fair value, then the effect of the change is recognised as a revaluation; the opening balance of equity is not adjusted and comparatives are not adjusted (see chapter 2.8). [IAS 8.17]

Compensation received

Compensation for insurance recoveries, including the loss or impairment of property, plant and equipment, is recognised in profit or loss when it becomes receivable. The loss or impairment is recognised in profit or loss as an expense when it occurs. [IAS 16.65–66]

There is no specific guidance on the recognition of contractually specified liquidated damages for the late delivery of property, plant and equipment, and judgement is often required in assessing whether recognition in profit or loss and/or against the carrying amount of the related asset is more appropriate.

Revaluations

Unlike IFRS, entities are not permitted to use the revaluation model under US GAAP. [ARB 43, Ch 9B.1]

Compensation received

Unlike IFRS, compensation for the loss or impairment of property, plant and equipment, to the extent of losses and expenses recognised in the financial statements, is recognised in profit or loss when receipt is probable (likely to occur). Compensation in excess of such amount is treated as a gain contingency (see chapter 3.12) and is not recognised until it is receivable, like IFRS. The loss or impairment is recognised in profit or loss as an expense when it occurs, like IFRS. [360-10-45-4, 450-30-25-1]

Unlike IFRS, contractually specified liquidated damages for the late delivery of property, plant and equipment are recognised as a reduction of its capitalised cost. [TFA 2210.28]
Retirements, disposals and changes in use

When an item of property, plant and equipment is disposed of or permanently withdrawn from use, a gain or loss is recognised for the difference between any net proceeds received and the carrying amount of the asset. Any attributable revaluation surplus may be transferred to retained earnings, but is not recognised in profit or loss. [IAS 16.41, 71]

The consideration receivable on disposal of an item of property, plant and equipment is measured at its fair value (see forthcoming requirements). [IAS 16.72]

IFRS does not provide special requirements for the accounting for disposals if the purchaser is a thinly capitalised or highly leveraged entity. Accordingly, the general requirements described above apply unless the substance of the transaction indicates that a disposal has not occurred.

Assets that are rented out and subsequently sold on a routine basis are transferred to inventories at their carrying amount when they cease to be rented and become held-for-sale. Proceeds from the sale are recognised as revenue. [IAS 16.68A]

An entity continues to recognise depreciation even when an asset is idle, unless the asset is fully depreciated or is classified as held-for-sale (see chapter 5.4). [IAS 16.55]

Forthcoming requirements

Initial recognition

Amendments to the standard on property, plant and equipment as a result of the new revenue standard (see chapter 4.2A) are effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

Under the general requirements of the new revenue standard, if a customer contributes goods to facilitate an entity’s fulfilment of the contract, then the entity assesses whether it obtains control of the goods. If it does, then the entity measures the non-cash consideration at fair value if it can be reasonably estimated. [IFRS 15.66–69]

Retirements, disposals and changes in use

Like IFRS, when an item of property, plant and equipment is disposed of or permanently withdrawn from use, a gain or loss is recognised for the difference between any net proceeds received and the carrying amount of the asset. Unlike IFRS, the revaluation model is not permitted and therefore no revaluation surplus exists. [360-10-35-40]

Like IFRS, the consideration receivable on disposal of an item of property, plant and equipment is measured at its fair value (see forthcoming requirements). [310-10-30-5]

Unlike IFRS, gain recognition may not be appropriate for a transaction otherwise accounted for as a sale if the purchaser is a thinly capitalised or highly leveraged entity, particularly if its assets consist principally of those bought from the seller and the seller has provided financing or has other forms of continuing involvement. [605-40-599-1]

Unlike IFRS, US GAAP has no explicit guidance on accounting for assets that are rented out and subsequently sold on a routine basis, and practice may vary. Proceeds from the sale would be accounted for in a manner that is consistent with the accounting for the asset.

Like IFRS, an entity continues to recognise depreciation even when an asset is idle, unless the asset is fully depreciated or is classified as held-for-sale (see chapter 5.4). [360-10-35-49]

Forthcoming requirements

Initial recognition

There are no forthcoming requirements under US GAAP.

Unlike IFRS, US GAAP has no explicit general guidance on property, plant and equipment that is contributed by a customer. The entity would need to consider the ownership of the asset and the scope of the leasing Codification Topic (see chapter 5.1), and the related supply contract. In many cases, we would expect this analysis to result in a similar conclusion to IFRS and, if so, the cost of such property, plant and equipment would be determined with reference to its fair value on initial recognition, like IFRS. However, differences may arise in practice regarding either the determination of whether the entity has an asset or its initial measurement. [340-10-25-1 – 25-3, 340-10-55-2 – 55-5]
Amendments to the standard on property, plant and equipment as a result of the new leases standard (see chapter 5.1A) are effective for annual periods beginning on or after 1 January 2019; early adoption is permitted if the new revenue standard is applied as well.

Under the amendments, subject to the usual criteria being met (see above), the cost of an item of property plant and equipment may include costs incurred relating to leases of assets that are used to construct, add to, replace part of or service an item of property, plant and equipment (e.g. depreciation of right-of-use assets). [IAS 16.10]

There are no forthcoming requirements under US GAAP.

The accounting for costs incurred relating to leases of assets depends on the nature of the activity.

- **Construction**: Cost includes all expenditure (not necessarily external or incremental) that is directly attributable to bringing the asset to the location and condition necessary for its intended use, like IFRS.
- **Additions**: Expenditure incurred subsequent to initial recognition is capitalised when it is probable that future economic benefits associated with the item will flow to the entity, like IFRS.
- **Part replacements**: Component accounting is not required and replacement components may be recognised without derecognising the replaced component, which may result in differences from IFRS.
- **Servicing**: Expenditure associated with the day-to-day servicing of assets is expensed as it is incurred, like IFRS. [360-10-30-1, TPA 2210.15]

**Retirements, disposals and changes in use**

Amendments to the standard on property, plant and equipment as a result of the new revenue standard (see chapter 4.2A) are effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

Under consequential amendments made by the new revenue standard, the date of disposal of an item of property, plant and equipment is the date on which the recipient obtains control of the asset, as defined in the new revenue standard. The amount of consideration included in calculating the gain or loss on disposal is determined in accordance with the requirements for determining the transaction price under the new revenue standard. [IAS 16.69, 72]

Like IFRS, under consequential amendments made by new revenue Codification Topic, the date of disposal of a non-financial asset is the date on which the recipient obtains control of the asset, as defined in the new revenue Codification Topic. The amount of consideration included in calculating the gain or loss on disposal is determined in accordance with the requirements for determining the transaction price under the new revenue Codification Topic, like IFRS. However, when control of an asset transfers but the requirements for a contract are not met, the non-financial asset is not derecognised, unlike IFRS. Additionally, the new requirements apply to the transfer of an entity that is an in-substance non-financial asset, unlike IFRS. [610-20-40-1]
3.3 Intangible assets and goodwill

Overview

– An ‘intangible asset’ is an identifiable non-monetary asset without physical substance.

– An intangible asset is ‘identifiable’ if it is separable or arises from contractual or other legal rights.

– In general, intangible assets are recognised initially at cost.

– The initial measurement of an intangible asset depends on whether it has been acquired separately or as part of a business combination, or was internally generated.

– Goodwill is recognised only in a business combination and is measured as a residual.

– Acquired goodwill and other intangible assets with indefinite useful lives are not amortised, but instead are subject to impairment testing at least annually.

– Intangible assets with finite useful lives are amortised over their expected useful lives.

– Subsequent expenditure on an intangible asset is capitalised only if the definition of an intangible asset and the recognition criteria are met.

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Overview (continued)

- Intangible assets may be revalued to fair value only if there is an active market.

- Internal research expenditure is expensed as it is incurred. Internal development expenditure is capitalised if specific criteria are met. These capitalisation criteria are applied to all internally developed intangible assets.

- In-process research and development (R&D) acquired in a business combination is accounted for under specific guidance.

- Advertising and promotional expenditure is expensed as it is incurred.

- Expenditure related to the following is expensed as it is incurred: internally generated goodwill, customer lists, start-up costs, training costs, and relocation or reorganisation.

Definition

An ‘intangible asset’ is an identifiable non-monetary asset without physical substance. To meet the definition of an intangible asset, an item lacks physical substance and is:

- identifiable;
- non-monetary; and
- controlled by the entity and expected to provide future economic benefits to the entity – i.e. meets the definition of an asset. [IAS 38.8–17]

Overview (continued)

- Unlike IFRS, the revaluation of intangible assets is not permitted.

- Unlike IFRS, both internal research and development (R&D) expenditure is expensed as it is incurred. Special capitalisation criteria apply to software developed for internal use, software developed for sale to third parties and motion picture film costs, which differ from the general criteria under IFRS.

- In-process research and development (R&D) acquired in a business combination is accounted for under specific guidance, like IFRS. However, that guidance differs in some respects.

- Unlike IFRS, direct-response advertising expenditure is capitalised if certain criteria are met. Other advertising and promotional expenditure is expensed as it is incurred, like IFRS, or deferred until the advertisement is shown, unlike IFRS.

- Like IFRS, expenditure related to the following is expensed as it is incurred: internally generated goodwill, customer lists, start-up costs, training costs, and relocation or reorganisation.

Definition

Under US GAAP, an ‘intangible asset’ is an asset (not including a financial asset) that lacks physical substance. Although this definition differs from IFRS, we would not generally expect differences in practice. [350-10-20]
An intangible asset is ‘identifiable’ if it:
- is separable – i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged either individually or together with a related contract, asset or liability; or
- arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations. [IAS 38.12]

**Initial recognition and measurement**

An intangible asset is recognised when:
- it is probable that future economic benefits that are attributable to the asset will flow to the entity; and
- the cost of the asset can be measured reliably. [IAS 38.21]

If an intangible asset is acquired in a business combination, then these criteria are assumed to be met. If an intangible asset is acquired in a separate acquisition (i.e. outside a business combination), then the ‘probability’ criterion is assumed to be met and the ‘reliable measurement’ criterion is usually met. [IAS 38.25–26, 33]

An intangible asset is recognised initially at cost. [IAS 38.24]

The cost of an intangible asset acquired in a separate acquisition is the cash paid or the fair value of any other consideration given plus transaction costs. [IAS 38.8, 27]

If payment is deferred beyond normal credit terms, then the cost of the asset is the cash price equivalent. [IAS 38.32]

Like IFRS, an intangible asset is ‘identifiable’ if it:
- is separable – i.e. capable of being separated or divided and sold, transferred, licensed, rented or exchanged either individually or together with a related contract, asset or liability, regardless of whether there is an intent to do so; or
- arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations. [805-20-20, 25-10]

**Initial recognition and measurement**

An identifiable intangible asset is recognised when it is acquired either individually or with a group of other assets, unless another specific Codification topic applies (see below). Unlike IFRS, there are no general criteria that apply to all intangible assets. [350-30-25-1]

An intangible asset acquired in a business combination is recognised when it meets the contractual-legal criterion or the separability criterion. If an intangible asset is acquired in a separate acquisition (i.e. outside a business combination), then it is recognised regardless of the contractual-legal and separability criteria because there is a bargained exchange transaction that is conducted at arm’s length, which provides reliable evidence about the existence and fair value of the asset. Although the wording of US GAAP differs from IFRS, we would not expect differences in practice. [350-30-25-4]

US GAAP does not establish a general measurement attribute that intangible assets are recognised at cost; however, in general we would not expect differences in measurement from IFRS in practice. [805-50-30-1]

Like IFRS, the cost of an intangible asset acquired in a separate acquisition is the cash paid or the fair value of any other consideration given plus transactions costs. [805-50-30-1 – 30-2]

If payment is deferred and initial recognition is based on the fair value of consideration given, then the purchase price is measured as the present value of the future payments discounted using a market rate of interest (see chapter 7.5); however, we would not generally expect a difference from IFRS in practice.
The cost of an internally generated intangible asset includes the directly attributable expenditure of preparing the asset for its intended use. The principles discussed in respect of property, plant and equipment (see chapter 3.2) apply equally to the recognition of intangible assets. Expenditure on training activities, identified inefficiencies and initial operating losses is expensed as it is incurred. [IAS 38.27–30, 66–67]

The cost of an intangible asset acquired in a business combination is its fair value. [IFRS 3.18, IAS 38.33]

An intangible asset acquired for defensive purposes rather than for active use may also meet the above recognition criteria.

**Research and development**

‘Research’ is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding. ‘Development’ is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use. Development does not include the maintenance or enhancement of ongoing operations. [IAS 38.8]

Research costs are generally expensed as they are incurred. [IAS 38.54]

If an internally generated intangible asset arises from the development phase of a project, then directly attributable expenditure is capitalised from the date on which the entity is able to demonstrate:

– the technical feasibility of completing the intangible asset so that it will be available for use or sale;
– its intention to complete the intangible asset and use or sell it;
– its ability to use or sell the intangible asset;
– how the intangible asset will generate probable future economic benefits;
– the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
– its ability to measure reliably the expenditure attributable to the intangible asset during its development. [IAS 38.57]

Unlike IFRS, internally developed intangible assets are recognised only if a specific Codification subtopic requires their recognition – e.g. software developed for internal use, software developed for sale to third parties, and motion picture films. Such assets are initially recognised by accumulating costs incurred after the capitalisation criteria are met; however, the capitalisation criteria differ for each subtopic and they differ from IFRS (see below). Like IFRS, expenditure on training activities, clearly identified inefficiencies and initial operating losses is expensed as it is incurred. [340-20-25-4, 350-30-30-1, 350-40-25, 926-20-25]

Like IFRS, intangible assets acquired in a business combination are initially recognised at fair value. [805-20-30-1]

Like IFRS, an intangible asset acquired for defensive purposes rather than for active use may also meet the above recognition criteria. [350-30-35-5A, 35-14]

**Research and development**

‘Research’ is a planned search or critical investigation aimed at the discovery of new knowledge with the hope that such knowledge will be useful in developing a new product or service or a new process or technique or in bringing about a significant improvement to an existing product, service, process or technique. ‘Development’ is the translation of research findings or other knowledge into a plan or design for a new product, service, process or technique, whether intended for sale or for use. Because the precise language under US GAAP differs from IFRS, it is possible that differences may arise in practice. [730-10-20]

Like IFRS, research costs are generally expensed as they are incurred. [730-10-25-1]

Unlike IFRS, with the exception of certain internally developed computer software and direct-response advertising (see below), all other internally generated development costs are expensed as they are incurred. [340-20-30-2, 350-40-25, 730-10-25-1, 25-3]
In-process research and development (R&D) acquired in a business combination is recognised initially at fair value. Subsequent to initial recognition, the intangible asset is accounted for following the general principles outlined in this chapter. [IAS 38.33–34]

In-process R&D acquired in a separate acquisition is recognised and initially measured at cost. In-process R&D acquired with a group of assets that does not constitute a business is recognised and measured based on its relative fair value in relation to the cost of the group of assets as a whole. [IFRS 3.2(b), IAS 38.8, 24, 26]

Expenditure on internally generated intangible assets such as brands, mastheads, publishing titles, customer lists and similar items is not capitalised. [IAS 38.63]

There are no special requirements for R&D activities that are funded by other parties.

Like IFRS, in-process research and development (R&D) acquired in a business combination is recognised initially at fair value. Unlike IFRS, subsequent to initial recognition the intangible asset is classified as indefinite-lived (regardless of whether it has an alternative future use) until the completion or abandonment of the associated R&D efforts, and is subject to annual impairment testing during the period over which these assets are considered indefinite-lived. All costs incurred to complete the project are expensed as they are incurred, unlike IFRS. [350-30-35-17A, 805-20-30-1]

In-process R&D acquired in a separate acquisition or with a group of assets that does not constitute a business is recognised as an asset only if it has an alternative future use, in which case it is initially measured at cost or based on its relative fair value in relation to the cost of the group of assets as a whole, like IFRS. In-process R&D acquired outside a business combination that does not have an alternative future use is measured at cost or based on its relative fair value in relation to the cost of the group of assets as a whole, and expensed at the time of acquisition, unlike IFRS. [730-10-25-2(c)]

Like IFRS, expenditure on internally generated intangible assets such as brands, mastheads, publishing titles, customer lists and similar items is not capitalised. [350-20-25-3, 805-20-25-4]

Unlike IFRS, there are special requirements for arrangements under which the R&D activities of an entity are funded by other parties, which may give rise to differences in practice. The R&D costs are accounted for following the general principles outlined above (generally expensed as they are incurred). To the extent that the entity has an obligation to repay the funding party, regardless of the outcome of the R&D activities, it recognises a liability; a repayment obligation may be explicit or implicit. Factors that lead to a presumption that the entity doing the research will pay back the funding party include:

- an indicated intent to repay;
- severe economic consequences for non-payment;
- a significant related party relationship; or
- the project is essentially complete when the arrangement is entered into; the apparent absence of an ability to repay the funding party does not overcome this presumption. [730-10-25-1, 730-20-25]
Software developed for sale
There are no special requirements for software developed for sale. The costs of such software are accounted for following the general principles for internally generated intangible assets. [IAS 38.57]

Internal-use software
There are no special requirements for the development of internal-use software. The costs of such software are accounted for under the general principles for internally generated intangible assets or, in the case of purchased software, following the general requirements for intangible assets. [IAS 38.57]

Software developed for sale
Unlike IFRS, there are special requirements for software developed to be sold. The costs incurred internally in creating a computer software product to be sold, leased or otherwise marketed as a separate product or as part of a product or process are R&D costs that are expensed as they are incurred until technological feasibility has been established for the product. ‘Technological feasibility’ is established on completion of a detailed programme and product design or, in the absence of the former, completion of a working model whose consistency with the product design has been confirmed through testing. Thereafter, all software development costs incurred up to the point of general release of the product to customers are capitalised and reported subsequently at the lower of amortised cost and net realisable value. Although the technological feasibility capitalisation threshold is similar to the general recognition principles for internally generated intangible assets under IFRS, because the precise language under US GAAP differs from IFRS, differences may arise in practice. [985-20-25-1 – 25-3, 35-4]

Internal-use software
Unlike IFRS, there are special requirements for the development of internal-use software. The costs incurred for such software that is acquired, internally developed or modified solely to meet the entity’s internal needs are capitalised depending on the stage of development. The stages of software development are the preliminary project stage, application development stage and post-implementation/operation stage. Costs incurred during the preliminary project stage and the post-implementation/operation stage are expensed as they are incurred. [350-40-25-1 – 25-2, 25-6]

Costs incurred in the application development stage that are capitalised include only:
- the external direct costs of materials and services consumed in developing or obtaining internal-use software;
- payroll and payroll-related costs for employees who are directly associated with and who devote time to the internal-use software project; and
- interest (borrowing costs) incurred during development (see chapter 4.6). [350-40-30-1]

General administrative and overhead costs are expensed as they are incurred. [350-40-30-3]
Website development costs

Costs associated with websites developed for advertising or promotional purposes are expensed as they are incurred. In respect of other websites, costs incurred during the planning stage (pre-development) are expensed when they are incurred; costs incurred during the application and infrastructure development stage, the graphical design stage and the content development stage are capitalised if the criteria for capitalising development costs are met (see above). The costs of developing content for advertising or promotional purposes are expensed as they are incurred. [SIC-32.8–9]

Cloud computing

There is no specific guidance for cloud computing arrangements and the general principles for intangible assets apply (see above).

Goodwill

Goodwill arising in a business combination is capitalised (see chapter 2.6). [IFRS 3.32]

Goodwill may include an amount that is attributable to NCI if an entity elects to initially measure such interests at fair value (see chapter 2.6). [IFRS 3.19]

The application development stage, which is necessary to commence capitalising costs under US GAAP, will often occur sooner than the date on which the criteria for capitalising development costs under IFRS are met. Therefore, both the timing of commencing capitalisation and the amounts capitalised are likely to differ from IFRS.

Website development costs

Unlike IFRS, website development costs are subject to the same general capitalisation criteria as internal-use software, which differs from the general capitalisation criteria for internally developed intangible assets under IFRS. Therefore, costs incurred during the application development stage are capitalised. US GAAP provides detailed guidance on the activities that are deemed to be within the application development stage for website development. Unlike IFRS, US GAAP does not provide guidance on the accounting for the costs of developing content for websites, and therefore differences from IFRS may arise in practice. [350-40-15]

Cloud computing

Unlike IFRS, there are specific criteria for determining whether a cloud computing arrangement includes both a licence of software and services or just services.

- To the extent that the arrangement includes a licence of software, the customer capitalises the fee attributable to the licence when the criteria for the capitalisation of internal-use software are met (see above).
- To the extent that the arrangement does not include a licence of software, the customer accounts for the arrangement as a service contract and expenses the cost as the services are received. [350-40-15]

Goodwill

Like IFRS, goodwill arising in a business combination is capitalised (see chapter 2.6). [805-30-30-1]

Unlike IFRS, goodwill always includes an amount that is attributable to NCI because NCI are initially measured at fair value (see chapter 2.6). [805-20-30-1]
Items that are expensed as they are incurred
Expenditure associated with the following costs is expensed as it is incurred, regardless of whether the general criteria for asset recognition appear to be met:
– internally generated goodwill;
– start-up costs, unless they qualify for recognition as part of the cost of property, plant and equipment (see chapter 3.2);
– training activities;
– advertising and promotional activities (see below); and
– relocating or reorganising part or all of an entity. \([\text{IAS 38.48, 69}]\)

Expenditure on advertising and promotional activities is recognised as an expense when the benefit of those goods or services is available to the entity. This requirement does not prevent the recognition of an asset for prepaid expenses, but a prepayment is recognised only for payments made in advance of the receipt of the corresponding goods or services. \([\text{IAS 38.69–70}]\)

Customer acquisition costs
There is no specific guidance in IFRS on the accounting for customer acquisition costs, and practice may vary.

Direct-response advertising
There is no specific guidance in IFRS on the accounting for direct-response advertising, and costs are expensed as they are incurred. \([\text{IAS 38.69}]\)

Emissions allowances
There is no specific guidance in IFRS on the accounting for emissions allowances. In our view, emissions allowances received by a participant in a ‘cap-and-trade’ scheme, whether they are bought or issued by the government, are intangible assets and therefore the general principles in this chapter apply. For emissions allowances that are government grants, non-monetary government grants may be recognised either at fair value or at a nominal amount (see chapter 4.3).

Items that are expensed as they are incurred
Like IFRS, expenditure associated with the following costs is expensed as it is incurred, regardless of whether the general criteria for asset recognition appear to be met:
– internally generated goodwill;
– start-up costs, unless they qualify for recognition as part of the cost of property, plant and equipment (see chapter 3.2);
– training activities; and

Unlike IFRS, direct-response advertising expenditure is capitalised if certain criteria are met (see below). Advertising production costs may be expensed as they are incurred or capitalised until the first time that the advertisement is shown, at which time the amount is expensed, unlike IFRS; other advertising and promotional activities are expensed as they are incurred, like IFRS. \([\text{720-35-25-1}]\)

Customer acquisition costs
Like IFRS, US GAAP generally does not have guidance on the accounting for customer acquisition costs other than in certain industries and certain transactions – e.g. deferred acquisition costs incurred by insurance companies, and initial direct costs in leasing transactions. Practice under US GAAP is to permit a policy election to capitalise the costs subject to a recoverability assessment, or to expense the costs as they are incurred. \([\text{605-10-599-1(f), 944-30-25-2, 49-2}]\)

Direct-response advertising
Unlike IFRS, the cost of direct-response advertising is capitalised if the following criteria are met:
– the primary purpose is to elicit sales from customers who can be shown to have responded specifically to that advertising; and
– there is persuasive evidence, including historical patterns, that the advertising will result in probable future economic benefits. \([\text{340-20-25-4}]\)

Emissions allowances
There is no specific guidance in US GAAP on the accounting for emissions allowances and practice varies, so differences from IFRS may arise in practice.
Amortisation

Acquired goodwill is not amortised, but instead is subject to impairment testing at least annually (see chapter 3.10). [IAS 36.10]

The useful life of intangible assets other than goodwill is either finite or indefinite. Intangible assets with indefinite useful lives are not amortised, but instead are subject to impairment testing at least annually (see chapter 3.10). [IAS 36.10, 38.89, 107–110]

An intangible asset has an ‘indefinite’ useful life if, based on an analysis of all relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity. [IAS 38.88–90]

An intangible asset with a finite life is amortised on a systematic basis over its useful life. [IAS 38.97]

There is no specific guidance on the amortisation of defensive intangible assets (see above) and the general principles apply. Accordingly, such assets are not written off immediately but are amortised over their useful lives and tested for impairment within the relevant cash-generating unit (see chapter 3.10).

A change in useful life is accounted for prospectively as a change in accounting estimate (see chapter 2.8). The amortisable amount of an intangible asset with a finite useful life is determined after deducting its residual value. The residual value of an intangible asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were of the age and in the condition expected at the end of its useful life. [IAS 38.8, 101, 104]

The residual value of an intangible asset with a finite useful life is assumed to be zero unless a third party has committed to buy the asset at the end of its useful life or there is an active market from which a residual value can be obtained and it is probable that such a market will exist at the end of the asset’s useful life. [IAS 38.100]

Amortisation

Like IFRS, acquired goodwill is not amortised, but instead is subject to impairment testing at least annually; the method of impairment testing differs in certain respects from IFRS (see chapter 3.10). [350-20-35-3]

Like IFRS, the useful life of intangible assets other than goodwill is either finite or indefinite. Like IFRS, intangible assets with indefinite useful lives are not amortised, but instead are subject to impairment testing at least annually; the method of impairment testing differs in certain respects from IFRS (see chapter 3.10). [350-30-35-1]

Like IFRS, an intangible asset has an ‘indefinite’ useful life if, based on an analysis of all relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity. However, because the specific criteria for considering whether an intangible asset is indefinite-lived under IFRS and US GAAP differ (see below), differences may arise in practice. [350-30-35-4]

Like IFRS, an intangible asset with a finite life is amortised on a systematic basis over its useful life. However, in some situations US GAAP specifies the amortisation method (e.g. proportionate to revenues), unlike IFRS. [350-30-35-6]

Defensive intangible assets are not written off immediately but are amortised over their useful lives, which is the period over which the assets contribute directly or indirectly to the entity’s cash flows, and tested for impairment within the asset group – e.g. the entity’s other assets supported by the defensive intangible assets. Because IFRS has no explicit guidance on the accounting for defensive intangible assets, differences may arise in practice. [350-30-35-5A, 35-14]

Like IFRS, a change in useful life is accounted for prospectively as a change in accounting estimate (see chapter 2.8). Like IFRS, the amortisable amount of an intangible asset with a finite useful life is determined after deducting its residual value. Residual value is the estimated fair value of an intangible asset at the end of its useful life to an entity, less any disposal costs; although this wording differs from IFRS, we would not generally expect differences in practice. [350-30-35-9 – 35-10, 35-13, 35-17]

Like IFRS, the residual value of an intangible asset with a finite useful life is assumed to be zero unless a third party has committed to buy the asset at the end of its useful life or there is an exchange transaction in an existing market and that market is expected to exist at the end of the asset’s useful life. [350-30-35-8]
The residual value of an intangible asset is reviewed at least at each annual reporting date. A change in the asset’s residual value is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [IAS 38.102]

If control of an intangible asset is based on legal rights that have been granted for a finite period, then the useful life cannot exceed that period unless:

– the legal rights are renewable;
– there is evidence to support the conclusion that they will be renewed; and
– the cost of renewal of such rights is not significant. [IAS 38.94–96]

There is no further guidance in IFRS on determining the useful life of an intangible asset.

An entity reviews the classification in each annual reporting period to decide whether the assessment made about the useful life of an intangible asset as indefinite or finite is still appropriate. Any such change is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [IAS 38.109]

The method of amortisation, which is reviewed at each annual reporting date, reflects the pattern of consumption of the economic benefits. If the pattern in which the asset’s economic benefits are consumed cannot be determined reliably, then the straight-line method is used. [IAS 38.97, 104]

Like IFRS, the residual value of an intangible asset is reviewed at least at each annual reporting date. Like IFRS, a change in the asset’s residual value is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [350-30-35-8 – 35-9]

The useful life of an intangible asset is based on an analysis of all relevant factors, including:

– whether the legal rights are renewable;
– the expected use of the asset by the entity;
– the expected useful life of another asset or group of assets to which the intangible asset may relate;
– legal, regulatory or contractual requirements that may limit the life;
– the entity’s own historical experience in renewing or extending similar arrangements, consistent with the intended use of the asset by the entity, regardless of whether those arrangements have explicit renewal or extension terms. In the absence of historical experience, the entity considers the assumptions that market participants would use about renewal or extension terms, consistent with the highest and best use of the asset by market participants, adjusted for entity-specific factors;
– the effects of obsolescence, demand, competition or other economic factors; and
– the level of maintenance expenditure required to obtain the expected future cash flows from the asset. [350-30-35-3]

These factors, although they are consistent with the requirements of IFRS, are more detailed and therefore differences may arise in practice.

Like IFRS, an entity reviews the classification in each annual reporting period to decide whether the assessment made about the useful life of an intangible asset as indefinite or finite is still appropriate. If there is a change in the assessment of the useful life of an intangible asset from indefinite to finite or vice versa, then that change is accounted for prospectively as a change in accounting estimate, like IFRS (see chapter 2.8). [350-30-35-9 – 35-10, 35-13, 35-16 – 35-17]

Unlike IFRS, there is no requirement to review the method of amortisation at each annual reporting date; rather, it is reviewed whenever events or changes in circumstances indicate that the current estimate is no longer appropriate. Like IFRS, the method of amortisation reflects the pattern of consumption of the economic benefits. Like IFRS, if that pattern cannot be determined reliably, then the straight-line method is used. [350-30-35-6, 35-9]
An entity is permitted to use a revenue-based method of amortisation only when:
- it can demonstrate that revenue and the consumption of the economic benefits of the intangible asset are ‘highly correlated’; or
- the intangible asset is expressed as a measure of revenue. [IAS 38.98A, 98C]

The ‘highly correlated’ test is a high threshold to be met before applying such an approach. In our view, an entity cannot simply assume that the consumption of economic benefits is based on revenue; it should be able to demonstrate the high correlation.

A change in the method of amortisation is accounted for prospectively as a change in accounting estimate (see chapter 2.8). There is no explicit requirement for the change in estimate to be justified by its preferability in the same way as a voluntary change in accounting policy. [IAS 38.104]

The amortisation of intangible assets with finite lives begins when the intangible asset is available for use – i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management – which may be before the asset is brought into use. [IAS 38.97]

Amortisation ceases at the earlier of the date when the asset is classified as held-for-sale (see chapter 5.4) or is derecognised. [IAS 38.97]

Expenditure related to direct-response advertising is expensed as it is incurred (see above). [IAS 38.69]

Unlike IFRS, US GAAP does not place explicit restrictions on a revenue-based method of amortisation; however, in practice such an approach is generally not appropriate because it would not reflect the pattern of consumption of the economic benefits. As an exception, for software developed with an intent to sell or license, amortisation on the basis of revenues is used such that the annual amortisation charge is the greater of the amounts determined on the following bases:
- the ratio that current gross revenue for a product bears to the total current and anticipated future gross revenues for that product; and
- straight-line amortisation over the remaining estimated economic life of the product, including the current period. [350-30-35-6, 985-20-35-1]

Like IFRS, a change in the method of amortisation is accounted for prospectively as a change in accounting estimate. However, unlike IFRS, there is an explicit requirement that the change be justified by its ‘preferability’ (see chapter 2.8). [250-10-45-18]

Like IFRS, the amortisation of intangible assets with finite lives begins when the intangible asset is available for use, which may be before the asset is brought into use. [350-30-35-2]

Like IFRS, amortisation ceases at the earlier of the date when the asset is classified as held-for-sale (see chapter 5.4) or is derecognised. [350-30-35-6, 35-9]

Unlike IFRS, direct-response advertising cost may be capitalised when specific criteria are met (see above). The capitalised cost of direct-response advertising is amortised using the ratio of current period revenues that relate to the direct-response advertising cost pool to the total of current and estimated future period revenues for that cost pool. The estimated future revenue for that cost pool may increase or decrease over time, and the ratio is recalculated at each reporting date. [340-20-35-2 – 35-3]

Subsequent expenditure

Subsequent expenditure to add to, replace part of or service an intangible asset is recognised as part of the cost of the intangible asset if an entity can demonstrate that the items meet:
- the definition of an intangible asset (see above); and
- the general recognition criteria for intangible assets (see above). [IAS 38.18]

Under US GAAP, expenditure that is incurred subsequent to the completion or acquisition of an intangible asset is not capitalised unless it can be demonstrated that the expenditure increases the utility of the asset. Although this wording differs from IFRS, we would not generally expect differences in practice. [350-30-25-1 – 25-3, TPA 2260.03]
The general recognition criteria for internally generated intangible assets are applied to subsequent expenditure on in-process R&D projects acquired separately or in a business combination. Therefore, capitalisation after initial recognition is limited to development costs that meet the recognition criteria (see above). [IAS 38.42, 54–62]

**Revaluations**

Intangible assets may be revalued to fair value only when there is an active market, which requires a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis (see chapter 2.4). [IAS 38.75]

If an intangible asset is revalued, then fair value is measured in accordance with the standard on fair value measurement (see chapter 2.4).

If an intangible asset is revalued, then all intangible assets in that class are revalued to the extent that there is an active market for such assets, and the revaluations are kept up to date. [IAS 38.72]

Most of the issues related to the accounting for revaluations of intangible assets are similar to those in respect of property, plant and equipment (see chapter 3.2). [IAS 8.16–17, 38.80, 87]

**Retirements and disposals**

When an operation to which goodwill relates is disposed of, goodwill allocated to that operation via cash-generating units is included in calculating the gain or loss on disposal. [IAS 36.86]

The amount of goodwill included in the carrying amount of the operation being disposed of is based on the relative values of the operation to be disposed of and the portion of the cash-generating unit that will be retained, unless the entity can demonstrate that another allocation method is preferable. [IAS 36.86]

Unlike IFRS, subsequent in-process R&D expenditure is generally expensed as incurred unless it qualifies for capitalisation under transaction-specific guidance such as for internal-use software (see above). [350-40-35-1, 35-9]

**Revaluations**

Unlike IFRS, entities are not permitted to use the revaluation model under US GAAP. [ARB 43, Ch 98.1]

**Retirements and disposals**

Like IFRS, when a portion of a reporting unit is disposed of, goodwill of that reporting unit is included in the carrying amount of the portion of the reporting unit in calculating the gain or loss on disposal. However, unlike IFRS, this requirement applies only if the reporting unit meets the definition of a business (see chapter 2.6), and differences may arise between a reporting unit and a cash-generating unit under IFRS (see chapter 3.10). [350-20-40-1 – 40-2]

The amount of goodwill included in the carrying amount of the operation being disposed of is based on the relative fair value of the business to be disposed of and the portion of the reporting unit that will be retained, unless, unlike IFRS, a prior acquisition has not yet been integrated into the reporting unit. If the operation being disposed of does not constitute a business, then goodwill is not included in the carrying amount of the operation being disposed of, unlike IFRS. Additionally, differences may arise because of a difference between a reporting unit under US GAAP and a cash-generating unit under IFRS (see chapter 3.10). [350-20-40-1 – 40-7]
When an intangible asset is disposed of or when no further economic benefits are expected from its use, the gain or loss is the difference between any net proceeds received and the carrying amount of the asset. Any attributable revaluation surplus may be transferred to retained earnings, but is not recognised in profit or loss. [IAS 38.87, 112–113]

If an entity recognises the cost of replacing part of an intangible asset, then it derecognises the carrying amount of the replaced part. [IAS 38.115]

The consideration that is receivable on disposal of an intangible asset is measured at its fair value (see forthcoming requirements). [IAS 38.116]

Amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully amortised or is classified as held-for-sale (see chapter 5.4). [IAS 38.117]

**Forthcoming requirements**

**Retirements and disposals**

Amendments to the standard on intangible assets as a result of the new revenue standard (see chapter 4.2A) are effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

Under consequential amendments made by the new revenue standard, the date of disposal of an intangible asset is the date on which the recipient obtains control of the asset, as defined in the new revenue standard. The amount of consideration included in calculating the gain or loss on disposal is determined in accordance with the requirements for determining the transaction price under the new revenue standard. [IAS 38.114, 116]

Like IFRS, when an intangible asset is disposed of or when no further economic benefits are expected from its use, the gain or loss is the difference between any net proceeds received and the carrying amount of the asset. Unlike IFRS, the revaluation model is not permitted and therefore no revaluation surplus arises. [380-10-40-5]

Unlike IFRS, component accounting is not required under US GAAP; therefore, it is possible for a replacement part to be capitalised without derecognising the part replaced, so differences from IFRS may arise in practice.

Like IFRS, the consideration that is receivable on disposal of an intangible asset is measured at its fair value (see forthcoming requirements). [845-10-30-1]

Like IFRS, amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully amortised or is classified as held-for-sale (see chapter 5.4). [350-30-35-10]

**Forthcoming requirements**

**Retirements and disposals**

Amendments to the requirements on the disposal of non-financial assets are effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted at the same time as the new revenue standard (see chapter 4.2A), but not before annual periods beginning after 15 December 2016. [ASU 2017-05]

Like IFRS, under consequential amendments made by the new revenue Codification Topic, the date of disposal of a non-financial asset is the date on which the recipient obtains control of the asset, as defined in the new revenue Codification Topic. The amount of consideration included in calculating the gain or loss on disposal is determined in accordance with the requirements for determining the transaction price under the new revenue Codification Topic, like IFRS. However, when control of an asset transfers but the requirements for a contract are not met, the non-financial asset is not derecognised, unlike IFRS. Additionally, the new requirements apply to the transfer of an entity that is an in-substance non-financial asset, unlike IFRS. [610-20-40-1]
Overview

- ‘Investment property’ is property (land or building) held to earn rentals or for capital appreciation, or both.

- Property held by a lessee under an operating lease may be classified as investment property if the rest of the definition of investment property is met and the lessee measures all of its investment property at fair value (see forthcoming requirements).

- A portion of a dual-use property is classified as investment property only if the portion could be sold or leased out under a finance lease. Otherwise, the entire property is classified as property, plant and equipment, unless the portion of the property used for own use is insignificant.

- If a lessor provides ancillary services, and such services are a relatively insignificant component of the arrangement as a whole, then the property is classified as investment property.

- Investment property is initially measured at cost.

- Subsequent to initial recognition, all investment property is measured under either the fair value model (subject to limited exceptions) or the cost model. If the fair value model is chosen, then changes in fair value are recognised in profit or loss.

- Disclosure of the fair value of all investment property is required, regardless of the measurement model used.

- Subsequent expenditure is capitalised only if it is probable that it will give rise to future economic benefits.

- Unlike IFRS, there is no specific definition of ‘investment property’; such property is accounted for as property, plant and equipment unless it meets the criteria to be classified as held-for-sale.

- Unlike IFRS, property held by a lessee under an operating lease cannot be recognised in the statement of financial position.

- Unlike IFRS, there is no guidance on how to classify dual-use property. Instead, the entire property is accounted for as property, plant and equipment.

- Unlike IFRS, ancillary services provided by a lessor do not affect the treatment of a property as property, plant and equipment.

- Like IFRS, investment property is initially measured at cost as property, plant and equipment.

- Unlike IFRS, subsequent to initial recognition all investment property is measured using the cost model as property, plant and equipment.

- Unlike IFRS, there is no requirement to disclose the fair value of investment property.

- Similar to IFRS, subsequent expenditure is generally capitalised if it is probable that it will give rise to future economic benefits.
Overview (continued)

- Transfers to or from investment property can be made only when there has been a change in the use of the property (see forthcoming requirements).

Definition and classification

The investment property standard is not a specialised industry standard. Therefore, determining whether a property is an investment property depends on the use of the property rather than the type of entity that holds the property. ‘Investment property’ is property that is held to earn rental income or for capital appreciation, or both, rather than for:
- use in the production or supply of goods or services or for administrative purposes; or
- sale in the ordinary course of business. [IAS 40.2, 5]

In determining the classification of a property in consolidated financial statements, the definition is assessed from the point of view of the group as a single reporting entity. [IAS 40.15]

Property held under an operating lease may be classified as investment property if the rest of the definition of investment property is met and the entity measures all of its investment property at fair value (see below). This election is available on a property-by-property basis. In such cases, the lessee accounts for the lease as if it were a finance lease (see chapter 5.1). See forthcoming requirements. [IAS 40.6]

Property often has dual purposes whereby part of the property is used for own-use activities, which would result in the property being considered property, plant and equipment (see chapter 3.2), and part of the property is used as investment property. A portion of a dual-use property is classified as an investment property only if the portion could be sold or leased out separately under a finance lease. If this is not the case, then the entire property is classified as property, plant and equipment unless only an ‘insignificant’ portion is held for own use. [IAS 40.10]

Overview (continued)

- Unlike IFRS, investment property is accounted for as property, plant and equipment, and there are no transfers to or from an ‘investment property’ category.

Definition and classification

Unlike IFRS, there is no specific guidance under US GAAP on accounting for investment property. Real estate (property) that meets the IFRS definition of investment property is accounted for as:
- property, plant and equipment if it is to be held and used (see chapter 3.2); or
- held-for-sale if the criteria are met (see chapter 5.4).

Special requirements exist for investment companies, which are outside the scope of this publication except in relation to consolidation (see chapter 5.6). Investments in real estate held by entities that follow specialised industry accounting practices for investment companies are measured at fair value through profit or loss.

The discussion that follows assumes that the property is accounted for as property, plant and equipment.

Unlike IFRS, there is no guidance on the classification of investment property from an entity vs a group point of view. However, this is less relevant because the property is accounted for as property, plant and equipment (see chapter 3.2).

Unlike IFRS, property held by a lessee under an operating lease is not classified as investment property; rather, it is accounted for as an operating lease and is not recognised in the statement of financial position (see chapter 5.1).

Unlike IFRS, because there is no concept of investment property, the whole property is accounted for as property, plant and equipment.
If the owner of a property provides ancillary services to tenants, then determining whether the property is investment property is based on whether the services provided are a ‘relatively insignificant component of the arrangement as a whole’. Judgement is required in assessing whether the definition of investment property is met and requires an entity to develop criteria that are consistently applied in making that assessment. [IAS 40.11–13]

Property under development or construction for future use as investment property is accounted for under the requirements of the investment property standard, using the measurement model elected for investment property. [IAS 40.8(e), 65]

If land is held for an undetermined future use, then it is classified as investment property because it is considered to be held for capital appreciation. [IAS 40.8(b)]

Unlike IFRS, all investment property is accounted for as property, plant and equipment (see chapter 3.2), regardless of whether it is held for an undetermined future use.

Initial measurement

Investment property is initially measured at cost unless it is:

- transferred from another category in the statement of financial position (see below);
- received as a government grant (see chapter 4.3);
- acquired in a share-based payment arrangement granted by the acquiring entity (see chapter 4.5); or
- acquired in a business combination (see chapter 2.6). [IAS 40.14A, 20]

The cost of investment property includes the directly attributable expenditure of preparing the asset for its intended use. The principles discussed in respect of property, plant and equipment (see chapter 3.2) apply equally to the initial recognition of investment property. [IAS 40.20–23]

If a property interest held by a lessee under an operating lease is classified as investment property, then cost is determined with reference to the amounts initially recognised for the asset and lease liability in accordance with the requirements for finance leases (see chapter 5.1). See forthcoming requirements. [IAS 40.25]

Unlike IFRS, an analysis of ancillary services is not relevant to the identification of investment property because such property is accounted for as property, plant and equipment. However, the owner of a property that provides ancillary services would identify the nature of the services and determine whether they should be accounted for separately. [805-25-25-2]

Unlike IFRS, all investment property is accounted for as property, plant and equipment (see chapter 3.2), regardless of the stage of completion.

Initial measurement

Like IFRS, investment property is initially measured at cost as property, plant and equipment. Unlike IFRS, the treatment of transfers to or from the investment property category is not relevant. [360-10-30-1]

Like IFRS, the cost of investment property includes the directly attributable expenditure of preparing the asset for its intended use. Because investment property is accounted for as property, plant and equipment under US GAAP, the principles discussed in respect of attributing cost to property, plant and equipment also apply to the cost of investment property; however, the determination of cost differs in certain respects from IFRS (see chapter 3.2). [360-10-30-1 – 30-2]

Unlike IFRS, property held by a lessee under an operating lease is not recognised in the statement of financial position; instead, it is accounted for as an operating lease (see chapter 5.1). [840-10-25-1]
Subsequent measurement

Subsequent to initial recognition, an entity chooses an accounting policy, to be applied consistently, either to:

- measure all investment property using the fair value model, subject to limited exceptions; or
- measure all investment property using the cost model. [IAS 40.30, 32A]

The investment property standard implies a preference for measuring investment property at fair value, noting that it would be very difficult to justify a voluntary change in accounting policy from the fair value model to the cost model (see chapter 2.8). In our view, a change in accounting policy from the fair value model to the cost model attributed solely to changes in market conditions is not justifiable. [IAS 40.31]

Disclosure of the fair value of investment property is required regardless of the basis of measurement. [IAS 40.79(e)]

Fair value model

If an entity chooses to measure investment property using the fair value model, then it measures the property at fair value at each reporting date, with changes in fair value recognised in profit or loss. [IAS 40.33–35]

In exceptional cases, there will be clear evidence on initial recognition of a particular investment property that its fair value cannot be measured reliably on a continuing basis. In such cases, the property in question is measured using the cost model as if it were property, plant and equipment, except that the residual value is deemed to be zero in all cases. [IAS 40.53]

However, if the fair value of an investment property under construction cannot be determined reliably but the entity expects the fair value of the completed property to be reliably measurable, then the investment property under construction is accounted for using the cost model until the earlier of the date that the fair value of the property can be measured reliably and the date that the construction is completed. [IAS 40.53–53B]

Subsequent measurement

Unlike IFRS, investment property is accounted for using the principles for property, plant and equipment. Accordingly, all investment property is measured using the cost model.

Unlike IFRS, there is no requirement to disclose the fair value of investment property.

Fair value model

Unlike IFRS, entities are not permitted to measure property, plant and equipment at fair value under US GAAP. [ARB 43, Ch 9B.1]
Cost model

If an entity chooses to measure investment property using the cost model, then it accounts for the property using the cost model for property, plant and equipment – i.e. at cost less accumulated depreciation (see chapter 3.2) and less any accumulated impairment losses (see chapter 3.10). However, the property continues to be classified as investment property in the statement of financial position. [IAS 40.56]

Subsequent expenditure

Expenditure incurred subsequent to the completion or acquisition of an investment property is capitalised only if it meets the general asset recognition criteria – i.e. it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably. Parts of investment property acquired through replacement are capitalised and included in the carrying amount of the property if the general asset recognition criteria are met; the carrying amount of the part replaced is derecognised. Expenditure related to the day-to-day servicing of the property is expensed as it is incurred. [IAS 40.16–19]

Transfers to or from investment property

Timing of transfers

Although an entity's business model plays a key role in the initial classification of property, the subsequent reclassification of property is based on an actual change in use rather than on changes in an entity’s intentions. See forthcoming requirements. [IAS 40.57–58]

To reclassify inventories to investment property, the change in use is generally evidenced by the commencement of an operating lease to another party. [IAS 40.57(c)]

In some cases, a property (or a part of a property) classified as inventory is leased out temporarily while the entity searches for a buyer. In our view, the commencement of such an operating lease, by itself, does not require the entity to transfer the property to investment property provided that the property continues to be held for sale in the ordinary course of business.

Cost model

Unlike IFRS, a cost model is used for all investment property. Like IFRS, the cost model used is the one used for other property, plant and equipment, with assets measured at cost less accumulated depreciation (see chapter 3.2) and less any accumulated impairment losses (see chapter 3.10). However, there are certain differences in the application of the cost model (see chapter 3.2) and impairment testing (see chapter 3.10), and therefore differences from IFRS may arise in practice. [360-10-35-20]

Subsequent expenditure

Like IFRS, expenditure incurred subsequent to the completion or acquisition of an investment property is generally capitalised if it meets the general asset recognition criteria – i.e. it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably. However, because US GAAP does not include a requirement for component depreciation of property, plant and equipment and permits the costs of planned major maintenance to be expensed as they are incurred, parts of investment property acquired through replacement may not necessarily be capitalised and included in the carrying amount of the property if the general asset recognition criteria are met. In addition, if they are, the carrying amount of the part replaced is not necessarily derecognised, unlike IFRS (see chapter 3.2). Expenditure related to the day-to-day servicing of the property is expensed as it is incurred, like IFRS. [970-34-25-17]

Transfers to or from investment property

Timing of transfers

Unlike IFRS, investment property is accounted for as property, plant and equipment and, accordingly, there are no transfers to or from the ‘investment property’ category. However, property, including investment property, is transferred between the held-and-used and the held-for-sale classifications under US GAAP when the relevant criteria are met (see chapter 5.4). [360-10-45-6, 45-10]
An entity may no longer have the intention or the ability to develop property classified as inventory for sale in the ordinary course of business as originally planned due to fluctuations in property and capital markets. Depending on the facts and circumstances, it may be appropriate to reclassify a property originally classified as inventory to investment property if there is a change in the business model of the entity or a change in the use of the property.

A reclassification of an investment property to inventory or property, plant and equipment is performed only if an entity’s use of the property has changed. In our view, the commencement of construction for sale or own use would usually mean that the property is no longer available for rent to third parties. Therefore, a change in use occurs on commencement of redevelopment and reclassification is appropriate at that point. [IAS 40.57]

Measurement of transfers

If an entity chooses to measure investment property using the cost model, then transfers to and from investment property do not alter the carrying amount of the property. Revaluations recognised for property, plant and equipment measured at fair value (see chapter 3.2) are not reversed when the property is transferred to investment property. [IAS 40.59]

If an entity chooses to measure investment property using the fair value model, then investment property transferred from another category in the statement of financial position is recognised at fair value on transfer. The treatment of the gain or loss on revaluation at the date of transfer depends on whether the property was previously held for own use. [IAS 40.61–65]

If the property was previously held for own use, then it is accounted for as property, plant and equipment up to the date of the change in use. Any difference at the date of the change in use between the carrying amount of the property and its fair value is recognised as a revaluation of property, plant and equipment (see chapter 3.2). [IAS 40.61]

If the property is inventory that is being transferred to investment property, then the gain or loss on revaluation, based on the asset’s carrying amount at the date of transfer, is recognised in profit or loss. [IAS 40.63–64]
When a property is transferred from investment property measured at fair value (whether to own-use properties or to inventories), the transfer is accounted for at fair value. The fair value at the date of transfer is then deemed to be the property’s cost for subsequent accounting. Any difference between the carrying amount of the property before transfer and its fair value on the date of transfer is recognised in profit or loss in the same way as any other change in the fair value of investment property. [IAS 40.60]

**Redevelopment**

When an entity redevelops an existing investment property, the property is not transferred out of investment property during redevelopment. This means that an investment property undergoing redevelopment continues to be measured under the cost model or at fair value (depending on the entity’s accounting policy). [IAS 40.58]

**Disposals**

The gain or loss on the disposal of investment property is measured as the difference between the net disposal proceeds and the carrying amount of the property, unless the transaction is a sale and leaseback (see chapter 5.1). See forthcoming requirements. [IAS 40.69]

When payment is deferred, the selling price of the investment property is the cash price equivalent for the property. [IAS 40.70]

**Forthcoming requirements**

**Definition and classification**

Amendments to the standard on investment property as a result of the new leases standard (see chapter 5.1A) are effective for annual periods beginning on or after 1 January 2019; early adoption is permitted if the new revenue standard is also adopted.

**Redevelopment**

Unlike IFRS, the issue of the redevelopment of investment property is not applicable because investment property is accounted for under the general principles for property, plant and equipment (see chapter 3.2).

**Disposals**

Like IFRS, the gain or loss on the disposal of investment property is generally measured as the difference between the net disposal proceeds and the carrying amount of the property. However, gain recognition may be deferred, limited or adjusted based on the specific facts of the disposal transaction. Such situations typically arise in sales that involve leasebacks (see chapter 5.1), if the seller retains an equity interest or provides guarantees and other forms of post-sale continuing involvement with the property, or the arrangement contains a put or call on the property. There is more specific guidance for these situations under US GAAP, including more explicit requirements for deferral; therefore, differences from IFRS may arise in practice. [360-10-35-38, 35-40, 40-5]

There is no specific guidance on payment deferral in respect of investment property. Under US GAAP, the sales value for all disposals is determined with reference to the stated sales price less a discount to reduce any receivables to their net present value. Certain other adjustments to the sales value may also be appropriate, such as amounts held in escrow and amounts attributable to future service arrangements. Because deferred payment may constitute a form of continuing involvement, this may result in a deferral of the recognition of the sale, depending on the form and terms of the deferred payment. [360-10-35-38, 35-40]

**Forthcoming requirements**

**Definition and classification**

There are no forthcoming requirements under US GAAP.
A lessee applies the standard on investment property to account for a right-of-use asset if the underlying asset would otherwise meet the definition of investment property. Therefore, in contrast to the current option for property held under operating leases (see above), all leasehold property will be treated as investment property if the definition is met. An entity applies its chosen valuation model (cost or fair value) to all its investment property, whether leased or owned. [IAS 40.2, 5, IFRS 16.48, 56]

Recognition
Under the new leases standard, an investment property held by a lessee as a right-of-use asset is recognised in accordance with this new leases standard. [IAS 40.19A, IFRS 16.22, 48]

Measurement
Under the new leases standard, an investment property held by a lessee as a right-of-use asset is measured initially at its cost in accordance with the new leases standard (see chapter 5.1A). [IAS 40.29A, IFRS 16.23–25]

If a lessee uses the fair value model for subsequent measurement of investment property, then it measures the right-of-use asset and not the underlying property at fair value. [IAS 40.40A, IFRS 16.34]

If a lessee uses the cost model for subsequent measurement of investment property, then it measures a right-of-use asset that is investment property and not held for sale in accordance with the new leases standard after initial recognition. [IAS 40.56(b), IFRS 16.30–33]

Transfers to or from investment property
Amendments to the standard on investment property are effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

A transfer to or from investment property is made when and only when property meets or ceases to meet the definition of investment property and there is evidence of the change in use. A change in management’s intention alone does not provide such evidence. [IAS 40.57–58]

Unlike IFRS, there is no specific guidance under US GAAP on accounting for investment property and the leases Codification Topic will be applicable.

Recognition
Unlike IFRS, there is no specific guidance under US GAAP on accounting for investment property and the leases Codification Topic will be applicable.

Measurement
Unlike IFRS, there is no specific guidance under US GAAP on accounting for investment property and the leases Codification Topic will apply.

Transfers to or from investment property
There are no forthcoming requirements under US GAAP.

Unlike IFRS, investment property is accounted for as property, plant and equipment and, accordingly, there are no transfers to or from the ‘investment property’ category. However, property, including investment property, is transferred between the held-and-used and the held-for-sale classifications under US GAAP when the relevant criteria are met (see chapter 5.4). [360-10-45-6, 45-10]
Disposals

Amendments to the standard on investment property as a result of the new revenue standard (see chapter 4.2A) are effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

Under consequential amendments made by the new revenue standard, the date of disposal of investment property is the date on which the recipient obtains control of the property, as defined in the new revenue standard. The amount of consideration included in calculating the gain or loss arising on disposal is determined in accordance with the requirements for determining the transaction price under the new revenue standard. [IAS 40.67, 70]

Disposals

Amendments to the requirements on the disposal of non-financial assets are effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted at the same time as the new revenue standard (see chapter 4.2A), but not before annual periods beginning after 15 December 2016. [ASU 2017-05]

Like IFRS, under consequential amendments made by the new revenue Codification Topic, the date of disposal of a non-financial asset is the date on which the recipient obtains control of the asset, as defined in the new revenue Codification Topic. The amount of consideration included in calculating the gain or loss on disposal is determined in accordance with the requirements for determining the transaction price under the new revenue Codification Topic, like IFRS. However, when control of an asset transfers but the requirements for a contract are not met, the non-financial asset is not derecognised, unlike IFRS. Additionally, the new requirements apply to the transfer of an entity that is an in-substance non-financial asset, unlike IFRS. [610-20-40-1]
3.5 Associates and the equity method  

Overview

- The definition of an associate is based on 'significant influence', which is the power to participate in the financial and operating policies of an entity, but is not control or joint control of those policies.

- There is a rebuttable presumption of significant influence if an entity holds 20 percent or more of the voting rights of another entity in which it does not have control.

- In determining applicability of the equity method, there are no special requirements for partnerships and similar entities.

- Potential voting rights that are currently exercisable are considered in assessing significant influence.

- Venture capital organisations, mutual funds, unit trusts and similar entities may elect to account for investments in associates and joint ventures at fair value (see forthcoming requirements). In addition, investment entities measure their investments in associates and joint ventures at fair value.

- Other associates and joint ventures are accounted for using the equity method (equity-accounted investees).

3.5 Equity-method investees

Overview

- Like IFRS, 'significant influence' is the ability to significantly influence the operating and financial policies of an investee, but is not control over the investee. The term 'equity-method investee' is used to describe what would be an associate under IFRS.

- Like IFRS, there is a rebuttable presumption of significant influence if an entity holds 20 percent or more of the voting rights of another corporate entity in which it does not have a controlling financial interest.

- Unlike IFRS, for partnerships and similar entities the equity method is applicable unless the investor has virtually no influence over the investee's operating and financial policies.

- Unlike IFRS, the role of currently exercisable potential voting rights is not explicitly addressed. However, because all factors are required to be considered, in effect any such voting rights would need to be assessed, which may result in the same outcome as IFRS.

- Unlike IFRS, an entity may elect to account for equity-method investees at fair value regardless of whether it is a venture capital or similar organisation. Additionally, investment companies account for investments in equity-method investees at fair value, like IFRS.

- Like IFRS, other equity-method investees are accounted for using the equity method. However, certain aspects of the application of the equity method differ from IFRS.
Overview (continued)

– Equity accounting is not applied to investees that are classified as held-for-sale.

– In applying the equity method, an investee’s accounting policies should be consistent with those of the investor.

– The annual reporting date of an equity-accounted investee may not differ from the investor’s by more than three months, and should be consistent from period to period. Adjustments are made for the effects of significant events and transactions between the two dates.

– When an equity-accounted investee incurs losses, the carrying amount of the investor’s interest is reduced but not to below zero. Further losses are recognised by the investor only to the extent that the investor has an obligation to fund losses or has made payments on behalf of the investee.

– Unrealised profits or losses on transactions with equity-accounted investees are eliminated to the extent of the investor’s interest in the investee.

– In our view, if an entity contributes a controlling interest in a subsidiary in exchange for an interest in an equity-accounted investee, then the entity may choose either to recognise the gain or loss in full or to eliminate the gain or loss to the extent of the investor’s interest in the investee.

– The carrying amount of an equity-accounted investee is written down if it is impaired.

Overview (continued)

– Like IFRS, equity accounting is not applied to equity-method investees that are classified as held-for-sale.

– Unlike IFRS, in applying the equity method, an investee’s accounting policies need not be consistent with those of the investor.

– Like IFRS, the annual reporting date of an equity-method investee may not differ from the investor’s by more than three months. However, unlike IFRS, adjustments are not made for the effects of significant events and transactions between the two dates; instead, disclosure is provided.

– Like IFRS, when an equity-method investee incurs losses, the carrying amount of the investor’s interest is reduced but not to below zero. Like IFRS, further losses are generally recognised by the investor only to the extent that the investor has an obligation to fund losses. However, unlike IFRS, further losses are also recognised if the investee is expected to return to profitability imminently, or if a subsequent further investment in the investee is in substance the funding of such losses.

– Like IFRS, unrealised profits or losses on transactions with equity-method investees are eliminated to the extent of the investor’s interest in the investee.

– Unlike IFRS, if an entity contributes a subsidiary or group of assets that constitutes a business in exchange for an interest in an equity-method investee, then the entity is required to recognise any gain or loss in full. See forthcoming requirements.

– Unlike IFRS, the carrying amount of an equity-method investee is written down only if there is an impairment of the carrying amount that is considered to be ’other than temporary’. 
Overview (continued)

- On the loss of significant influence, the fair value of any retained investment is taken into account to calculate the gain or loss on the transaction, as if the investment were fully disposed of; this gain or loss is recognised in profit or loss. Amounts recognised in OCI are reclassified or transferred as required by other standards.

- When an investment becomes an equity-accounted investee, in our view the investor may either remeasure the previously held interest to fair value through profit or loss, or add the newly incurred additional cost to the cost of the previously held investment.

- In our view, an increase in holding should be accounted for using an ‘allocation’ approach, whereby only the incremental investment is measured at fair value.

- In our view, a decrease in holding (while continuing to apply equity accounting) results in the recognition of a gain or loss in profit or loss.

Associates

An ‘associate’ is an entity over which an investor has significant influence. ‘Significant influence’ is the power to participate in the financial and operating policy decisions of the investee, but is not control over the investee (see chapter 2.5). The assessment of ‘significant influence’ focuses on the ability to exercise significant influence and not whether it is actually exercised. [IAS 28.3]

Significant influence is presumed to exist when an investor holds 20 percent or more of the voting rights of another entity in which it does not have control. Conversely, it is presumed that significant influence does not exist with a holding of less than 20 percent. These presumptions may be overcome in circumstances in which an ability, or lack of ability, to exercise significant influence can be demonstrated clearly. [IAS 28.5]

Equity-method investees

Like IFRS, for a corporate investee, an equity-method investee is an entity over whose operating and financial policies the investor has significant influence, but not control. Unlike IFRS, for a partnership or similar investee, an equity-method investee is an entity over which the investor has more than virtually no influence over its operating and financial policies. [323-10-15-6]

Like IFRS, an investor owning 20 percent or more of the voting rights of a corporate investee in which it does not have a controlling financial interest is presumed to have the ability to exercise significant influence over that investee, and an investment of less than 20 percent is presumed not to give the ability to exercise significant influence. Like IFRS, these presumptions may be overcome in circumstances in which an ability, or lack of ability, to exercise significant influence can be demonstrated clearly. Unlike IFRS, for partnerships and similar entities, virtually no influence over the operating and financial policies is deemed to exist for an investment of less than 3 to 5 percent. [323-10-15-8 – 15-11]
In determining whether an entity has significant influence over another entity, the focus is on the ability to exercise significant influence. It does not matter whether significant influence actually is exercised. IFRS does not include specific guidance on assessing significant influence when the investor attempts to exercise significant influence, but is unable to do so effectively; instead, the general principles apply. [IAS 28.6–8]

In assessing whether voting rights give rise to significant influence, it is necessary to consider both direct holdings and holdings of the investor’s subsidiaries (see chapter 2.5). In our view, holdings of the investor’s joint ventures and other associates should not be included in this evaluation. [IAS 28.5]

In assessing significant influence, the impact of potential voting rights that are currently exercisable are considered. All potential voting rights are taken into account, whether they are held by the entity or by other parties. Such potential voting rights may take many forms, including call options, warrants, debt or equity instruments that are convertible into ordinary shares, and other similar instruments that have the potential, if they are exercised or converted, to give the holder voting power. Only those rights that either would give the entity voting power or that would reduce another party’s voting rights are considered. Management’s intentions with respect to the exercise of potential voting rights are ignored in assessing significant influence. The exercise price of potential voting rights, and the financial capability of the holder to exercise them, are also ignored. [IAS 28.7–8]

IFRS does not contain specific guidance on interests in an investee that are not equity instruments but are similar in substance to equity instruments. In our experience, we would expect the impact of such interests to be included in the assessment of significant influence.

Like IFRS, in determining whether an entity has significant influence over another entity, the focus is on the ability to exercise significant influence, and it does not matter whether significant influence actually is exercised. However, unlike IFRS, US GAAP includes specific guidance that if the investor attempts to exercise influence, but is unable to do so effectively, then it does not have the ability to exercise significant influence. [323-10-15-10]

Like IFRS, when assessing whether voting rights give rise to significant influence, it is necessary to consider both direct holdings and holdings of the investor’s subsidiaries (see chapter 2.5). Holdings of the investor’s equity-method investees are not included in this evaluation, like IFRS. [323-10-15-8]

Unlike IFRS, US GAAP does not explicitly address whether currently exercisable potential voting rights held both by the entity and by other parties should be considered in determining whether significant influence exists. However, because US GAAP requires consideration of all factors in determining whether the investor has the ability to exercise significant influence, currently exercisable potential voting rights may need to be evaluated to determine whether they affect the influence that the investor is able to exert over the investee. Accordingly, any difference from IFRS will depend on the specific facts and circumstances. [323-10-15-9]

In assessing whether an investor’s interest in an investee gives rise to significant influence, the rights conveyed by interests considered to be ‘in-substance common stock’ are also considered, along with investments in other securities of the investee (e.g. preferred shares, options, warrants and convertible bonds), some of which may be considered potential voting rights under IFRS. An interest is in-substance common stock if the interest is substantially similar to an investment in the investee’s common shares. Characteristics common to in-substance common stock are subordination and risks and rewards substantially similar to an investment in common shares. An investment interest is not considered in-substance common stock if the investee is expected to transfer substantive value to the investor and the common shareholders do not participate in a similar manner. If the investor has significant influence, then the equity method is applied based on both the interest in common shares and the in-substance common stock. Generally, we would not expect differences from IFRS in practice. [323-10-15-13]
There is no specific guidance on assessing significant influence in a partnership or similar entities; the above general principles apply.

**Venture capital organisations**

IFRS contains an optional exemption from the requirement to apply equity accounting for investments in associates or joint ventures held by, or indirectly held through, an entity that is a venture capital organisation, investment fund or mutual fund, unit trust or similar entity, including investment-linked insurance funds. Such entities may elect to measure investments in those investees at fair value through profit or loss in accordance with the financial instruments standards (see chapters 7.4–7.6). See forthcoming requirements. ([IAS 28.18](#)

A venture capital or similar organisation that qualifies as an investment entity for the purpose of applying the exception from consolidation measures its investments in associates and joint ventures at fair value through profit or loss (see chapter 5.6). ([IFRS 10.B85L(b)](#)

**The equity method**

The discussion in this section applies to associates and joint ventures (see chapter 3.6) accounted for using the equity method (together, ‘equity-accounted investees’).

An investment is accounted for using the equity method from the date on which it becomes an associate or joint venture. ([IAS 28.32](#)

Unlike IFRS, non-controlling general partners, limited partnership interests and investors in limited liability companies (LLCs) that maintain specific ownership accounts similar to a partnership capital structure apply the equity method unless their investment gives them virtually no influence over the operating and financial policies of the investee. An investor is presumed to have more than virtually no influence when its ownership threshold is 3 to 5 percent or higher. ([323-30-599-1](#)

**Investment companies and the fair value option**

Unlike IFRS, an entity may elect under the fair value option to account for equity-method investees as financial assets at fair value through profit or loss regardless of whether it is a venture capital or similar organisation; this election is made when significant influence is obtained and is irrevocable. ([323-10-15-4, 825-10-25-7, 946-10-15-2](#)

In general, investment companies are required to account for investments in equity-method investees as financial assets at fair value through profit or loss, like IFRS. However, unlike IFRS, an exception arises if the equity-method investee provides services only to the investment company (see chapter 5.6). ([946-323-45-1](#)

**The equity method**

The discussion in this section applies to all equity-method investees other than those measured at fair value under the fair value option or in accordance with specialised industry practices (see above). ([323-10-35-3, 15-5](#)

Like IFRS, an investment in an equity-method investee is accounted for using the equity method from the date on which the investor obtains significant influence (more than virtually no influence in the case of partnerships and similar entities) over the operating and financial policies of the investee. ([323-10-35-4, 35-33](#)
Under the equity method:
- the investment is stated as one line item at cost plus the investor’s share of post-acquisition retained profits and other changes in net assets;
- cost includes the goodwill arising on the acquisition;
- the investor’s share of the post-tax profit or loss of the associate, adjusted for fair value adjustments recognised on initial recognition, is presented as a single line item in profit or loss;
- the investor’s share of OCI of the associate – e.g. foreign currency translation differences and changes in a cash flow hedging reserve – is recognised in OCI; and
- distributions received from the associate generally reduce its carrying amount in the statement of financial position. [IAS 1.82, 28.3, 10]

It is not clear in IFRS whether equity accounting should be understood as a one-line consolidation or as a measurement approach. This leads to instances in which the application of the equity method is similar to consolidation principles, and other instances in which it is not.

**Accounting periods and policies**

The investee’s financial statements used for the purpose of applying the equity method are drawn up for the same accounting period as that of the investor, unless this is impracticable. [IAS 28.33]

The difference between the annual reporting date and the date of the financial statements of an investee may not exceed three months, and should be consistent from period to period. If different reporting periods are used for the purpose of applying the equity method, then adjustments are made for the effects of any significant events or transactions that occur between the two reporting dates. [IAS 28.34]

For the purpose of applying the equity method, the financial information of the investee is prepared on the basis of IFRS. The investor’s accounting policies are applied. [IAS 28.35]

Unlike IFRS, under the equity method:
- the investment is stated as one line item at cost plus the investor’s share of post-acquisition retained profits and other changes in net assets;
- cost includes the goodwill arising on the acquisition;
- the investor’s share of the post-tax profit or loss of the equity-method investee, adjusted for fair value adjustments recognised on initial recognition, is presented as a single line item in profit or loss;
- the investor’s share of OCI of the equity-method investee – e.g. foreign currency translation differences and changes in a cash flow hedging reserve – is recognised in OCI; and
- distributions received from the equity-method investee generally reduce its carrying amount in the statement of financial position. [323-10-35-4, 35-13, 35-17 – 35-18, 35-34, 45-1]

Unlike IFRS, it is clear under US GAAP that the equity method is not deemed to be a one-line consolidation in all respects. However, the instances in which it is deemed to be one-line consolidation vs a measurement approach differ from IFRS in some cases, so differences from IFRS may arise in practice. [323-10-25-2A, 30-2A – 30-2B, 35-14A, 35-32A, 40-1]

**Accounting periods and policies**

Unlike IFRS, an equity-method investee’s financial statements used for the purpose of applying the equity method may be drawn up for an accounting period that is different from that of the investor, if the investee’s statements are not sufficiently timely; the lag in reporting needs to be consistent every year. [323-10-35-6]

Like IFRS, a difference between the annual reporting date of the investor and the investee (lag period) may not exceed three months, and should be consistent from period to period. However, unlike IFRS, adjustments are not made for the effects of any significant events or transactions that occur between the two reporting dates, although disclosure is required. [810-10-45-12]

For the purpose of applying the equity method, the financial information of the investee is prepared on the basis of US GAAP. However, unlike IFRS, in applying the equity method, the investor’s accounting policies need not be applied by the investee except for entities with oil and gas producing activities. [TPA 2220-03]
If a non-investment entity investor has an interest in an equity-accounted investee that is an investment entity (see chapter 5.6) and has subsidiaries, then it may retain the fair value accounting applied by its investment entity equity-accounted investee to the subsidiaries. [IAS 28.36A, BC46A–BC46G]

Initial carrying amount of an associate
The initial carrying amount of an investment in an equity-accounted investee comprises the purchase price and other costs that are directly attributable to the acquisition of the investment. In our view, costs directly attributable to the acquisition of an investment in an equity-accounted investee do not normally include costs incurred after the acquisition is completed, except for the costs related to the acquisition of additional interests. [IU 07-09]

In our view, costs that are directly attributable to a probable future acquisition of an investment accounted for under the equity method should be recognised as a prepayment (asset) in the statement of financial position. The costs should be included in the initial carrying amount at the date of acquisition, or recognised in profit or loss if the acquisition is no longer expected to be completed.

There is no specific guidance on the treatment of contingent consideration in acquiring an investment in an equity-accounted investee. In our view, contingent consideration arising from the acquisition of an equity-accounted investee should be recognised initially at fair value as part of the cost of acquisition. [IFRS 3.39–40, 58(b), IAS 28.26]

On the date of acquisition of an equity-accounted investee, fair values are determined for the investee’s identifiable assets and liabilities as if the transaction were the acquisition of a subsidiary. Any difference between the investor’s share of the fair values of the acquired net assets and the cost of acquisition is goodwill. Goodwill arising on the acquisition of an equity-accounted investee is not subject to mandatory annual impairment testing. Instead, the entire investment is assessed for impairment under certain circumstances (see below). [IAS 28.32, 42]

If a non-investment company investor has an interest in an investee that is an investment company (see chapter 5.6) and has subsidiaries, then it retains the fair value accounting applied by its investment company investee and its subsidiaries. Unlike IFRS, this is not an accounting policy choice. [323-946-15-1]

Initial carrying amount of an equity-method investee
Like IFRS, the initial carrying amount of an investment in an equity-method investee comprises the purchase price and other costs that are directly attributable to the acquisition of the investment. Costs directly attributable to the acquisition of an investment in an equity-method investee do not normally include costs incurred after the acquisition is completed, except for the costs related to the acquisition of additional interests. [323-10-30-2, 805-50-30-1]

Like IFRS, costs that are directly attributable to a probable future acquisition of an investment accounted for under the equity method should be recognised as a prepayment (asset) in the statement of financial position. The costs should be included in the initial carrying amount at the date of acquisition, or recognised in profit or loss if the acquisition is no longer expected to be completed, like IFRS. [SAB Topic 5.A]

Unlike IFRS, contingent consideration is not generally recognised until the contingency is resolved; once it has been resolved, the contingent consideration is recognised as an adjustment to the carrying amount of the investment. [323-10-30-2A]

Like IFRS, on the date of acquisition of an equity-method investee, fair values are determined for the investee’s identifiable assets and liabilities as if the transaction were the acquisition of a subsidiary, and any difference between the investor’s share of the fair values of the acquired net assets and the cost of acquisition is goodwill. Like IFRS, goodwill arising on the acquisition of an equity-method investee (equity-method goodwill) is not subject to mandatory annual impairment testing. Instead, like IFRS, the entire investment is assessed for impairment under certain circumstances, which differs in some respects from IFRS (see below). [323-10-35-13, 350-20-35-59]
Percentage attributable to the investor

In some cases, the economic interests of an investor will not equal its shareholding (voting interest). In these cases, in our view the investor should account for its economic interest in the profits and net assets of the investee, which would include instruments that are similar in substance to equity instruments. [IAS 28.3, 10, 13, 37]

Like IFRS, the investor generally only applies the equity method based on its investment in common shares and in-substance common stock of the investee. However, the nature of the interests in the investee should be taken into account – for example:

- If an investee has outstanding preferred stock and the preferred shareholders are entitled to dividends (even though they are not earned) before the declaration of common stock dividends, or as a preference on liquidation, then the dividends should be deducted from investee earnings, or added to investee losses, before determining the investor’s share of the investee’s earnings and losses, like IFRS.
- If an investor holds interests other than common or in-substance common stock, then it may be appropriate to use the hypothetical liquidation at book value (HLBV) method, under which an investor determines its share of an investee’s earnings or losses for a period by calculating, at each reporting date, the amount that it would receive (or be obliged to pay) if the investee were to liquidate all of its assets at their recorded amounts and distribute the resulting cash to creditors and investors in accordance with their respective priorities, which may differ from the result obtained under IFRS. [323-10-15-3, 30-1, 35-16]

Indirect holdings

Shareholdings of the parent and all subsidiaries are considered in applying the equity method. Shareholdings of other equity-accounted investees are not considered. [IAS 28.27]

Indirect holdings
Like IFRS, shareholdings of the parent and all subsidiaries are taken into account in applying the equity method. Also like IFRS, shareholdings of other equity-method investees are not considered. [223-10-15-8]

Interest in an entity held via an equity-accounted investee

An investor’s equity-accounted investee may have non-wholly owned subsidiaries. NCI in the investee’s subsidiary are not reflected in the investor’s consolidated financial statements. The investor’s interest or entitlement is determined only after the investee’s NCI holders have been attributed their interest in the investee. [IAS 28.27]

Interest in an entity held via an equity-method investee

An investor’s equity-method investee may have non-wholly owned subsidiaries. Like IFRS, NCI in the investee’s subsidiary are not reflected in the investor’s consolidated financial statements. The investor’s interest or entitlement is determined only after the investee’s NCI holders have been attributed their interest in the investee, like IFRS. [323-10-35-5]
The equity-accounted investee may sell or purchase NCI in its subsidiaries and account for these transactions as equity transactions in its consolidated financial statements (see chapter 2.5). In our view, there are two possible approaches for the investor to account for such transactions, and the investor should choose an accounting policy, to be applied consistently to all transactions with NCI at the associate level.

- Under the first approach, such transactions are not considered as equity transactions from the investor’s perspective, because the NCI of the equity-accounted investee do not meet the definition of NCI at the investor’s level. Therefore, the transaction is a transaction with third parties from the perspective of the investor and is accounted for accordingly, with any dilution gain or loss being recognised in profit or loss.

- Under the second approach, such transactions are reflected directly in equity at the investor level, based on the fact that this reflects the post-acquisition change in the net assets of the investee (see above).

**Potential voting rights**
Potential voting rights are not taken into account in applying the equity method, unless in substance they give access to the returns associated with an ownership interest. [IAS 28.12–13]

**Equity-settled share-based payment issued by an equity-accounted investee**
When an equity-settled share-based payment is issued by an equity-accounted investee to its own employees, in our view the investor should record its share of the associate’s share-based remuneration expense as part of the associate’s share of the associate’s profit or loss. However, in our view the investor should not account for a share in the credit to shareholders’ equity recognised by the investee. Instead, the offsetting credit entry should reduce the investment in the investee because equity instruments of the investee that have been granted to third parties represent a dilution of the investor’s interest in the investee.

The equity-method investee may sell or purchase NCI in its subsidiaries and account for these transactions as equity transactions in its consolidated financial statements (see chapter 2.5). Unlike IFRS, under US GAAP the investor does not adjust its investment but rather reflects the new basis difference that has arisen as an additional adjustment to the investee’s earnings in its subsequent application of the equity method. [223-10-35-5]

**Potential voting rights**
Like IFRS, potential voting rights are not taken into account in applying the equity method. Instead, the investor applies the equity method based on its investments in common shares and in-substance common stock, like IFRS. [323-10-15-9]

**Equity-settled share-based payment issued by an equity-method investee**
When an equity-settled share-based payment is issued by an equity-method investee to its own employees, the investor may either record its share of the investee’s share-based remuneration expense as part of its share of the investee’s profit or loss, like IFRS, or use the HLBV method to determine the combined impact of its share of the investee’s share-based remuneration expense and any remaining dilution gain or loss. Under either approach, the offsetting entry is an adjustment to the investment in the equity-method investee. If the HLBV method is not used, then the investor amortises the difference between the carrying amount of its investment and its share of the investee’s underlying net assets (including the effect of dilution resulting from the transaction) over time as an adjustment to equity-method income or loss. [323-10-55-19 – 55-26]
Losses
The investor’s share of losses of an equity-accounted investee is recognised until the carrying amount of the investor’s equity interest in the investee is reduced to zero. For the purposes of this calculation, the equity interest in the investee includes any loans or other balances that in substance form part of the net investment. [IAS 28.38]

After the investor’s interest is reduced to zero, a liability is recognised only to the extent that the investor has an obligation to fund the investee’s operations, or has made payments on behalf of the investee. [IAS 28.39]

Transactions with equity-accounted investees and elimination of balances
Unrealised profits on transactions with an equity-accounted investee are eliminated to the extent of the investor’s interest in the investee. Unrealised losses in a downstream transaction are not eliminated to the extent that they provide evidence of a reduction in the net realisable value or an impairment loss of the underlying asset. If an upstream transaction provides evidence of a reduction in the net realisable value of the assets to be purchased, then the investor recognises its share of those losses. [IAS 28.26, 28–29]

Balances such as receivables or payables and deposits or loans to or from equity-accounted investees are not eliminated when applying the equity method. [IAS 28.28]

Losses
Like IFRS, the investor’s share of losses is recognised until the equity investment (including interests considered to be in-substance common stock), plus other interests in the investee (e.g. long-term loans and advances, preferred shares and debt securities), is reduced to zero. [323-10-35-19]

After the investment has been reduced to zero, equity method losses continue to be recognised, with the investor recognising a liability to the extent:
– of an obligation to fund the investee’s losses or other commitments to provide additional financial support, like IFRS;
– that it has made payments on behalf of the investee, like IFRS;
– that the imminent return to profitable operations by the investee appears to be assured, unlike IFRS;
– of an equity investment that (1) does not result in the ownership interest increasing from one of significant influence to one of control; and (2) is in substance the funding of prior losses, unlike IFRS; or
– of loans or investments in other securities of the investee. Because US GAAP contains more specific guidance than IFRS in this regard, differences may arise in practice. [323-10-25-2, 35-21, 35-24, 35-29]

Transactions with equity-method investees and elimination of balances
Like IFRS, unrealised profits from transactions with equity-method investees are eliminated only to the extent of the investor’s ownership percentage in the equity-method investee. Unrealised losses are eliminated in the same way, except to the extent that the underlying asset is impaired, like IFRS. [323-10-35-7 – 35-11]

Like IFRS, balances such as receivables or payables and deposits or loans to or from equity-method investees are not eliminated when applying the equity method. [323-10-35-8]
An investor may enter into a downstream transaction with an equity-accounted investee for which its share of the gain arising from the transaction exceeds its interest in the investee. In our view, there are two possible accounting approaches for such an excess, and an entity should choose an accounting policy, to be applied consistently to all downstream transactions with equity-accounted investees.

- Under the first approach, once the investor’s interest in the investee has been reduced to zero, any remaining portion of the investor’s share of the gain is not eliminated, because the resulting credit in the statement of financial position does not meet the definition of a liability. Therefore, it is possible that the investor’s share of the gain may not be fully eliminated in the investor’s financial statements. If the investee earns a profit in subsequent periods, then the investor recognises its share of such profits only after adjusting for the excess gain that was not eliminated previously.

- Under the second approach, the investor eliminates in full its share of the gain. The amount of the elimination in excess of the carrying amount of the investor’s interest in the investee is presented as deferred income. If the investee earns a profit in subsequent periods and the carrying amount of the investment in the investee becomes positive, then the investor changes its presentation of the deferred income so that it is offset against the investment in the investee in the usual way.

**Distributions in excess of carrying amount**

There is no specific guidance on the accounting for distributions in excess of the investee’s carrying amount in the investor’s financial statements when applying the equity method. In our view, an entity has the same accounting policy choice as in accounting for a downstream transaction with an equity-accounted investee for which its share of the gain arising from the transaction exceeds its interest in the investee (see above).

**Contribution of a subsidiary to an equity-accounted investee**

When an entity contributes a controlling interest in a subsidiary in exchange for an interest in an equity-accounted investee, in our view it may choose to either recognise the gain or loss in full or eliminate the gain or loss to the extent of its interest in the investee.

An investor may enter into a downstream transaction with an equity-method investee for which its share of the gain arising from the transaction exceeds its interest in the investee. Unlike IFRS, rather than a policy election, the investor eliminates in full its share of the gain. The amount of the elimination in excess of the carrying amount of the investor’s interest in the investee is presented as deferred income, like the second approach under IFRS. If the investee earns a profit in subsequent periods and the carrying amount of the investment in the investee becomes positive, then the investor changes its presentation of the deferred income so that it is offset against the investment in the investee in the usual way, like the second approach under IFRS. [323-10-35-11]

**Distributions in excess of carrying amount**

When an equity-method investee enters into a refinancing transaction with a third party, after repayment of the existing financing it is not uncommon for the investee to distribute the remaining proceeds from a refinancing transaction to its investors. Unlike IFRS, if the cash distribution to an equity-method investor is in excess of the investor’s carrying amount of the investment, then the SEC Staff has indicated that the excess may be recognised as a gain provided that the investor is not obliged to provide financial support to the investee or others. [2008 AICPA Cont]

**Contribution of a business to an equity-method investee**

Unlike IFRS, when an entity contributes a subsidiary or group of assets that constitutes a non-profit activity or a business other than in-substance real estate or oil and gas mineral rights in exchange for an interest in an equity-method investee, it is required to recognise any gain or loss in full. See forthcoming requirements. [810-10-40-3A]
Contribution of a non-monetary asset to equity-accounted investee

If an entity contributes a non-monetary asset to an equity-accounted investee in exchange for an equity interest in the investee, then the entity recognises a gain or loss following the guidance on upstream and downstream transactions (see above). However, no gain or loss is recognised if the transaction lacks commercial substance. [IAS 28.30]

Equity-accounted investees classified as held-for-sale

Equity accounting is not applied to an investment, or portion of an investment, in an associate or joint venture that meets the criteria to be classified as held-for-sale. These investments are measured at the lower of their carrying amount and fair value less costs to sell (see chapter 5.4). For any retained portion of the investment that has not been classified as held-for-sale, the entity applies the equity method until disposal of the portion classified as held-for-sale. After disposal, any retained interest in the investment is accounted for as an associate or financial asset (see chapter 7.1), as appropriate. [IAS 28.20]

Impairment

Fair value adjustments and goodwill recognised on acquisitions of equity-accounted investees are not recognised separately. Goodwill recognised on the acquisition of an equity-accounted investee is not subject to an annual impairment test. Instead, after applying equity accounting, the investment is tested for impairment when there is an indication of a possible impairment. The guidance for financial asset impairment is used to determine whether it is necessary to perform an impairment test for investments in equity-accounted investees (see chapter 7.6). However, the impairment test that is applied if there is an indication of impairment follows the principles in the impairment standard (see chapter 3.10). [IAS 28.40–42]

Contribution of a non-monetary asset to equity-method investee

Unlike IFRS, when a group of non-monetary assets that do not comprise a business are contributed to a joint venture solely in exchange for an equity interest in the venture, the investor generally recognises the assets on a carry-over basis and does not recognise a gain or loss. Unlike IFRS, when a group of assets that constitute a non-profit activity or a business (other than in-substance real estate or oil and gas mineral rights) that is not a subsidiary is contributed in return for an equity interest in a joint venture, the investor recognises any gain or loss in full. See forthcoming requirements. [845-10-30-3A]

Equity-method investees classified as held-for-sale

Unlike IFRS, equity accounting continues to be applied to equity-method investees that meet the criteria to be classified as held-for-sale. Unlike IFRS, an equity-method investee is not classified as held-for-sale unless the definition of a discontinued operation is also met (see chapter 5.4). [205-20-45]

Impairment

Like IFRS, fair value adjustments and goodwill recognised on acquisitions of equity-method investees are not recognised separately, and an equity-method investment may be impaired even if the investee has accounted for impairment losses of its own underlying assets. However, unlike IFRS, impairments of investments in equity-method investees are generally recognised only if the impairments are ‘other than temporary’. Evidence of a loss in value might include, but would not necessarily be limited to, an absence of an ability to recover the carrying amount of the investment or inability of the investee to sustain an earnings capacity that would justify the carrying amount of the investment. A current fair value of an investment that is less than its carrying amount may indicate a loss in value of the investment; however, a decline in the quoted market price below the carrying amount or the existence of operating losses is not necessarily indicative of a loss in value that is ‘other than temporary’. [323-10-35-32]
After applying the equity method, any impairment loss on an investment in an equity-accounted investee is not allocated to the underlying assets that make up the carrying amount of the investment, including goodwill. In addition, any such impairment loss is reversed if the recoverable amount increases subsequently. The requirements of the impairment standard are applied to the entire carrying amount of an investment in an equity-accounted investee without ‘looking through’ the investment to the investor’s carrying amount of individual assets within the investee. [IAS 28.42]

**Accounting for a disposal**

When an investment that is accounted for using the equity method is sold, the difference between the proceeds from the disposal and the carrying amount of the investment (including the carrying amount of any related goodwill) is recognised in profit or loss as a gain or loss on disposal. [IAS 28.22]

**Changes in the status of equity-accounted investees**

**Investment becomes an equity-accounted investee**

There is no specific guidance on the accounting when an investment becomes an equity-accounted investee. In our view, there are two possible approaches to accounting for a step acquisition to achieve significant influence or joint control.

- Under the *remeasurement approach*, the previously held interest is remeasured to fair value through profit or loss for the period and any available-for-sale revaluation reserve is reclassified to profit or loss.
- Under the *cost approach*, one acceptable approach is that the newly incurred additional cost is added to the cost of the previously held investment and any available-for-sale revaluation reserve is transferred to retained earnings.

**Acquisition of additional interests**

In our view, an existing interest should not be remeasured if an acquisition of additional interests does not change the classification as an associate or as a joint venture. We believe that reserves, such as the cumulative foreign currency translation reserve, should not be reclassified to profit or loss or transferred to retained earnings. [IAS 28.24]

There is no specific guidance on the accounting for an additional interest while continuing to apply equity accounting. In our view, an entity should apply an ‘allocation’ approach similar to that applied when an interest is acquired in a new equity-accounted investee, whereby goodwill is calculated on the incremental interest acquired as a residual after valuing the incremental share of identifiable net assets at fair value. This results in identifiable net assets being valued on a mixed measurement basis.

Like IFRS, an investor does not perform a separate impairment test on the investee’s underlying assets. Instead, the entire equity-method investment is subject to an other-than-temporary impairment model, which is different from the impairment model under IFRS. Unlike IFRS, an impairment cannot be reversed subsequently. However, the impairment loss creates a basis difference between the investor’s carrying amount and the investor’s share of the investee’s net book value, which is allocated to the investor’s underlying share of the investee’s assets that make up the investment, including equity-method goodwill, unlike IFRS. [323-10-35-32A]

**Accounting for a disposal**

Like IFRS, when an investment that is accounted for using the equity method is sold, the difference between the proceeds from the disposal and the carrying amount of the investment (including the carrying amount of any related goodwill) is recognised in profit or loss as a gain or loss on disposal. [323-10-35-35]

**Changes in the status of equity-method investees**

**Investment becomes an equity-method investee**

Unlike IFRS, when an investment becomes an equity-accounted investee, the newly incurred additional cost is required to be added to the cost of the previously held investment, and the equity method is applied from that date. If the investment was an available-for-sale security, then any unrealised holding gain or loss in accumulated OCI is recognised in profit or loss, like IFRS under the remeasurement approach. [323-10-35-33]

**Acquisition of additional interests**

An existing interest is not remeasured if an acquisition of additional interests does not change the classification of an equity-method investee, like IFRS. Similarly, reserves are not reclassified to profit or loss, like IFRS. [323-10-35-33]

The ‘step-by-step’ method is applied to the initial and subsequent investment in an equity-method investee – i.e. the initial investment keeps its current basis and the subsequent investment is measured based on fair values at the date of acquisition. This is like the ‘partial step-up’ approach under IFRS. [323-10-35-33]
Decrease in interest held
In our view, a retained interest should not be remeasured if the decrease does not change the classification as an associate or as a joint venture. [IAS 28.24]

If an entity’s ownership interest in an equity-accounted investee is reduced, but the entity continues to apply equity accounting, then in our view the difference between the proceeds from the sale and the cost of the investment sold should be recognised in profit or loss.

If an entity’s ownership interest in an equity-accounted investee is reduced, but the entity continues to apply equity accounting, then it also rec classifies to profit or loss any equity-accounted gain or loss previously recognised in OCI in proportion to the reduction in the ownership interest. This rec classification applies only if that gain or loss would be rec classified to profit or loss on disposal of the related asset or liability – e.g. available-for-sale revaluation reserve or a foreign currency translation reserve. Otherwise, the portion of reserves is transferred to retained earnings – e.g. revaluation reserve. [IAS 28.25]

IFRS is silent on how to determine the cost of the investment sold and the portion of reserves that is reclassified or transferred. In our view, the guidance on cost formulas for inventories should be applied to determine the cost of financial assets sold when the financial assets are part of a homogeneous portfolio. Therefore, an entity should choose an accounting policy, to be applied consistently, to use any reasonable cost allocation method – e.g. weighted-average cost or first-in, first-out – in determining the cost of the investment sold. We believe that the portion of reserves reclassified or transferred should be calculated consistently with the gain or loss of the partial disposal.

A decrease in interest (while the investment continues to be classified as an associate or joint venture) can also result from a dilution. A dilution of an interest in an equity-accounted investee may occur, for example, when the investee issues shares to other parties. The gain or loss on the dilution of an interest in an equity-accounted investee is recognised in profit or loss.

Loss of significant influence or joint control
The equity method continues to apply until significant influence or joint control ceases, or until the investment is classified as held-for-sale. [IAS 28.9, 22]

Loss of significant influence or joint control
When an investor’s holding in an equity-method investee decreases, but the investor maintains significant influence or joint control, the investor does not remeasure its retained interest, like IFRS. [323-10-35-35]

When an investor’s holding in an equity-method investee decreases, but the investor maintains significant influence or joint control, the partial disposal of the investor’s ownership interest in an associate (while maintaining significant influence) is recognised in profit or loss for the difference between the proceeds from the sale and the cost of the investment sold, like IFRS. [323-10-35-35]

Unlike IFRS, reserves are not reclassified to profit or loss unless an entity sells a portion of an equity-method investee that is a foreign operation while retaining significant influence, in which case a proportionate amount of the translation adjustment is reclassified to profit or loss. If a sale occurs and there is a decrease in the investor’s ownership interest in an equity-method investee while maintaining significant influence, then there is a reclassification of a portion of accumulated OCI to profit or loss, like IFRS. Unlike IFRS, all accumulated OCI items are reclassified to profit or loss; none is transferred to retained earnings. The portion of accumulated OCI reclassified is calculated in proportion to the interest disposed of, so that it is calculated on a consistent basis with the gain or loss calculated on the partial disposal, like IFRS. [830-30-40-2]

When there is a decrease in interest held, the cost of the investment disposed of is a pro rata share of the carrying amount of the investee, which may differ from the accounting policy elected under IFRS. Similarly, a pro rata share of the cumulative translation reserve is reclassified, which may differ from the accounting policy elected under IFRS.

Like IFRS, the investor accounts for the issuance of shares by the equity-method investee that reduces the investor’s ownership percentage in the same manner as if the investor had sold a proportionate share of its investment, with a dilution gain or loss recognised in profit or loss. [323-10-40-1]

Loss of significant influence
Like IFRS, the equity method continues to apply until significant influence ceases, or until the investment is classified as held-for-sale. [323-10-35-36, 205-10-45-1C]
If an investment in an associate becomes an investment in a joint venture or vice versa, then the equity method continues to be applied and the entity does not remeasure the retained interest. [IAS 28.24]

When equity accounting ceases, an investor recognises a gain or loss in profit or loss calculated as the difference between:
- the sum of:
  - the fair value of any proceeds from the interests disposed of;
  - the fair value of any retained investment; and
  - the amount reclassified from OCI; and
- the carrying amount of the investment at the date on which significant influence is lost. [IAS 28.22-23]

Amounts recognised in OCI in relation to the investee are accounted for on the same basis as would be required if the entity had disposed directly of the related assets and liabilities. [IAS 28.23]

In the case of a partial disposal, depending on the level of influence still held by the investor, the remaining investment is accounted for:
- as an associate or joint venture; or
- as a financial asset (see chapter 7.4). [IAS 28.22]

Gain of control of existing associate or joint venture
When an investor obtains control over an existing associate or joint venture that meets the definition of a business, it applies the guidance for a business combination achieved in stages (see chapter 2.6). [IFRS 3.41–42]

IFRS does not provide specific guidance for cases in which an investor obtains control over an existing associate or joint venture that does not meet the definition of a business. In our view, one acceptable approach is to account for an existing associate or joint venture at cost – i.e. without remeasurement. [IFRS 3.2(b)]

Forthcoming requirements
Venture capital organisations and investment entities
Amendments to the standard on investments in associates and joint ventures are effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

Unlike IFRS, when equity accounting ceases and the investee becomes an investment, the deemed cost of the investment is the carrying amount of the investor’s interest in the investee rather than fair value. The carrying amount includes all amounts in the investor’s financial statements related to the previous equity accounting, including any deferred amounts related to the elimination of transactions and amounts in accumulated OCI. [323-10-35-36]

Unlike IFRS, an investor’s proportionate share of an investee’s equity adjustments in accumulated OCI is offset against the carrying amount of the investment when significant influence is lost. To the extent that the offset results in a carrying amount of the investment that is less than zero, any additional amount is recognised in profit or loss, unlike IFRS. [323-10-35-39]

In the case of a partial disposal, depending on the level of influence still held by the investor, the remaining investment is accounted for:
- as an equity-method investee; or
- as an investment (see chapter 7.4). [323-10-35-36]

Gain of control of existing associate or joint venture
Like IFRS, when an investor obtains control over an existing associate or joint venture that meets the definition of a business, it applies the guidance for a business combination achieved in stages (see chapter 2.6). [805-10-25-9]

When an investor obtains control over an existing associate or joint venture that does not meet the definition of a business, the existing interest is not remeasured, which may differ from the accounting policy elected under IFRS. [805-60-30-1, 810-10-30-4]

Forthcoming requirements
Investment companies and the fair value option
There are no forthcoming requirements under US GAAP.
The election for venture capital organisations and similar entities to measure an investment in an associate or a joint venture at fair value through profit or loss is available on an investment-by-investment basis. [IAS 28.18]

The election for a non-investment entity investor to retain the fair value accounting applied by its investment entity (see chapter 5.6) equity-accounted investees to their subsidiaries is available on an investment-by-investment basis. [IAS 28.36A]

Subsidiary contributed to equity-accounted investee
Amendments to the consolidation suite of standards were originally meant to be effective for annual periods beginning on or after 1 January 2016. In December 2015, the IASB decided to postpone the effective date of these amendments indefinitely pending the outcome of its research project on the equity method of accounting.

If a parent loses control of a subsidiary by contributing it to an equity-accounted investee, then the recognition of any gain or loss depends on whether the subsidiary meets the definition of a business (see chapter 2.6).
- If the former subsidiary is a business, then the parent recognises the full gain or loss on the loss of control.
- If the former subsidiary is not a business, then the parent recognises a gain or loss on the loss of control only to the extent of the unrelated investors’ interests in the equity-accounted investee. [IFRS 10.B99A, IAS 28.30, 31A]

Subsidiary contributed to equity-method investee
Amendments to the consolidation Codification Topic as a result of the new revenue Codification Topic (see chapter 4.2A) are effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted but not before annual periods beginning after 15 December 2016.

If a parent loses control of a subsidiary by contributing it to an equity-method investee, then the recognition of any gain or loss generally depends on whether the subsidiary meets the definition of a business (see chapter 2.6) or is in-substance non-financial assets.
- If the former subsidiary is in-substance non-financial assets (whether or not it is also a business), then the parent recognises a gain or loss on the loss of control using the recognition and measurement requirements of the revenue Codification Topic (see chapter 4.2A), unlike IFRS.
- Other than in-substance non-financial assets or oil- and gas-producing activities, if the former subsidiary is a business, then the parent recognises the full gain or loss on the loss of control, like IFRS.
- Other than in-substance non-financial assets, if the former subsidiary is not a business, then the parent recognises a gain or loss on the loss of control only to the extent of the unrelated investors’ interests in the equity-method investee, like IFRS. [B10-10-40-3A, 40-5]
Overview

A ‘joint arrangement’ is an arrangement over which two or more parties have joint control. There are two types of joint arrangements: a joint operation and a joint venture.

In a ‘joint operation’, the parties to the arrangement have rights to the assets and obligations for the liabilities related to the arrangement. A joint arrangement not structured through a separate vehicle is a joint operation.

In a ‘joint venture’, the parties to the arrangement have rights to the net assets of the arrangement.

A joint arrangement structured through a separate vehicle may be either a joint operation or a joint venture. Classification depends on the legal form of the vehicle, contractual terms and other facts and circumstances.

Generally, a joint venturer accounts for its interest in a joint venture under the equity method.

In relation to its involvement in a joint operation, a joint operator recognises its assets, liabilities and transactions, including its share in those arising jointly. The joint operator accounts for each item in accordance with the relevant IFRS.

Overview

Unlike IFRS, there is no definition of a ‘joint arrangement’, and the accounting distinction largely depends on whether the arrangement is conducted with the use of a legal entity.

Unlike IFRS, there is no definition of a ‘joint operation’. In practice it is understood to be an arrangement conducted without the use of a legal entity.

Unlike IFRS, the definition of a ‘joint venture’ refers to a jointly controlled activity conducted with the use of a legal entity.

Unlike IFRS, a jointly controlled activity conducted with the use of a legal entity is referred to as a joint venture.

Like IFRS, investors in a corporate joint venture generally account for the investment under the equity method.

For operations conducted without a legal entity, the participant to the arrangement accounts for its asset, liabilities and transactions, which may differ from the application of IFRS in practice.
Identifying and classifying joint arrangements

A ‘joint arrangement’ is an arrangement over which two or more parties have joint control, which is the contractually agreed sharing of control – i.e. unanimous consent is required for decisions about the relevant activities. [IFRS 11.4, 7]

Joint arrangements are classified either as:
- a joint operation, whereby the jointly controlling parties, known as the ‘joint operators’, have rights to the assets and obligations for the liabilities of the arrangement; or
- a joint venture, whereby the jointly controlling parties, known as the ‘joint venturers’, have rights to the net assets of the arrangement. [IFRS 11.14–16]

Test 1: Structure. A joint arrangement not structured through a separate vehicle is classified as a joint operation. A joint arrangement structured through a separate vehicle can be either a joint venture or a joint operation. [IFRS 11.B16, B19]

Test 2: Legal form. If the joint arrangement is structured through a separate vehicle, then the legal form of the separate vehicle is considered as the next step. If the legal form of the separate vehicle does not confer separation between the parties and the separate vehicle – i.e. the assets and liabilities placed in the separate vehicle are the parties’ assets and liabilities – then the joint arrangement is a joint operation. [IFRS 11.B22, B24]

Test 3: Contractual terms. If, in spite of the structure and legal form indicating that the arrangement is a joint venture, the contractual terms specify that the parties have rights to the assets and obligations for the liabilities of the arrangement, then the arrangement is a joint operation. [IFRS 11.B26–B27]

Test 4: Other facts and circumstances. The test at this step of the analysis is to identify whether, in spite of the legal form and contractual terms indicating that the arrangement is a joint venture, other facts and circumstances:
- give the parties rights to substantially all of the economic benefits of the arrangement (asset test); and
- cause the arrangement to depend on the parties on a continuous basis for settling its liabilities (liability test). [IFRS 11.B29–B32]

If so, then the arrangement is a joint operation. [IFRS 11.B30]

Corporate joint ventures

Unlike IFRS, US GAAP does not define a joint arrangement other than a joint venture or corporate joint venture. [S23-10-20]

The US GAAP definition of a joint venture differs from IFRS. Specifically, a joint venture is a jointly controlled activity carried on through a separate entity – e.g. a corporation or partnership – which is more restrictive than IFRS.

Unlike IFRS, US GAAP does not define a joint operation. In practice they are understood to arise from an arrangement that is a joint arrangement carried on with assets that are controlled jointly, whether or not they are owned jointly, but not through a separate entity, like IFRS. Additionally, under US GAAP a ‘collaborative arrangement’ is defined as a contractual arrangement that involves a joint operating activity between two or more parties who are active participants in the activity and are exposed to the significant risks and rewards dependent on the commercial success of the activity. [B08-10-20]
Accounting for joint arrangements

There are two types of joint arrangement, which determines the accounting.

A joint controller in a joint venture accounts for its interest using the equity method, unless one of the exemptions applies (see chapter 3.5). [IFRS 11.24]

A joint controller in a joint operation recognises its assets, liabilities and transactions, including its share of those incurred jointly. These assets, liabilities and transactions are accounted for in accordance with the relevant IFRSs. The joint operator does not additionally account for its shareholding in the separate vehicle. [IFRS 11.20–21, 26(a), IU 03-15]

Transactions with joint arrangements

A joint operator recognises gains and losses from a sale or contribution of assets to a joint operation only to the extent of the other parties’ interests in the joint operation. The full amount of any loss is recognised immediately by the joint operator to the extent that these transactions provide evidence of impairment of any assets to be sold or contributed. [IFRS 11.22, B34–B38]

When a joint operator purchases assets from a joint operation, it does not recognise its share of the gains or losses until those assets have been sold to a third party. The joint operator’s share of any losses is recognised immediately, to the extent that these transactions provide evidence of impairment of those assets. [IFRS 11.22, B36–B37]

Transactions with a joint venture are subject to the same requirements as transactions with an associate (see chapter 3.5).

Accounting for joint arrangements

Unlike IFRS, there is no categorisation of joint arrangements that determines the accounting. As a general principle, if an entity is substantive, then the parties to the arrangement apply the equity method of accounting. If an entity is not substantive, then the parties to the arrangement account for their own assets and liabilities. Because this analysis differs from IFRS, differences in practice may arise.

The equity method is required for joint ventures conducted in a legal entity, with the exception of unincorporated entities if specialised industry practices permit the use of proportionate consolidation, unlike IFRS. [810-10-45-14]

Although US GAAP does not define a joint operation, in practice they are understood to arise from an arrangement that is a joint arrangement carried on with assets that are controlled jointly, whether or not they are owned jointly, but not through a separate entity, which may differ from IFRS. Although each party would account for its own assets, given the lack of guidance under US GAAP differences from IFRS may arise.

Transactions with joint arrangements

US GAAP does not define a joint operation. However, when an investor contributes assets to an entity that is jointly controlled, it recognises the full gain or loss on the assets and liabilities transferred if they constitute a business (unless they are in-substance real estate or oil- and gas-producing activities), unlike IFRS. If the assets and liabilities transferred do not constitute a business, then a gain or loss is recognised only to the extent of the other parties’ interests in the entity, like IFRS. [323-10-30-2, 35-7]

US GAAP does not define a joint operation. However, when a joint operator purchases assets from an entity that is jointly controlled, it does not recognise its share of the gains or losses until those assets have been sold to a third party, like IFRS. [323-10-35-7]

Like IFRS, transactions with a joint venture are subject to the same requirements as transactions with an equity-method investee (see chapter 3.5).
Acquisition of an interest in a joint operation
If a joint operator acquires an interest in a joint operation that constitutes a business, then it applies the relevant principles for business combinations accounting (see chapter 2.6). This includes recognising goodwill, recognising deferred taxes from the initial recognition of the identifiable assets acquired and liabilities assumed, and recognising acquisition-related costs in profit or loss. However, the principles for business combinations accounting do not apply if the formation of the joint operation coincides with the formation of the business. [IFRS 11.21A, B33A–B33B]

These principles apply to the acquisition of both the initial interest and additional interests of the joint operation in respect of the acquired interest. However, when an additional interest is acquired (without obtaining control), previously held interests in the joint operation are not remeasured. [IFRS 11.21A, B33C]

If the joint operation does not constitute a business, then a cost-based approach is used and any existing assets are generally not remeasured. [IFRS 3.2(b), IU 01-16]

Accounting by joint ventures for contributions received
IFRS is silent on how a joint venture itself should account for contributions received. If assets not comprising a business are contributed to a joint venture in exchange for equity instruments, then the joint venture applies the share-based payments standard and measures the contributed assets at fair value (see chapter 4.5). [IFRS 2.5]

If assets comprising a business are contributed on formation of the joint venture, then in our view the joint venture should choose an accounting policy, to be applied consistently, to recognise such contributions either in accordance with the business combinations standard (see chapter 2.6) or based on book values. If the contribution of a business occurs subsequent to the formation of the joint venture, then the joint venture should apply the business combinations standard. [IFRS 2.5, 3.2(a)]

Acquisition of a joint controlling interest in assets
US GAAP does not define a joint operation. However, when a joint operator acquires a joint controlling interest in assets, the accounting depends on whether those assets are a business. If those assets are a business then, like IFRS, in practice the joint operator applies the relevant principles for business combinations accounting (see chapter 2.6). Like IFRS, this includes recognising goodwill, recognising deferred taxes from the initial recognition of the identifiable assets acquired and liabilities assumed, and recognising acquisition-related costs in profit or loss.

Like IFRS, these principles apply to the acquisition of both the initial interest and additional interests of the jointly controlled assets in respect of the acquired interest. However, when an additional interest is acquired, previously held interests in the joint operation are not remeasured, like IFRS.

If the joint operation does not constitute a business, then a cost-based approach is used and any existing assets are generally not remeasured, like IFRS.

Accounting by joint ventures for contributions received
Like IFRS, US GAAP is silent on how a joint venture itself should account for contributions received. In practice, the accounting by a joint venture often depends on whether it is a public or non-public entity. We understand that the SEC Staff has not objected to public joint ventures measuring at fair value contributions of subsidiaries or groups of assets that constitute businesses or non-profit activities and are not in-substance real estate or oil- and gas-producing activities. Joint ventures generally measure other contributions at the investor’s basis (i.e. carry-over basis), unless certain conditions are met – e.g. another investor’s cash contribution remains in the joint venture. However, non-public joint ventures may make an accounting policy choice to measure other contributions at either fair value or on a carry-over basis. Therefore, differences from IFRS may arise in practice.
3.8 Inventories

Overview

- Inventories are generally measured at the lower of cost and net realisable value.

- ‘Cost’ includes all direct expenditure to get inventory ready for sale, including attributable overheads.

- Decommissioning and restoration costs incurred through the production of inventory are included in the cost of that inventory.

- The cost of inventory is generally determined using the first-in, first-out (FIFO) or weighted-average cost method. The use of the last-in, first-out (LIFO) method is prohibited.

- Other cost formulas, such as the standard cost or retail methods, may be used if the results approximate actual cost.

- The same cost formula is applied to all inventories having a similar nature and use to the entity.

- The cost of inventory is recognised as an expense when the inventory is sold.

- Inventories are written down to net realisable value when net realisable value is less than cost.
Overview (continued)

– ‘Net realisable value’ is the estimated selling price less the estimated costs of completion and sale.

– If the net realisable value of an item that has been written down subsequently increases, then the write-down is reversed.

Scope exclusions

The inventories standard applies to all inventories, except:

– work in progress arising under construction contracts, including directly related service contracts (see chapter 4.2); and
– financial instruments (see chapter 7.1); and
– biological assets related to agricultural activity and agricultural produce before the point of harvest (see chapter 3.9). [IAS 2.2]

The inventories standard does not apply to the measurement of inventories held by:

– producers of agricultural and forest products and mineral ores that are measured at net realisable value in accordance with well-established practices in those industries; and
– commodity broker-traders who measure their inventories at fair value less costs to sell. [IAS 2.3]

The inventories standard applies to agricultural produce from the point of harvest (see chapter 3.9). [IAS 41.3]

Inventories exempt from the measurement aspects of the inventories standard are still required to comply with the disclosure requirements. [IAS 2.4–6]

Overview (continued)

– Like IFRS, ‘net realisable value’ is the estimated selling price less the estimated costs of completion and sale. Unlike IFRS, ‘market value’ is current replacement cost limited by net realisable value (ceiling) and net realisable value less a normal profit margin (floor).

– Unlike IFRS, a write-down of inventory to net realisable value (or market) is not reversed for subsequent recoveries in value unless it relates to changes in exchange rates.

Scope exclusions

Like IFRS, the inventories Codification Topic applies to all inventories, except:

– work in progress arising under construction contracts, including directly related service contracts (see chapter 4.2); and
– financial instruments (see chapter 7.1); and
– inventories of agricultural producers and cooperatives from the point of harvest (see chapter 3.9). [825, 330-905, 330-910]

The inventories Codification Topic does not apply to the measurement of:

– inventories of agricultural producers; development costs of land, trees and vines, intermediate-life plants and animals; product deliveries to co-operatives by members; and accounting by co-operatives for products received from members; instead, guidance in a separate Codification topic applies, which differs from IFRS in certain respects (see chapter 3.9); and
– commodities, whether held by a broker-dealer or by another entity; there is no specific guidance on accounting for commodity inventories and differences from IFRS may arise in practice.

Unlike IFRS, the inventories Codification Topic does not apply to agricultural produce from the point of harvest unless the scope criteria of that Codification Topic are not met (see chapter 3.9). [905-330-35-3, 35-4]

Unlike IFRS, inventories covered by other Codification topics/subtopics are not subject to the general disclosure requirements for inventories, but are subject to the disclosure requirements of those Codification topics/subtopics. [330-905 – 330-985]
Definition

‘Inventories’ are assets:
– held for sale in the ordinary course of business (finished goods);
– in the process of production for sale (work in progress); or
– in the form of materials or supplies to be consumed in the production process
  or in the rendering of services (raw materials). [IAS 2.6]

Inventory may include intangible assets that are produced for resale – e.g. software. Inventory also includes properties that have been purchased or are being developed for resale in the ordinary course of business. If an entity is a service provider, then inventory includes the cost of the service for which the entity has not recognised the related revenue. Financial assets held for resale are not accounted for as inventories (see chapter 7.4). [IAS 2.6, 38.2–3, 40.5, 9]

Recognition and derecognition

Inventory is recognised on the date on which the entity obtains the risks and rewards of ownership of the inventory. Generally, a legal principle establishes when the risks and rewards of ownership transfer.

The carrying amount of inventories is generally recognised as an expense when the inventories are sold. [IAS 2.34]

Measurement

Inventory is measured at the lower of cost and net realisable value (see below). [IAS 2.9]

Net realisable value write-downs are normally determined on an individual item basis. However, in some cases it may be appropriate to group together similar products. [IAS 2.29]

Definition

Like IFRS, ‘inventories’ are assets:
– held for sale in the ordinary course of business (finished goods);
– in the process of production for such sale (work in progress); or
– to be consumed in the production of goods or services to be available for sale
  (raw materials). [330-10-20]

Inventory does not include intangible assets and differences from IFRS may arise in practice – e.g. software inventory would include only costs incurred for duplicating, documenting and producing materials from the product masters and for physically packaging them for sale. Like IFRS, inventory includes properties that have been purchased or are being developed for resale in the ordinary course of business. If an entity is a service provider, then inventory might include the cost of the service for which the entity has not recognised the related revenue. Financial assets held for resale are not accounted for as inventories, like IFRS (see chapter 7.4). [330-10-30-18]

Like IFRS, assets held for resale, but not in the ordinary course of business, are not inventories. [IAS 2.6]

Unlike IFRS, US GAAP has no explicit guidance on accounting for assets that are rented out and then subsequently sold on a routine basis, and practice may vary. Proceeds from the sale would be accounted for in a manner consistent with the accounting for the asset.

Recognition and derecognition

Like IFRS, inventory is recognised on the date on which the entity obtains the risks and rewards of ownership of the inventory. Like IFRS, a legal principle generally establishes when the risks and rewards of ownership transfer.

Like IFRS, the carrying amount of inventories is generally recognised as an expense when the inventories are sold. [330-10-30-9, 30-10]

Measurement

Unlike IFRS, inventories whose cost is based on the last-in, first-out (LIFO) or retail methods are measured at the lower of cost and market. Other inventories are measured at the lower of cost and net realisable value, like IFRS. [330-10-35-1A – 35-1C]

Like IFRS, net realisable value (or market value) write-downs are normally applied separately to each item of inventory, although it may be appropriate to use a group or category of inventory in some cases. [330-10-35-9 – 35-10]
Cost

‘Cost’ includes purchase costs, production or conversion costs and other costs incurred in bringing inventory to its present location and condition. [IAS 2.10]

Purchase costs

‘Purchase costs’ include the purchase price, transport and handling costs, taxes that are not recoverable from the taxing authority and other costs directly attributable to the purchase. Cash, trade or volume discounts and rebates are deducted from the cost of purchase. [IAS 2.11]

IFRS provides limited guidance on amounts received from vendors. Amounts that represent a reduction in the prices of the manufacturer’s products or services (e.g. trade discounts, rebates and other similar items) are deducted from the cost of purchase. [IAS 2.11]

Costs of production or conversion

‘Costs of production or conversion’ include all direct costs such as labour, material and direct overheads, and an allocation of fixed and variable production overheads. ‘Labour costs’ include wage taxes, post-employment benefit costs and share-based payment costs associated with labour that is directly involved in the production process. The costs do not need to be external or incremental. [IAS 2.12]

The allocation of fixed production overheads is based on the normal capacity of production facilities. Unallocated overheads are recognised as an expense in the period in which they are incurred. Abnormal amounts of waste and spoilage are recognised in profit or loss. [IAS 2.13, 16]

Decommissioning and restoration costs incurred as a consequence of the production of inventory in a particular period are part of the cost of that inventory. Accordingly, the effect of any changes to an existing obligation for decommissioning and restoration costs related to items that have been sold is recognised in profit or loss. [IAS 16.16(c), 18, IFRIC 1.4]

Cost

Like IFRS, ‘cost’ includes purchase costs, production or conversion costs and other costs incurred in bringing inventory to its present location and condition. [330-10-30-1]

Purchase costs

Like IFRS, ‘purchase costs’ include the purchase price, transport and handling costs, taxes that are not recoverable from the taxing authority and other costs directly attributable to the purchase. Cash, trade or volume discounts and rebates are deducted from the cost of purchase, like IFRS. [330-10-35-22, 605-50-25-10]

Unlike IFRS, US GAAP has specific guidance on amounts received from vendors. Such amounts are presumed to be a reduction in the prices of the manufacturer’s products or services (e.g. trade discounts, rebates and other similar items) and are presented as a reduction in inventory cost. The presumption can be overcome if a payment is either for a separately identifiable benefit in exchange for the consideration or a reimbursement of costs incurred by the customer to sell the vendor’s products and the cash consideration is specific, incremental and identifiable. [605-50-45-12 – 45-15]

Costs of production or conversion

Like IFRS, ‘costs of production or conversion’ include all direct costs such as labour, material and direct overheads, and an allocation of fixed and variable production overheads. ‘Labour costs’ include wage taxes, pension and post-employment benefit costs, and share-based payment costs associated with labour that is involved directly in the production process, like IFRS. Also like IFRS, the costs do not need to be external or incremental. [330-10-30-3, 30-8]

Like IFRS, the allocation of fixed production overheads is based on the normal capacity of production facilities. Like IFRS, unallocated overheads are recognised as an expense in the period in which they are incurred. Abnormal amounts of waste and spoilage are recognised in profit or loss, like IFRS. [330-10-30-3, 30-7]

Unlike IFRS, asset retirement obligations (decommissioning costs) incurred as a consequence of the production of inventory in a particular period are not part of the cost of inventory, but are added to the carrying amount of the related property, plant and equipment. The subsequent depreciation of that cost is included in production overheads in future periods over the asset’s estimated remaining useful life (see chapter 3.2), unlike IFRS. [410-20-35-8]
Other costs

Selling and advertising costs are not included in the cost of inventory. [IAS 2.16]

Distribution costs and costs of transporting goods to customers are generally recognised as an expense as they are incurred. However, if such costs relate to goods in transit, then they are deferred and recognised when the related revenue is recognised. However, transport and distribution costs that are necessary to get the inventory to a present location or condition for sale form part of the cost of inventory. Similarly, packaging costs incurred to prepare inventory for sale are part of the cost of inventory. [IAS 2.10–11, 15]

Storage and holding costs are generally expensed as they are incurred, unless storage is necessary before a further stage in the production process, the inventory is produced as a discrete project or the inventory requires a maturation process to bring it to a saleable condition. [IAS 2.16(b)]

A production process may result in more than one output being produced. If the cost of the individual products cannot be identified, then the total production costs are allocated between the products on a rational and consistent basis. [IAS 2.14]

Borrowing costs are capitalised on inventory that is a qualifying asset (see chapter 4.6). [IAS 2.17, 23.4, 7, BC6]

A basis adjustment resulting from fair value hedging is an adjustment to the cost basis of inventory. Cash flow hedges are permitted to be treated as a basis adjustment when the inventory is acquired. Any such basis adjustments are an adjustment to the initial carrying amount of inventory (see chapter 7.7). [IAS 39.97–100]

Agricultural produce harvested from biological assets

Agricultural produce that an entity has harvested from its biological assets is measured at fair value less costs to sell at the point of harvest. This amount becomes deemed cost of the produce for the purpose of applying the inventories standard (see chapter 3.9). [IAS 2.20]

Other costs

Like IFRS, selling and advertising costs are not included in the cost of inventory. [330-10-30-6]

Like IFRS, distribution costs and costs of transporting goods to customers are generally recognised as an expense as they are incurred. However, like IFRS, if such costs relate to goods in transit, then they are deferred and recognised when the related revenue is recognised. Like IFRS, transport and distribution costs that are necessary to get the inventory to a present location or condition for sale form part of the cost of inventory, as are packaging costs incurred to prepare inventory for sale. [330-10-30-1]

Unlike IFRS, US GAAP does not contain specific guidance on storage and holding costs, which may give rise to differences from IFRS in practice.

Like IFRS, if a production process results in more than one output being produced and the cost of the individual products cannot be identified, then the total production costs are allocated between the products on a rational and consistent basis. [330-10-30-3]

Like IFRS, interest (borrowing costs) is capitalised on inventory that is a qualifying asset. However, the specific requirements differ from IFRS in certain respects (see chapter 4.6). [835-20-15-5]

Like IFRS, a basis adjustment resulting from fair value hedging is an adjustment to the cost basis of inventory. However, unlike IFRS, the amount recognised in accumulated OCI is reclassified to profit or loss in the period in which the inventory is sold, rather than adjusting the initial carrying amount (see chapter 7.7). [330-10-35-6]

Agricultural produce harvested from biological assets

Unlike IFRS, growing crops are accounted for at the lower of cost and net realisable value (see chapter 3.9). Also unlike IFRS, at harvest and until sale, crops are reported at fair value less costs of disposal (see chapter 3.9). [905-330-35-1 – 35-2]
Cost formulas

If items of inventory are not interchangeable or comprise goods or services produced for specific projects, then cost is determined on an individual item (specific identification) basis. If there are many interchangeable items, then the cost formula used is first-in, first-out (FIFO) or weighted-average cost. The last-in, first-out (LIFO) method is prohibited. [IAS 2.23, 25, BC9]

The same type of cost formula need not be used for all inventories. However, the same cost formula is applied to all inventories with a similar nature and use to the entity, even if they are held by different group entities or in different countries. [IAS 2.25–26]

The standard cost method may be used for convenience if the results approximate actual cost. No specific disclosures are required if this method is chosen. [IAS 2.21]

Under the retail method the cost of inventory is determined by reducing the retail value of the inventory by a gross margin percentage. The retail method may be used if the result approximates the actual costs. The retail amount should be reviewed regularly, in our view at least at each reporting date, to determine that it approximates cost. Adjustments should be made when inventory has been marked down to below its selling price. [IAS 2.21–22]

Changing the cost formula from, for example, FIFO to weighted-average is accounted for as a change in accounting policy (see chapter 2.8). [IAS 2.25, 36(a)]

Net realisable value

‘Net realisable value’ is the estimated selling price in the ordinary course of business less the estimated costs of completion and sale. [IAS 2.6]

The estimated costs of sale include relevant marketing and distribution costs. [IAS 2.6]
The estimated selling price takes into account the intended use of the items. [IAS 2.31]

Changes in exchange rates may require a net realisable value write-down.

If an entity has a contract to sell inventory for less than the cost of fulfilling its obligations under the contract, then it has an onerous contract and a provision may be necessary if the write-down to net realisable value is insufficient to absorb the loss (see chapter 3.12). [IAS 2.31]

Any write-down to net realisable value is recognised as an expense, but IFRS does not specify in which line item the write-down is included. In our view, write-downs of inventory as well as any reversals should be presented in cost of sales. [IAS 2.34]

Reversals of previous write-downs are recognised in profit or loss in the period in which the reversal occurs. [IAS 2.34]

Like IFRS, the estimated selling price takes into account the intended use of the items, although this would generally be the price in the ordinary course of business. [330-10-35-2 – 35-5]

Like IFRS, changes in exchange rates may require a write-down to net realisable value (or market value). [830-10-55-8]

Unlike IFRS, US GAAP does not permit recognising provisions for onerous contracts for the sale of inventory unless required by specific guidance (see chapter 3.12). However, a loss on a firm purchase commitment is recognised, like IFRS. [605-35-25-46]

Any write-down to net realisable value (or market value) is normally included in cost of goods sold, like IFRS. [330-10-50-1]

Unlike IFRS, reversals of previous write-downs are not permitted, unless they relate to changes in exchange rates. [330-10-35-14, 835-10-50-8]
3.9 Biological assets

Overview

- Biological assets are measured at fair value less costs to sell unless it is not possible to measure fair value reliably, in which case they are measured at cost. Gains and losses from changes in fair value less costs to sell are recognised in profit or loss.

- Agricultural produce harvested from a biological asset is measured at fair value less costs to sell at the point of harvest. After harvest, the inventories standard generally applies.

Definition and scope

‘Biological assets’ are living animals and plants that are capable of biological transformation or harvest into either agricultural produce that is accounted for as inventory (see chapter 3.8) or other biological assets. Determining whether an asset is a biological asset or inventory sometimes depends on the purpose for which the asset is held. [IAS 41.5]

Animals or plants that are not subject to a process of management of biological transformation are not in the scope of the agriculture standard. [IAS 41.1, 6]

Bearer plants are accounted for in accordance with the property, plant and equipment standard (see chapter 3.2), rather than under the agriculture standard. Therefore, the cost model is permitted as an accounting policy choice. However, any produce growing on bearer plants is accounted for under the agriculture standard. [IAS 41.1(a), 2(b)]

US GAAP has a Codification Topic applicable only to agricultural producers and co-operatives, and does not use the term ‘biological assets’. Crops are segregated into ‘growing crops’ and ‘harvested crops’. Animals are segregated into ‘developing animals’, ‘animals available and held for sale’, and ‘production animals’ (e.g. dairy cattle). [905-330-05-2]

Unlike IFRS, animals and plants not held by agricultural producers or co-operatives are not in the scope of the Codification Topic. [905-10-05-1]

Direct and indirect development costs of groves, orchards and vineyards are required to be capitalised during the development period and depreciated over the estimated useful life of the particular asset, which may result in the same outcome as under IFRS when the cost model is elected. Unlike IFRS, such assets are not permitted to be revalued. Unlike IFRS, produce growing on bearer plants is not accounted for separately until the point of harvest. [905-330-35-4, 905-360-25-3, 360-35, ARB 43, Ch 98.1]
A ‘bearer plant’ is a plant that is:
– used in the supply of agricultural produce;
– expected to bear produce for more than one period; and
– has a remote likelihood of being sold as agricultural produce, except for scrap sales. [IAS 41.5]

Land is not a biological asset in the scope of the agriculture standard, even if it is used in the production of such assets. Such land is accounted for as property, plant and equipment (see chapter 3.2). [IAS 41.2(a)]

**Measurement**

Biological assets are measured at fair value less costs to sell. If the fair value of a biological asset cannot be measured reliably at the date of initial recognition, then the asset is stated at cost less any accumulated depreciation and less any accumulated impairment losses. The presumption that the fair value of a biological asset can be measured reliably can be rebutted only on initial recognition when quoted market prices are not available and alternative fair value measurements are determined to be clearly unreliable. If fair value subsequently becomes reliably measurable, then the asset is measured at fair value less costs to sell. Once a biological asset has been measured at fair value less costs to sell, it continues to be measured on this basis until disposal. Changes in fair value less costs to sell are recognised in profit or loss. [IAS 41.12, 26, 30–31, BC4C, IU 07-17]

**Fair value measurement**

For a discussion of fair value measurement, see chapter 2.4.

Because biological assets are measured at their fair value less costs to sell based on their exit price, as discussed in chapter 2.4, costs involved in developing biological assets are expensed as they are incurred. [IAS 41.12]

US GAAP does not use the term ‘bearer plant’. However, there is specific guidance on accounting for groves, orchards and vineyards, which would generally meet the definition of bearer plants under IFRS. [905-360-20]

Although land used for agriculture is subject to the Codification Topic for agricultural producers and co-operatives, these requirements are generally the same as for property, plant and equipment (see chapter 3.2), and therefore differences from IFRS in practice are not expected for land used in the production of biological assets. [905-360-05-2]

**Measurement**

Unlike IFRS, ‘growing crops’ and ‘animals being developed for sale’ (which are what would be described as biological assets under IFRS) are classified as inventory and therefore are measured at the lower of cost and market (see chapter 3.8). [905-330-35-1 – 35-2]

Unlike IFRS, ‘other livestock’ such as production animals (dairy cattle, sheep and breeding stock), which would also be described as biological assets under IFRS, are accounted for as property, plant and equipment and the historical costs are depreciated over the animals’ useful lives. Animals with short productive lives, such as poultry, may be classified as inventory, unlike IFRS. [905-330-25-3, 905-360-30-4 – 30-5]

Unlike IFRS, the measurement for crops, whether at the lower of cost and market or at sales price less costs of disposal, starts at the point of harvest, which is when these crops are first transferred to inventory under IFRS (see chapter 3.8). Once animals are held for sale, they are measured either at the lower of cost and market, or at sales price less estimated costs of disposal if specific criteria are met (see below). [905-330-25-1 – 25-2, 905-360-30-2]

**Fair value measurement**

For a discussion of fair value measurement, see chapter 2.4.

Unlike IFRS, US GAAP requires growing crops to be measured at the lower of cost and market. Therefore, the costs involved in developing the growing crops and animals being developed for sale are capitalised in measuring cost. [905-330-35-1 – 35-2]
Agricultural produce

‘Agricultural produce’, which is the harvested product of an entity’s biological assets, is measured at fair value less costs to sell at the point of harvest. This amount becomes deemed cost for the purposes of subsequent accounting under the inventories standard (see chapter 3.8). [IAS 41.3, 13, 32]

After harvest, agricultural produce is treated as inventory (see chapter 3.8), even if the harvested produce requires additional biological transformation or harvest (e.g. fermentation). [IAS 41.IN2]

Agricultural produce

Unlike IFRS, ‘harvested crops’ and ‘animals held for sale’ (which would be described as agricultural produce under IFRS) are measured at sales price less costs of disposal, with changes recognised in profit or loss, only when the harvested crop or animal held for sale:

- has a reliable, readily determinable and realisable market value;
- has relatively insignificant and predictable costs of disposal; and
- is available for immediate delivery. [905-330-35-3]

Harvested crops and animals held for sale for which these criteria are not met are measured at the lower of cost and market (see chapter 3.8), unlike IFRS. [905-330-35-3]

Unlike IFRS, crops need to be available for immediate delivery in order to be treated as ‘harvested’ – i.e. there should be no additional biological transformation expected. There may be instances in which additional costs such as costs of special tillage, chopping or burning are required after harvest of a particular crop to overcome a physical or noxious condition; however, those costs are estimated and accrued as costs of the harvested crop, which is not considered an additional biological transformation as it is in IFRS. [905-330-30-2]
3.10 Impairment of non-financial assets

Overview

- The impairment standard covers the impairment of a variety of non-financial assets, including: property, plant and equipment, intangible assets and goodwill, investments in subsidiaries and equity-accounted investees.

- Impairment testing is required when there is an indication of impairment.

- Annual impairment testing is required for goodwill and intangible assets that are not yet available for use or have an indefinite useful life. This impairment test may be performed at any time during the year provided that it is performed at the same time each year.

- Depending on the specific asset and circumstances, assets are tested for impairment as an individual asset, as part of a cash-generating unit (CGU) or as part of a group of CGUs. A CGU is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or groups of assets.

Overview

- Like IFRS, the impairment Codification Topics deal with the impairment of a variety of non-financial long-lived assets, including: property, plant and equipment, intangible assets and goodwill. However, unlike IFRS, different topics/subtopics address the impairment of biological assets and investments in equity-method investees.

- Like IFRS, impairment testing is required when there is an indicator of impairment.

- Like IFRS, annual impairment testing is required for goodwill and intangible assets that have an indefinite useful life. Unlike IFRS, intangible assets not yet available for use are tested for impairment only if there is an indicator of impairment. Like IFRS, the impairment test may be performed at any time during the year provided that it is performed at the same time each year.

- Unlike IFRS, depending on the specific asset and circumstances, assets are tested for impairment as an individual asset, as part of an asset group or at the reporting unit (RU) level.
  - An asset group is the lowest level for which there are identifiable cash flows (i.e. both cash inflows and cash outflows) that are largely independent of the net cash flows of other groups of assets, which may differ from a CGU under IFRS.
  - An RU is an operating segment or one level below an operating segment if certain conditions are met, unlike IFRS.
Overview (continued)

- Whenever possible, an impairment test is performed for an individual asset. Otherwise, assets are tested for impairment in CGUs.

- Goodwill is allocated to CGUs or groups of CGUs that are expected to benefit from the synergies of the business combination from which it arose. The allocation is based on the level at which goodwill is monitored internally, restricted by the size of the entity’s operating segments.

- The carrying amount of goodwill is grossed up for impairment testing if it arose in a transaction in which NCI were measured initially based on their proportionate share of identifiable net assets.

- An impairment loss is recognised if an asset’s or CGU’s carrying amount exceeds its recoverable amount. ‘Recoverable amount’ is the higher of fair value less costs of disposal and value in use (which is always based on the net present value of future cash flows). The impairment loss is measured as the difference between the carrying amount of the asset, or CGU, and its recoverable amount.

Overview (continued)

- Impairment tests for long-lived assets subject to depreciation or amortisation are applied to individual assets if possible, like IFRS. If this is not possible, then these assets are tested for impairment at the asset group level; an asset group may or may not be a CGU under IFRS. Unlike IFRS, certain long-lived depreciable or amortisable assets have a separate impairment test (e.g. capitalised software intended for sale). Unlike IFRS, an indefinite-lived intangible asset is generally tested as an individual asset.

- Unlike IFRS, goodwill is allocated to RUs that are expected to benefit from the synergies of the business combination from which it arose.

- Unlike IFRS, the carrying amount of goodwill is not grossed up for impairment testing because NCI are measured at fair value in the acquisition accounting.

- Unlike IFRS, an impairment loss is triggered for assets other than goodwill and identifiable intangibles with indefinite lives only if the asset’s, or asset group’s, carrying amount exceeds its recoverable amount (i.e. the carrying amount is less than the undiscounted cash flows of the asset or asset group). If the carrying amount is not recoverable, then the impairment loss is the difference between the carrying amount of the asset (asset group) and the fair value of the asset (asset group), unlike IFRS.
  - Unlike IFRS, goodwill is impaired if the RU’s fair value is less than its carrying amount and the amount of the impairment is measured as the difference between goodwill’s ‘implied’ fair value and its carrying amount. See forthcoming requirements.
  - Unlike IFRS, an indefinite-lived identifiable intangible asset is impaired if its fair value is less than its carrying amount.
Overview (continued)

– Estimates of future cash flows used in the value in use calculation are specific to the entity, and need not be the same as those of market participants. Conversely, estimates of future cash flows used to estimate fair value less costs of disposal are consistent with those of a market participant. All cash flows used to estimate the recoverable amount are discounted to a present value. The discount rate used in the value in use calculation reflects the market’s assessment of the risks specific to the asset or CGU.

– An impairment loss for a CGU is allocated first to any goodwill and then pro rata to other assets in the CGU that are in the scope of the impairment standard.

– An impairment loss is generally recognised in profit or loss. An exception relates to assets revalued through OCI.

– Reversals of impairment are recognised, other than for impairments of goodwill. A reversal of an impairment loss is generally recognised in profit or loss. An exception relates to assets revalued through OCI.

Scope

The impairment standard deals with the impairment of all assets except for:

– investment property measured at fair value (see chapter 3.4);
– financial assets (see chapter 7.6);
– inventories (see chapter 3.8);
– deferred tax assets (see chapter 3.13);
– assets arising from construction contracts (see chapter 4.2);
– assets arising from employee benefit plans (see chapter 4.4);
– deferred acquisition costs and intangible assets arising from an insurer’s contractual rights under insurance contracts in the scope of the insurance standard (see chapter 8.1);

– Unlike IFRS, estimates of future cash flows used to assess the recoverability of depreciable or amortisable assets (asset groups) are always consistent with those of a market participant. Unlike IFRS, the cash flows used to determine recoverability (before calculating an impairment loss) are not discounted.

– Unlike IFRS, an impairment loss for an asset group is allocated pro rata to assets in the asset group, excluding working capital, goodwill, corporate assets and indefinite-lived intangible assets. Goodwill and indefinite-lived intangible assets are tested after the asset group has been tested for impairment and separately as a reporting unit, unlike IFRS.

– Unlike IFRS, impairment losses are always recognised directly in profit or loss and the revaluation of property, plant and equipment and intangible assets is not permitted.

– Unlike IFRS, reversals of impairments are prohibited.

Scope

Like IFRS, the impairment Codification Topics deal with the impairment of all assets, except for:

– financial assets (see chapter 7.6);
– inventories (see chapter 3.8);
– deferred tax assets (see chapter 3.13);
– assets arising from construction contracts (see chapter 4.2);
– assets arising from employee benefit plans (see chapter 4.4);
– deferred acquisition costs and intangible assets arising from an insurer’s contractual rights under insurance contracts (see chapter 8.1); and
– other intangible assets for which specific guidance is applicable (e.g., capitalised software intended for sale). [350-20-35, 350-30-35, 360-10-35-16 – 35-37]
Summary of approach

The following is a summary of certain aspects of impairment testing under IFRS, which are explained in more detail below.

- Goodwill is tested for impairment annually, as are indefinite-lived intangible assets and intangible assets not yet available for use, or more frequently if there is an indicator of impairment.
- Other assets are tested for impairment when there is an indication of impairment.
- Whenever possible, an asset is tested for impairment on its own; otherwise, assets are grouped into cash-generating units (CGUs) and tested.
- An asset is impaired when its carrying amount exceeds its recoverable amount. Recoverable amount is determined for an individual asset unless that asset does not generate cash inflows that are largely independent of those from other assets or group of assets. If this is the case, then recoverable amount is determined for CGUs.
- Corporate assets that contribute to more than one CGU are allocated to CGUs and are tested as part of the testing of individual CGUs if there is an indicator of impairment. If allocation is not possible, then the CGUs to which corporate assets relate are tested together if there is an indicator of impairment.
- Goodwill is allocated to CGUs and tested for impairment at least annually, either as part of the testing of individual CGUs if there is an indicator of impairment, or as a separate test if there is no indicator of impairment.
- An “impairment loss” is the excess of an asset’s (CGU’s) carrying amount over its recoverable amount.
- ‘Recoverable amount’ is the higher of value in use (which reflects entity-specific future cash flows) and fair value less costs of disposal (which reflects market participant assumptions – see chapter 2.4).

Unlike IFRS, the impairment Codification Topics:

- exclude all assets that would be biological assets, under IFRS, which are covered by industry-specific guidance; and
- include long-lived assets (disposal groups) classified as held-for-sale (see chapter 5.4).

The impairment testing of equity-method investees, which differs from IFRS, is discussed in chapter 3.5.

A reference to the impairment testing of an asset in the rest of this chapter refers to an asset in the scope of the impairment standard.

Summary of approach

The following is a summary of certain aspects of impairment testing under US GAAP, which are explained in more detail and contrasted with IFRS below.

- A depreciable or amortisable asset is generally tested for impairment when there is an indicator of impairment. However, some assets have specific impairment tests (e.g. capitalised software intended for sale).
- Goodwill is tested for impairment annually, as are indefinite-lived intangible assets, or more frequently if there is an indicator of impairment.
- Long-lived depreciable and amortisable assets are tested for impairment in asset groups, which are defined as the lowest level of assets that generate identifiable cash flows that are largely independent of the cash flows from the other asset groups. An individual long-lived asset is tested for impairment whenever events or changes in circumstances indicate that the asset group is not recoverable. An individual asset is tested for recoverability only if it meets the definition of an asset group.
- Intangible assets with an indefinite life are tested for impairment at the individual asset level unless they are operated as a single asset and as such they are essentially inseparable from one another.
- Corporate assets are generally tested for impairment at the entity level.
- Goodwill is allocated to reporting units (RUs) and tested for impairment at least annually at that level.
- A long-lived asset (asset group) is impaired if its carrying amount exceeds its recoverable amount.
- Other than for goodwill, indefinite-lived intangible assets and other long-lived assets for which there is a separate impairment test, recoverable amount is based on undiscounted future cash flows of the asset (asset group). If an asset (asset group) is impaired, then the amount of the impairment is calculated with reference to the fair value of that asset (asset group).
Asset groupings

Impairment tests are applied to the individual asset if the asset generates cash inflows that are largely independent of those from other assets or groups of assets. When this is not possible, assets are tested for impairment in groupings called CGUs. [IAS 36.66]

A CGU is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or groups of assets. [IAS 36.6]

IFRS does not have a category of asset groupings other than CGUs.

If an active market exists for the output from a group of assets, then that group of assets is a separate CGU even if the output is sold only to other units of the same entity. [IAS 36.70]

Corporate assets are assets other than goodwill that contribute to the future cash flows of more than one CGU. If possible, corporate assets are allocated to CGUs on a reasonable and consistent basis. [IAS 36.100–102]

Goodwill may be impaired if the carrying amount of the RU containing the goodwill is greater than its fair value or if the carrying amount of the RU is negative and other indicators of impairment exist (these are referred to as ‘Step 1’). If Step 1 indicates that goodwill may be impaired, then in Step 2 the amount of the impairment is measured as the difference between the carrying amount and the ‘implied’ fair value of the goodwill. See forthcoming requirements.

An indefinite-lived intangible asset is impaired if its carrying amount exceeds its fair value.

Entities are permitted to assess qualitative factors to evaluate whether it is more likely than not that goodwill or identifiable long-lived assets are impaired; this is sometimes referred to as Step 0. If, based on a qualitative assessment, an entity determines that it is not more likely than not that the fair value of an RU (for goodwill) or an identifiable indefinite-lived intangible is less than its carrying amount, then a quantitative test is not required.

In addition to asset groups, US GAAP defines an RU as an operating segment (see chapter 5.2) or one level below an operating segment if certain criteria are met (see below). [350-20-35-33 – 35-38]

Unlike IFRS, even if an active market exists for the output from a group of assets, that group of assets is not a separate asset group unless cash flows are generated predominantly from transactions with external parties. [360-10-35-23]

Corporate assets are assets that lack identifiable cash flows that are largely independent of the cash flows of other groups of assets. [360-10-35-24]
For impairment testing purposes, goodwill is allocated to those CGUs or groups of CGUs that are expected to benefit from the synergies of the combination even if no other assets or liabilities of the acquiree are assigned to that CGU. The allocation is determined at the date of acquisition. [IAS 36.80]

Each CGU or group of CGUs to which goodwill is allocated:
- represents the lowest level within the entity for which information about goodwill is available and monitored for internal management purposes; but
- cannot be larger than an operating segment before aggregation, determined in accordance with the operating segments standard (see chapter 5.2). [IAS 36.80]

**When to test for impairment**

An entity assesses at each reporting date whether there is an indication that an asset is impaired. [IAS 36.9]

Impairment testing is required both:
- for any asset when there is an indication of a possible impairment at the reporting date; and
- annually for the following assets, regardless of whether there is an indication of a possible impairment:
  - intangible assets with an indefinite useful life and intangible assets not yet available for use (see chapter 3.3); and
  - CGUs to which goodwill has been allocated. [IAS 36.9–10]

The annual impairment test for goodwill, indefinite-lived intangible assets and intangible assets not yet available for use may be performed at any time during the annual reporting period, but is performed at the same time each year. [IAS 36.10, 96]

If the goodwill relates to a business combination that occurred during the current reporting period, then the related CGUs are generally tested for impairment before the reporting date. [IAS 36.10, 84, 96]

Although goodwill is allocated to reporting units, which may differ from CGUs under IFRS, the allocation is done on the same basis as IFRS. Like IFRS, for impairment testing purposes, goodwill is allocated to those RUs that are expected to benefit from the synergies of the combination even if no other assets or liabilities of the acquiree are assigned to that RU. Like IFRS, the allocation is determined as at the date of acquisition. [350-20-35-41]

The groupings to which goodwill is allocated may differ from IFRS. Goodwill is allocated to RUs, which are:
- operating segments (see chapter 5.2); or
- one level below the operating segment level, if it constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of that component. [350-20-35-33 – 35-38]

**When to test for impairment**

Like IFRS, an entity assesses the recoverability of a depreciable or amortisable long-lived asset when there is an indication that an asset’s (asset group’s) carrying amount may no longer be recoverable. [360-10-35-21 – 35-22]

Impairment testing is required both:
- for any asset when there is an indication of a possible impairment during the reporting period, which is a broader requirement than IFRS; and
- annually for the following assets, regardless of whether there is an indication of a possible impairment:
  - intangible assets with an indefinite useful life, like IFRS;
  - intangible assets not yet available for use do not have to be tested for impairment annually (see chapter 3.3), unlike IFRS; and
  - RUs to which goodwill has been allocated, which is like IFRS except that RUs and CGUs are often at different levels. [350-20-35-28, 350-30-35-18, 360-10-35-21]

Like IFRS, the annual impairment test for goodwill and indefinite-lived intangible assets may be performed at any time during the annual reporting period, but is performed at the same time each year. [350-20-35-28]

Unlike IFRS, there is no specific requirement for goodwill arising from a business combination that occurred during the current reporting period to be tested for impairment before the reporting date. However, there is a requirement to test for impairment if a triggering event occurs in the recoverability of an asset group or an RU and an RU is tested at least annually, at the same time each year. [350-20-35-26 – 35-32, 350-30-35-14, 35-18, 360-10-35-21 – 35-22]


**Calculation of recoverable amount**

An asset or CGU is impaired if its carrying amount exceeds its recoverable amount. The recoverable amount of an asset or a CGU is the higher of its fair value less costs of disposal and its value in use. [IAS 36.6, 8]

If a CGU rather than an individual asset is tested for impairment (see above), then goodwill is included in that impairment test to the extent that goodwill was allocated to that CGU. [IAS 36.90]

If an indication of impairment exists in respect of a CGU that is smaller than the group of CGUs identified as relevant for goodwill impairment testing (and that includes the smaller CGU), then that smaller CGU is tested for impairment first. If it is determined that there is an impairment loss for that smaller CGU, then this impairment loss is recognised in the carrying amounts of the individual assets making up the smaller CGU, as appropriate. Only then is the larger CGU (or group of CGUs) tested for impairment (based on the revised carrying amounts for assets in the smaller CGU). [IAS 36.97]

Goodwill is impaired if the carrying amount of the CGU(s) to which it is allocated exceeds the recoverable amount of the CGU(s). [IAS 36.90]

**Calculation of recoverable amount**

Like IFRS, an asset or asset group is impaired if its carrying amount exceeds its recoverable amount. However, the term ‘recoverable amount’ means the undiscounted future cash flows that are directly associated with and that are expected to arise as a direct result of the use and eventual disposition of the asset or asset group, unlike IFRS. For the impairment of goodwill related to a reporting unit, ‘recoverable amount’ is the fair value of the reporting unit, unlike IFRS. [350-20-35-4, 360-10-35-17]

Unlike IFRS, goodwill is tested for impairment at the RU level. [350-20-35]

Like IFRS, if an indicator of impairment exists in respect of an asset group, then the asset group is first tested for impairment and any impairment loss is recognised as described above. However, as noted above, the determination of whether there is an impairment loss and if so how much of a loss differs from IFRS. Additionally, indefinite-lived intangible assets are tested for impairment before goodwill is tested for impairment at the RU level, unlike IFRS. [350-20-35-31, 360-10-35-27]

Unlike IFRS, when evaluating goodwill for impairment, there is a two-step process with an optional qualitative assessment (sometimes referred to as a ‘Step 0’). See forthcoming requirements.

- Before applying Step 1, entities are permitted, but not required, to evaluate qualitative factors to determine whether it is more likely than not that the fair value of the RU is below its carrying amount; if not, an entity does not need to apply the two-step test below.
- Step 1 compares the fair value of the RU with its carrying amount. If the carrying amount is greater than its fair value, then the second step is to measure the amount of the goodwill impairment loss.
- Step 2 compares the implied fair value of the goodwill with its carrying amount. The ‘implied fair value’ of the goodwill is determined based on the value that would be ascribed to goodwill if the RU were acquired in a business combination at the date of the impairment test. The difference between the implied fair value of the goodwill and its carrying amount is the amount of the goodwill impairment loss. [350-20-35-3 – 35-13]
For the impairment testing of goodwill and indefinite-lived intangible assets, an entity may rely on its previous calculation of recoverable amount if:
- the assets and liabilities making up the relevant CGUs have not changed significantly since the last determination of recoverable amount;
- the last determination of recoverable amount resulted in carrying amount being exceeded by a substantial margin; and
- management assesses, based on an analysis of the facts and circumstances, that the likelihood of an impairment loss is remote. [IAS 36.24, 99]

Corporate assets (see above) are allocated to CGUs on a reasonable and consistent basis. If it is impracticable to allocate a portion of a corporate asset to a CGU on such a basis, then two levels of impairment testing are carried out.
- First, the individual CGU is tested without any portion of the corporate asset (‘bottom-up’ test).
- Second, the minimum collection of CGUs to which the corporate asset can be allocated reasonably and consistently is tested, including the corporate asset (‘top-down’ test). [IAS 36.102]

**Fair value less costs of disposal**
The fair value element of fair value less costs of disposal is measured in accordance with the fair value measurement standard (see chapter 2.4).

Costs of disposal are incremental costs directly attributable to the disposal of an asset or CGU. Finance costs and income taxes are excluded, as are costs already recognised as a liability. [IAS 36.6, 28]

**Value in use**
‘Value in use’ represents the discounted expected future net cash flows from the continuing use and ultimate disposal of an asset or CGU. [IAS 36.6, 31]

Unlike IFRS, an entity is not permitted to carry forward its previous calculation of the fair value of an RU or an indefinite-lived intangible asset; however, the previous calculation of the fair value of an RU may be considered in the optional qualitative assessment. [350-20-35-3C, 350-30-35-188]

Unlike IFRS, corporate assets are generally tested for impairment at the entity level when there is an indicator of possible impairment. [350-20-35-39, 360-10-35-24]

**Fair value**
The fair value measurement Codification Topic applies to all fair value measurements, including the impairment of long-lived assets, goodwill and other indefinite-lived intangible assets (see chapter 2.4). [820-10-35-2, 35-28]

Unlike IFRS, costs to sell are not included in determining whether assets held for use are impaired. [360-10-35-17]

**Recoverable amount**
Unlike IFRS, a ‘value in use’ type of measurement is not applicable in determining recoverability and is also not used for the impairment testing of long-lived assets. Instead, for US GAAP the ‘recoverable amount’ of a depreciable or amortisable asset (asset group) is the sum of the undiscounted cash flows that are expected to result from the use and eventual disposition of the asset or asset group. Therefore, the discussion in this section relates to the cash flows used in this test. [350-20-35, 360-10-35-17]
Cash flows
The value in use calculation is based on cash flows approved by management. These cash flow forecasts should cover a maximum of five years unless a longer period can be justified. Thereafter, the cash flow projections are extrapolated over the useful life of the asset or CGU using a steady or declining growth rate that is consistent with that of the product, industry or country, unless there is clear evidence to support another basis. [IAS 36.33, 35]

The cash flows used in the calculation are those specific to the entity – i.e. they incorporate the entity’s own assumptions about its future. [IAS 36.33]

Cash flows include cash inflows from continuing use, cash outflows necessary to generate the cash inflows including attributable overheads, and net cash flows from the ultimate disposal of the asset or CGU. [IAS 36.39, 41]

In general, estimates of future cash flows do not include cash outflows that will be required to settle obligations that have been recognised as liabilities, and these liabilities are not deducted from the carrying amount of the CGU. However, such cash outflows are included if a recognised liability needs to be considered in determining the recoverable amount of a CGU – e.g. when the disposal of a CGU would require the buyer to assume the liability. Such a liability is included in the carrying amount of the CGU to ensure consistency. [IAS 36.43, 78]

Inflows from assets that generate inflows that are largely independent of the cash inflows from the asset or CGU under review are also not included. [IAS 36.43]

IFRS does not provide specific guidance on cash flows related to environmental exit costs and the general principles apply (see above). If the disposal of a CGU would require the buyer to assume a liability (e.g. a decommissioning liability), then the carrying amount of the liability is deducted both from the CGU’s carrying amount and from its value in use. [IAS 36.78, IU 05-16]

Cash flows exclude amounts from financing activities. [IAS 36.50]

Cash flows
Cash flows used are those consistent with management’s internal budget assumptions and other information communicated to others, like IFRS. However, unlike IFRS, US GAAP specifies that cash flows should be projected for the remaining useful life of the primary asset of the group – i.e. it does not limit the period for which cash flow forecasts may be used. [360-10-35-29 – 35-35]

Like IFRS, the cash flows used to test the recoverability of depreciable and amortizable assets are those specific to the entity. [360-10-35-30]

Like IFRS, cash flows include only the future cash flows that are directly associated with, and that are expected to arise as a direct result of, the use and eventual disposal of the asset (asset group). Unlike IFRS, US GAAP does not address whether cash flow projections include attributable overheads, and therefore differences from IFRS may arise in practice. [360-10-35-29 – 35-35]

Like IFRS, cash flows of an asset group exclude the principal amount of any liabilities included in the asset group when that principal amount is not included in the carrying amount of the asset group. However, there are specific requirements for environmental exit costs (see below). [360-10-35-29]

Like IFRS, inflows from assets that generate inflows that are largely independent of the cash inflows from the asset or asset group under review are also not included. [360-10-35-23]

Unlike IFRS, for environmental exit costs that have not been recognised as a liability, whether they are included in the undiscounted expected future cash flows used to test a long-lived asset for recoverability depends on management’s intent with respect to the asset. Like IFRS, for environmental exit costs that have been recognised as a liability, the carrying amount of the asset (asset group) being tested for impairment includes the amount capitalised on the asset. Like IFRS, the estimated future cash flows to settle the liability are excluded from the undiscounted future cash flows used to test the asset for recoverability. [360-10-55-7 – 55-18]

Like IFRS, the estimates of future cash flows used to test recoverability exclude interest that will be recognised as an expense as it is incurred. [360-10-35-29]
Cash flow estimates reflect the asset in its current condition. Therefore, they exclude future capital expenditure that will improve or enhance the asset’s performance, or restructurings to which the entity is not yet committed and the expected benefits related to restructuring. [IAS 36.44–47]

Expenditure that is necessary to maintain the performance of an asset is included in the cash flow estimates. [IAS 36.49]

If a CGU consists of assets with different useful lives, including indefinite-lived intangible assets or goodwill when appropriate, all of which are essential to its ongoing operation, then the replacement of assets and components with shorter lives is considered to be part of the day-to-day servicing of the unit. These servicing costs are included when estimating the cash flows of the CGU. [IAS 36.42]

If an asset is not ready for use and requires future expenditure to prepare it for use, then these expected cash outflows are included in the estimated cash flows. [IAS 36.43]

If a CGU sells or purchases goods or services from another operation within the same consolidated group, and the goods or services could be sold in an active market, then the market price for the goods or services is used when estimating the cash inflows. Additionally, if an active market exists for the output from a group of assets, then that group of assets is a separate CGU even if the output is sold only to other divisions of the same entity. [IAS 36.70]

If the cash flows of an asset or CGU are generated in a foreign currency, then the cash flows used in the calculation are in that foreign currency. If a CGU is a foreign operation, then any impairment loss is calculated in the foreign currency (the CGU’s functional currency) and is then translated into the entity’s presentation currency using the principles in chapter 2.7. [IAS 21.25, 36.54]

Like IFRS, estimates of future cash flows used to test recoverability reflect the asset in its current condition. Therefore, like IFRS, they exclude future capital expenditure that will improve or enhance the asset’s performance. However, unlike IFRS, cash flow projections under US GAAP can be produced using probability-weighted cash flows based on possible outcomes and may include the effect of restructurings to which the entity is not yet committed, and the expected benefits related to restructuring. Therefore, differences from IFRS may arise in practice. [360-10.35-29 – 35-35]

Like IFRS, only capital expenditure that is necessary to maintain the current service potential of an asset is included in cash flow estimates used to test recoverability. This would include expenditure necessary to reinvest in production capacity during the useful life of the primary asset of the asset group. [360-10.35-33]

Estimates of future cash flows used to test recoverability for an asset group are based on the primary asset of the group (i.e. the most significant component of the asset group generating cash flows), like IFRS. Therefore, like IFRS, the replacement of assets with shorter lives is included when estimating the cash flows. However, unlike IFRS, a primary asset cannot be an indefinite-lived intangible asset or goodwill. [360-10.35-31]

Like IFRS, for assets that are under development, cash outflows expected in preparing the asset for use are included in cash flow estimates used to test recoverability. [360-10.35-35]

Like IFRS, if an RU sells goods or services to another operation within the same consolidated group, and the goods or services could be sold in an active market, then the market price for the goods or services is used when estimating the cash flows used to test recoverability. However, unlike IFRS, even if an active market exists for the output from a group of assets, that group of assets is not a separate asset group for the purpose of testing depreciable and amortisable assets for recoverability unless cash flows are generated predominantly from transactions with external parties. [360-10.35-23]

Like IFRS, if the cash flows of an asset or asset group are generated in a foreign currency, then the cash flows used in the calculation are in that foreign currency. Like IFRS, any impairment loss for an asset (asset group) is calculated in the foreign currency and is then translated into the entity’s reporting currency using the principles in chapter 2.7. [360-10.35-29 – 35-35]
Discount rate
The discount rate is based on a market-related rate that reflects the current market assessment of risks specific to the asset at the current date. Therefore, although the cash flows in the value in use calculation are entity-specific, the discount rate is not. An entity typically estimates an appropriate rate using the weighted-average cost of capital (WACC) formula and may adjust the WACC to develop a market participant discount rate. [IAS 36.55–56, A16–A18, BCZ53]

Non-controlling interests
If NCI were initially measured based on their proportionate interest in the identifiable net assets of the subsidiary, then the carrying amount of goodwill allocated to such a CGU or group of CGUs is grossed up to include the unrealised goodwill attributable to the NCI. For impairment testing purposes, it is this adjusted carrying amount that is compared with the recoverable amount. This gross-up is not required if NCI were initially measured at fair value. [IAS 36.C4]

The impairment standard illustrates the gross-up of the carrying amount of goodwill allocated to a CGU or group of CGUs on the same basis as profit or loss is allocated to the parent and the NCI. However, in our view the standard does not preclude using another rational basis of gross-up – e.g. one that takes into account any control premium paid in the acquisition. [IAS 36.C4, IE62–IE65]

If a non-wholly owned CGU is impaired, then any impairment losses are allocated between the amount attributable to the parent and to NCI. The impairment standard refers to allocating the impairment loss on the same basis as profit or loss is allocated to the parent and the NCI (i.e. a mechanical allocation). However, in our view the standard does not preclude using another rational basis of allocation – e.g. one that takes account of any control premium paid in the acquisition. [IAS 36.C6]

If a non-wholly owned CGU is impaired, then to the extent that the impairment loss is allocated to NCI that were initially measured at their proportionate interest in the identifiable net assets of the subsidiary, that impairment is not recognised in the financial statements. [IAS 36.C6, C8, IE66–IE68]

Recognition and measurement of an impairment loss
An impairment loss is recognised to the extent that the carrying amount of an asset or a CGU exceeds its recoverable amount. [IAS 36.6, 59]

Discount rate
Unlike IFRS, the cash flows used to assess recoverability of depreciable and amortisable assets are not discounted. [360-10-35-17]

Non-controlling interests
Unlike IFRS, the carrying amount of goodwill is not grossed up for impairment testing because NCI are measured at fair value in the acquisition accounting (see chapter 2.6). [350-20-35-57A]

If a non-wholly owned RU is impaired, then any impairment losses are allocated between the amount attributable to the parent and to the NCI. Unlike IFRS, this allocation is required to be based on the initial allocation of goodwill between the parent and the NCI, which takes account of any control premium paid in the acquisition. [350-20-35-57A]

Because NCI are measured at fair value in the acquisition accounting (see chapter 2.6), the allocation of impairment losses to NCI measured on a different basis is not relevant.

Recognition and measurement of an impairment loss
Unlike IFRS, an impairment loss is recognised for a depreciable or amortisable asset (asset group) only if the carrying amount of the asset (asset group) exceeds its recoverable amount, which is the undiscounted entity-specific future cash flows of the asset (asset group). If the asset is not recoverable, then an asset’s (asset group’s) impairment is calculated with reference to the fair value of that asset (asset group) in comparison to its carrying amount. [360-10-35-17]
Impairment losses are generally recognised in profit or loss. However, assets that are measured at a revalued amount under another standard are first revalued applying the principles in the relevant standard. Any impairment loss is calculated on the basis of the revalued carrying amount. Any impairment loss is charged directly to the revaluation reserve in OCI to the extent that it reverses a previous revaluation surplus related to the same asset. Any excess is recognised in profit or loss. [IAS 36.60]

Any impairment loss is allocated first by writing down the goodwill that is allocated to the CGU and then pro rata to the CGU's other assets (including intangible assets) in the scope of the impairment standard on the basis of their carrying amount. However, no asset is written down to below its known recoverable amount. A liability for any remaining amount of the impairment loss is recognised only if it is required by another standard. [IAS 36.104–108]

Reversal of impairment

At each reporting date, an entity assesses whether there is an indication that a previously recognised impairment loss has reversed. If there is such an indication and the recoverable amount of the impaired asset or CGU increases subsequently, then the impairment loss is reversed. [IAS 36.110, 117]

An impairment loss is not reversed when the increase in recoverable amount is caused only by the passage of time – i.e. unwinding of the discount used in calculating value in use. [IAS 36.116]

An impairment loss for goodwill is never reversed, including an impairment loss recognised in a previous interim period. [IAS 36.122, 124, IFRIC 10.8]

The maximum amount of a reversal is the amount necessary to restore the assets of the CGU to their pre-impairment carrying amounts, less subsequent depreciation or amortisation that would have been recognised. [IAS 36.117, 123]
A reversal of an impairment loss is generally recognised in profit or loss. A reversal of an impairment loss on a revalued asset is recognised in profit or loss to the extent that it reverses an impairment loss on the same asset that was previously recognised as an expense in profit or loss. Any additional increase in the carrying amount of the asset is treated as a revaluation increase. In our view, a reversal should be allocated only to previously impaired assets that are still used and are part of the CGU at the date of reversal, irrespective of the CGU in which the assets were originally impaired. [IAS 36.119]

**Forthcoming requirements**

There are no forthcoming requirements under IFRS.

Goodwill is impaired if the carrying amount of the CGU(s) to which it is allocated exceeds the recoverable amount (the higher of fair value and value in use) of the CGU(s). An impairment loss is the excess of an asset's (CGU's) carrying amount over its recoverable amount. [IAS 36.6, 90]

**Forthcoming requirements**

Amendments to the intangibles Codification Topic are effective for annual periods beginning after 15 December 2019 (public business entities that file with the SEC), after 15 December 2020 (public business entities that do not file with the SEC) or after 15 December 2021 (other entities); early adoption is permitted for goodwill impairment tests with measurement dates after 1 January 2017. [ASU 2017-04]

Unlike IFRS, goodwill is impaired if the carrying amount of the RU to which it is allocated exceeds the fair value of the RU. An impairment loss is the excess of the RU’s carrying amount over its fair value, which may differ from the amount calculated under IFRS. The existing Step 2 test, which compares the carrying amount of the RU to its implied fair value to measure the amount of the impairment loss, is eliminated. [350-20-35-2]
**Overview**

- A provision is recognised for a legal or constructive obligation arising from a past event, if there is a probable outflow of resources and the amount can be estimated reliably. ‘Probable’ in this context means more likely than not.

- A ‘constructive obligation’ arises when an entity’s actions create valid expectations of third parties that it will accept and discharge certain responsibilities.

- A provision is measured at the ‘best estimate’ of the expenditure to be incurred.

- If there is a large population of items, then the obligation is generally measured at its expected value.

- If there is a continuous range of equally possible outcomes for a single event, then the obligation is measured at the mid-point in the range.

- If the possible outcomes of a single obligation are mostly higher (lower) than the single most likely outcome, then the obligation is measured at an amount higher (lower) than the single most likely outcome.

**Overview**

- A contingency (provision) is recognised if it is probable that a liability has been incurred and the amount is reasonably estimable. However, ‘probable’ in this context means likely to occur, which is a higher recognition threshold than IFRS.

- Like IFRS, a ‘constructive obligation’ arises when an entity’s actions create valid expectations of third parties that it will accept and discharge certain responsibilities. However, unlike IFRS, constructive obligations are recognised only if they are required by a specific Codification topic/subtopic.

- Unlike IFRS, a recognised contingency is measured using a ‘reasonable estimate’. However, under some Codification topics obligations that would be deemed a provision under IFRS are measured at fair value, unlike IFRS.

- Like IFRS, if there is a large population of items, then the obligation is generally measured at its expected value.

- Unlike IFRS, if no amount within a range is a better estimate than any other, then the obligation is measured at the low end of the range.

- Unlike IFRS, an obligation is measured at the single most likely outcome even if the possible outcomes are mostly higher or lower than that amount.
### Overview (continued)

- Provisions are discounted if the effect of discounting is material.

- A reimbursement right is recognised as a separate asset when recovery is virtually certain, capped at the amount of the related provision.

- A provision is not recognised for future operating losses.

- A provision for restructuring costs is not recognised until there is a formal plan and details of the restructuring have been communicated to those affected by the plan.

- IFRS does not specifically address provisions for contract termination costs.

- Provisions are not recognised for repairs or maintenance of own assets or for self-insurance before an obligation is incurred.

- A provision is recognised for a contract that is onerous.

- ‘Contingent liabilities’ are present obligations with uncertainties about either the probability of outflows of resources or the amount of the outflows, and possible obligations whose existence is uncertain.

### Overview (continued)

- Unlike IFRS, recognised contingencies are not discounted except in limited cases, in which case specific requirements apply that may differ from IFRS.

- Like IFRS, a reimbursement right is recognised as a separate asset. However, unlike IFRS, such a right is recognised when recovery is probable. Like IFRS, the asset is capped at the amount of the related recognised contingency.

- Like IFRS, a provision is not recognised for future operating losses.

- A provision for restructuring costs is not recognised until there is a formal plan and details of the restructuring have been communicated to those affected by the plan, unless the benefits will be paid under an ongoing post-employment benefit plan or a contractual arrangement, which differs from IFRS in certain respects.

- Unlike IFRS, a liability for contract termination costs is recognised only when the contract has been terminated pursuant to its terms or the entity has permanently ceased using the rights granted under the contract.

- Like IFRS, provisions are not recognised for repairs or maintenance of own assets or for self-insurance before an obligation is incurred.

- Unlike IFRS, there is no general requirement to recognise a loss for onerous contracts; such a provision is recognised only when required by a specific Codification topic/subtopic.

- Unlike IFRS, ‘loss contingencies’ are uncertain obligations, both recognised and unrecognised.
### Overview (continued)

- Contingent liabilities are not recognised except for those that represent present obligations in a business combination.

- Details of contingent liabilities are disclosed in the notes to the financial statements unless the probability of an outflow is remote.

- ‘Contingent assets’ are possible assets whose existence is uncertain.

- Contingent assets are not recognised in the statement of financial position. If an inflow of economic benefits is probable, then details are disclosed in the notes.

### Scope

This chapter deals with all provisions other than:
- restructurings recognised as liabilities in a business combination (see chapter 2.6);
- financial instruments including guarantees (see chapter 7.1);
- deferred taxes and income tax uncertainties (see chapter 3.13);
- provisions for construction contract losses (see chapter 4.2);
- provisions related to employee benefits (see chapter 4.4);

Unlike IFRS, the term ‘contingent liability’ under US GAAP refers to both recognised and unrecognised uncertain obligations. US GAAP does not have separate terms to describe contingent liabilities that meet the recognition criteria vs those that do not. [450-20-20]

Contingent liabilities that are recognised for US GAAP purposes are referred to as ‘provisions’ throughout this chapter for ease of comparison.

### Scope

Like IFRS, this chapter deals with all provisions (referred to as ‘contingencies’ under US GAAP) other than:
- restructurings recognised as liabilities in a business combination (see chapter 2.6);
- financial instruments including guarantees (see chapter 7.1);
- deferred taxes and income tax uncertainties (see chapter 3.13);
- provisions for construction contract losses (see chapter 4.2);
– liabilities for share-based payments (see chapter 4.5);
– liabilities for insurance contract obligations (see chapter 8.1); and
– non-onerous executory contracts. [IAS 37–2, 5]

The provisions dealt with in this chapter are in the scope of a single IFRS, the provisions standard.

**Definition and recognition**

A ‘provision’ is a liability of uncertain timing or amount. A provision is recognised when:

– there is a legal or constructive obligation arising from past events, or when it is more likely than not that a legal or constructive obligation has arisen from a past event;
– it is more likely than not that there will be an outflow of benefits; and
– the amount can be estimated reliably. [IAS 37.10, 14, 23]

Possible new legislation gives rise to a legal obligation when it is virtually certain to be enacted. However, in many cases it is not possible to be virtually certain that the legislation will be enacted before actual enactment. [IAS 3722]

A constructive obligation arises when an entity, by past practice or sufficiently specific communication to affected parties, has created a valid expectation in other parties that it will carry out an action. A management or board decision alone (e.g. to restructure) does not give rise to a constructive obligation; see below for decommissioning, and chapter 4.4 for termination benefits. [IAS 37.10, 75]

A past event gives rise to a present obligation if it is more likely than not that a present obligation exists at the reporting date. [IAS 37.15–16]

– provisions related to employee benefits (see chapter 4.4);
– liabilities for share-based payments (see chapter 4.5);
– liabilities for insurance contract obligations written by insurance entities (see chapter 8.1); and
– non-onerous executory contracts.

Unlike IFRS, under US GAAP there are different Codification topics that address different types of provisions. As a consequence, the comparison between IFRS and US GAAP differs depending on the type of provision.

**Definition and recognition**

Unlike IFRS, a ‘contingency’ (provision) is an existing condition or situation involving uncertainty about the range of possible loss to the entity. Unlike IFRS, a loss contingency (provision) is recognised when:

– it is probable that a liability has been incurred; ‘probable’ is defined as likely to occur, which is a higher threshold than ‘more likely than not’ under IFRS; and
– the amount is reasonably estimable. [450-10-20, 450-20-20, 25-2]

Unlike IFRS, under US GAAP, legal obligations arising from legislation are recognised only when the legislation is enacted. [410-20-20, 55-1]

Like IFRS, a constructive obligation arises when an entity has created a valid expectation in other parties that it will carry out an action. Like IFRS, a management or board decision alone does not give rise to a constructive obligation. However, unlike IFRS, constructive obligations are recognised only if recognition is required by a specific Codification topic/subtopic; see below for asset retirement obligations, and chapter 4.4 for termination benefits. [710-10-25-2]

Unlike IFRS, US GAAP focuses on whether it is probable that amounts will be paid rather than whether there is a present obligation; for asset retirement obligations and other provisions measured at fair value, probability is incorporated into the fair value measurement. [410-20-25-2, 450-20-25-2]
An entity may be subject to penalties only if obligating events are detected. In our view, if an entity is obliged to self-report obligating events, then the detection risk (i.e. the possibility that the event will not be detected) should not be considered when measuring the obligation. Examples of events that generally require self-reporting include, but are not limited to, taxes (see chapter 3.13 for income tax exposures) and, in some countries, environmental contamination. When self-reporting is not required and there is uncertainty about the amount of an obligation in respect of a past event, then we believe that it may be appropriate to consider detection risk in measuring the provision (i.e. the possibility that the event will not be detected).

If the existence of an obligation depends on the future actions of the entity, then a provision is not recognised until the obligation is unavoidable, except for guarantees (see chapter 7.1). [IAS 37.19]

Generally, a provision cannot be recognised for expenses to be incurred in a future period or future operating losses, with the exception of qualifying restructuring costs and onerous contracts (see below). [IAS 37.18, 63, 66]

A provision for restructuring costs is not recognised until there is a formal plan and details of the restructuring have been communicated to those affected by the plan. [IAS 37.71–72]

A ‘contingent liability’ is an obligation of sufficient uncertainty that it does not qualify for recognition as a provision, unless it is acquired in a business combination. The uncertainty may arise due to any of the following reasons.

- It is a possible obligation (i.e. one whose existence will be confirmed by the occurrence or non-occurrence of uncertain future events not wholly within the control of the entity). For example, if an entity is jointly and severally liable for an obligation, then the portion of the obligation that is expected to be met by other parties is an example of a possible obligation.

- It is a present obligation, but it is not more likely than not that there will be an outflow of resources embodying economic benefits, so that the probability of an outflow is 50 percent or less. An example is a claim against an entity if the entity concludes that it is liable but that it is likely to defend the case successfully.

- It is a present obligation, but its amount cannot be estimated reliably. These cases are expected to be extremely rare. [IAS 37.10, 29]

Like IFRS, if the existence of an obligation depends on the future actions of the entity, then a provision is not generally recognised until the obligation is unavoidable, except for guarantees (see chapter 7.1). However, some Codification topics/subtopics have different recognition requirements, which may result in differences from IFRS. [450-20-25-2, 460-10-25-3]

Like IFRS, a provision cannot be recognised for future expenses and operating losses unless a specific Codification topic/subtopic requires recognition — e.g. for qualifying restructuring costs (see below). [420-10-25-3, 450-20-25-3]

A provision for restructuring costs to terminate employees is not generally recognised until there is a formal plan and details of the restructuring have been communicated to those affected by the plan. However, if the benefits will be paid under an ongoing post-employment benefit plan or a contractual arrangement, then they are recognised when they are probable and reasonably estimable, unlike IFRS. [420-10-25-1 – 25-2, 25-4]

Unlike IFRS, the term ‘loss contingencies’ under US GAAP refers to both recognised and unrecognised uncertain obligations. US GAAP does not have separate terms to describe loss contingencies that meet the recognition criteria and those that do not.

Although both IFRS and US GAAP use the term ‘probable’ as a recognition threshold, under US GAAP ‘probable’ is defined as likely to occur, which is a higher recognition threshold than the more-likely-than-not (above 50 percent) threshold used under IFRS. [450-20-20]
Contingent liabilities are not recognised in the statement of financial position unless they were assumed in a business combination. In a business combination, a contingent liability is recognised if it is a present obligation that arises from past events and its fair value can be measured reliably (see chapter 2.6). [IFRS 3.23, IAS 37.27]

If a present obligation relates to a past event, the possibility of an outflow is probable (i.e. more likely than not) and a reliable estimate can be made, then the obligation is not a contingent liability, but instead is a liability for which a provision is required. [IAS 37.14]

The expectation that an outflow related to an obligation will be reimbursed – e.g. that an environmental obligation will be covered by an insurance policy – does not affect the assessment of the probability of an outflow for the obligation. [IAS 37.39]

A ‘contingent asset’ is a possible asset that arises from past events and whose existence will be confirmed by the occurrence or non-occurrence of uncertain future events not wholly within the control of the entity. [IAS 37.10]

Contingent assets are not recognised in the statement of financial position. When realisation of a contingent asset is virtually certain, it is no longer considered contingent and is recognised as an asset. [IAS 37.31, 33, 35]

Measurement
The amount recognised as a provision is the best estimate of the expenditure to be incurred. [IAS 37.36]

If the provision is being made for a large population of items, such as for product warranties, then the provision is measured at its expected value, which considers all possible outcomes weighted based on their probabilities. [IAS 37.39]

Items that are not probable to result in an outflow of resources are not recognised, like IFRS. However, unlike IFRS, there are exceptions for certain types of legal or contractual obligations that are recognised at fair value, such as asset retirement obligations and guarantees. Unlike IFRS, contingent liabilities that represent present obligations are recognised in a business combination only when (1) fair value is determinable within the measurement period (see chapter 2.6); or (2) it is probable that an obligation exists at the date of acquisition and the amount can be reasonably estimated. [450-20-25-2, 805-20-25-19 – 25-20]

Like IFRS, if a possible obligation relates to a past event, the possibility of an outflow is probable, which unlike IFRS means likely to occur, and a reasonable estimate can be made, then the obligation is recognised as a liability. [450-20-25-2]

Like IFRS, the expectation that an obligation will be reimbursed does not affect the assessment of the probability of an outflow for the obligation. [210-20-45]

A ‘gain contingency’ is an item whose existence will be confirmed by the occurrence or non-occurrence of uncertain future events, like IFRS. [450-20-25-2]

Unlike IFRS, gain contingencies are not recognised until they are realised (i.e. no longer contingent). However, if a gain contingency related to insurance recoveries offsets a recognised loss in the financial statements, then the gain contingency is recognised when it is probable (likely to occur) and collectible, unlike IFRS. [450-20-55-17A, 450-30-50-1]

Measurement
Unlike IFRS, the amount recognised as a provision depends on the specific Codification topic/subtopic that applies. In some cases, US GAAP requires a provision to be measured at fair value (e.g. asset retirement obligations or decommissioning, and one-time termination benefits); in other cases, it is the reasonably estimated amount, the best estimate or the expected value. [410-20-30-1, 410-30-30-1, 420-10-30-1, 450-20-30-1]

Like IFRS, provisions related to a large population are measured based on their expected value. [450-20-30-1]
If there is a continuous range of possible outcomes in which each value is as likely as any other, then the provision is measured at the mid-point of the range. [IAS 37:39]

If a single obligation is being measured and the possible outcomes are mostly higher (or mostly lower) than the single most likely outcome, then the amount provided for will be higher (lower) than the single most likely outcome. [IAS 37:40]

In our view, when a provision is measured at its best estimate, which is less than the amount that could be payable, the difference between the two amounts is not a contingent liability, and there is no requirement to disclose the possible additional obligation. [IAS 1.125, 37:85(b)]

IFRS does not provide much guidance on the types of costs to be included in the measurement of a provision. In our view, anticipated incremental costs that are related directly to the settlement of a provision should be included in the measurement of the provision to the extent that a third party who assumes the liability would require compensation. This is likely to be the case if the incremental costs are probable and can be estimated reliably. Therefore, we believe that costs that are not incremental should not be included in the measurement of a provision, even if there is a reasonable basis for allocating a portion of these costs to the settlement of the provision. [IAS 37:18, 36-37]

If the effect is material, then the estimate of a provision is discounted at a pre-tax rate that reflects the time value of money and the risks specific to the liability, even if the timing of the outflows is not fixed or determinable. Risk is reflected by adjusting either the cash flows or the discount rate. The rate of return on assets set aside to fund an obligation is not used to discount the provision. [IAS 37:45, 47]

Provisions are remeasured at each reporting date based on the best estimate of the expenditure to be incurred, and for changes in interest rates. [IAS 37:36, 59, IFRIC 1.4]

Unlike IFRS, if no amount within a range is a better estimate than any other, then the low end of the range is provided for when the probable criterion is met. [450-20-30-1]

Unlike IFRS, if the reasonable estimate of a loss is a range, and one amount within the range is considered a better estimate than any other amount, then that amount is provided for. [450-20-30-1]

Unlike IFRS, both the amount provided for and possible additional obligations above that amount are described under US GAAP as ’contingent liabilities’. Unlike IFRS, an entity provides either disclosure of the potential range of loss or a statement that an estimate cannot be made. [450-20-20, 50-4]

There is guidance on the measurement of certain provisions – e.g. environmental remediation liabilities, asset retirement obligations or involuntary redundancy. For provisions that are subject to the general guidance on the recognition of contingent liabilities, the incremental amount is provided for, like IFRS. [410, 420]

Unlike IFRS, provisions are not generally discounted. However, certain obligations (e.g. environmental remediation liabilities) are discounted if the amount and timing of payments is fixed or reliably determinable; such liabilities are generally discounted using a risk-adjusted rate, which may differ from IFRS. Obligations that are required to be measured at fair value (e.g. asset retirement obligations and one-time termination benefits) may be measured as discounted future cash flows, like IFRS. Like IFRS, the return on assets set aside to fund an obligation is not used to discount the provision. [410-20-30-1, 410-30-35-12, 420-10-30-2, 450-20-5-99-1]

Like IFRS, provisions are remeasured at each reporting date. However, the amounts may be different depending on whether measurement is based on current reasonable estimates of the settlement amount or fair value, which depends on which Codification topic/subtopic applies. Further differences from IFRS may arise because some topics/subtopics that require provisions to be discounted require an adjustment for changes in interest rates, whereas others prohibit adjustments for changes in interest rates (e.g. termination benefits). [410-20-35-3, 410-30-35-1 – 35-5, 420-10-35-4]
Future events are reflected in measuring a provision if there is sufficient objective evidence that they will occur. For example, a technological development that would make decommissioning less expensive is considered if there is evidence that the new technology will be available. [IAS 37.48–49]

Gains from the expected disposal of assets are not considered in measuring a provision. [IAS 37.51]

Reimbursements
Reimbursements (such as insurance recoveries, indemnities or warranties) are recognised as a separate asset when recovery is virtually certain. The amount recognised is limited to the amount of the related provision. Changes in the amount of a reimbursement right are recognised in profit or loss. [IAS 37.53]

Unlike IFRS, insurance recoveries are recognised as a separate asset when recovery is ‘probable’, which may be a lower recognition threshold than ‘virtually certain’. There is no specific guidance for other types of reimbursements, which may lead to differences from IFRS in practice. Like IFRS, the amount recognised is limited to the amount of the related provision. Changes in the amount of a reimbursement right are recognised in profit or loss, like IFRS. [410-30-35-8]

Specific application guidance
Restructuring
A ‘restructuring’ is a programme planned and controlled by management that significantly changes the scope of the business or the manner in which it is conducted. [IAS 37.10]

A constructive obligation for a restructuring arises only when:
- there is a formal plan for the restructuring specifying:
  - the business or part of a business concerned;
  - the principal locations affected;
  - the location, function and approximate number of employees whose services will be terminated;
  - the expenditure to be incurred; and
  - when the plan will be implemented; and
- the entity has raised a valid expectation in those affected that it will carry out the plan by either:
  - starting to implement the plan; or
  - announcing its main features to those affected by it. [IAS 37.72]

Implementation of the plan should begin as soon as possible and be completed in a timeframe that makes significant changes unlikely. [IAS 37.74]

For provisions measured at fair value, the provision reflects assumptions that market participants would make about the outcome of the uncertainty related to amount and timing, including uncertainty related to advances in technology, and the effects on cash flows if the information is available without undue cost and effort. Therefore, differences from IFRS may arise in practice. [820-10-35-9]

Like IFRS, gains from the expected disposal of assets are not considered in measuring a provision. [450-30-25-1]

Reimbursements
Unlike IFRS, insurance recoveries are recognised as a separate asset when recovery is ‘probable’, which may be a lower recognition threshold than ‘virtually certain’. There is no specific guidance for other types of reimbursements, which may lead to differences from IFRS in practice. Like IFRS, the amount recognised is limited to the amount of the related provision. Changes in the amount of a reimbursement right are recognised in profit or loss, like IFRS. [410-30-35-8]

Specific application guidance
Exit activities (restructuring)
The term ‘exit activities’ encompasses what would be a ‘restructuring’ under IFRS, but may be broader. The US GAAP requirements apply broadly to exit activities that do not necessarily involve a newly acquired business or the disposal of a business. [420-10-15-3]

Unlike IFRS, US GAAP divides restructuring into three types of cost:
- termination benefits;
- costs to terminate a contract; and
- costs to consolidate facilities or relocate employees. [420-10-05-2]

US GAAP contains separate criteria for the recognition of each type of cost (see below). [420-10-05-2]
For a discussion of accounting for employee termination payments, see chapter 4.4.

IFRS does not specifically address provisions for contract termination costs. However, an obligating event that results in an entity having no realistic alternative to settling the obligation would be provided for as an onerous contract – e.g. a lease contract under which the entity will continue to incur costs for its remaining term without economic benefit.

Restructuring provisions include only incremental costs associated directly with the restructuring. [IAS 3780]

IFRS prohibits the recognition of a provision for costs associated with ongoing activities. [IAS 3780(b), 81]

**Gift certificates or vouchers**

Retailers may sell gift vouchers that can be exchanged for goods or services. An entity selling such vouchers determines if the voucher is the unfulfilled portion of a contract. Whether an unfulfilled contract exists is usually determined based on the revenue recognition requirements and could arise if there are multiple deliverables with separate revenue streams. For further discussion of gift vouchers, including vouchers issued as part of a sales transaction and redeemable against future transactions, see chapter 4.2. [IAS 18, IFRIC 13]

**Warranties**

A warranty provision is measured based on the probability of the underlying goods requiring repair or replacement, and the best estimate of the costs to be incurred, in respect of defective products sold on or before the reporting date. See forthcoming requirements. [IAS 37:IE.C.Ex1]

Unlike IFRS, US GAAP has different requirements for the recognition of an employee termination payment depending on whether it is a one-time benefit, an ongoing benefit arrangement, or pursuant to a plan or a contract. For a discussion of accounting for employee termination payments, see chapter 4.4. [420-10-05-4]

Unlike IFRS, a provision for contract termination costs, in which a contract is terminated or the entity will continue to incur costs under a contract for its remaining term without economic benefit, is recognised only when the contract is terminated or when the entity permanently ceases using the rights granted under the contract. Therefore, the timing of recognition of a provision is likely to be later than IFRS. When the provision is recognised, it is measured at fair value, which may differ from IFRS. [420-10-25-11 – 25-13, 30-7]

Unlike IFRS, restructuring costs other than employee termination benefits and contract termination costs are recognised at fair value when the liability is incurred, which is generally in the period in which the goods or services (e.g. relocation services) are received. [420-10-25-15, 30-10]

Like IFRS, a provision cannot be recognised for costs associated with ongoing activities. [420-10-25-3]

**Gift certificates or vouchers**

Retailers may sell gift vouchers that can be exchanged for goods or services. Like IFRS, an entity selling such vouchers determines if the voucher is the unfulfilled portion of a contract. Whether an unfulfilled contract exists is usually determined based on the revenue recognition requirements and could arise if there are multiple deliverables with separate revenue streams, like IFRS. For further discussion of gift vouchers, including vouchers issued as part of a sales transaction and redeemable against future transactions, see chapter 4.2. [605-10-S99]

**Warranties**

Like IFRS, a warranty provision is measured using estimates of future outflows associated with the obligation. Although this is described as a ‘reasonable estimate’ under US GAAP, for warranty obligations this will generally represent the estimated cost of settling the warranty claim, like IFRS. See forthcoming requirements. [460-10-25-6, 25-6, 30-3 – 30-4]
Customer refunds
An obligation to give refunds to unsatisfied customers is considered in determining whether to recognise revenue. Revenue is recognised only if the right of return does not result in the seller retaining significant risks of ownership and the entity can estimate returns (see chapter 4.2). [IAS 18.16(d), 17.1.2(b)]

Assuming that the revenue recognition criteria are met, a past practice or published policy of giving refunds to unsatisfied customers creates a constructive obligation; the obligating event is the sale of the product. If it is probable that a certain portion of the goods sold will be returned, then a provision is recognised (at the same time as revenue is recognised) for the best estimate of the cost of refunds, applying the same principles as for warranty provisions. See forthcoming requirements. [IAS 37.1.E.C.Ex4]

Self-insurance
Entities may elect not to insure against some risks, or to obtain insurance that covers only a certain portion of incurred losses; this is sometimes referred to as ‘self-insurance’. A provision is not recognised for future losses or costs associated with self-insurance. However, a provision is recognised for costs related to loss events (insured or not) that occur before the reporting date. [IAS 37.14, 18]

Environmental provisions
Although there is no formal distinction between environmental and decommissioning provisions under IFRS, in general environmental provisions exclude provisions related to damage incurred in installing an asset (see decommissioning provisions below).

A provision is recognised for environmental obligations when:
– there is either a legal or constructive obligation to restore a site;
– the damage has already occurred;
– it is probable that a restoration cost will be incurred; and
– the costs can be reliably estimated. [IAS 37.14]

Future changes in environmental legislation give rise to a legal obligation only once they are virtually certain of being enacted. [IAS 37.22]

Customer refunds
US GAAP contains requirements for determining when revenue may be recognised if a sale is made subject to a right of return. As described in chapter 4.2, differences from IFRS may arise in practice. [605-15-25-1 – 25-4]

Like IFRS, assuming that the revenue recognition criteria are met, a past practice or published policy of giving refunds to dissatisfied customers creates an obligation that should be evaluated as a right of return; the obligating event is the sale of the product, like IFRS. If it is probable that a certain portion of the goods sold will be returned, then a provision is recognised (at the same time as revenue is recognised) for the best estimate of the cost of refunds. However, unlike IFRS, US GAAP does not refer to applying the same principles as for warranty provisions. Because the precise language between IFRS and US GAAP differs, differences may arise in practice. See forthcoming requirements. [605-15-15-2]

Self-insurance
Like IFRS, a provision is not recognised for future losses or costs associated with self-insurance. However, a provision is recognised for costs related to loss events (insured or not) that occur before the reporting date, like IFRS. [405-30-25-1]

Environmental provisions
Unlike IFRS, there is a distinction between obligations that arise from the ‘improper’ and the ‘normal’ operation of an asset. Environmental obligations relate to environmental remediation and environmental contamination that arises from the ‘improper’ operation of an asset. Environmental obligations that arise from the ‘normal’ operation of an asset are asset retirement (decommissioning) obligations (see below). [410-20-15-2 – 15-3, 410-30-15-3]

A provision is recognised for environmental obligations when:
– there is a legal obligation to restore a site, like IFRS;
– the damage has already occurred, like IFRS;
– it is probable that a restoration cost will be incurred; however, unlike IFRS, ‘probable’ means likely; and
– the costs can be reasonably estimated, like IFRS. [410-30-25-1, 25-3 – 25-4, 25-7, 450-20-20]

Unlike IFRS, changes in environmental legislation are not taken into account until they are enacted. [410-30-35-4]
A provision is measured at the best estimate of the future clean-up costs. It reflects the amount that the entity would be required to pay to settle the obligation that has been incurred at the reporting date. [IAS 37.36]

Anticipated cost savings arising from future improvements in technology are considered in measuring the provision only if their existence is reasonably certain. [IAS 37.36]

Environmental provisions are discounted if the effect of discounting is material. [IAS 37.45]

If an obligation to restore the environment arises on the initial recognition of the asset, then the amount is included in the cost of the related asset and is not recognised immediately in profit or loss (see chapter 3.2). [IAS 16.16(c)]

Decommissioning
Decommissioning obligations are obligations to make good environmental or other damage incurred in installing an asset – e.g. an obligation to dismantle an oil rig.

The decommissioning obligation is recognised immediately because the damage arises from a past event, which is the installation of the asset. [IAS 37.14]

Uncertainty over the timing of the obligation would generally result in recognition, with the uncertainty being considered in the best estimate measurement. [IAS 37.39]

The obligation is discounted at a pre-tax rate that reflects the time value of money and the risks specific to the liability, unless the future cash flows are adjusted for these risks. The discount rate used would not generally include an adjustment for an entity’s own credit risk. [IAS 37.47]

A provision is measured using a reasonable estimate of the future clean-up costs. As discussed above, a reasonable estimate may be a particular amount within a range that is better than any other estimate or, if no amount is better, the low end of that range, which may differ from the amount provided for under IFRS. [410-30-25-9]

Anticipated cost savings arising from future improvements in technology are considered in measuring the provision only if it is probable that the improvements will be formally accepted, which may result in differences from IFRS. [410-30-35-8]

Unlike IFRS, environmental liabilities are discounted only if the amount and timing of the cash outflows is fixed or reliably determinable. In practice, such provisions are not typically discounted, unlike IFRS. [410-30-35-12]

Unlike IFRS, an obligation related to environment damage is usually recognised immediately in profit or loss. [410-30-25-16]

Asset retirement obligation
Asset retirement obligations arise from the acquisition, construction or development of an asset, and include environmental remediation liabilities that relate to the ‘normal’ operation of the asset. [410-20-15-2 – 15-3]

Like IFRS, the obligation to make good environmental or other damage incurred in installing an asset is recognised immediately because the damage arises from a past event, which is the installation of the asset. However, the obligation associated with normal use is measured at fair value (asset retirement obligation) and the amount associated with other damage is measured as an environmental obligation (see above), which may give rise to differences from IFRS in practice. [410-20-15-2 – 15-3, 25-4]

Unlike IFRS, US GAAP provides that in some circumstances significant uncertainty about the timing of settlement results in a conclusion that the retirement obligation should not yet be recognised. [410-20-25-10]

Unlike IFRS, an asset retirement obligation is measured by discounting the expected cash flows using an interest rate that equates to a risk-free interest rate adjusted for the effect of the entity’s credit standing (a credit-adjusted risk-free rate). [410-20-55-10]
If an obligation to restore the environment or dismantle an asset arises on the initial recognition of the asset, then the amount is included in the cost of the related asset and is not recognised immediately in profit or loss (see chapter 3.2). [IAS 16.16(c)]

The effect of any changes to an existing obligation is added to or deducted from the cost of the related asset and depreciated prospectively over the asset’s remaining useful life (see chapter 3.2). Changes in the obligation include changes that arise from changes in the discount rate. [IFRIC 1.4–5]

If an obligation to dismantle or decommission an asset or restore the environment arises after the initial recognition of the asset, then a provision is recognised when the obligation arises. In our view, the estimated cost should be recognised as an adjustment to the cost of the asset and depreciated prospectively over the remaining useful life of the asset, assuming that the liability was not created through use of the item – e.g. production of inventory (see chapter 3.2). [IAS 37.14]

However, decommissioning and restoration costs incurred as a consequence of the production of inventory in a particular period are part of the cost of that inventory. The effect of any changes to an existing obligation for decommissioning and restoration costs related to items that have been sold is recognised in profit or loss (see chapter 3.8). [IAS 16.16(c), 18]

A provision reflects only damage incurred at the reporting date; a provision is not recognised for expected future damage. [IAS 37.18–19]

Environmental and similar funds

Sometimes funds are established to finance environmental or other remediation costs. A fund may be set up to meet the decommissioning costs of a single contributor or several contributors.

If the operator continues to bear the primary obligation for the decommissioning, then it continues to recognise a provision for its obligation and does not net its obligation with potential recoveries from the fund. [IFRIC 5.7]

Like IFRS, if an obligation to dismantle an asset arises on the initial recognition of the asset, then the amount is included in the cost of the related asset and is not recognised immediately in profit or loss (see chapter 3.2). [410-20-25-5]

Like IFRS, the effect of any changes to an existing obligation is added to or deducted from the cost of the related asset and depreciated prospectively over the asset’s remaining useful life if the initial recognition of the obligation resulted in an addition to the asset’s cost (see chapter 3.2). However, unlike IFRS, if the estimated amount of cash flows changes, then the original discount rate is used for decreases in estimated cash flows, but a current rate is used for increases in estimated cash flows; this results in a ‘layering’ of cash flows, with different discount rates associated with each layer. [410-20-35-1 – 35-8]

Like IFRS, if an obligation to dismantle or decommission an asset or restore the environment arises after the initial recognition of the asset, then a provision is recognised when the obligation arises. Like IFRS, the estimated cost is recognised as an adjustment to the cost of the asset and depreciated prospectively over its remaining useful life if it relates to the obligation to dismantle or decommission the asset (see chapter 3.2). [410-20-25-4 – 25-5, 35-1 – 35-2]

Unlike IFRS, asset retirement obligations incurred as a consequence of the production of inventory in a particular period are added to the carrying amount of the related asset; the subsequent depreciation of that cost is included in production overheads over the asset’s estimated remaining useful life. [410-20-25-5]

Like IFRS, a provision reflects only the obligation incurred at the reporting date; a provision is not recognised for an expected future obligation. [410-20-25-1]

Environmental and similar funds

Sometimes funds are established to finance environmental or other remediation costs. A fund may be set up to meet the decommissioning costs of a single contributor or several contributors. [410-30-45-1]

Like IFRS, if an entity continues to be the primary obligor for a liability, then it continues to recognise a provision for the obligation and does not net its obligation with potential recoveries from the fund. [410-30-45-2]
If the fund is a subsidiary, joint arrangement or associate of the operator, then it is consolidated, accounted for based on the operator’s rights and obligation to individual assets and liabilities or equity accounted, as appropriate (see chapters 2.5, 3.5 and 3.6). Otherwise, the contributor recognises the right to receive compensation from the fund as a reimbursement right. The reimbursement right is measured at the lower of:
- the amount of the decommissioning obligation recognised; and
- the contributor’s share of the fair value of the net assets of the fund attributable to the contributors. [IFRIC 5.8–9]

Changes in the carrying amount of the reimbursement right other than from contributions to and payments from the fund are recognised in profit or loss in the period in which they occur. An obligation to make additional contributions is treated as a provision or contingent liability, as applicable. A residual interest in a fund that exceeds the right to reimbursement, such as a contractual right to distributions when decommissioning has been completed, may be an equity instrument (see chapter 7.1). [IFRIC 5.5, 9–10]

Waste electrical and electronic equipment
In the EU, the costs of disposing of waste electrical and electronic equipment are borne by the producers. An entity has an obligation to contribute to waste management costs for historical household equipment (equipment sold to private households, generally before 13 August 2008) based on its share in the market in the measurement period. The measurement period is specified in national law, which may vary from country to country. It is an entity’s participation in the market in the measurement period that is the past event that triggers the recognition of an obligation to meet waste management costs. [IFRIC 6]

Obligation to acquire or replace assets
Generally, a legal or constructive obligation is recognised as a liability (provision) if the recognition criteria are met. However, a legal or contractual obligation to acquire or replace assets is recognised as a liability only to the extent of the performance of the obligation — i.e. the extent to which the costs of acquiring and replacing the asset have been incurred. [IAS 37/E.C.E=x]

Repairs and maintenance
A provision is not recognised for repairs and maintenance of own assets. These costs are generally expensed as they are incurred. [IAS 37/E.C.E=x11]

Unlike IFRS, US GAAP does not provide explicit guidance on the accounting for a fund established to finance environmental obligations. If the fund is a subsidiary, equity-method investee or joint venture of the operator, then the guidance in chapters 2.5, 3.5 and 3.6 applies, which is different in certain respects from IFRS. Like IFRS, in other instances the contributor recognises the right to receive compensation from the fund as a reimbursement right. The reimbursement right (if it meets the recognition threshold, which may be different from IFRS — see above), is measured, like IFRS, at the lower of:
- the amount of the decommissioning obligation recognised; and
- the contributor’s share of the fair value of the net assets of the fund attributable to the contributors. [410-30-35-8]

Like IFRS, changes in the carrying amount of a reimbursement right other than for cash payments and receipts to or from the fund are recognised in profit or loss in the period in which they occur. Like IFRS, an obligation to make additional contributions is treated as an unrecognised contingent liability or as a provision. A residual interest in a fund needs to meet the definition of a security (see chapter 7.1) to be accounted for as such, and therefore differences from IFRS may arise in practice. [410-30-35-8]

Waste electrical and electronic equipment
Like IFRS, the past event that triggers recognition of an obligation for historical household waste electrical and electronic equipment in the EU is participation in the market in the measurement period. [720-40-25-1]

Obligation to acquire or replace assets
Like IFRS, a legal obligation is generally recognised as a liability (provision) if the recognition criteria are met. However, unlike IFRS, a constructive obligation is recognised only if it is required by a specific Codification topic/subtopic. A legal or contractual obligation to acquire or replace assets is recognised as a liability only to the extent of the performance of the obligation — i.e. the extent to which the costs of acquiring and replacing the asset have been incurred, like IFRS. [908-360-25-2]

Repairs and maintenance
Like IFRS, a provision is not recognised for repairs and maintenance of own assets. These costs are generally expensed as they are incurred, like IFRS.
The prohibition on recognising a provision for future repairs and maintenance applies even if there is a legal requirement to undertake the specified repairs and maintenance activities. [IAS 37.I.C.Ex11B]

Onerous contracts
An ‘onerous contract’ is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under the contract. In assessing whether a contract is onerous, an entity considers:
- the unavoidable costs of meeting the contractual obligations, which is the lower of the net costs of fulfilling the contract or the cost of terminating it; and
- the economic benefits expected to be received. [IAS 37.10]

The present value of the obligation under an onerous contract is recognised as a provision. [IAS 37.66]

In our view, if a contract is for the sale of goods, or if an entity recognises and measures onerous customer service contracts under the provisions standard, then only the unavoidable costs that are directly associated with meeting the entity’s obligations to deliver the goods or services under the contract should be considered in determining whether the contract is onerous and in measuring any resulting provision. We believe that the ‘unavoidable costs’ of meeting the obligations under the contract are only costs that:
- are directly variable with the contract and therefore incremental to the performance of the contract;
- do not include allocated or shared costs that will be incurred regardless of whether the entity fulfils the contract; and
- cannot be avoided by the entity’s future actions.

Like IFRS, the prohibition on recognising a provision for future repairs and maintenance applies even if there is a legal requirement to undertake the specified repairs and maintenance activities. [360-10-25-5]

Onerous contracts
Unlike IFRS, there is no general requirement to recognise a loss for onerous contracts – i.e. executory contracts that are anticipated to result in a loss. Such a provision is recognised only if there is specific guidance – e.g. contractual sub-lease losses, firm purchase commitments for inventory that are impaired, and contracts to construct property for others that are expected to result in a loss.

Because specific Codification topics/subtopics specify the recognition of a loss, the amount recognised is based on the present value of the obligation only if the particular topic/subtopic requires or permits discounting, unlike IFRS.

When US GAAP specifically requires the recognition of a loss, the costs provided for generally exclude costs that could be avoided by the entity’s future actions or that are not related directly to the contract, like IFRS. Unlike IFRS, certain Codification topics require the inclusion of allocable costs as well as incremental costs in determining the onerous provision.

Software modification costs
When an external event, such as the introduction of a new currency, requires an entity to make a modification of its software in order to continue to operate once the new currency is introduced, the entity does not have a present obligation to modify software. In our view, a provision is not recognised because the entity is able to avoid the expenditure by its future actions. However, an entity should consider whether the costs incurred qualify for capitalisation as either an intangible or a tangible asset. [IAS 37.19, I.E.C.Ex11]

Like IFRS, when an external event, such as the introduction of a new currency, requires an entity to make a modification of its software in order to continue to operate once the new currency is introduced, the entity does not have a present obligation to modify software. A provision is not recognised because the entity is able to avoid the expenditure by its future actions. However, an entity should consider whether the costs incurred qualify for capitalisation as either an intangible or a tangible asset, like IFRS. Additionally, an entity should consider whether it has an ‘if-and-when’ available or specified upgrade deliverable that may impact revenue recognition (see chapter 4.2). [985-605-25-44 – 25-46]
Legal claims
In our view, the relevant past event for a legal claim is the event that gives rise to the claim, rather than receipt of the claim itself.

However, the mere existence of a present obligation as a result of a past event is not a sufficient basis on which to recognise a provision. In addition, the entity should consider whether it is probable that the obligating event will result in an outflow of resources. In our view, the assertion of a claim is not determinative evidence that a present obligation exists. Instead, the receipt of a claim will require assessment of whether there is a present obligation, taking account of all available evidence, including the opinion of experts, for example. [IAS 37.16, 23]

There is no specific guidance in IFRS on whether a provision for legal claims should include the expected legal costs of defending the claim. In our view, any such costs that are incremental should be provided for only if a past obligating event for the underlying claim exists.

Levies
A ‘levy’ is an outflow of resources embodying economic benefits from an entity imposed by a government in accordance with legislation. Income taxes in the scope of the income taxes standard, fines and penalties and payments to a government for purchases of assets or services are not in the scope of the interpretation. [IFRIC 21.4–5]

Under IFRS, the obligating event that gives rise to a liability is the activity that triggers the payment of the levy in accordance with legislation. An entity does not recognise a liability at an earlier date even if it has no realistic opportunity to avoid performing the activity that triggers the levy. [IFRIC 21.8–10]

Income tax exposures
In our view, obligations for possible income tax exposures should be treated as income tax liabilities, and not as provisions in the scope of the provisions standard (see chapter 3.13). [IAS 37.1(c), 5]

Legal claims
Unlike IFRS, the ‘existing condition’ for the evaluation of a legal claim is the assertion of a claim, although the assertion in and of itself does not necessarily mean that a provision is accrued. [450-20-20, 55-11]

Like IFRS, the mere existence of an existing condition is not a sufficient basis on which to recognise a provision. In addition, the entity should consider whether it is probable (which is a higher threshold than under IFRS) that the existing condition will result in an outflow of resources. The assertion of a claim is not determinative evidence that a loss related to a contingent liability should be recognised. Instead, the receipt of a claim will require assessment of whether there is a probable loss, taking account of all available evidence, including the opinion of experts, for example, like IFRS. [450-20-25-2]

Unlike IFRS, US GAAP provides that the legal costs associated with defending the claim may either be accrued or expensed as they are incurred as an accounting policy election. [460-20-S99-2]

Levies
Unlike IFRS, there is no general guidance on accounting for levies that covers all industries. Also unlike IFRS, fees paid to the US Federal Government by pharmaceutical manufacturers and health insurers are generally recognised on a pro rata basis throughout the year. In our experience, real estate entities also typically recognise property taxes on a pro rata basis throughout the year, and differences from IFRS may arise in practice after an evaluation of the legal facts and circumstances under which real property tax can be enforced by a governmental authority (e.g. State, County or City). We would also expect potential differences from IFRS in practice in the accounting for taxes and levies (that are outside the scope of the income taxes Codification Topic) in other industries. [720-50]

Income tax exposures
Like IFRS, income tax uncertainties are subject to the Codification Topic on accounting for income taxes (see chapter 3.13). [740-10-25-16]
Disclosure
Contingent liabilities are disclosed unless an outflow of resources is only remote. An entity discloses a brief description of the nature of each class of contingent liabilities and, when it is practicable, an estimate of the financial effect, an indication of uncertainties relating to the amount and timing of the outflow and any possible reimbursement. [IAS 37.86, 91]

If crystallisation of a contingent liability would affect an entity’s ability to continue as a going concern, then additional disclosures are required. [IAS 12.6]

In the extremely rare case that disclosure could seriously prejudice the entity’s position in a dispute with another party, the entity need only disclose the general nature of the dispute and the reasons for not disclosing the information. [IAS 37.92]

Contingent assets are disclosed when an inflow of economic benefits is considered probable (i.e. more likely than not to occur). The disclosure includes the nature and, when it is practicable, the estimated future effects of the contingent asset. [IAS 37.89-91]

Forthcoming requirements
A new revenue standard is effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

The new standard will affect the recognition and measurement of construction contract losses, warranties, customer refunds and liabilities arising from the sale of gift vouchers. The requirements of the new standard are the subject of chapter 4.2A.

Disclosure
Like IFRS, loss contingencies are generally disclosed unless an outflow is remote. However, unlike IFRS, certain loss contingencies are disclosed even if the likelihood of an outflow is remote (e.g., guarantees). The disclosures required under US GAAP are broader than those required by IFRS and include the risks and uncertainties related to the nature of the entity’s operations. However, disclosures about loss contingencies are less detailed than those under IFRS. [450-20-50-1 – 50-10, 460-10-50-2]

Like IFRS, if there is substantial doubt about the entity’s ability to continue as a going concern, then additional disclosures are required. However, the factors considered in evaluating going concern differ in some respects from IFRS. [275-10-50-16 – 50-21]

Unlike IFRS, US GAAP does not provide an exception to the disclosure requirements for sensitive information. [450-20-50-1 – 50-10]

Unlike IFRS, there is no specific probability threshold for disclosing gain contingencies. Adequate disclosure needs to be made of contingencies that might result in gains, with appropriate caution that the amounts have not yet been realised. [450-30-50-1]

Forthcoming requirements
A new revenue Codification Topic is effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted but not before annual periods beginning after 15 December 2016.

Unlike IFRS, the new standard will generally have no effect on the recognition and measurement of construction contract losses and standard warranties (i.e. warranties that do not represent a separate performance obligation). However, differences in the recognition and measurement of construction contract losses could arise as a result of a change in the accounting unit for which potential contract losses need to be evaluated. Like IFRS, the new standard will affect the accounting for customer refunds and sales of gift vouchers. The requirements of the new Codification Topic are the subject of chapter 4.2A.
### Overview

- ‘Income taxes’ are taxes based on taxable profits, and taxes that are payable by a subsidiary, associate or joint arrangement on distribution to the reporting entity (e.g. withholding taxes).

- The total income tax expense (income) recognised in a period is the sum of current tax plus the change in deferred tax assets and liabilities during the period, excluding tax recognised outside profit or loss – i.e. in OCI or directly in equity, or arising from a business combination.

- ‘Current tax’ is the amount of income taxes payable (recoverable) in respect of the taxable profit (loss) for a period.

- ‘Deferred tax’ is recognised for the estimated future tax effects of temporary differences, unused tax losses carried forward and unused tax credits carried forward.

- A deferred tax liability is not recognised if it arises from the initial recognition of goodwill.

- A deferred tax asset or liability is not recognised if it arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, it affects neither accounting profit nor taxable profit.

- A deferred tax liability (asset) is recognised for the step-up in tax bases as a result of an intra-group transfer of assets between jurisdictions. Additionally, the current tax effects for the seller are recognised in the current tax provision.

- Like IFRS, ‘current tax’ is the amount of income taxes payable (recoverable) in respect of the taxable profit (loss) for a period.

- Like IFRS, ‘deferred tax’ is recognised for the estimated future tax effects of temporary differences, unused tax losses carried forward and unused tax credits carried forward.

- Like IFRS, a deferred tax liability is not recognised if it arises from the initial recognition of goodwill.

- Unlike IFRS, there is no exemption from recognising a deferred tax asset or liability for the initial recognition of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting profit nor taxable profit.

- Unlike IFRS, the tax effects for the seller are deferred and a deferred tax liability (asset) is not recognised for the step-up in tax bases for the buyer as a result of an intra-group transfer of assets between jurisdictions. See forthcoming requirements.
Overview (continued)

– A deferred tax liability (asset) is recognised for exchange gains and losses related to foreign non-monetary assets and liabilities that are remeasured into the functional currency using historical exchange rates or indexing for tax purposes.

– Deferred tax is not recognised in respect of investments in subsidiaries, associates and joint arrangements (both foreign and domestic) if certain criteria are met.

– A deferred tax asset is recognised to the extent that it is probable that it will be realised – i.e. a net approach.

– Current and deferred tax are measured based on rates and tax laws that are enacted or substantively enacted at the reporting date.

– Deferred tax is measured based on the expected manner of settlement (liability) or recovery (asset).

– Deferred tax is measured on an undiscounted basis.

– Deferred tax assets and liabilities are classified as non-current in a classified statement of financial position.

– Income tax relating to items recognised outside profit or loss, in the current or a previous period, is itself recognised outside profit or loss.

Overview (continued)

– Unlike IFRS, if the reporting currency is the functional currency, then a deferred tax liability (asset) is not recognised for exchange gains and losses related to foreign non-monetary assets and liabilities that are remeasured into the reporting currency using historical exchange rates or indexing for tax purposes.

– Like IFRS, deferred tax is not recognised in respect of investments in foreign or domestic subsidiaries, foreign corporate joint ventures and equity-method investees if certain criteria are met; however, these criteria differ from IFRS, which may give rise to differences from IFRS.

– Unlike IFRS, all deferred tax assets are recognised and a valuation allowance is recognised to the extent that it is more likely than not that the deferred tax assets will not be realised – i.e. a gross approach.

– Unlike IFRS, current and deferred tax are only measured based on rates and tax laws that are enacted at the reporting date.

– Deferred tax is measured based on an assumption that the underlying asset (liability) will be recovered (settled) in a manner consistent with its current use in the business, which is generally like IFRS.

– Like IFRS, deferred tax is measured on an undiscounted basis.

– Like IFRS, public business entities classify deferred tax assets and liabilities as non-current in a classified statement of financial position. Unlike IFRS, other entities classify deferred tax assets and liabilities, but not the valuation allowance, as either current or non-current in the statement of financial position according to the classification of the related asset or liability (see forthcoming requirements); the valuation allowance is allocated against current and non-current deferred tax assets for the relevant tax jurisdiction on a pro rata basis.

– Like IFRS, income tax relating to items recognised outside profit or loss during the current reporting period is itself recognised outside profit or loss. However, unlike IFRS, subsequent changes are generally recognised in profit or loss.
Overview (continued)

– Deferred tax assets recognised in relation to share-based payment arrangements are adjusted each period to reflect the amount of tax deduction that the entity would receive if the award were tax-deductible in the current period based on the current market price of the shares.

– Current tax assets and liabilities are offset only if there is a legally enforceable right to set off and the entity intends to offset or to settle simultaneously.

– Deferred tax liabilities and assets are offset if the entity has a legally enforceable right to set off current tax liabilities and assets, and the deferred tax liabilities and assets relate to income taxes levied by the same tax authority on either the same taxable entity or different taxable entities that intend to settle current taxes on a net basis or their tax assets and liabilities will be realised simultaneously.

– IFRS does not include specific guidance on income tax exposures. The general provisions of the income taxes standard apply (see forthcoming requirements).

Scope
The scope of the income taxes standard is limited to ‘income taxes’, which are taxes based on taxable profits; and taxes that are payable by a subsidiary, associate or joint arrangement on distribution to the reporting entity (e.g. withholding taxes). [IAS 12.2]

Overview (continued)

– Unlike IFRS, temporary differences related to share-based payment arrangements are based on the amount of compensation cost that is recognised in profit or loss without any adjustment for the entity’s current share price until the tax benefit is realised.

– Like IFRS, current tax assets and liabilities are offset only if there is a legally enforceable right to set off and the entity intends to set off.

– For a particular tax-paying component of an entity and within a particular tax jurisdiction, public business entities offset and present as a single amount all deferred tax liabilities and assets (including any related valuation allowance), like IFRS; other entities offset and present as a single amount all non-current deferred tax liabilities and assets and, separately, all current deferred tax liabilities and assets, unlike IFRS (see forthcoming requirements). Deferred tax liabilities and assets attributable to different tax-paying components of the entity or to different tax jurisdictions may not be offset, which differs from IFRS in certain aspects.

– Unlike IFRS, US GAAP has specific guidance on the recognition of uncertainty in income taxes (income tax exposures). The benefits of uncertainty in income taxes are recognised only if it is more likely than not that the tax positions are sustainable based on their technical merits. For tax positions that are more likely than not of being sustained, the largest amount of tax benefit that is greater than 50 percent likely of being realised on settlement is recognised.

Scope
US GAAP defines ‘income taxes’ as all domestic federal, state and local (including franchise) taxes based on income, including foreign income taxes from an entity’s operations that are consolidated, combined or accounted for under the equity method, both foreign and domestic. Although the wording differs from IFRS, we would not generally expect differences from IFRS in the application of the scope of the income taxes Codification Topic. [T40-10-15-3 – 15-4]
**Taxes that are not based on taxable profits** are not in the scope of the standard; examples include social taxes payable by an employer based on a percentage of an employee’s wages, which may be employee benefits (see chapter 4.4); and taxes payable on capital and reserves.

The following are also excluded from the scope of the income taxes standard: government grants (see chapter 4.3); and investment tax credits (see below). [IAS 12.4]

There is no specific guidance on sales and similar taxes that are not income taxes. In our view, taxes that are not income taxes should generally be accounted for as provisions (see chapter 3.12), or as financial liabilities (see chapter 7.3), as appropriate.

‘Income tax’ comprises current tax and deferred tax. The total income tax expense (income) recognised in a period is the sum of current tax plus the change in deferred tax assets and liabilities during the period, excluding tax recognised outside profit or loss – i.e. either in OCI or directly in equity, or arising from a business combination. [IAS 12.5-6]

Interest and penalties related to income taxes are not explicitly included in the scope of the income tax standard. To determine the appropriate accounting, an entity first considers whether interest or a penalty itself meets the definition of an income tax. If so, then it applies the income tax standard; if not, then it applies the provisions standard (see chapter 3.12) to that amount. This is not an accounting policy choice – i.e. an entity needs to apply judgement based on the specific facts and circumstances.

**Current tax**

‘Current tax’ is the amount of income taxes payable or recoverable in respect of the taxable profit or loss for a period. A current tax liability or asset is recognised for income tax payable or paid but recoverable in respect of all periods to date. [IAS 12.5, 12]

**Deferred tax**

**Temporary differences**

A ‘temporary difference’ is the difference between the tax base of an asset or liability and its carrying amount in the financial statements that will result in taxable or deductible amounts in future periods when the carrying amount is recovered or settled. This approach focuses on the statement of financial position carrying amounts, rather than on the differences between the profit or loss and taxable profits. [IAS 12.5]

**Deferred tax**

**Temporary differences**

Like IFRS, a ‘temporary difference’ is the difference between the tax carrying amount (tax base) of an asset or liability and its carrying amount in the financial statements that will result in taxable or deductible amounts in future periods when the carrying amount is recovered or settled. Like IFRS, this approach focuses on the statement of financial position carrying amounts, rather than on the differences between the profit or loss and taxable profits. [740-10-20]

**Current tax**

Like IFRS, ‘current tax’ is the amount of income taxes payable or recoverable in respect of the taxable profit or loss for a period. A current tax liability or asset is recognised for income tax payable or paid but recoverable in respect of all periods to date, like IFRS. [740-10-20]

**Deferred tax**

**Temporary differences**

Like IFRS, taxes that are not based on taxable profits do not fall in the scope of the topic; examples include social taxes payable by an employer based on a percentage of an employee’s wages, which are employee benefits (see chapter 4.4), and taxes payable on capital and reserves. [740-10-15-3 – 15-4]

Government grants in the form of tax benefits are excluded from the scope of the income taxes Codification Topic, like IFRS. However, unlike IFRS, investment tax credits are in the scope of the topic (see below). [740-10-25-20]

Taxes that are not based on taxable profits are accounted for based on other guidance, including the guidance on contingencies (see chapter 3.12) and sales taxes (see chapter 4.2). Like IFRS, in the absence of specific guidance, practice may vary, and therefore differences from IFRS may arise in practice. [740-10-15-3 – 15-4]

Like IFRS, ‘income tax’ comprises current tax and deferred tax. Like IFRS, the total income tax expense (income) recognised in a period is the sum of current tax plus the change in deferred tax assets and liabilities during the period, excluding tax recognised outside profit or loss – i.e. either in OCI or directly in equity, or arising from a business combination. [740-10-30-3 – 30-4]

Unlike IFRS, the classification of interest and penalties either in the tax provision or as an expense is an accounting policy election. [740-10-25-56 – 25-57]
Liability recognition

Unless an exemption applies (see below), a deferred tax liability is recognised for all taxable temporary differences; the partial recognition method is not permitted. Therefore, it is not relevant under IFRS that some or all of the differences may not be expected to be incurred in the future. [IAS 12.16]

Initial recognition exemption

Deferred tax is not recognised for certain temporary differences that arise on the initial recognition of assets and liabilities. The exemption applies to:

- a deferred tax liability (but not a deferred tax asset) that arises from the initial recognition of goodwill (see below); and
- a deferred tax asset or liability that arises from the initial recognition of an asset or liability in a transaction that is not a business combination and that at the time of the transaction affects neither accounting profit nor taxable profit.

[IAS 12.15, 22(c), 24, 32A, 33, IU 03-17]

In respect of the second part of the exemption, if the exemption applies and no deferred tax is recognised initially, then generally no deferred tax is recognised subsequently as the carrying amount of the asset or liability changes. However, in our view exceptions arise if an asset is revalued subsequent to initial recognition or if a partial tax deduction will be received.

[IAS 12.15(b), 21A–21B]

If a new levy in the scope of the income tax standard is introduced in addition to the existing income tax and some assets or liabilities are treated differently for the purposes of that levy, then new temporary differences may arise in relation to the existing assets or liabilities. In our view, the initial recognition exemption does not apply to such temporary differences. However, the initial recognition exemption does apply to assets and liabilities recognised on or after the date on which the tax law is enacted or substantively enacted.

[IAS 12.15, 24]

Asset recognition

Unlike deferred tax liabilities, a deferred tax asset is recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences or the unused tax losses and tax credits can be used.

[IAS 12.24, 34]

‘Probable’ is not defined in the income taxes standard. In our experience, entities often use a working definition of ‘more likely than not’ (i.e. a likelihood of more than 50 percent).

Liability recognition

Like IFRS, unless an exemption applies (see below), a deferred tax liability is recognised for all taxable temporary differences and the partial recognition method is not permitted. Therefore, like IFRS, it is not relevant that some or all of the differences may not be expected to be incurred in the future. However, the exemptions under US GAAP differ from those under IFRS (see below). [740-10-25-3]

Initial recognition exemption

Like IFRS, a deferred tax liability (but not a deferred tax asset) that arises on the initial recognition of goodwill is exempt from recognition. Unlike IFRS, US GAAP does not have an exemption for the initial recognition of an asset or liability in a transaction that is not a business combination, that at the time of the transaction affects neither accounting profit nor taxable profit. Under US GAAP the deferred tax is determined using the ‘simultaneous equation’ method. [740-10-25-3, 25-51]

Unlike IFRS, because there is no initial recognition exemption for the initial recognition of an asset or liability in a transaction that is not a business combination and that at the time of the transaction affects neither accounting profit nor taxable profit, deferred tax is recognised on all subsequent temporary differences as the carrying amount of the asset or liability changes. [740-10-25-3]

Asset recognition

Unlike IFRS, all deferred tax assets are recognised and a valuation allowance is recognised to the extent that it is more likely than not that the deferred tax assets will not be realised – i.e. deferred tax assets are recognised on a gross basis with a corresponding valuation allowance. [740-10-30-5]

Like IFRS, ‘more likely than not’ is a likelihood of more than 50 percent. [450-20-20, 740-10-20, 30-17]
Taxable profit used for the asset recognition test is different from taxable profit on which income taxes are payable. To avoid double counting, an entity excludes reversals of existing taxable and deductible temporary differences in determining whether sufficient future taxable profits are available to recognise deferred tax assets in excess of taxable temporary differences. In addition, an entity does not include in that assessment new deductible temporary differences that originate in future periods, because the deferred tax asset arising from these deductible temporary differences will itself require future taxable profit in order to be utilised. [IAS 12.29(a), BC56, IE.Ex7]

All deductible temporary differences are assessed together unless, under tax law, their use is restricted to deductions against income of a specific type. [IAS 12.27A]

The estimate of probable future profits may include the recovery of some of the assets for more than their carrying amounts if there is sufficient evidence that it is probable that a higher amount will be realised. [IAS 12.29A]

In considering whether taxable profit will be available in the future, an entity considers, among other things, tax planning opportunities. There is no specific guidance in IFRS on whether management’s intention to use the tax planning opportunities should affect whether the opportunities are taken into account in assessing the recognition of a deferred tax asset. However, in our view it should be more likely than not that management will take advantage of the opportunities, before they can be used to justify the recognition of deferred tax assets. IFRS is silent on whether any related tax expenses or losses that would be incurred are taken into account, and practice may vary. [IAS 12.28–30]

When an entity has a history of recent losses, a deferred tax asset is recognised only to the extent that the entity has sufficient taxable temporary differences or there is convincing evidence that sufficient taxable profit will be available against which the tax losses or tax credits can be used. [IAS 12.34–36]

Like IFRS, an entity excludes reversals of existing taxable and deductible temporary differences in determining whether sufficient future taxable profits are available to recognise deferred tax assets in excess of taxable temporary differences. Unlike IFRS, future originating temporary differences and their subsequent reversals are implicit in estimates of future taxable income. Like IFRS, an entity does not include in that assessment new deductible temporary differences that originate in future periods if the newly originated deferred tax assets are not more likely than not of being realised when the newly originated deferred tax assets reverse. [7 40-10-30-18]

All applicable provisions of enacted tax law are considered in determining the amount of the valuation allowance that should be recognised, like IFRS. [7 40-10-30-16, 55-12]

The estimate of probable future profits may include the recovery of available-for-sale debt securities for more than their carrying amounts if the entity has the ability and intent to hold the debt securities until maturity and collect the contractual cash flows. Because a qualifying tax planning strategy (see below) needs to be primarily within an entity’s control, it generally cannot anticipate recovery of the portion of the fair value of the security that is dependent upon a change in market conditions. See forthcoming requirements. [7 40-10-30-19, 30-20, 55-39 – 55-48]

Like IFRS, an entity takes into account tax planning opportunities in assessing whether a valuation allowance is required. However, unlike practice under IFRS, for a tax planning opportunity to be considered, it needs to be prudent and feasible, and an action that management may not ordinarily take but has the intent and ability to implement in order to prevent the tax benefit from expiring unused. Additionally, unlike IFRS, when tax planning opportunities are taken into account, any attributable expenses or losses that would be incurred are considered in determining the appropriate valuation allowance. [7 40-10-30-16, 30-19 – 30-20]

The existence of recent cumulative accounting losses is significant negative evidence that is difficult to overcome that future taxable profit may not be available, and the recognition of a deferred tax asset is generally limited to available taxable temporary differences in such cases, like IFRS. [7 40-10-30-21]
Loss-making entities recognise a deferred tax asset for the carry-forward of unused tax losses only to the extent of the taxable temporary differences of an appropriate type that reverse in an appropriate period. Consequently, future tax losses are not considered when measuring the amount of the deferred tax asset. In addition, if a tax law limits the extent to which unused tax losses can be recovered against future taxable profits in each year, then the amount of a deferred tax asset from unused tax losses is restricted as specified by the tax law. [IU 05-14]

During the assessment of whether a valuation allowance is required for deferred tax assets, an entity that has experienced cumulative losses in recent years has a significant piece of negative evidence to evaluate in determining the recoverability of deferred tax assets. Existing taxable temporary differences of an appropriate character that are expected to reverse in an appropriate period are one source of potential recoverability of the deferred tax assets. The recognition of deferred tax assets may be limited to such available taxable temporary differences and available carry-backs when cumulative losses exist (this evaluation is based on the specific facts and circumstances, considering all positive and negative evidence that exists). In addition, like IFRS, provisions in the tax law that limit the use of an operating loss carry-forward are applied in determining whether a valuation allowance is required. [7 40-10-18 – 30-22, 55-36]

Measurement
Deferred tax assets and liabilities are measured based on:
– the expected manner of recovery (asset) or settlement (liability); and
– the tax rates expected to apply when the underlying asset (liability) is recovered (settled), based on rates that are enacted or substantively enacted at the reporting date. [IAS 12.47, 51]

When income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is distributed, deferred tax is based on the tax rate applicable to undistributed profits. [IAS 12.52A]

Unlike IFRS, US GAAP requires the use of the distributed rate on profits of the foreign subsidiary if the parent is not applying the ‘indefinite reversal criteria’ (see below). If the parent is applying the indefinite reversal criteria, then the undistributed rate is used for profits of the foreign subsidiary to the extent that the parent has not provided for deferred taxes on the unremitted earnings of the foreign subsidiary. [7 40-10-25-41, 7 40-30-25-17 – 25-19]

Like IFRS, deferred tax is measured based on an assumption that the underlying asset (liability) will be recovered (settled) in a manner consistent with its intended use in the business. [7 40-10-25-23]

If an entity has a dual intention in respect of an asset (e.g. to operate the asset and then to sell it before the end of its useful life), then it follows from the general principle that the carrying amount will be recovered in two ways and, in our view, the calculation of deferred tax reflects that dual intention.

Measurement
Deferred tax assets and liabilities are measured based on:
– an assumption that the underlying asset (liability) will be recovered (settled) in a manner consistent with its current use in the business; although the precise wording differs in certain respects, we would not generally expect significant differences in practice from IFRS; and
– the rate of tax expected to apply when the underlying asset (liability) is realised (settled), like IFRS; but based on rates that are enacted at the reporting date, unlike IFRS. [7 40-10-25-2 – 25-23, 25-47]

In some jurisdictions, the applicable tax rate or tax base depends on how the carrying amount of an asset or liability is recovered or settled. In such cases, management’s intentions are key in determining the amount of deferred tax to recognise. [IAS 12.51–51A]

Like IFRS, if an entity has a dual intention in respect of an asset (e.g. to operate the asset and then to sell it before the end of its useful life), then the carrying amount will be recovered in two ways and the calculation of deferred tax reflects that dual intention. [7 40-10-25-20]
For investment property measured using the fair value model (see chapter 3.4), the measurement of deferred tax is based on a rebuttable presumption that the carrying amount of the investment property will be recovered entirely through sale. The presumption is rebutted if the investment property is depreciable and is held within a business model whose objective is to consume substantially all of the asset’s economic benefits over time, rather than through sale. [IAS 12.51C]

When a non-depreciable item of property, plant and equipment is revalued (see chapter 3.2), the deferred tax on the revaluation is measured using the tax rate that applies on disposal. [IAS 12.51B]

The tax treatment of an asset may be different depending on whether the asset is treated as an individual asset or as part of a corporate structure. In our view, the tax base in consolidated financial statements should be determined based on the tax treatment of individual assets and liabilities on an item-by-item basis.

In an extreme case, an asset (e.g. a building) might be held by a group as the sole asset within a corporate shell for tax planning reasons. If a tax law attributes separate tax bases to the asset and the shares, then the entity recognises:
- the deferred tax related to the asset; and separately
- the deferred tax related to the shares. [IU 07-14]

Deferred tax assets and liabilities are not discounted, even if the effect of discounting would be material. [IAS 12.53]

**Classification and presentation**

**Where to recognise income tax**

Income tax is recognised in profit or loss except that:
- deferred tax recognised as part of the acquisition accounting in a business combination is recognised as an adjustment to goodwill (see below); and
- income tax related to items recognised, in the current or a previous period, outside profit or loss is recognised consistently with that item – i.e. in OCI or directly in equity. [IAS 12.57–58, 61A, 66]

Like IFRS, deferred tax assets and liabilities are not discounted, even if the effect of discounting would be material. [740-10-30-8]

Unlike IFRS, US GAAP prescribes the calculation for intra-period tax allocation and identifies the classification of the tax effect of specific items that are to be charged or credited directly to continuing operations, discontinued operations, OCI and equity. [740-20-45-2]
A change in deferred tax caused by a change in tax rate is recognised in profit or loss in the period in which the change is substantively enacted, except to the extent that it relates to an item recognised outside profit or loss in the current or in a previous period. [IAS 12.60]

Certain tax effects of share-based payment transactions are recognised directly in equity (see below).

Whether the initial recognition of a deferred tax related to a revaluation or fair value remeasurement is recognised in profit or loss or in OCI depends on the treatment of the revaluation or remeasurement under IFRS. [IAS 12.61A, 62, 64]

Because transactions involving an entity’s own shares (e.g. the purchase and reissue of treasury shares) are recognised directly in equity, the related income tax is also initially recognised directly in equity. [IAS 12.61A]

The requirement to recognise in OCI or directly in equity the tax effect of items recognised in OCI or directly in equity extends beyond the initial recognition of a deferred tax liability (or asset) to certain subsequent revisions to the tax balance – e.g. subsequent changes due to changes in tax rates or from the assessment of the recoverability of a deferred tax asset. [IAS 12.61A]

The classification between profit or loss, OCI and directly in equity of the tax effects of dividend payments follows the same general principles as outlined above. [IAS 12.52B]

If dividend withholding taxes are collected by the entity on behalf of the tax authorities, then they are recognised directly in equity as part of the distribution to shareholders. [IAS 12.65A]

Unlike IFRS, the recognition of a change in deferred tax caused by a change in tax rate is always recognised in profit or loss (income from continuing operations) in the period in which the change is enacted. [740-10-35-4, 740-20-45-8]

In most cases, the tax effects of share-based payment transactions are recognised in profit or loss, unlike IFRS (see below).

Like IFRS, whether the initial recognition of a deferred tax related to a fair value remeasurement is recognised in profit or loss or in OCI depends on the treatment of the remeasurement. [740-20-45-11]

Like IFRS, because transactions involving an entity’s own shares are recognised directly in equity, the resulting income tax is also initially recognised directly in equity. [740-20-45-11]

Like IFRS, the tax effect of items charged or credited to OCI or directly to equity during the current reporting period is itself charged or credited to OCI or directly to equity. However, unlike IFRS, subsequent changes to deferred tax from changes in tax rates or from the assessment of the recoverability of a deferred tax asset are recognised in profit or loss. [740-20-45-2, 45-11]

Unlike IFRS, income taxes linked to the payment of dividends are recognised in profit or loss except for dividends paid on unallocated shares of an employee share ownership plan (ESOP) by an entity other than a public business entity (see forthcoming requirements). [740-20-45-8]

Unlike IFRS, dividend withholding taxes are recognised directly in equity as part of the dividend distribution if:
- the tax is payable by the entity if and only if a dividend is distributed to shareholders, and the tax does not reduce future income taxes that the entity would otherwise pay; and
- shareholders receiving the dividend are entitled to a tax credit that is at least equal to the tax paid by the entity and that credit is realisable either as a refund or as a reduction of taxes otherwise due, regardless of the tax status of the shareholders. [740-10-15-4]
The recognition or elimination of deferred taxes caused by a change in the tax status of an entity or its shareholders is recognised in profit or loss in the current period, except to the extent that it relates to an item recognised in OCI or directly in equity in the current or in a previous period. [SIC-25.4]

**Current vs non-current**
Deferred tax liabilities and assets are classified as non-current when a classified statement of financial position is presented (see chapter 3.1), even though some part of the tax balance may be expected to reverse within 12 months of the reporting date. [IAS 1.56]

Deferred tax liabilities and assets are presented separately from current tax liabilities and assets. [IAS 1.54]

**Offsetting**
Current tax liabilities and assets are offset if the entity:
- has a legally enforceable right to offset current tax liabilities and assets. This will normally be the case only if the tax payable or receivable relates to income taxes levied by the same taxation authority and the taxation authority permits the entity to make or receive a single net payment; and
- intends to offset or to settle its tax assets and liabilities simultaneously. [IAS 12.71–72]

Unlike IFRS, the recognition or elimination of deferred taxes caused by a change in the tax status of an entity or its shareholders is recognised in profit or loss (income from continuing operations) in the current period. [740-10-45-19]

**Current vs non-current**
Like IFRS, public business entities classify deferred tax liabilities and assets as non-current when a classified statement of financial position is presented (see chapter 3.1), even though some part of the tax balance may be expected to reverse within 12 months of the reporting date. [740-10-45-4 – 45-6]

Unlike IFRS, other entities classify deferred tax liabilities and assets, but not the valuation allowance, as either current or non-current according to the classification of the asset or liability giving rise to the temporary difference. The valuation allowance is allocated against current and non-current deferred tax assets for the relevant tax jurisdiction on a pro rata basis, unlike IFRS. The expected timing of the reversal of deferred taxes is not considered in the classification of deferred tax balances except when a deferred tax balance cannot be related to a recognised asset or liability for financial reporting (e.g. tax loss carry-forwards). See forthcoming requirements. [740-10-45-4 – 45-5]

Like IFRS, public business entities present deferred tax liabilities and assets separately from current tax liabilities and assets. Other entities present non-current deferred tax liabilities and assets separately from current tax liabilities and assets (like IFRS) and separately from current deferred tax liabilities and assets (unlike IFRS); see forthcoming requirements. [740-10-45-4]

**Offsetting**
Like IFRS, the net current tax liabilities or assets of one tax-paying component of an entity are netted against the current tax liabilities or assets of another tax-paying component of the entity, but only if the entity has a legally enforceable right to offset the current tax amounts and the entity intends to set off those amounts. Like IFRS, the offsetting of tax assets and liabilities that relate to different tax jurisdictions is not permitted. [210-20-45-1]
Deferred tax liabilities and assets are offset if the entity has a legally enforceable right to offset current tax liabilities and assets, and the deferred tax liabilities and assets relate to income taxes levied by the same tax authority on either:

- the same taxable entity; or
- different taxable entities, but these entities intend to settle current tax liabilities and assets on a net basis, or their tax assets and liabilities will be realised simultaneously for each future period in which these differences reverse. [IAS 12.74]

Deferred tax assets and liabilities are not offset against current tax assets and liabilities.

**Specific application issues**

**Intra-group transactions**

Intra-group transactions are eliminated on consolidation (see chapter 2.5). However, any corresponding tax effects – e.g. arising from a change in the tax base of those assets or liabilities or from the tax rate applicable to the recovery or settlement of those assets or liabilities – are not eliminated. Any related deferred tax effects are measured based on the tax rate of the purchaser. Additionally, the current tax effects for the seller are recognised in the current tax provision. [IAS 12.IE.A.14, IE.B.11, IU 05-14]

**Consolidated tax return**

In consolidated financial statements, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. However, when entities in the same consolidated group file separate tax returns, separate temporary differences arise in those entities. Consequently, when an entity prepares its consolidated financial statements, deferred tax balances are determined separately for temporary differences arising from separate tax returns, using the applicable tax rates for each entity’s tax jurisdiction. [IAS 12.11, IU 05-14]

Under US GAAP, for a particular tax-paying component of an entity and within a particular tax jurisdiction, public business entities offset and present as a single amount all deferred tax liabilities and assets (including any related valuation allowance), like IFRS; other entities offset and present as a single amount all non-current deferred tax liabilities and assets and, separately, all current deferred tax liabilities and assets, unlike IFRS (see forthcoming requirements). Deferred tax liabilities and assets attributable to different tax-paying components of the entity or to different tax jurisdictions may not be offset, which differs from IFRS in certain respects. [740-10-45-6]

Like IFRS, deferred tax assets and liabilities are not offset against current tax assets and liabilities. [740-10-45-4]

**Specific application issues**

**Intra-group transactions**

Like IFRS, intra-group transactions are eliminated on consolidation (see chapter 2.5). Unlike IFRS, income taxes paid by the seller on intra-group profits related to assets that remain within the consolidated group, including the tax effect of any reversing temporary differences in the seller’s tax jurisdiction, are deferred. The amount is recognised in other assets or liabilities in the statement of financial position until such time as the asset leaves the consolidated group, at which point the amount is reclassified to income tax expense. Depending on the specific facts and circumstances of the transfer and the assets transferred, the amount may be amortised over the life of the underlying asset transferred. Additionally, unlike IFRS, the recognition of a deferred tax asset, for the excess of the new tax basis of the assets in the buyer’s tax jurisdiction over the carrying amount of the assets in the consolidated financial statements, is prohibited. See forthcoming requirements. [740-10-25-55, 810-10-45-8, 55-4]

**Consolidated tax return**

Like IFRS, subsidiaries that file a separate tax return determine income tax expense based on the separate tax return filed for that subsidiary. A parent entity with a subsidiary that files a separate return does not offset its deferred taxes and liabilities against those of the subsidiary. Deferred taxes are determined separately for each tax-paying component in each tax jurisdiction using the enacted tax rate(s) in the periods in which the deferred tax liability or asset is expected to be settled or realised. [740-10-30-5, 45-6]
Investments in subsidiaries, branches, joint arrangements and associates

Taxable temporary differences in respect of investments in subsidiaries, branches, associates and joint arrangements are not recognised if:
- the investor is able to control the timing of the reversal of the temporary difference; and
- it is probable that the temporary difference will not reverse in the foreseeable future. [IAS 12.39]

Because an entity controls an investment in a subsidiary or branch, there is generally no need to consider whether the entity can control the timing of the reversal of a taxable temporary difference.

An investor does not control an associate and therefore is not generally in a position to control the timing of the reversal of a temporary difference related to the investment in the associate. Therefore, a deferred tax liability is recognised unless the investor can otherwise control the timing of the reversal of the temporary differences – e.g. if the associate has agreed that profits will not be distributed in the foreseeable future. [IAS 12.42]

Deductible temporary differences in respect of investments in subsidiaries, branches, associates and joint arrangements are recognised 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 used in the future. [IAS 12.44]

Foreign currencies and hyperinflation

Temporary differences that arise when changes in exchange rates lead to changes in the tax basis rather than the carrying amounts under IFRS are recognised in full – i.e. a deferred tax liability (asset) is recognised. [IAS 12.41, IU 01-16]

Investments in subsidiaries, foreign corporate joint ventures and equity-method investees

Unlike IFRS, taxable temporary differences in respect of investments in certain foreign subsidiaries and foreign corporate joint ventures, sometimes referred to as ‘outside basis differences’, are recognised unless (indefinite reversal criteria):
- the investor is able to control the timing of the reversal of the temporary difference, like IFRS; and
- undistributed earnings will be reinvested indefinitely or can be distributed on a tax-free basis, unlike IFRS. [740-30-25-17]

Unlike IFRS, a deferred tax liability for outside basis differences is recognised in respect of domestic subsidiaries that are greater than 50 percent owned, unless the tax law permits a tax-free recovery of the investment and the parent entity expects that it will ultimately use that means of recovery. [740-30-25-5 – 25-7, 25-17 – 25-18]

Unlike IFRS, there is no exception for investments in equity-method investees. Unlike IFRS, there are exemptions from recognising the effect of an outside basis difference that is essentially permanent in duration related to a foreign corporate joint venture and undistributed pre-1993 earnings of a domestic corporate joint venture. [323-740-15-1, 599-1, 740-30-25-5 – 25-6, 25-18]

Like IFRS, deductible temporary differences arising on investments in subsidiaries or corporate joint ventures (both foreign and domestic) are recognised only if it is apparent that the difference will reverse in the foreseeable future. Once it has been recognised, an entity determines whether there will be future taxable profit against which to use the deductible difference to establish whether there is a need for a valuation allowance, unlike IFRS. [740-30-25-9, 25-11]

Foreign currencies and hyperinflation

Unlike IFRS, when the reporting currency is the functional currency, US GAAP prohibits the recognition of deferred tax for differences related to exchange gains and losses on foreign non-monetary assets or liabilities that are remeasured from the local currency into the reporting currency using historical exchange rates, and that result from either changes in exchange rates or indexing for tax purposes. [830-740-25-10]
Temporary differences arise when current purchasing power adjustments are made to the assets and liabilities of entities operating in hyperinflationary economies if the value in the financial statements is increased but the tax base remains stated in the historical measuring unit. Such temporary differences are recognised in full. [IAS 12:IE.A.18]

Unlike IFRS, when the functional currency is that of a highly inflationary economy, temporary differences are determined based on the difference between the indexed tax basis amount of the asset or liability and the related price-level restated amount recognised in the financial statements. The deferred tax expense or benefit is calculated as the difference between (1) deferred tax assets and liabilities recognised at the current reporting date, using current reporting date purchasing power units, determined on the ending temporary difference; and (2) deferred tax assets and liabilities reported at the prior reporting date, remeasured to units of current general purchasing power at the current reporting date. The remeasurement of deferred tax assets and liabilities at the prior reporting date is recognised together with the remeasurement of all other assets and liabilities as an adjustment of opening equity. [830-740-25-2 – 25-4, 45-2]

In the opening statement of financial position of the first financial statements in which the functional currency becomes hyperinflationary, deferred tax is calculated based on the nominal carrying amounts of non-monetary items by applying the effect of inflation from the date of acquisition (or revaluation/remeasurement) to the opening date of the current reporting period. Then to calculate the opening balances, deferred tax is remeasured by applying the effects of inflation from the opening date to the reporting date. At the closing reporting date, deferred taxes are calculated in accordance with the standard on income taxes. [IFRIC 74]

In hyperinflationary economies, temporary differences that arise when changes in exchange rates lead to changes in the tax basis rather than the carrying amounts under IFRS are recognised in full.

Unlike IFRS, for a foreign operation that is highly inflationary and that will be included in the parent’s consolidated results, deferred tax is computed in accordance with the Codification Topic on income taxes and then is remeasured as a monetary item in accordance with the requirements for remeasurement of the financial statements of a foreign operation that is highly inflationary (see chapter 2.4). [830-10-45-11]

Unlike IFRS, in highly inflationary economies US GAAP excludes the effects of changes in exchange rates and indexation for tax purposes in measuring temporary differences, which are based on historical carrying amounts in the local currency and the tax basis without indexation. [830-10-45-16]

Income tax exposures

The term ‘income tax exposures’ generally refers to positions taken by an entity that may be challenged by the tax authorities, and which may result in additional taxes, penalties or interest.

Like IFRS, in the opening statement of financial position of the first financial statements that will be price-level adjusted, deferred tax is calculated based on the nominal carrying amounts of non-monetary items by applying the effect of inflation from the date of acquisition (or remeasurement) to the opening date of the current reporting period. Then to calculate the opening balances, deferred tax is remeasured by applying the effects of inflation from the opening date to the reporting date, like IFRS. At the closing reporting date, deferred taxes are calculated in accordance with the Codification Topic on income taxes. [830-740-55-1 – 55-3]

Tax positions with uncertainty

Similar to IFRS, ‘tax positions with uncertainty’ refers to tax positions taken by an entity that may be challenged by the tax authorities, and which may result in additional taxes, penalties or interest. [740-10-25-6]
In our view, income tax exposures fall in the scope of the income taxes standard. To the extent that a tax exposure affects the calculation of income tax in respect of the current or prior periods, it falls within the definition of current tax. To the extent that a tax exposure affects the carrying amount of an asset or liability for accounting or tax purposes, it falls within the definition of deferred tax. [IAS 12.5]

There is no specific guidance in respect of recognition and measurement of income tax exposures. In our view, consistent with the definition of a current tax liability (or asset) in IAS 12, the amount to be provided for is the best estimate of the tax amount expected to be paid (or recovered). This amount may be determined using different methods, e.g. the most likely outcome method or an expected value method. See forthcoming requirements. [IAS 12.46]

**Investment tax credits**

Investment tax credits (ITCs) are excluded from the scope of the income taxes (see above) and government grants standards (see chapter 4.3). However, in our experience entities generally account for ITCs using one of these two standards by analogy.

- Following the income taxes standard by analogy, ITCs are presented in profit or loss as a deduction from current tax expense to the extent that the entity is entitled to claim the credit in the current reporting period. Any unused ITC is recognised as a deferred tax asset and income if it meets the recognition criteria (see above).

- Following the government grants standard by analogy, ITCs are recognised over the periods necessary to match them with the related costs that they are intended to compensate. The ITC is presented in the statement of financial position initially as a receivable from the government and deferred income; or alternatively, if the grant relates to an asset, as a deduction from the carrying amount of the asset. It is subsequently presented in profit or loss either as other income or as a deduction from the related expense, as appropriate.

In our view, management needs to choose an accounting approach that best reflects the economic substance of the ITC. This determination requires judgement in light of all relevant facts and circumstances.

To the extent that a tax position affects the calculation of income tax in respect of the current or prior periods, it falls within the definition of current tax, like IFRS. To the extent that a tax exposure affects the carrying amount of an asset or liability for accounting or tax purposes, it is within the definition of deferred tax, like IFRS. [740-10-25-16 - 25-17]

Unlike IFRS, US GAAP has specific guidance on the recognition of uncertainty in income taxes (income tax exposures). The benefits of uncertainty in income taxes are recognised only if it is more likely than not that the tax positions are sustainable based on their technical merits (i.e. without considering detection risk). For tax positions that are more likely than not of being sustained, the largest amount of tax benefit that is greater than 50 percent likely of being realised on settlement is recognised. [740-10-25-6]

**Investment tax credits**

Unlike IFRS, ITCs are recognised in profit or loss either immediately in the period in which the credit is realised (flow-through method), or over the period and based on the depreciation pattern used for the asset giving rise to the credit (deferral method). These methods may be similar to practice under IFRS, although differences in practice cannot be ruled out. [740-10-25-46]
Share-based payments
In some tax jurisdictions, an entity may receive a tax deduction on share-based payment arrangements that in amount or timing differs from the cumulative expense recognised in profit or loss. Generally, this will give rise to the recognition of deferred tax on the temporary differences. For measurement purposes, the entity has to determine the amount of the tax deduction to which it will be entitled. The amount should be estimated based on the information available at the reporting date, including share price, exercise year and exercise price and number of options expected to be exercised. The information used to estimate the deductions available in future periods needs to be consistent with that applied in measuring the share-based payment expense. Changes in the amount of tax benefit that would be realised based on conditions as at the reporting date are recognised as an adjustment to the deferred tax asset. The tax benefit is recognised in profit or loss to the extent of the cumulative remuneration expense recognised. Any excess benefit is recognised directly in equity. [IAS 12.68A–68C, IE Ex5]

If the amount of a tax deduction (or estimated future tax deduction) for a share-based payment transaction exceeds the amount of the related cumulative remuneration expense, then the excess is recognised directly in equity. IFRS does not specifically address the situation in which the amount of the tax deduction is less than the related cumulative remuneration expense. [IAS 12.68A–68C]

IFRS does not provide specific guidance for tax-deductible dividends paid on unallocated shares of an employee share ownership plan (ESOP) and the general recognition principle applies. [IAS 12.52B, 57]

Share-based payments
Unlike IFRS, the temporary difference on share-based payment arrangements is based on the amount of compensation cost recognised in profit or loss without any adjustment for the entity’s current share price. [718-740-35-2]

The difference between the deduction for tax purposes and the compensation cost recognised in the financial statements creates an excess tax benefit or tax deficiency.
- Public business entities: Unlike IFRS, such entities record all excess tax benefits and tax deficiencies as an income tax benefit or expense, respectively, in profit or loss in the period in which the tax deduction arises.
- Other entities (see forthcoming requirements): Like IFRS, any excess tax benefits are recognised directly in equity (in paid-in capital); however, unlike IFRS, the amount is not recognised directly in equity until the tax deduction is realised through a reduction in taxes payable. Unlike IFRS, any tax deficiencies are recognised directly in equity to the extent of prior excess tax benefits, and in profit or loss thereafter. [718-740-35-3, 35-5]

Unlike IFRS, tax deductible dividends paid on unallocated shares of an employee share ownership plan (ESOP) are required to be recognised in profit or loss (public business entities) or in the related component of equity (other entities – see forthcoming requirements). [718-740-45-8]
Tax groups

IFRS does not contain specific guidance on allocating taxes to the financial statements of members within a consolidated tax group that file a consolidated tax return, and practice may vary.

Business combinations

Deferred taxes are recognised in accordance with the principles discussed above in the acquisition accounting. This applies to unused tax losses and unused tax credits of the acquiree, and temporary differences between the tax bases of identifiable assets acquired and liabilities assumed in a business combination and the related amounts recognised in the acquisition accounting. [IAS 12.19, 26(c), 66, 68]

Deferred tax liabilities are not recognised for taxable temporary differences related to the initial recognition of goodwill in a business combination. A deferred tax asset is recognised (subject to a realisability assessment) for goodwill for which the tax base exceeds its carrying amount at the date of acquisition. [IAS 12.15(a), 19, 24]

Changes in the acquirer’s deferred taxes, including the assessment of their realisability, that result from a business combination are accounted for separately from the acquisition accounting. [IAS 12.67]

If a liability (asset) in relation to contingent consideration recognised in the acquisition accounting will result in amounts that are deductible (taxable) in future periods, then deferred taxes are generally recognised for the resulting temporary differences. In our view, the tax effects of such contingent consideration are recognised in the acquisition accounting consistent with the recognition of the contingent consideration. Subsequent tax effects resulting from the remeasurement or settlement of the contingent consideration are accounted for separately from the acquisition accounting. [IAS 12.61A, 66]

Tax groups

Unlike IFRS, US GAAP contains guidance on allocating taxes to the financial statements of members with a consolidated tax group that file a consolidated tax return. The consolidated amount of current and deferred tax expense for a group that files a consolidated tax return is allocated among the members of the group when those members issue separate financial statements. The method of allocation adopted needs to be systematic, rational and consistent with the broad principles established by the income taxes Codification Topic. This would include, for example, allocating current and deferred taxes to members of the group on a pro rata basis or by applying the guidance to each member as if it were a separate taxpayer. [740-10-30-27 – 30-28]

Business combinations

Like IFRS, deferred taxes are recognised in accordance with the principles discussed above, which differ in some respects from IFRS, in the acquisition accounting. This applies to unused tax losses and unused tax credits of the acquiree, and temporary differences between the tax bases of identifiable assets acquired and liabilities assumed in a business combination and the related amounts recognised in the acquisition accounting. [805-740-25]

Unlike IFRS, deferred tax liabilities are not recognised for taxable temporary differences related to the initial recognition of goodwill in a business combination. Unlike IFRS, deferred tax asset is recognised for tax goodwill that is in excess of accounting goodwill (referred to as ‘second component financial statement’ goodwill). Like IFRS, a deferred tax asset is recognised for tax goodwill that is in excess of accounting goodwill (referred to as ‘second component tax’ goodwill) at the date of acquisition. Like IFRS, a valuation allowance is used as an offset to the deferred tax asset to reflect the assessment of realisability. Also unlike IFRS, the deferred tax asset is measured using the ‘simultaneous equation’ approach. [805-740-25-8 – 25-9, 55-9 – 55-13]

Unlike IFRS, changes in the acquirer’s deferred taxes, including the assessment of their realisability, that result from a business combination are accounted for separately from the acquisition accounting. [805-740-25]

Unlike IFRS, contingent consideration that will be deductible for tax purposes in future periods is characterised as tax-deductible goodwill when determining the first and second components of goodwill. Contingent consideration that will not be deductible for tax purposes in future periods results in a difference between the financial statement carrying amount and the tax basis of the acquirer’s investment in the shares of the subsidiary (outside basis difference). Like IFRS, subsequent tax effects resulting from the remeasurement or settlement of the contingent consideration are accounted for separately from the acquisition accounting. [805-740-25]
The tax effects of the recognition of equity-settled replacement share-based payment awards attributed to pre-combination service are recognised in the acquisition accounting, consistent with the recognition of such awards.

The deferred tax effects of items recognised separately from a business combination (e.g. acquisition costs or the settlement of a pre-existing relationship) are also recognised separately from the business combination.

An entity recognises deferred taxes that result from a business combination as part of the acquisition accounting. However, in our view, except for limited circumstances of a transaction and the applicable tax laws, the tax effect of post-acquisition events, or the acquirer’s post-acquisition actions, should not be anticipated. [IAS 12.66]

Even if no deferred taxes are recognised in respect of goodwill in the acquisition accounting, deferred taxes may need to be recognised in respect of such temporary differences that arise subsequent to the business combination – e.g. if goodwill is amortised for tax purposes. [IAS 12.218]

In our view, the deferred tax effect related to the gain or loss on the remeasurement of the acquirer’s previously held investment in a step acquisition (see chapter 2.6) is recognised separately from the acquisition accounting. [IAS 12.58]

A change in a parent’s ownership interest in a subsidiary while retaining control is accounted for as an equity transaction. In our view, the direct tax effects of the transaction are also recognised directly in equity.

**Government grants**

No deferred tax asset is recognised in respect of non-taxable government grants. [IAS 12.22, 33]

**Leveraged leases**

There are no special requirements in respect of deferred taxes on leveraged leases because IFRS does not include the concept of leveraged leases.

Like IFRS, the tax effects of the recognition of equity-classified replacement share-based payment awards attributed to pre-combination service are recognised in the acquisition accounting, consistent with the recognition of such awards. However, US GAAP and IFRS differ on the accounting for tax effects of share-based payment awards (see above). [805-740-25]

Like IFRS, the deferred tax effects of items recognised separately from a business combination (e.g. acquisition costs or the settlement of a pre-existing relationship) are also recognised separately from the business combination. [805-740-25]

Like IFRS, an entity recognises deferred taxes that result from a business combination as part of the acquisition accounting. However, the tax effect of post-acquisition events, or the acquirer’s post-acquisition actions, is not anticipated, like IFRS. [740-10]

Like IFRS, in certain circumstances, the acquisition accounting is adjusted due to new information that becomes available during the measurement period. The related tax effects are recognised at the same time as the measurement-period adjustments. [IAS 12.68(a), IFRS 3.45–50]

Like IFRS, even if no deferred taxes are recognised in respect of goodwill in the acquisition accounting, deferred taxes may need to be recognised in respect of such temporary differences that arise subsequent to the business combination – e.g. if goodwill is amortised for tax purposes. [805-740-45]

Like IFRS, the deferred tax effect related to the gain or loss on the remeasurement of the acquirer’s previously held investment in a step acquisition (see chapter 2.6) are recognised separately from the acquisition accounting. [740-10, 805-740-35]

Like IFRS, a change in a parent’s ownership interest in a subsidiary while retaining control is accounted for as an equity transaction. The direct tax effects of the transaction are also recognised directly in equity, like IFRS. [740-20-45-2]

**Government grants**

Like IFRS, no deferred tax asset is recognised in respect of non-taxable government grants.

**Leveraged leases**

Unlike IFRS, there is a specific exemption from the basic principle of accounting for deferred taxes for leveraged leases (see chapter 5.1). [840-30-45-6, 45-7]
**Special deductions**

IFRS does not contain specific guidance on the recognition of tax benefits from special deductions and does not include a list of jurisdiction-specific special deductions.

**Forthcoming requirements**

**Asset recognition**

There are no forthcoming requirements under IFRS.

All deductible temporary differences are assessed together unless, under tax law, their use is restricted to deductions against income of a specific type. [IAS 12.27A]

**Intra-group transactions**

There are no forthcoming requirements under IFRS.

Intra-group transactions are eliminated on consolidation (see chapter 2.5). However, any corresponding tax effects – e.g. arising from a change in the tax base of those assets or liabilities or from the tax rate applicable to the recovery or settlement of those assets or liabilities – are not eliminated. Any related deferred tax effects are measured based on the tax rate of the purchaser. Additionally, the current tax effects for the seller are recognised in the current tax provision. [IAS 12.IE.A.14, IE.B.11, IU 05-14]

**Special deductions**

Unlike IFRS, US GAAP specifies that the tax benefit from special deductions is ordinarily recognised no earlier than the period in which those special deductions are deductible on the tax return. US GAAP does not define a special deduction, but does give examples of special deductions available in the US. [740-10-25-37]

**Forthcoming requirements**

**Asset recognition**

Amendments to the income taxes Codification Topic are effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is not permitted unless certain criteria are met. [ASU 2016-01]

All applicable provisions of enacted tax law are considered in determining the amount of the valuation allowance that should be recognised, like IFRS. The amendments clarify that an entity assesses the need for a valuation allowance on a deferred tax asset related to available-for-sale debt securities in combination with other deferred tax assets. [740-10-30-16, 55-12]

**Intra-group transactions**

Amendments to the income taxes Codification Topic related to transfers of assets other than inventory are effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted. [ASU 2016-16]

Like IFRS, intra-group transactions are eliminated on consolidation (see chapter 2.5). However, unlike IFRS, tax effects of transfers of inventory and tax effects of transfers of other assets are treated differently.

Like IFRS, for transfers of assets other than inventory, any corresponding tax effects – e.g. arising from a change in the tax base of those assets or liabilities or from the tax rate applicable to the recovery or settlement of those assets or liabilities – are not eliminated. Any related deferred tax effects are measured based on the tax rate of the purchaser. Additionally, the current tax effects for the seller are recognised in the current tax provision. [740-10-25-2]
3 Statement of financial position

3.13 Income taxes

Unlike IFRS, income taxes paid by the seller on intra-group profits related to inventory that remain within the consolidated group, including the tax effect of any reversing temporary differences in the seller’s tax jurisdiction, are deferred. The amount is recognised in other assets or liabilities in the statement of financial position until such time as the inventory leaves the consolidated group, at which point the amount is reclassified to income tax expense. Additionally, unlike IFRS, the recognition of a deferred tax asset, for the excess of the new tax basis of the inventory in the buyer’s tax jurisdiction over the carrying amount of the inventory in the consolidated financial statements, is prohibited. [740-10-25-55, 810-10-45-8, 55-4]

Income tax exposures

There are no forthcoming requirements under US GAAP.

The income taxes Codification Topic covers accounting for uncertainty in income taxes and, unlike IFRS, has guidance on accounting for and disclosure of interest and penalties on unrecognised tax benefit. [740-10-25-56 – 25-57 30-29, 40-5]

Unlike IFRS, if there is uncertainty about an income tax treatment, then an entity considers whether it is more likely than not, based on the technical merits, that some level of tax benefit related to the position will be sustained upon examination. Like IFRS, the underlying assumption in the assessment is that a tax authority will examine all amounts reported and will have full knowledge of all relevant information. [IFRIC 23.8–9]

Unlike IFRS, for tax positions that are more likely than not of being sustained, the largest amount of tax benefit that is greater than 50 percent likely of being realised on settlement is recognised. Unlike IFRS, neither the most likely amount nor the expected value method are accepted. If it is not more likely than not that tax positions will be sustained, tax payable is established for the entire tax benefit, unlike IFRS. [740-10-25-6, 25-8]

Like IFRS, the estimates and assumptions are reassessed if facts and circumstances change or new information emerges. [740-10-35-2]

Income tax exposures

A new interpretation on accounting for uncertain income tax treatments is effective for annual periods beginning on or after 1 January 2019; earlier application is permitted.

This interpretation applies to current and deferred taxes if there is uncertainty about an income tax treatment, but does not address the accounting for the related interest or penalties. [IFRIC 23.4]

If there is uncertainty about an income tax treatment, then an entity considers whether it is probable that a tax authority will accept the entity’s tax treatment included or planned to be included in its tax filing. The underlying assumption in the assessment is that a tax authority will examine all amounts reported and will have full knowledge of all relevant information. [IFRIC 23.8–9]

If the tax authority is likely to accept the entity’s tax treatment, then the current and deferred taxes are measured consistently with the tax treatment in the income tax filing. Conversely, if the tax authority is unlikely to accept the entity’s tax treatment, then the effect of the tax uncertainty is reflected in determining the related taxable profit, tax bases, unused tax losses, unused tax credits and tax rates. To do so, the entity uses either the most likely amount or the expected value method – whichever better predicts the resolution of the uncertainty. [IFRIC 23.10–11]

The estimates and assumptions are reassessed if facts and circumstances change or new information emerges. [IFRIC 23.13]
**Share-based payments**

There are no forthcoming requirements under IFRS.

If the amount of a tax deduction (or estimated future tax deduction) for a share-based payment transaction exceeds the amount of the related cumulative remuneration expense, then the excess is recognized directly in equity. IFRS does not specifically address the situation in which the amount of the tax deduction is less than the related cumulative remuneration expense. [IAS 12.68A–68C]

IFRS does not provide specific guidance for tax-deductible dividends paid on unallocated shares of an employee share ownership plan (ESOP) and the general recognition principle applies. [IAS 12.52B, 57]

**Classification and presentation**

There are no forthcoming requirements under IFRS.

Deferred tax liabilities and assets are classified as non-current when a classified statement of financial position is presented (see chapter 3.1), even though some part of the tax balance may be expected to reverse within 12 months of the reporting date. [IAS 1.56]

Deferred tax liabilities and assets are presented separately from current tax liabilities and assets. [IAS 1.54]

**Share-based payments**

Amendments to the share-based payment Codification Topic are effective for annual periods beginning after 15 December 2017 for entities other than public business entities; early adoption is permitted. [ASU 2016-09]

The difference between the deduction for tax purposes and the compensation cost recognized in the financial statements creates an excess tax benefit or tax deficiency. Unlike IFRS, entities record all excess tax benefits and tax deficiencies as an income tax benefit or expense, respectively, in the income statement in the period in which they are deducted on the income tax return. [ASU 2016-09]

Unlike IFRS, tax deductible dividends paid on unallocated shares of an employee share ownership plan (ESOP) are recognized in profit or loss. [ASU 2016-09]

**Classification and presentation**

Amendments to the income taxes Codification Topic are effective for annual periods beginning after 15 December 2017 for entities other than public business entities; early adoption is permitted. [ASU 2015-17]

Like IFRS, deferred tax liabilities and assets are classified as non-current when a classified statement of financial position is presented (see chapter 3.1), even though some part of the tax balance may be expected to reverse within 12 months of the reporting date. [740-10-45-4]

Like IFRS, deferred tax liabilities and assets are presented separately from current tax liabilities and assets. [740-10-45-4]
## 4 Specific items of profit or loss and OCI

### 4.1 General

**Overview**

- A statement of profit or loss and OCI is presented either as a single statement, or as a statement of profit or loss followed immediately by a statement of comprehensive income (beginning with profit or loss and displaying components of OCI).

- Although IFRS requires certain items to be presented in the statement of profit or loss and OCI, there is no prescribed format.

- An analysis of expenses is required, either by nature or by function, in the statement of profit or loss and OCI or in the notes.

- The presentation of alternative earnings measures is not prohibited, either in the statement of profit or loss and OCI or in the notes to the financial statements.

- In our view, use of the terms ‘unusual’ or ‘exceptional’ should be infrequent and reserved for items that justify greater prominence.

### 4.1 General

**Overview**

- Like IFRS, an entity may present a statement of comprehensive income either as a single statement, or as an income statement followed immediately by a separate statement of comprehensive income (beginning with profit or loss and displaying components of OCI).

- Unlike IFRS, SEC regulations prescribe the format and minimum line item presentation for SEC registrants. For non-SEC registrants, there is limited guidance on the presentation of the income statement or statement of comprehensive income, like IFRS.

- Unlike IFRS, there is no requirement for expenses to be classified according to their nature or function. SEC regulations prescribe expense classification requirements for certain specialised industries, unlike IFRS.

- Unlike IFRS, the presentation of non-GAAP measures in the financial statements by SEC registrants is prohibited. In practice, non-GAAP measures are also not presented in the financial statements by non-SEC registrants, unlike IFRS.

- Unlike IFRS, transactions of an ‘unusual’ nature are defined as possessing a high degree of abnormality and of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity. Unlike IFRS, material events or transactions that are unusual and/or occur infrequently are presented separately in the income statement or disclosed in the notes.
Overview (continued)

- The presentation or disclosure of items of income and expense characterised as ‘extraordinary items’ is prohibited.

- Items of income and expense are not offset unless required or permitted by another standard, or if the amounts relate to similar transactions or events that are not material.

Definitions

‘Comprehensive income’ is the total change in equity during the period, excluding changes that arise from transactions with owners in their capacity as owners. Comprehensive income comprises profit or loss and items of ‘other comprehensive income’ (OCI). [IAS 1.7]

OCI comprises items of income and expense that are not recognised in profit or loss, as required or permitted by IFRS. [IAS 1.7]

IFRS does not use the term ‘accumulated OCI’ (AOCI), although in practice it is sometimes used to refer to the cumulative amount remaining in OCI at a particular point in time.

Format of the statement of profit or loss and OCI

Profit or loss and OCI may be presented in either:
- a single statement that includes all components of profit or loss and OCI in two separate sections; or
- a statement of profit or loss followed immediately by a ‘statement of comprehensive income’ beginning with profit or loss and displaying components of OCI. [IAS 1.10–10A]

Definitions

Like IFRS, ‘comprehensive income’ is the total change in equity during the period, excluding changes that arise from transactions with owners in their capacity as owners. Comprehensive income comprises net income (profit or loss) and items of ‘other comprehensive income’ (OCI). [ASC Master Glossary]

OCI comprises revenues, expenses, gains and losses that are not recognised in profit or loss, like IFRS. However, as discussed throughout this publication, there are some differences from IFRS in the specific items that comprise OCI. [ASC Master Glossary]

Various Codification topics/subtopics use the term ‘accumulated OCI’ (AOCI) to refer to the cumulative amount remaining in OCI at a particular point in time, like practice under IFRS.

Format of the statement of comprehensive income

Like IFRS, an entity may present comprehensive income in either:
- a single statement of comprehensive income, which includes all components of profit or loss and OCI; or
- an income statement followed immediately by a separate statement of comprehensive income beginning with profit or loss and displaying components of OCI. [220-10-45, 220-10-55]
Although the format of the statement of profit or loss and OCI is not prescribed, certain items are required to be presented in the statement. In our experience, there is limited flexibility over the order of these items, which tends to follow the order of the items set out in IAS 1. [IAS 1.81A–82A]

Classification of expenses
An entity presents an analysis of expenses recognised in profit or loss using a classification based on either their nature or their function within the entity, whichever provides information that is reliable and more relevant. This analysis may be presented in the notes to the financial statements. [IAS 1.99–100]

Additional, unusual or exceptional items
An entity presents additional items of income or expense, headings or subtotals if they are relevant to an understanding of the entity’s financial performance. Factors to consider when determining whether to present additional items include materiality and the nature and function of the components of income and expenses. [IAS 1.85–86]

When an entity presents additional subtotals in the statement of profit or loss and OCI, the subtotals:
- comprise line items made up of amounts recognised and measured in accordance with IFRS;
- are presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable;
- are consistent from period to period;
- are displayed with no more prominence than other subtotals and totals presented in the statement of profit or loss and OCI; and
- are reconciled in the statement of profit or loss and OCI with the subtotals and totals required by the standard. [IAS 1.85A–85B, BC38G, BC58B]

Unlike IFRS, SEC regulations prescribe the format of the income statement and minimum line item presentation for SEC registrants in general and by industry, which include:
- general instructions for financial statements;
- commercial and industrial companies;
- insurance companies; and
- bank holding companies. [Reg S-X Art 3, 5, 7, 9]

For non-SEC registrants, US GAAP has limited guidance on the information to be presented in the income statement or statement of comprehensive income, like IFRS. [225-10-S99]

Classification of expenses
Unlike IFRS, there is no requirement for expenses to be classified according to their nature or function. SEC regulations prescribe expense classification requirements for certain specialised industries, unlike IFRS, and these may differ from the classifications permitted or required by IFRS. [Reg S-X §210.5-03, §210.7-04, §210.9-04]

Unusual or infrequent items
A material event or transaction that is unusual in nature or occurs infrequently is reported as a separate component of income from continuing operations, which may differ from the approach under IFRS. Like IFRS, additional line items, headings and subtotals may be presented if they improve the understandability of the income statement. The nature and financial effects of each event or transaction are disclosed in the income statement or in the notes to the financial statements, like IFRS. [225-20-45]

Unlike IFRS, there is no specific guidance on the presentation of additional subtotals in the income statement that is equivalent to IFRS. However, the general concepts of consistency, clarity and understandability would apply.
IFRS does not describe events or items of income or expense as 'unusual' or 'exceptional'. In our view, if the description 'unusual' or 'exceptional' is used, then its use should be infrequent and reserved for items that justify greater prominence than that achieved by separate presentation or disclosure. Separate presentation in the statement that reports profit or loss should be given only for very significant items when separate reporting is necessary for a fair presentation. In our view, when classifying expenses by nature or function, any amount described as unusual or exceptional should be classified in the same way as usual or non-exceptional amounts of the same function or nature. \([\text{IAS 1.17(c), 97}]\)

Like IFRS, US GAAP makes no distinction between ordinary and extraordinary activities. The presentation, disclosure or characterisation of items of income and expense as 'extraordinary items' in the statement of profit or loss and OCI or in the notes to the financial statements is prohibited. \([\text{IAS 1.87}]\)

**Operating results**

Entities are permitted, but not required, to provide a subtotal for the results of operating activities before profit or loss for the reporting period. There is no definition of ‘operating’ and ‘non-operating’ for the purposes of the statement of profit or loss. \([\text{IAS 1.82, 85–85A, BC55–BC56}]\)

**Share of profit of equity-accounted investees**

An investor’s share of profit or loss of equity-accounted investees is presented as a separate line item in profit or loss (see chapter 3.5). \([\text{IAS 1.82(c), IG6, 28.10}]\)

**Reclassifications from OCI**

An entity presents the items of OCI that may be reclassified to profit or loss in the future if certain conditions are met separately from those that will never be reclassified to profit or loss. Examples of items of income and expense that may subsequently be reclassified to profit or loss include:
- foreign exchange differences on the translation of foreign operations (see chapter 2.7);
- the effects of cash flow hedging (see chapter 7.7);
- the remeasurement of available-for-sale financial assets (see chapter 7.6); and
- the income tax effect of the above items (see chapter 3.13). \([\text{IAS 1.82A}]\)

Transactions of an unusual nature are defined under US GAAP as events or transactions possessing a high degree of abnormality and of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity. Unlike IFRS, material events or transactions that are unusual and/or occur infrequently are presented separately in the statement that reports profit or loss or disclosed in the notes. \([\text{225-20-45-2, 16}]\)

Like IFRS, US GAAP makes no distinction between ordinary and extraordinary activities. The presentation, disclosure or characterisation of items of income and expense as ‘extraordinary items’ in the statement of profit or loss and OCI or in the notes to the financial statements is prohibited.

**Operating results**

Like IFRS, entities are permitted, but not required, to provide a subtotal for the results of operating activities before profit or loss for the reporting period. Like IFRS, US GAAP does not define ‘operating’ and ‘non-operating’, and therefore differences may arise in practice.

**Share of profit of equity-method investees**

Like IFRS, an investor’s share of profit or loss from equity-method investees is presented as a separate line item in the income statement (see chapter 3.5). \([\text{323-10-35-4, 35-18}]\)

**Reclassifications from OCI**

Unlike IFRS, all items of OCI are reclassified to profit or loss in the future, and therefore there is no distinction similar to that made under IFRS.

Like IFRS, examples of items of income and expense that are subsequently reclassified to profit or loss include:
- foreign exchange differences on the translation of foreign operations (see chapter 2.7);
- the effects of cash flow hedging (see chapter 7.7);
- the remeasurement of available-for-sale financial assets (see chapter 7.6); and
- the income tax effect of the above items (see chapter 3.13). \([\text{220-10-45-10A}]\)

Unlike IFRS, and depending on the accounting policy chosen, an entity reclassifies gains or losses associated with pension or other post-retirement benefits initially recognised in OCI in the future to profit or loss (see chapter 4.4). \([\text{715-30-35-4(e)]}\)
The title of ‘the statement of profit or loss and OCI’ and other titles used in the standard are not mandatory. [IAS 1.10]

**Alternative earnings measures**

An entity may wish to present alternative earnings measures in the statement of profit or loss and OCI. IFRS does not prohibit the presentation of subtotals, including certain alternative earnings measures, if relevant criteria are met. In our view, if a measure (e.g. EBITDA or EBIT) is made up of amounts recognised and measured in accordance with IFRS, then it may be considered an additional subtotal. [IAS 1.85A–85B, BC38G]

**Non-GAAP measures**

Unlike IFRS, SEC rules define non-GAAP measures as numerical measures of financial performance, financial position or cash flows that (1) exclude amounts that are included in the most directly comparable measure calculated and presented in accordance with US GAAP, or (2) include amounts that are excluded from the most directly comparable measure calculated and presented in accordance with US GAAP. SEC registrants are prohibited from presenting non-GAAP measures in the financial statements. There is no specific guidance for non-SEC registrants; in practice, non-GAAP measures are not presented anywhere in the financial statements. If presented outside of the financial statements (such as in MD&A), then SEC registrants are required to reconcile the non-GAAP measures to the most directly comparable GAAP measure. Additionally, SEC registrants may not display non-GAAP measures more prominently than GAAP measures even when presented outside the financial statements. [Reg G, Reg S-K 10(e)]

If an entity uses EBITDA or a similar measure to evaluate an operating segment’s performance, then that information is included in the segment disclosures (see chapter 5.2).

EPS amounts for alternative earnings measures cannot be presented on the face of the financial statements but may be presented elsewhere. [IAS 33.73–73A]

**Offsetting**

Items of income and expense are offset when it is required or permitted by an IFRS, or when gains, losses and related expenses arise from the same transaction or event or from similar individually immaterial transactions and events. [IAS 1.32–35]

Unlike IFRS, EPS amounts for non-GAAP measures cannot be presented anywhere in the financial statements. [260-10-45-6]

If an entity uses EBITDA or a similar measure to evaluate an operating segment’s performance, then that information is included in the segment disclosures (see chapter 5.2), like IFRS; because the segment Codification Topic requires disclosure of the information in that situation, it is not considered a non-GAAP measure. [Reg G, Reg S-K 10(e)]

**Offsetting**

Like IFRS, items of income and expense are not offset unless it is required or permitted by another Codification topic/subtopic, or when the amounts relate to similar transactions or events that are not significant. However, offsetting is permitted in more circumstances under US GAAP than under IFRS. For example, derivatives executed with the same counterparty under a master netting arrangement may be offset, unlike IFRS. [605-60-45, 815-10-45]
4.2 Revenue

Overview

– Revenue is recognised only if it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably.

– Revenue recognition is mainly based on general principles that are applied to different types of transactions.

– If an arrangement includes more than one component, then it may be necessary to account separately for the revenue that is attributable to each component.

– Revenue from the sale of goods is recognised when the entity has transferred the significant risks and rewards of ownership to the buyer and it no longer retains control or has managerial involvement in the goods.

– Construction contracts are accounted for using the percentage-of-completion method. The completed-contract method is not permitted.

Overview

– The general guidance in US GAAP is that revenue is recognised when it is earned and realised or realisable. However, US GAAP includes specific revenue recognition criteria for different types of revenue-generating transactions, which in many cases differ from IFRS.

– Unlike IFRS, there is extensive guidance on revenue recognition specific to the industry and type of contract.

– Like IFRS, if an arrangement includes multiple elements, then it may be necessary to account separately for the revenue that is attributable to each element, depending on whether they constitute one or multiple units of accounting. Unlike IFRS, there is specific guidance on making this assessment.

– Like IFRS, revenue from the sale of goods is recognised when the entity has transferred the significant risks and rewards of ownership to the buyer and it no longer retains control or managerial involvement in the goods. However, the specific criteria underlying these principles are different from those under IFRS in certain respects.

– Construction contracts are accounted for using the percentage-of-completion method when an entity has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs, like IFRS. Otherwise, unlike IFRS, the completed-contract method is used.
Overview (continued)

– Under the percentage-of-completion method, both contract revenue and costs are recognised with reference to the stage of completion of the work.

– Construction contracts are segmented when certain criteria are met.

– Revenue from service contracts is recognised in the period during which the service is rendered, generally under the percentage-of-completion method.

– There is no specific guidance on software revenue recognition.

– There is specific guidance on accounting for agreements for the construction of real estate. Application of this guidance may result in revenue being recognised on a percentage-of-completion basis, a continuous delivery basis or at a single point in time.

– Revenue comprises the gross inflows of economic benefits received by an entity for its own account. In an agency relationship, amounts collected on behalf of the principal are not recognised as revenue by the agent. IFRS includes some guidance on evaluating whether an entity is acting as a principal or an agent.

Overview (continued)

– Under the percentage-of-completion method, both contract revenue and costs may be recognised with reference to the stage of completion of the work, like IFRS. However, unlike IFRS, entities are also permitted to recognise all costs incurred, with revenue calculated with reference to the gross margin earned on the contract during the period.

– Unlike IFRS, construction contracts may, but are not required, to be segmented when certain criteria are met; additionally, the criteria differ from IFRS.

– Like IFRS, revenue from service contracts is recognised in the period during which the service is rendered. However, unlike IFRS, revenue from services is generally recognised under the proportional performance or straight-line method rather than the percentage-of-completion method.

– Unlike IFRS, there is specific guidance on software revenue recognition.

– Like IFRS, there is specific guidance on accounting for sales of real estate. However, application of this guidance results in revenue being recognised under the full accrual method, the instalment method, the cost recovery method, the percentage-of-completion method or the deposit method, which is a broader range of possibilities than IFRS.

– Like IFRS, revenue comprises the gross inflows of economic benefits received by an entity for its own account. Like IFRS, in an agency relationship amounts collected on behalf of the principal are not recognised as revenue by the agent. However, there is more guidance than IFRS on evaluating whether an entity is acting as a principal or agent.
IFRS contains general principles for revenue recognition that apply to all entities. There is limited supplemental industry-specific guidance on revenue recognition.

**Definition**

‘Revenue’ is defined as income that arises in the course of the ordinary activities of the entity (e.g. the sale of inventory). [IAS 18.7]

‘Other income’ arises outside the course of the ordinary activities of the entity, such as from the sale of an entity’s property, plant and equipment, and is not revenue but is a gain (or loss). However, if on a routine basis an entity rents out property, plant and equipment and then sells it, then the proceeds from such sales are recognised as revenue. [IAS 16.68A, 18.7]

Contributions by shareholders in their capacity as shareholders do not generate revenue or income (see chapter 7.3). [CF 4.25]

**Measurement**

Revenue is measured at the fair value (see chapter 2.4) of the consideration received, taking into account any trade discounts and volume rebates (see below). [IAS 18.9–11]

The amount of revenue recognised is discounted to the present value of the consideration due if payment extends beyond normal credit terms. [IAS 18.11]

Unlike IFRS, the revenue recognition guidance under US GAAP is extensive, with specific guidance for many different industries or types of transactions (e.g. real estate, software, cable television and broadcast companies, and film producers). General principles for revenue recognition apply only to industries or transactions for which no specific guidance is applicable. [605, 905 – 985, SAB Topic 13]

**Definition**

‘Revenue’ is defined as inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity’s ongoing major or central operations. Because the precise language under US GAAP differs from IFRS, it is possible that differences may arise in practice, although the overall principle is the same as IFRS. [CON 6.78]

Gains (losses) are defined as increases (decreases) in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity, except those that result from revenues or investments by owners. Because the precise language under US GAAP differs from IFRS, it is possible that differences may arise in practice, although the overall principle is the same as IFRS. Also, proceeds from the sale of assets that are rented out then subsequently sold on a routine basis are recognised as other income, unlike IFRS. [CON 6.62]

Like IFRS, contributions by shareholders in their capacity as shareholders do not generate revenue or income (see chapter 7.3). [CON 6.66–67]

**Measurement**

Like IFRS, revenue is measured at the fair value (see chapter 2.4) of the consideration received, taking into account any trade discounts and volume rebates (see below). [605-50]

Like IFRS, the amount of revenue recognised is discounted to the present value of the consideration due if payment extends beyond normal credit terms. However, payment terms of less than one year do not generally require discounting regardless of materiality, unlike IFRS. Additionally, unlike IFRS, for certain types of transaction (e.g. software) extended payment terms may lead to the conclusion that the amount of revenue is not fixed or determinable (see below), resulting in the deferral of all revenue until an amount is due and payable. [835-30-15-3a, 985-605-25-25-35, SAB Topic 13A.1]
Linked transactions

If two or more transactions are linked so that the individual transactions have no commercial effect on their own, then it is the combined effect of the two transactions together that is accounted for. [IAS 18.13]

Multiple-component transactions

A contract may include multiple components, such as when goods are sold with subsequent support or maintenance services. In these cases, it may be necessary to separate the single contract into its various components, with different revenue allocations for each component. [IAS 18.13]

There is no general guidance on how separate components within a contract or agreement should be identified. However, in our view an entity should consider the requirements for combining and segmenting construction contracts (see below) and the following tests:

- the component has stand-alone value to the customer; and
- the fair value of the component can be reliably measured. [IFRIC 18.15]

In assessing whether a component has stand-alone value to the customer, in our view an entity should choose an accounting policy, to be applied consistently, to apply either of the following interpretations:

- a component has stand-alone value if a vendor sells the item on a stand-alone basis or the customer could resell it; or
- a component has stand-alone value if the customer derives value from that item that is not dependent on receiving other deliverables under the same arrangement.

Linked transactions

Like IFRS, if two or more transactions are linked so that the individual transactions have no commercial effect on their own, then it is the combined effect of the two transactions together that is accounted for. However, unlike IFRS, US GAAP provides additional guidance on the linking of transactions, which may give rise to differences in practice. Under US GAAP, separate contracts with the same entity or related parties that are entered into at or near the same time are presumed to have been negotiated as a package and are evaluated as a single arrangement in considering whether there are one or more deliverables in the arrangement. [605-25-25-3]

Multiple-element (multiple-component) transactions

US GAAP provides specific guidance on determining when a contract that includes multiple elements should be separated into multiple units of accounting. [605]

Unless a specific Codification topic/subtopic applies to the arrangement, a multiple-element revenue arrangement is separated into multiple units of accounting if the delivered item has stand-alone value to the customer and, if the arrangement includes a general right of return on the delivered item, delivery of the undelivered item is considered probable and substantially under the control of the vendor. Additionally, the amount allocated to the delivered item is limited to the non-contingent portion of the consideration. The application of these specific criteria may give rise to differences from IFRS in practice. [605-25-25-5]

Unlike IFRS, a component has stand-alone value only if the item is sold separately by any vendor or the customer could resell it on a stand-alone basis. [605-25-5]
There is no general guidance on how revenue should be allocated between different components of a multiple-component arrangement. Possible methods of allocation include:

- relative fair values; or
- fair value of undelivered components (residual method), whereby each undelivered element is measured at fair value and the remaining consideration is allocated to the delivered elements. [IFRIC 13.5–7, BC14, 15.8]

In our view, the reverse residual method, in which the delivered components are measured at fair value, and the remainder of the consideration is allocated to the undelivered component(s), is not an appropriate basis for allocating revenue.

IFRS does not provide specific guidance on revenue recognition when a portion of the revenue is contingent on future performance.

Apart from the recognition of interest, dividends (see chapter 7.6) and royalties, revenue recognition can be categorised under three headings: sale of goods, construction contracts and the provision of services. There are three common recognition requirements:

- it is probable that the economic benefits of the transaction will flow to the entity;
- the revenue can be reliably measured; and
- the costs (both those incurred to date and expected future costs) are identifiable and can be measured reliably (see below). [IAS 11.23, 18.14, 20]

The costs related to completing performance should be reliably measurable before recognising revenue (see above). If they are not, then revenue recognition is deferred, not only for the portion of the sale to be completed, but also for the goods that have already been delivered. [IAS 18.19]

Unlike IFRS, US GAAP contains specific requirements for how revenue is allocated between different components of a multiple-element arrangement. If the arrangement has multiple units of accounting, then revenue is allocated to the different components based on their relative stand-alone selling prices unless another Codification topic/subtopic specifies a different allocation method. The stand-alone selling price used for allocation is vendor-specific objective evidence of selling price (VSOE), if it exists; otherwise, third party evidence of selling price (TPE) is used. If neither VSOE nor TPE exists for a component, then the best estimate of selling price is used. [605-25-30-2]

Like IFRS, the reverse residual method is not an appropriate basis for allocating revenue under the general multiple-element Codification Subtopic. [605-25-30-2]

Unlike IFRS, no amount of arrangement consideration that is deemed to be ‘contingent’ consideration (e.g. a portion of the arrangement consideration that is refundable for failure to deliver an undelivered element) can be allocated to the delivered elements. Because of these specific requirements under US GAAP, differences from IFRS in the amounts allocated to elements of the arrangement may arise in practice. [605-25-30-5]

Like IFRS, US GAAP contains revenue recognition criteria for sales of products when specialised industry guidance is not applicable, and for construction contracts. Unlike IFRS, specific revenue recognition guidance exists for many industries and transactions (e.g. real estate, broadcasters, insurance or software). Under US GAAP, the four general revenue recognition requirements, when specialised industry or other guidance is not applicable, are:

- persuasive evidence of an arrangement exists, generally in writing, unlike IFRS;
- delivery has occurred or services have been rendered, like IFRS;
- the price is fixed or determinable, like IFRS; and
- collectibility is reasonably assured, like IFRS. [SAB Topic 13]

Unlike IFRS, under US GAAP there is no revenue recognition criterion related to the costs of completing performance. However, if the costs of honouring a standard warranty cannot be estimated reliably and the potential range of costs is wide, then revenue is deferred until either a reliable estimate can be made or the warranty period lapses, like IFRS. [460-10-25-6]
**Sale of goods**

In addition to the general recognition criteria (see above), the following need to be met for the sale of goods before revenue can be recognised:

- there is no continuing managerial involvement with the goods to the degree usually associated with ownership; and
- the significant risks and rewards of ownership of the goods have been transferred to the buyer and there is no effective control over the goods.

[IAS 18.14]

Revenue is recognised once all significant performance obligations have been met. For example, if goods are subject to installation or inspection (and that is a significant part of the contract), then revenue is recognised once the installation or inspection is complete.  

[Warranty obligations]

Granting a typical guarantee or warranty (see chapter 3.12) does not normally result in the retention of significant risks by the seller and would not preclude the recognition of revenue. The expected future costs of satisfying the obligation are accrued.

Even if the warranty period extends beyond a standard period, this does not normally prevent revenue recognition for the item sold. Instead, this is treated as a multiple-component arrangement, with the consideration received or receivable allocated between the delivered item and the extended warranty. However, an abnormal warranty obligation – e.g. a warranty related to the amount of revenue that use of the asset will generate for the buyer – may indicate that the significant risks and rewards of ownership have not passed to the buyer, or that the seller has not performed all of its obligations in delivering a product that the buyer can use.  

[IAS 18.16a]

**Right of return by the buyer**

If the buyer has a right of return and there is uncertainty about the possibility of return, then revenue is not recognised until the shipment has been accepted by the buyer or the goods have been delivered and the period for rejection has elapsed. However, revenue is recognised with a provision for returns (see chapter 3.12) if a reliable estimate of expected returns can be made.  

[IAS 18.16d, IAS 18.25b]

**Sale of goods**

The general revenue recognition criteria (see above), which apply to the sale of goods unless other specialised industry guidance applies, are similar to the criteria under IFRS. However, because the specific criteria under US GAAP differ from IFRS and because specialised guidance applies for certain industries (e.g. software or motion pictures), it is possible that differences may arise in practice.

[605, 905 – 985, SAB Topic 13]

Like IFRS, if an arrangement constitutes a single unit of accounting (see above), then revenue is not recognised until the seller substantially completes its performance obligations, such as the completion of installation or inspection.

[Warranty obligations]

Like IFRS, granting a standard, short-term and relatively minor product warranty does not normally result in the retention of significant risks by the seller and would not preclude the recognition of revenue. The expected future costs of satisfying the obligation are accrued, like IFRS.

If the arrangement contains a separately priced warranty, then the warranty arrangement is accounted for as a separate deliverable from the product, with the revenue related to the separately priced warranty recognised as the services are provided (see above). This treatment is more prescriptive than the general considerations under IFRS, which may give rise to differences in practice. Additionally, if the seller has the right under the warranty agreement to pay a third party to provide the warranty service, then it may elect to measure the warranty agreement at fair value through profit or loss (fair value option), unlike IFRS.  

[605-20-25-1 – 25-6, 825-10-05-5]

**Right of return by the buyer**

Like IFRS, if the buyer has a right of return and there is uncertainty about the possibility of return, then revenue is not recognised until the goods have been accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed. However, revenue is recognised with a provision for returns (see chapter 3.12) if a reliable estimate of expected returns can be made, like IFRS.  

Unlike IFRS, there are more explicit criteria for revenue to be recognised with a provision for returns (see chapter 3.12):
- the seller's price to the buyer is substantially fixed or determinable at the date of sale;
- the buyer has paid the seller or the buyer is obliged to pay the seller and the obligation is not contingent on resale of the product;
- the buyer's obligation to the seller would not be changed in the event of theft or physical destruction, or damage of the product;
- the buyer acquiring the product for resale has economic substance apart from that provided by the seller;
- the seller does not have significant obligations for future performance to directly bring about resale of the product by the buyer; and
- the amount of future returns can be reasonably estimated. [605-15-25-1]

These criteria may also be relevant considerations under IFRS. However, because there is no explicit requirement to consider them, differences may arise in practice, with the additional criteria delaying revenue recognition under US GAAP.

**Sell-through arrangements**

Like IFRS, if the receipt of revenue is contingent on the customer making a sale of the goods, then revenue is recognised only when the inventory has been sold by the customer unless, unlike IFRS, the seller has sufficient experience to conclude that the amount of revenue is determinable (‘sell-in’). If revenue is deferred until resold, then this is commonly referred to under US GAAP as the ‘sell-through’ method. [SAB Topic 13A.2]

**Repurchase options**

At the time of the sale, an entity (seller) may enter into an agreement to repurchase the same goods at a later date or the seller may have an option to repurchase the goods at a later date. An entity may also provide a guarantee to pay the customer any shortfall between the residual value of an item and a guaranteed amount. If the overall effect of the agreements is that the seller has not transferred the risks and rewards of ownership of the asset, then the transaction is considered to be a financing arrangement and no revenue is recognised with respect to the initial ‘sale’. Additionally, lease accounting may apply (see chapter 5.1). [IAS 18.IE5]
Residual value guarantees
A seller may offer a guaranteed residual or reimbursement to the customer. Such guaranteed residual amounts may preclude revenue recognition if significant risks are retained. In our view, not retaining significant risks requires a guaranteed residual amount at or near the end of the useful life of the asset, measured on a present value basis, to transfer substantially all (as that term is used in the context of evaluating the classification of a lease agreement) of the initial sales price risk to the customer. [IAS 17.10(d), 18.14(d)]

Bill-and-hold transactions
Revenue is recognised on bill-and-hold transactions when the customer takes title, provided that:
- it is probable that delivery will be made;
- the item is on hand, identified and ready for delivery to the buyer at the time when the sale is recognised;
- the buyer specifically acknowledges the deferred delivery instructions; and
- the usual payment terms apply. [IAS 18.IE1]
Construction contracts

A ‘construction contract’ is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely inter-related or interdependent in terms of their design, technology and function or their ultimate purpose or use. Accordingly, the scope of the construction contract standard under IFRS requires a high degree of customer specification. [IAS 11.3]

Construction contract accounting applies not only to the construction of buildings, but also to the production of other complex assets or pieces of equipment. [IAS 11.4]

Construction contracts are classified either as fixed-price contracts or as cost-plus contracts. [IAS 11.3]

Construction contracts

Contracts covered by the construction contract accounting Codification Subtopic are binding agreements between buyers and sellers in which the seller agrees, for compensation, to perform a service to the buyer’s specifications. ‘Contracts’ consist of legally enforceable agreements in any form and include amendments, revisions and extensions of such agreements. Performance will often extend over long periods and the seller’s right to receive payment depends on its performance in accordance with the agreement. The service may consist of designing, engineering, fabricating, constructing or manufacturing related to the construction or the production of tangible assets. Contracts covered include, but are not limited to:

- contracts in the construction industry, such as those of general building, heavy earth moving, dredging, demolition, design-build contractors and speciality contractors – e.g. mechanical, electrical or paving;
- contracts to design and build ships and transport vessels;
- contracts to design, develop, manufacture or modify complex aerospace or electronic equipment to a buyer’s specification or to provide services related to the performance of such contracts;
- contracts for construction consulting services, such as under agency contracts or construction management agreements; and
- contracts for services performed by architects, engineers or architectural or engineering design firms. [605-35-15-2 – 15-3]

Because US GAAP applies construction contract accounting to arrangements that require a high degree of customer specification and to arrangements to design, develop or manufacture complex applications (even if there is not a high degree of customer specification), more arrangements may be accounted for under the construction contract accounting Codification Subtopic under US GAAP than under IFRS. [605-35-15-2 – 15-3]

Like IFRS, construction contract accounting applies not only to the construction of buildings, but also to the production of other complex assets or pieces of equipment. [605-35-15-2 – 15-3]

Like IFRS, construction contracts can be classified as fixed-price contracts or as cost-plus contracts. However, unlike IFRS, US GAAP identifies two additional types of construction contracts: time-and-material (similar to cost-plus) and units-of-production contracts. [605-35-15-4]
Combining and segmenting construction contracts

The components of a contract are accounted for as separate contracts if each segment functions on a stand-alone basis and all of the following criteria are met:

- separate proposals were submitted for each component;
- each component was subject to separate negotiation and could have been accepted or rejected; and
- the costs and revenue for each component can be identified. [IAS 11.7–8]

Unlike IFRS, segmenting construction contracts is permitted but not required when specified criteria (see below) are met. Additionally, the segmentation criteria under US GAAP are different from IFRS, and therefore differences may arise in practice.

Construction contracts may be segmented if all of the following steps were taken:

- the contractor submitted bona fide proposals on the separate components of the project and on the entire project, like IFRS;
- the customer had the right to accept the proposals on either basis, like IFRS; and
- the aggregate price of the proposals on the separate components approximated the price of the proposal on the entire project, unlike IFRS. [605-35-25-10, 25-12, 25-14]

Unlike IFRS, a project that does not meet the above criteria may still be segmented, but only if it meets all of the following criteria:

- the terms and scope of the contract or project clearly call for separable phases or elements;
- the separable phases or elements of the project are often bid or negotiated separately;
- the market assigns different gross profit rates to the segments;
- the contractor has a significant history of providing similar services to other customers under separate contracts, for each significant segment to which a profit margin higher than the overall profit margin on the profit is ascribed; and that history is relatively stable in terms of pricing policy, rather than being unduly weighted by erratic pricing decisions;
- the excess of the sum of the prices of the separate elements over the price of the total project is clearly attributable to cost savings incidental to the combined performance of the contract obligations; and
- the similarity of services and prices in the contract segments, and the services and prices of such services to other customers contracted separately, have been documented and are verifiable. [605-35-25-13]

Under US GAAP, contracts are treated as a single construction contract if they:

- are negotiated as a package in the same economic environment with an overall profit margin objective, like IFRS;
- constitute, in essence, an agreement to do a single project, like IFRS;
- require closely inter-related construction activities with substantial common costs that cannot be separately identified with, or reasonably allocated to, the elements, phases or units of output, unlike IFRS;

A group of contracts (whether with a single customer or not) is treated as a single construction contract if they do not function on a stand-alone basis and:

- they were negotiated as part of a single package;
- the contracts are effectively part of a single project with an overall profit margin; and
- the contracts are performed concurrently or in continuous sequence. [IAS 11.9]
Recognition of contract revenue and expenses

Once the relevant revenue recognition criteria are satisfied, both contract revenue and contract costs of both fixed-price and cost-plus construction contracts are recognised with reference to the stage of completion of the contract. Any costs incurred or consideration received in excess of the stage of completion are generally deferred. [IAS 11.22]

The completed-contract method is not permitted in accounting for construction contracts.

In addition to the general revenue recognition criteria (see above), the following criteria should also be met before revenue can be recognised under the percentage-of-completion method (fixed-price contracts):
- the outcome of the contract can be reliably estimated; and
- the stage of completion of the contract can be reliably measured. [IAS 11.23]

If the outcome of a construction contract cannot be reliably estimated, then no profit is recognised, but revenue is recognised to the extent of costs incurred that are probable of recovery. Costs are recognised as an expense as they are incurred. [IAS 11.32]

Recognition of contract revenue and expenses

Like IFRS, for all types of contracts (fixed-price, cost-plus, time-and-material and units-of-production) in the scope of the construction contract accounting Codification Subtopic, the percentage-of-completion method is applied when the relevant criteria are met (see below). [605-35-25-8]

Unlike IFRS, the completed-contract method is required in accounting for construction contracts if the criteria for recognising revenue under the percentage-of-completion method are not met (see below); the criteria for recognising revenue under the percentage-of-completion method are assessed each reporting period. Under the completed-contract method, costs, including costs attributable to unpriced change orders, are deferred if it is probable that the aggregate contract costs will be recoverable from contract revenues. [605-35-25-61, 25-98]

Like IFRS, before revenue can be recognised under the percentage-of-completion method, the entity needs to be able to make reliable estimates of the extent of progress towards completion, contract revenues and contract costs. Additionally, the following conditions need to be met:
- executed contracts are required and these contracts include enforceable rights regarding goods or services to be delivered, the consideration and the manner and terms of settlement; and
- the buyer and contractor can be expected to satisfy/perform their obligations under the contract. [605-35-25-67]

These criteria may also be relevant considerations under IFRS. However, because there is no explicit requirement to consider them, differences may arise in practice, with the additional criteria delaying revenue recognition under US GAAP.

Unlike IFRS, if the entity cannot make a reliable determination of whether a loss will be incurred and cannot make reliable estimates of costs to complete, then the completed contract method is applied. [605-35-25-61]
Once the revenue recognition criteria are satisfied, both contract revenue and contract costs are recognised with reference to the stage of completion of the contract in the period in which the work is performed. [IAS 11.22]

Any consideration received in excess of the stage of completion is generally deferred. [IAS 11.22]

Contract costs incurred that relate to future activities are deferred and recognised as inventory (see chapter 3.8). [IAS 11.22, 27]

**Contract revenue**

Revenue is recognised at the fair value of the amount receivable. [IAS 11.12]

Contract revenue comprises:

- the initial amount of revenue agreed in the contract; and
- variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and the additional revenue is reliably measurable. [IAS 11.11]

Revenue measurements are based on estimates that are revised as events and uncertainties are resolved. [IAS 11.12]

Any penalty for late delivery is recognised as a reduction in contract revenue. [IAS 11.12(c)]

Incentive payments are additional amounts paid to the contractor if specified performance standards are met. Incentive payments are included in contract revenue when:

- the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and
- the amount of the incentive payment can be measured reliably. [IAS 11.15]

Once the revenue recognition criteria are satisfied, revenue and costs recognised each period may be determined using either of the following methods:

- recognise both revenue and expenses in proportion to the work performed under the contract during the period, like IFRS; or
- recognise expenses equal to the costs incurred during the period and recognise revenue based on the estimated percentage of the gross margin earned on the contract during the period, unlike IFRS. [605-35-25-82 – 25-84]

Like IFRS, any consideration received in excess of the stage of completion is deferred; the amount is presented as ‘billings in excess of uncompleted contracts’. [605-35-45-3 – 45-5]

Like IFRS, except for cost-type contracts, contract costs incurred related to future activities are deferred and recognised as inventory (costs incurred in excess of billings), if their recovery from future contract revenue is probable. [605-35-25-41]

**Contract revenue**

Unlike IFRS, revenue is recognised at the amount negotiated in the arrangement. [605-35-25-15 – 25-17]

Like IFRS, contract revenue comprises:

- the initial amount of revenue agreed in the contract; and
- variations in contract work, claims and incentive payments, to the extent that it is probable that these will result in revenue and the additional revenue is reliably measurable. [605-35-25-15 – 25-16, 25-28, 25-31, 25-64]

Like IFRS, revenue measurements are based on estimates that are revised as events and uncertainties are resolved. [605-35-25-15]

Like IFRS, any penalty for late delivery is recognised as a reduction in contract revenue. [605-35-25-31]

As with change orders (see below), accounting for incentive payments depends on the terms of the contract. Inclusion of incentive payments in total contract revenue depends on an entity’s assessment of whether the amount will be realised. Because the specific requirements differ in certain respects from IFRS, the timing of recognition may differ in certain situations. This evaluation is performed throughout the life of the contract. [605-35-25-15, 25-25 – 25-26]
Contract costs

Contract costs include the costs that are attributable to a contract from the date of securing the contract to the final completion of the contract. Contract costs comprise:

- costs that relate directly to the contract (e.g. labour and materials);
- costs that are attributable to contract activity in general (e.g. insurance and overheads) and that can be allocated to the contract on a systematic and rational basis based on normal contract activity; and
- other costs that are specifically chargeable to the customer. [IAS 11.16–19, 21]

Costs that cannot be allocated directly to contracts or attributed to contract activity include selling costs, general administrative costs and other costs that are not reimbursable under the terms of specific contracts. [IAS 11.20]

‘Learning curve’ costs are losses that may be incurred on the manufacture of earlier units, whereas later production is more profitable as a result of construction efficiencies. IFRS does not contain specific guidance on the treatment of learning curve or start-up costs. In our view, the learning curve costs associated with a single contract should be capitalised over the units under that contract for which there are firm orders.

Borrowing costs related to contract costs for which revenue has not been recognised are included in contract costs when the criteria for capitalisation are met (see chapter 4.6). [IAS 11.18]

Costs that are directly related to securing a contract and other pre-contract costs are included as part of contract costs only when it is probable that the contract will be obtained and the costs can be identified separately and measured reliably. If pre-contract costs are expensed in the period in which they were incurred, then they are not reinstated subsequently as contract costs when the contract is obtained. [IAS 11.21]

Contract costs

Like IFRS, contract costs include the costs that are attributable to a contract from the date of securing the contract to the final completion of the contract. Contract costs comprise:

- all direct costs (e.g. material, labour and subcontracting costs), like IFRS;
- indirect costs that are allocable to contracts, including indirect labour, contract supervision, tools and equipment, supplies, quality control and inspection, insurance, repairs and maintenance, depreciation and amortisation, like IFRS; however, because there is diversity in practice over which types of indirect costs are allocable under US GAAP, differences from IFRS may arise in practice; and
- other costs that are specifically chargeable to the customer, like IFRS. [605-35-25-37]

Like IFRS, costs that cannot be allocated directly to contracts or attributed to contract activity include selling costs, general administrative costs and other costs that are not reimbursable under the terms of specific contracts. Unlike IFRS, which does not allow the completed-contract method (see above), when the completed-contract method is used it may be appropriate to allocate general and administrative costs to construction contracts. [605-35-25-37, 25-99]

Unlike IFRS, under US GAAP learning curve or start-up costs are generally expensed as they are incurred. However, unlike IFRS, if such costs are incurred in connection with existing construction contracts and in anticipation of follow-on or future construction contracts with the same customer for the same goods or services, then they are charged to existing and future construction contracts. [605-35-25-39, 25-41]

Like IFRS, interest costs (borrowing costs) related to contract costs for which revenue has not been recognised are included in contract costs when the criteria for capitalisation are met (see chapter 4.6). [605-35-25-38]

Like IFRS, costs that are directly attributable to securing a contract are included as part of contract costs only when it is probable that the contract will be obtained and their recoverability from the contract is probable. In practice, this criterion is not usually met and therefore differences from IFRS may arise in practice. Like IFRS, if pre-contract costs are expensed in the period in which they were incurred, then they are not subsequently reinstated as contract costs when the contract is obtained. [605-35-25-41a, 25-41f]
IFRS does not specifically address unpriced change orders and the general principles for contract costs apply. In accordance with general principles, costs attributable to unpriced change orders are treated as costs of contract performance in the period in which the costs are incurred, and revenue and profit under the percentage-of-completion method are adjusted and, if appropriate, the recognition of expected losses (see below) is considered.

The following guidelines apply to accounting for unpriced change orders under the percentage-of-completion method:

- Costs attributable to unpriced change orders are treated as costs of contract performance in the period in which the costs are incurred if it is not probable that the costs will be recovered through a change in the contract price, like IFRS.
- If it is probable that the costs will be recovered through a change in the contract price, then the costs are deferred (i.e. excluded from the cost of contract performance) until the parties have agreed on the change in contract price, unlike IFRS. Alternatively, they are treated as costs of contract performance in the period in which they are incurred and contract revenue is recognised to the extent of the costs incurred, unlike IFRS.
- If it is probable that the contract price will be adjusted by an amount that exceeds the costs attributable to the change order and the amount of the excess can be estimated reliably, then the original contract price is adjusted for that amount when the costs are recognised as costs of contract performance, like IFRS. However, because the substantiation of the amount of future revenue is difficult, revenue in excess of the costs that are attributable to unpriced change orders is recognised only in circumstances in which realisation is assured beyond reasonable doubt, unlike IFRS. [605-35-25-87]

Stage of completion

No specific method is mandated for assessing the stage of completion. An entity may use the more appropriate of input measures (consideration of the efforts devoted to a contract), or output measures (consideration of the results achieved). [IAS 11.30]

Expected contract losses

If it is probable that the total contract costs will exceed contract revenue, then the expected loss is recognised as an expense immediately. [IAS 11.36]

Service contracts

Service contracts are generally accounted for using the percentage-of-completion method following the same principles as for construction contracts. In this regard, the revenue recognition standard explicitly refers to the construction contract accounting standard. [IAS 18.21]

Stage of completion

Like IFRS, no specific method is mandated for assessing the stage of completion, and both input and output measures are used in practice. [605-35-25-51 – 25-52, 25-70 – 25-81]

Expected contract losses

Like IFRS, if it is probable that there will be a loss on the contract, then the entire expected loss is recognised immediately. [605-35-25-45 – 25-46]

Service contracts

Unlike IFRS, the construction contract accounting Codification Subtopic is not applied to service contracts. Service contracts are accounted for in a manner consistent with that in which performance of the services occurs, which may result in differences from IFRS in practice; possible revenue recognition methods include the proportional performance method, the straight-line method or recognition on completion of all related services. [605-20, 605-35-15-6]
Specific application issues

Sales incentives

IFRS does not contain guidance on the recognition and measurement of early settlement discounts. In our view, if it is probable that an early settlement discount will be taken, and the amount can be measured reliably, then the discount should be recognised as a reduction of revenue as the sales are recognised.

IFRS contains specific guidance on accounting for loyalty programmes, in which:
- an entity grants award credits as part of a sales transaction; and
- the customer can redeem the award credits for free or discounted goods or services, subject to meeting any other conditions. [IFRIC 13.3]

Award credits granted under customer loyalty programmes are recognised as a separately identifiable component of revenue and deferred at the date of initial sale. The consideration received or receivable from the customer is allocated between the current sales transaction and the award credits with reference to fair values, but a particular method of allocation is not prescribed. Revenue that is attributable to award credits is recognised when the entity has fulfilled its obligation or when a third party assumes the underlying obligation. [IFRIC 13.5–7, BC14]

IFRS does not contain specific guidance on the accounting treatment of slotting fees, which are payments made by an entity to a reseller – e.g. in exchange for product placement in the reseller’s store. In our view, an entity should determine whether slotting fees are paid for an identifiable benefit that is separable from the supply contract, and should therefore be recognised as an expense; or whether they are sales incentives granted by the entity, and should therefore be recognised as a reduction of revenue.

Sales agreements may include rebates payable to the customer if sales reach a certain volume. In our view, if it is probable that the rebate will be granted and the amount can be measured reliably, then the rebate should be recognised as a reduction of revenue as the sales are recognised – i.e. before the threshold is met. [IAS 18.10]

Sales incentives

Unlike IFRS, US GAAP contains specific guidance that if it is probable that an early settlement discount will be taken by the customer, and the amount can be measured reliably, then the discount is recognised as a reduction of revenue as the sales are recognised. (605-50-25-1 – 25-9)

Unlike IFRS, US GAAP does not specifically address the accounting for loyalty programmes.

In the absence of specific guidance, practice varies over whether a portion of the revenue is deferred, like IFRS, or whether revenue is recognised with a corresponding provision for the incremental cost of fulfilling the loyalty award, unlike IFRS. Even if an entity chooses to defer revenue, practice under US GAAP may differ from IFRS.

Unlike IFRS, consideration paid by a vendor to a customer is presumed to be a reduction of revenue. Also unlike IFRS, the presumption is overcome and the payment is recognised as an asset or expense, as appropriate, if (1) the vendor receives or will receive an identifiable benefit in exchange for the consideration; and (2) the fair value of the identifiable benefit can be reasonably estimated. If a separately identifiable benefit exists, then it is recognised as an asset or expense in accordance with other Codification topics/subtopics. (605-50-25-1 – 25-2)

Sales agreements often include rebates (cash incentives) or discounts payable by the seller to its customer. Unlike IFRS, US GAAP specifies that the amount is presumed to be a reduction of revenue unless specific criteria are met. Unlike IFRS, provided that the incentive will not result in a loss on the sale of a product or service, the rebate or discount is recognised at the later of:
- the date on which the related revenue is recognised by the seller; and
- the date on which the rebate or discount is offered, which would be the case if the rebate or discount offer is made after the seller has recognised revenue (e.g. when a manufacturer issues coupons offering discounts on a product that it has already sold to retailers). (605-50-25-3, 25-5, 45-2)
Generally, the expected amount of the rebates can be estimated reliably. In the rare cases in which the expected amount of the rebate cannot be estimated reliably, in our view the entity should estimate the appropriate amount of revenue to recognise at the time of the initial sales transaction, considering the uncertainty over potential future rebates. We believe that one appropriate approach in these circumstances may be to deduct the maximum potential amount of the rebates from the revenue that is recognised at the time of the initial sale transaction.

4.2 Revenue

Like IFRS, the measurement of the total rebate or refund obligation is based on the estimated amount of rebates or refunds that will be claimed by customers. If the amount of future rebates or refunds cannot be estimated reliably, then a liability is recognised for the maximum potential amount of the refund or rebate, which may differ from practice under IFRS. [605-60-25-4]

Real estate

There is specific guidance on accounting for agreements for the construction of real estate. Application of this guidance may result in revenue being recognised on a percentage-of-completion basis, a continuous delivery basis or at a single point in time. [IFRIC 15.4, 6, 10–12]

If a contract for the sale of property is signed before completion of the building, then the agreement is treated as a construction contract if the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress, regardless of whether this ability is exercised.

Other contracts are accounted for in accordance with the revenue standard. If the risks and rewards of ownership are transferred to the buyer on a continuous basis as development progresses, then revenue is recognised on a percentage-of-completion basis. In the more likely event that the risks and rewards of ownership are transferred to the buyer on completion, revenue is recognised at a single point of time as a sale of goods (see above). [IAS 18.14, IFRIC 15.17–18]

Real estate

There are specific, detailed criteria to be met in order to recognise revenue from the sale of real estate. Unlike IFRS, the application of these criteria results in revenue from sales of real estate being recognised under the full accrual method, the instalment method, the cost recovery method, the percentage-of-completion method or the deposit method. [970-605, 972-605, 974-605, 976-605, 978-605]

Unlike IFRS, contracts for the sale of residential properties signed before construction of the building is complete qualify for percentage-of-completion accounting during the construction phase if:

– construction is beyond a preliminary stage;
– the buyer is committed to the extent of being unable to require a refund except for non-delivery of the unit or interest;
– sufficient units have been sold to assure that the entire property will not revert to rental property;
– sales prices are collectible; and
– aggregate sales proceeds and costs can be reasonably estimated. [360-20-40-80, 40-54]

If these conditions are not met, then proceeds are accounted for as deposits until the criteria are met, at which time percentage-of-completion accounting is applied. [970-605]
Software revenue

IFRS does not provide specific guidance on revenue recognition for software-related transactions. Often, software sales arrangements are for the sale of the software together with subsequent servicing or licence arrangements. The substance of the transaction needs to be considered to determine whether the various components are linked and therefore accounted for as a single contract, or accounted for separately as a multiple-component transaction.

The general revenue recognition requirements are applied to each component of the transaction. The following are examples.

- If the software entity is selling software products, then the principles for the sale of goods apply.
- If the software entity provides services related to software sold (e.g. upgrades or support), then revenue from these services is deferred and recognised when the services are provided.
- If the software entity is developing customised software, then revenue is recognised with reference to the stage of completion of the development.
- When the software entity enters into a licensing arrangement, revenue is accounted for in accordance with the substance of the arrangement.

Unlike IFRS, US GAAP provides specific guidance on revenue recognition for software and software-related deliverables in an arrangement, including determining when a contract includes multiple elements, which elements are considered software and software-related elements, and how the individual elements in a multiple-element arrangement are evaluated for separation. Tangible products that contain software components and non-software components that function together to deliver the tangible product’s essential functionality are excluded from the scope of the specific software industry guidance and follow the general revenue recognition guidance for multiple-element arrangements (see above) for separation and allocation of arrangement consideration. The application of the specific requirements under US GAAP may give rise to differences from IFRS in practice. [985-605]

If VSOE of fair value exists for undelivered elements (services, maintenance and support), but does not exist for one or more delivered elements, then the arrangement fee is allocated to the elements under the residual method whereby each undelivered element is measured at fair value, and the remaining consideration is allocated to the delivered elements. If VSOE of fair value does not exist for the undelivered elements, then no revenue from the arrangement is recognised until VSOE of fair value exists or the last element in the arrangement is delivered. [985-605-25-9, 25-10e]

If the arrangement calls for significant production, customisation or modification of the software, then the percentage-of-completion method is applied to the arrangement.
4.2 Revenue

Service fees, including up-front fees
An up-front fee is recognised as revenue if there is no significant uncertainty about its collection and the entity has no further performance obligations that are linked to the fee. [IAS 18.20]

If services are performed through an indefinite number of repetitive acts over a specified period of time, then revenue is recognised on a straight-line basis over the specified period unless some other method better represents the stage of completion. If a specific act is much more significant than any other acts, then revenue is recognised only after the significant act is performed. [IAS 18.25]

Licence fees and royalties
To determine the appropriate method of recognising revenue in the form of licence fees and royalties, an entity considers its ongoing performance obligations and determines whether the transaction is, in substance, a sale of the asset or rights or a licensing arrangement. [IAS 18.30, IE20]

The above analysis of the substance of the transaction is based on the general principles for the recognition of revenue (see above). The arrangement would in substance be a sale, with revenue recognised on transfer of the rights to the licensee, in the following circumstances:
- the rights to the asset are assigned to the licensee in return for a fixed fee or non-refundable guarantee;
- the contract is non-cancellable;
- the licensee is able to exploit its rights to the asset freely; and
- the licensor has no remaining obligations to perform.

Service fees, including up-front fees
Unlike IFRS, an up-front fee is not recognised as revenue unless it meets the requirements for treatment as a separate unit of accounting in a multiple-element transaction (see above). In many cases, up-front fees may be wholly or partly an advance payment for future products or services and therefore do not qualify as a separate unit of accounting because they do not have stand-alone value to the customer. [SAB Topic 13A.3.f, 605-25]

Like IFRS, if services are performed through an indefinite number of repetitive acts over a specified period of time, then revenue is recognised on a straight-line basis over the specified period unless some other method better represents the stage of completion. However, unlike IFRS, US GAAP does not specifically address the appropriate method of revenue recognition if a specific act is much more significant than any other acts, and differences may arise in practice. [SAB Topic 13A.3.f]

Licence fees and royalties
Like IFRS, to determine the appropriate pattern of revenue recognition for a licence or royalty arrangement, the substance of the agreement is considered. This consideration includes whether the seller has any continuing obligation over the period of the agreement and whether the transaction is, in substance, a sale of the asset or rights or a licensing arrangement. [SAB Topic 13]

Unlike IFRS, specific revenue recognition criteria may apply depending on the intellectual property (e.g. software, film rights or broadcasting rights) that is being licensed.
- **Software**: There are two revenue recognition models (completed-performance and proportional-performance) to account for software revenue. The appropriate model depends on whether the licence software requires significant production, modification or customisation. If none is required, then the completed-performance model is used. Otherwise, contract accounting is required, which generally requires application of the percentage-of-completion model.
  - **Film and broadcasting rights**: Revenue is recognised on the sale or licence of films when the following criteria are met:
    - persuasive evidence of a sale or licensing arrangement with a customer exists;
    - the film is complete and, in accordance with the terms of the arrangement, has been delivered or is available for immediate and unconditional delivery;
    - the licence period of the arrangement has begun and the customer can begin its exploitation, exhibition or sale;
Financial service and related fees

Financial service fees may be considered an integral part of the effective yield of the instrument (see chapter 7.6); otherwise, they are recognised in accordance with the above general requirements. [IAS 18.IE14]

Product financing arrangements and sales of tax benefits

Sometimes arrangements in the legal form of a lease do not convey the right to use an asset, but may be designed to achieve a tax advantage that is shared with another entity in the form of a fee. [SIC-27]

In such cases, an entity distinguishes between fees earned on the execution of a significant act and fees related to future performance and risks retained, which is done following the general principles for the recognition of revenue (see above). Whether the fee is recognised immediately or over the period of the transaction depends on whether the fee is contingent on future actions of the entity, including refraining from certain actions. In some cases, it might be concluded that the contract is a multiple-component transaction (see above). [SIC-27]

Advertising

Revenue for advertising services is generally recognised only when the related advertisement appears before the public. However, any production commissions are recognised with reference to the stage of completion. [IAS 18.IE12]

Specific requirements apply to barter transactions involving advertising (see chapter 5.7).

- the arrangement fee is fixed or determinable; and

Although consideration of each of the above factors may be relevant for IFRS, differences may arise in practice because they are not explicit under IFRS, with the additional criteria delaying revenue recognition under US GAAP.

Financial service and related fees

Unlike IFRS, specific criteria are provided under US GAAP depending on the type of financial service provided. For example, US GAAP requires loan origination fees to be deferred and recognised over the life of the loan as an adjustment of yield, like IFRS, and mortgage servicing fees to be recognised based on the amortisation method or the fair value measurement method. However, due to the specific criteria under US GAAP, differences from IFRS may arise in practice. [310-20-25-2, 35-2]

Product financing arrangements and sales of tax benefits

Sometimes arrangements in the legal form of a lease do not convey the right to use an asset, but may be designed to achieve a tax advantage that is shared with another entity in the form of a fee.

Like IFRS, it is necessary to distinguish between the nature of the fees earned. This analysis includes assessing whether the individual services in the arrangement are separate units of accounting (multiple-element transaction – see above); in this case, differences from IFRS may arise in practice. [605-25]

Advertising

Like IFRS, revenue for advertising services is generally recognised only when the related advertisement appears before the public. Like IFRS, production commissions are recognised using the proportional-performance method (stage-of-completion method).

Like IFRS, specific requirements apply to barter transactions involving advertising (see chapter 5.7). However, the specific criteria differ from IFRS. [605-20-25-14 – 25-18]
4 Specific items of profit or loss and OCI

4.2 Revenue

**Transfers of assets from customers**

When an asset that is not a government grant is transferred to an entity by its customer and is recognised at fair value by the entity (see chapter 5.7), the exact timing of revenue recognition depends on the facts and circumstances of each particular arrangement. The entity receiving the assets needs to consider the following in determining the timing of revenue recognition:

- what performance obligations it has as a result of receiving the customer contribution;
- whether these performance obligations should be separated for revenue recognition purposes; and
- when revenue related to each separately identifiable performance obligation should be recognised. [IAS 18.13, IFRIC 18.13–21]

Unlike IFRS, there is no explicit guidance on the revenue recognition of an asset transferred to an entity by its customers, and practice may vary.

The exact timing of gain or loss recognition would be based on the recognition principles applicable to the transaction, and therefore differences from IFRS in the timing of when gain or loss is recognised may arise in practice.

**Gross or net presentation**

Revenue represents amounts received or receivable by the entity for its own account. Therefore, revenue is stated at its gross amount and is measured before deducting related costs such as costs for materials and salaries. [IAS 18.7–8]

Like IFRS, revenue represents amounts received or receivable by the entity for its own account. Revenue is stated at its gross amount and is measured before deducting related costs such as costs for materials and salaries. [CON 6.83]

**Agent vs principal**

In an agency relationship, amounts collected on behalf of and passed on to the principal are not revenue of the agent. The revenue of the agent is the amount of commission, plus any other amounts charged by the agent to the principal or other parties. [IAS 18.8]

The principal in an agency relationship recognises the gross amount charged to the ultimate customer as revenue. Commission paid to the agent is accounted for as an expense by the principal. [IAS 18.8]

Like IFRS, in an agency relationship amounts collected on behalf of and passed on to the principal are not revenue of the agent. The revenue of the agent is the amount of commission plus any other amounts charged by the agent to the principal or other parties, like IFRS. [605-45-45-1b]

Unlike IFRS, determining whether an entity is acting as an agent or principal is based on the application of specific indicators. Indicators that revenue should be reported gross (principal) are that the entity:

- is the primary obligor in the arrangement;
- has general inventory risk;
- has discretion in establishing price; and
- has credit risk. [IAS 18.1E21]
Indicators that revenue should be reported net (agent) are:
– the supplier is the primary obligor in the arrangement;
– the amount that the entity earns is fixed; and/or
– the supplier has credit risk. [605-45-15 – 45-18]

None of the above indicators is presumptive or determinative, and judgement is required to determine whether gross or net presentation is appropriate. Although all of these factors may be relevant to a determination under IFRS, there is no specific requirement to consider them. Therefore, differences from IFRS may arise in practice.

Unlike IFRS, the presentation of sales and other similar taxes (e.g. VAT) on either a gross or net basis is permissible as an accounting policy election. [605-45-50-3]

Unlike IFRS, amounts related to shipping and handling costs billed to a customer by the vendor in a sale transaction are classified as revenue. [605-45-45-20 – 45-21]

Unlike IFRS, reimbursements received for out-of-pocket expenses that are incidental to the provision of services to a customer are classified as revenue. [605-45-45-22 – 45-23]

Allowances from suppliers
Like IFRS, consideration received by a retailer for assets or services delivered to a supplier (e.g. slotting fees) is recognised by the retailer in profit or loss. However, unlike IFRS, cash consideration received by a customer, including a reseller, from a vendor is presumed to be a reduction of the price of the vendor’s products or services and is presented as a reduction in cost of sales. That presumption is overcome if:
– the consideration is a payment for assets or services delivered to the vendor, in which case it is presented as revenue or other income (as appropriate), like IFRS; or
– the consideration is a reimbursement of specific, incremental, identifiable costs incurred by the customer to sell the vendor’s products, in which case it is presented as a reduction of that cost.

These criteria are more restrictive than under IFRS, which may give rise to differences in practice. [605-50, 605-45-12 – 45-13]

Revenue does not include sales taxes, value added taxes (VAT) or goods and services taxes when the entity is acting as a collection agent on behalf of the tax authorities. [IAS 18.IE21]

Revenue is recognised net of transport costs incurred on the delivery of goods to customers if the entity acts as an agent and recharges the customer for the actual costs incurred, plus a margin. If transport costs are included in the sales price, and the entity is exposed to the price risk associated with such costs, then the entity is acting as the principal and revenue is presented on a gross basis. [IAS 18.8, IE21]

IFRS does not provide specific guidance on the accounting for reimbursements received for out-of-pocket expenses that are incidental to the provision of services to a customer.

Allowances from suppliers
Following general principles, cash consideration received by a retailer for assets or services delivered to a supplier (e.g. slotting fees) is recognised by the retailer in profit or loss. In our view, cash consideration received by a retailer from a supplier should be accounted for as follows:
– the consideration should be presented as revenue by the retailer if it relates to goods or services sold or delivered in the course of its ordinary activities, or as other income if the activities are incidental to the retailer’s main operations;
– the cash consideration that is a reimbursement of costs incurred by an entity to sell the manufacturer’s products should be presented as a reduction of that cost incurred by the entity. [IAS 1.34]

Revenue does not include sales taxes, value added taxes (VAT) or goods and services taxes when the entity is acting as a collection agent on behalf of the tax authorities. [IAS 18.IE21]
In our view, consideration that represents a reduction of the prices of the manufacturer’s products or services – e.g. trade discounts, rebates and other similar items – should be presented as a reduction of the retailer’s inventory and therefore cost of sales (see chapter 3.8); it is not recognised as revenue. [IAS 2.11]

Like IFRS, consideration that represents a reduction of the prices of the manufacturer’s products or services is presented as a reduction of the entity’s inventory and therefore cost of sales (see chapter 3.8); it is not recognised as revenue. However, under US GAAP there are more specific criteria than under IFRS regarding whether consideration is a discount, which may give rise to differences from IFRS in practice. (605-50-25-10 – 25-12, 45-12 – 45-15)

**Forthcoming requirements**

A new revenue standard is effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

The new revenue standard is discussed in chapter 4.2A.

A new revenue Codification Topic is effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted but not before annual periods beginning after 15 December 2016.

The new revenue Codification Topic is discussed in chapter 4.2A.
Overview of forthcoming requirements

– The new standard is effective for annual periods beginning on or after 1 January 2018. Early adoption is permitted.

– The new standard provides a framework that replaces existing revenue guidance.

– A five-step model is used to implement the core ‘transfer of control’ principle that is used to determine when to recognise revenue, and at what amount.

– Under Step 1 (identify the contract), an entity accounts for a contract under the model when it is legally enforceable and specific criteria are met. These criteria include that collection of consideration is ‘probable’, which means ‘more likely than not’.

– Under Step 2 (identify the performance obligations in the contract), an entity breaks down the contract into one or more distinct performance obligations.

– Under Step 3 (determine the transaction price), an entity determines the amount of consideration to which it expects to be entitled in exchange for transferring goods or services to a customer.

– Unlike IFRS, the new Codification Topic is effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities). Early adoption is permitted but not before annual periods beginning after 15 December 2016.

– Like IFRS, the new Codification Topic provides a framework that replaces existing revenue guidance. In particular, it moves away from the industry- and transaction-specific requirements under US GAAP, which are also used by some IFRS preparers in the absence of specific IFRS guidance.

– Like IFRS, a five-step model is used to implement the core ‘transfer of control’ principle that is used to determine when to recognise revenue, and at what amount.

– Like IFRS, under Step 1 (identify the contract), an entity accounts for a contract under the model when it is legally enforceable and specific criteria are met. These criteria include that collection of consideration is ‘probable’, which, unlike IFRS, means ‘likely’.

– Like IFRS, under Step 2 (identify the performance obligations in the contract), an entity breaks down the contract into one or more distinct performance obligations.

– Like IFRS, under Step 3 (determine the transaction price), an entity determines the amount of consideration to which it expects to be entitled in exchange for transferring goods or services to a customer.
Overview of forthcoming requirements (continued)

– Consideration includes an estimate of variable consideration to the extent that it is ‘highly probable’ that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

– Under Step 4 (allocate the transaction price to the performance obligations in the contract) an entity generally allocates the transaction price to each performance obligation in proportion to its stand-alone selling price.

– Under Step 5 (recognise revenue) an entity recognises revenue when or as it satisfies a performance obligation by transferring a good or service to a customer, either at a point in time or over time. A good or service is transferred when or as the customer obtains control of it.

– An entity generally capitalises incremental costs to obtain a contract with a customer if it expects to recover those costs. An entity capitalises the costs of fulfilling a contract if certain criteria are met. An impairment loss recognised in respect of capitalised costs is reversed if the carrying amount is no longer impaired.

– A contract modification is accounted for prospectively or using a cumulative catch-up adjustment depending on whether the modification results in additional goods or services that are ‘distinct’.

– If the entity is a principal, then revenue is recognised on a gross basis – corresponding to the consideration to which the entity expects to be entitled. If the entity is an agent, then revenue is recognised on a net basis – corresponding to any fee or commission to which the entity expects to be entitled.

Overview of forthcoming requirements (continued)

– Like IFRS, consideration includes an estimate of variable consideration to the extent it is ‘probable’ that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Although ‘probable’ rather than ‘highly probable’ is used under US GAAP, the IASB and the FASB explain that these are intended to be the same threshold so differences of interpretation are not expected.

– Like IFRS, under Step 4 (allocate the transaction price to the performance obligations in the contract) an entity generally allocates the transaction price to each performance obligation in proportion to its stand-alone selling price.

– Like IFRS, under Step 5 (recognise revenue) an entity recognises revenue when or as it satisfies a performance obligation by transferring a good or service to a customer, either at a point in time or over time. Like IFRS, a good or service is transferred when or as the customer obtains control of it.

– Like IFRS, an entity generally capitalises incremental costs to obtain a contract with a customer if it expects to recover those costs. Like IFRS, an entity capitalises the costs of fulfilling a contract if certain criteria are met. Unlike IFRS, an impairment loss recognised in respect of capitalised costs is not reversed.

– Like IFRS, a contract modification is accounted for prospectively or using a cumulative catch-up adjustment depending on whether the modification results in additional goods or services that are ‘distinct’.

– Like IFRS, if the entity is a principal, then revenue is recognised on a gross basis – corresponding to the consideration to which the entity expects to be entitled. Like IFRS, if the entity is an agent, then revenue is recognised on a net basis – corresponding to any fee or commission to which the entity expects to be entitled.
The requirements in this chapter are forthcoming from the new standard on revenue. The standard was developed with the FASB and is therefore largely converged with US GAAP; however, some differences exist between the two standards. The standard provides a framework that replaces the existing revenue recognition guidance in IFRS.

This chapter highlights only the key differences between the forthcoming IFRS and US GAAP requirements. For more detailed information about the differences, see KPMG’s publication Revenue – Issues In-Depth.

The new standard is effective for annual periods beginning on or after 1 January 2018. Early adoption is permitted.

An entity may choose to adopt the new standard either retrospectively or through a cumulative effect adjustment as of the start of the first period for which it applies the new standard. An entity may apply one or more practical expedients.

Unlike IFRS, the new Codification Topic is effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities). Early adoption is permitted but not before annual periods beginning after 15 December 2016.

Like IFRS, an entity may choose to adopt the new standard either retrospectively or through a cumulative effect adjustment as of the start of the first period for which it applies the new Codification Topic. An entity may apply one or more practical expedients, which are not entirely the same as IFRS.
The standard applies to all contracts with customers, except for:
- leases (see chapter 5.1);
- insurance contracts (see chapter 8.1);
- financial instruments and other contractual rights or obligations in the scope of other IFRS guidance, including financial guarantees; and
- non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. [IFRS 15.5]

For contracts partially in the scope of another IFRS and partially in the scope of the new standard, if the other IFRS specifies how to separate and/or initially measure one or more parts of the contract with a customer, then an entity first applies those requirements. Next, the entity applies the new standard to separate and/or initially measure the remaining separately identified parts of the contract. [IFRS 15.7]

The new standard is generally applied to an individual contract with a customer. However, as a practical expedient, an entity may apply the revenue model to a portfolio of contracts with similar characteristics if the entity reasonably expects that the financial statement effects of applying the new standard to the portfolio or to individual contracts within that portfolio would not differ materially. [IFRS 15.4]

The core principle of the new standard is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. [IFRS 15.2]

Entities implement the core principle by applying a five-step model to determine when to recognise revenue, and at what amount.
- Step 1: Identify the contract with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognise revenue when or as the entity satisfies a performance obligation.

The Codification Topic applies to all contracts with customers except for:
- leases (see chapter 5.1), like IFRS;
- insurance contracts issued by insurance entities (see chapter 8.1), which is narrower than the scope-out under IFRS;
- financial instruments and other contractual rights or obligations within the scope of the applicable Codification Topics, which differ from IFRS in certain respects;
- guarantees in the scope of the Codification Topic on guarantees, which is broader than IFRS; and
- non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers, like IFRS, although the specific accounting requirements differ from IFRS (see chapter 5.7). [606-10-15-2]

Like IFRS, for contracts partially in the scope of another Codification topic/subtopic and partially in the scope of the new revenue Codification Topic, if the other Codification topic/subtopic specifies how to separate and/or initially measure one or more parts of the contract with a customer, then an entity first applies those requirements. Next, the entity applies the new Codification Topic to separate and/or initially measure the remaining separately identified parts of the contract. [606-10-15-4]

Like IFRS, the new Codification Topic is generally applied to an individual contract with a customer. However, like IFRS, as a practical expedient, an entity may apply the revenue model to a portfolio of contracts with similar characteristics if the entity reasonably expects that the financial statement effects of applying the new standard to the portfolio or to individual contracts within that portfolio would not differ materially. [606-10-10-4]

Like IFRS, entities implement the core principle by applying a five-step model to determine when to recognise revenue, and at what amount.
- Step 1: Identify the contract with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognise revenue when or as the entity satisfies a performance obligation.
**Step 1: Identify the contract with a customer**

A contract with a customer is in the scope of the new standard when it is legally enforceable and all of the following criteria are met:

- the contract is approved and the parties are committed to their obligations;
- rights to goods or services and payment terms can be identified;
- the contract has commercial substance; and
- collection of consideration is ‘probable’. [IFRS 15.9]

In applying the collection criterion, ‘probable’ means ‘more likely than not’. [IFRS 15.9(e)]

Contracts entered into at or near the same time with the same customer (or related parties) are combined if one or more of the following criteria are met:

- the contracts were negotiated as a single commercial package;
- the consideration in one contract depends on the other contract; or
- the goods or services (or some of the goods or services) promised in the contracts are a single performance obligation. [IFRS 15.17]

If the criteria are not initially met, then an entity continually reassesses the contract against the criteria and applies the requirements of the new standard to the contract from the date on which the criteria are met. Any consideration received for an arrangement that does not meet the criteria is generally recognised as a liability. [IFRS 15.14–16]

Such consideration is recognised as revenue only when:

- a contract exists and revenue is recognised under the model;
- the entity has no remaining obligations to transfer goods or services to the customer and substantially all of the consideration has been received by the entity and the amount is non-refundable; or
- the contract has been terminated and the consideration received from the customer is non-refundable. [IFRS 15.15]
Step 2: Identify the performance obligations in the contract

An entity assesses the goods or services promised in a contract with a customer and identifies as a performance obligation either:
- a good or service (or a bundle of goods or services) that is distinct; or
- a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer. [IFRS 15.22, 26]

A good or service is ‘distinct’ if both of the following criteria are met:
- the customer can benefit from the good or service on its own or together with other readily available resources (i.e. it is capable of being distinct); and
- the entity’s promise to transfer the good or service is separately identifiable from other promises in the contract (i.e. it is distinct within the context of the contract). [IFRS 15.27]

If a promised good or service is determined not to be distinct, then an entity continues to combine that good or service with other goods or services until the combined bundle is a distinct performance obligation, or until all of the goods or services in the contract have been combined into a single performance obligation. [IFRS 15.30]

IFRS does not provide specific guidance on immaterial goods or services and therefore the general materiality guidance applies. [IFRS 15.BC116A–BC116E]

Under IFRS, shipping and handling activities undertaken after the customer has obtained control of the related goods may represent a performance obligation. [IFRS 15.BC116R–BC116U]

Step 3: Determine the transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer, excluding amounts collected on behalf of third parties – e.g. some sales taxes. [IFRS 15.47]

Step 3: Determine the transaction price

Like IFRS, an entity assesses the goods or services promised in a contract with a customer and identifies as a performance obligation either:
- a good or service (or a bundle of goods or services) that is distinct; or
- a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer. [606-10-25-14, 25-18]

Like IFRS, a good or service is ‘distinct’ if both of the following criteria are met:
- the customer can benefit from the good or service on its own or together with other readily available resources (i.e. it is capable of being distinct); and
- the entity’s promise to transfer the good or service is separately identifiable from other promises in the contract (i.e. it is distinct within the context of the contract). [606-10-25-19]

Like IFRS, if a promised good or service is determined not to be distinct, then an entity continues to combine that good or service with other goods or services until the combined bundle is a distinct performance obligation, or until all of the goods or services in the contract have been combined into a single performance obligation. [606-10-25-22]

Unlike IFRS, US GAAP explicitly permits an entity not to identify promised goods or services that are immaterial in the context of the contract as performance obligations. When an entity chooses to use this practical expedient, it does not need to evaluate whether the financial statements, taken as a whole, are materially affected. It is unclear whether this difference in wording will give rise to differences in practice. [606-10-25-16A]

Unlike IFRS, US GAAP includes an accounting policy election to treat shipping and handling activities undertaken after the customer has obtained control of the related goods as a fulfilment activity instead of treating them as a performance obligation. [606-10-25-18A–8]

Step 3: Determine the transaction price

Like IFRS, the transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer, excluding amounts collected on behalf of third parties – e.g. some sales taxes. However, unlike IFRS, US GAAP includes an accounting policy choice to exclude from the measurement of transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with the specific revenue-producing transaction and collected by the entity from a customer – e.g. sales, use, value-added and some excise taxes. [606-10-32-2 – 32-2A]
The transaction price includes variable consideration (e.g. rebates, incentives, performance bonuses), based on the estimated amount to which the entity expects to be entitled, having regard to the risk of revenue reversal in making the estimate. [IFRS 15.48, 50–51]

An entity includes an estimate of variable consideration in the transaction price to the extent that it is ‘highly probable’ that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. [IFRS 15.56, BC208–BC212]

To estimate the transaction price in a contract, an entity adjusts the promised amount of consideration for the time value of money if that contract contains a significant financing component. The discount rate used is the rate that would be reflected in a separate financing transaction between the entity and the customer at contract inception. As a practical expedient, an entity is not required to adjust the transaction price for the effects of a significant financing component if the entity expects, at contract inception, that the period between customer payment and the transfer of goods or services will be one year or less. [IFRS 15.60–61, 63–64]

Non-cash consideration received from a customer is measured at fair value (see chapter 2.4). No specific guidance is provided in respect of the measurement date for non-cash consideration and judgement is required to determine it. If an entity cannot make a reasonable estimate of the fair value, then it refers to the stand-alone selling price of the promised goods or services. [IFRS 15.66–67, BC254B–BC254E]

An entity evaluates any consideration payable to a customer (e.g. cash, a coupon or voucher) to determine whether the amount represents a reduction of the transaction price, a payment for distinct goods or services, or a combination of the two. [IFRS 15.70]

**Step 4: Allocate the transaction price to the performance obligations in the contract**

An entity generally allocates the transaction price to each performance obligation in proportion to its stand-alone selling price. [IFRS 15.73–75]

Like IFRS, the transaction price includes variable consideration (e.g. rebates, incentives, performance bonuses), based on the estimated amount to which the entity expects to be entitled, having regard to the risk of revenue reversal in making the estimate. [606-10-32-3]

Like IFRS, an entity includes an estimate of variable consideration to the extent it is ‘probable’ that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Although ‘probable’ rather than ‘highly probable’ is used under US GAAP, the term ‘highly probable’ was used by the IASB with the intention of converging with the term ‘probable’ as used in the US GAAP version of the new standard; therefore, differences of interpretation are not expected. [606-10-32-11, ASU 2014-09.BC208–BC212]

Like IFRS, to estimate the transaction price in a contract, an entity adjusts the promised amount of consideration for the time value of money if that contract contains a significant financing component. The discount rate used is the rate that would be reflected in a separate financing transaction between the entity and the customer at contract inception. As a practical expedient, an entity is not required to adjust the transaction price for the effects of a significant financing component if the entity expects, at contract inception, that the period between customer payment and the transfer of goods or services will be one year or less. [606-10-32-15 – 32-16, 32-18]

Like IFRS, non-cash consideration received from a customer is measured at fair value (see chapter 2.4). Unlike IFRS, the measurement date for non-cash consideration is the date of the contract inception. Like IFRS, if an entity cannot make a reasonable estimate of the fair value, then it refers to the stand-alone selling price of the promised goods or services. [606-10-32-21 – 32-22, 55-250]

Like IFRS, an entity evaluates any consideration payable to a customer (e.g. cash, a coupon or voucher) to determine whether the amount represents a reduction of the transaction price, a payment for distinct goods or services, or a combination of the two. [606-10-32-25]

**Step 4: Allocate the transaction price to the performance obligations in the contract**

Like IFRS, an entity generally allocates the transaction price to each performance obligation in proportion to its stand-alone selling price. [606-10-32-28 – 32-30]
An entity considers all information that is reasonably available when estimating a stand-alone selling price – e.g. market conditions, entity-specific factors, and information about the customer or class of customer. It also maximises the use of observable inputs and applies consistent methods to estimate the stand-alone selling price of other goods or services with similar characteristics. [IFRS 15.78]

Step 5: Recognise revenue

An entity recognises revenue when or as it satisfies a performance obligation by transferring a good or service to a customer, either at a point in time or over time. A good or service is transferred when or as the customer obtains control of it. [IFRS 15.31–32]

If one or more of the following criteria are met, then the entity recognises revenue over time, using a method that depicts the pattern of transfer of control of the good or service to the customer:

- the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs, and another entity would not need to substantially reperform the work completed to date;
- the entity’s performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the entity’s performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date. [IFRS 15.35, B4]

If none of the above criteria is met, then control transfers to the customer at a point in time and the entity recognises revenue at that point in time. [IFRS 15.38]

Contract costs

An entity capitalises incremental costs to obtain a contract with a customer (e.g. sales commissions) if it expects to recover those costs. However, as a practical expedient, an entity is not required to capitalise the incremental costs to obtain a contract if the amortisation period for the asset would be one year or less. [IFRS 15.91–92, 94]

Like IFRS, an entity considers all information that is reasonably available when estimating a stand-alone selling price – e.g. market conditions, entity-specific factors, and information about the customer or class of customer. Like IFRS, it also maximises the use of observable inputs and applies consistent methods to estimate the stand-alone selling price of other goods or services with similar characteristics. [606-10-32-33]

Step 5: Recognise revenue

Like IFRS, an entity recognises revenue when or as it satisfies a performance obligation by transferring a good or service to a customer, either at a point in time or over time. A good or service is transferred when or as the customer obtains control of it. [606-10-25-23]

Like IFRS, if one or more of the following criteria are met, then the entity recognises revenue over time, using a method that depicts the pattern of transfer of control of the good or service to the customer:

- the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs, and another entity would not need to substantially reperform the work completed to date;
- the entity’s performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the entity’s performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date. [606-10-25-27, 55-6]

Like IFRS, if none of the above criteria is met, then control transfers to the customer at a point in time and the entity recognises revenue at that point in time. [606-10-25-30]

Contract costs

Like IFRS, an entity capitalises incremental costs to obtain a contract with a customer (e.g. sales commissions) if it expects to recover those costs. However, as a practical expedient, an entity is not required to capitalise the incremental costs to obtain a contract if the amortisation period for the asset would be one year or less. [340-40-25-1 – 25-2, 25-4]
If the costs incurred in fulfilling a contract with a customer are not in the scope of another standard (e.g. inventories), then an entity recognises an asset only if the fulfilment costs meet the following criteria:
- they relate directly to an existing contract or specific anticipated contract;
- they generate or enhance resources of the entity that will be used to satisfy performance obligations in the future; and
- they are expected to be recovered. [IFRS 15.96]

An entity amortises the asset recognised for the costs to obtain and/or fulfil a contract on a systematic basis, consistent with the pattern of transfer of the good or service to which the asset relates. [IFRS 15.99]

Before an entity recognises an impairment loss for capitalised costs (see below), it first recognises any impairment loss on assets related to the contract that are recognised under another standard (e.g. the inventories standard – see chapter 3.8). [IFRS 15.103]

An impairment related to the capitalised costs is recognised in profit or loss to the extent that the carrying amount exceeds recoverable amount, which is defined as:
- the remaining expected amount of consideration to be received in exchange for the goods or services to which the asset relates; less
- the costs that relate directly to providing those goods or services and that have not been recognised as expenses. [IFRS 15.101]

After applying the impairment test, the resulting carrying amount is included in the relevant cash-generating unit for impairment testing (see chapter 3.10). [IFRS 15.103]

An impairment loss is reversed, limited to the carrying amount, net of amortisation, that would have been determined if no impairment loss had been recognised when the carrying amount is no longer impaired. [IFRS 15.104]

**Contract modifications**

A contract modification is a change in the scope or price of a contract, or both. When a contract modification is approved, it creates or changes the enforceable rights and obligations of the parties to the contract. [IFRS 15.18]
A contract modification is treated as a separate contract (prospective treatment) if the modification results in:
- a promise to deliver additional goods or services that are distinct; and
- an increase to the price of the contract by an amount of consideration that reflects the entity’s stand-alone selling price of those goods or services adjusted to reflect the circumstances of the contract. [IFRS 15.20]

Like IFRS, a contract modification is treated as a separate contract (prospective treatment) if the modification results in:
- a promise to deliver additional goods or services that are distinct; and
- an increase to the price of the contract by an amount of consideration that reflects the entity’s stand-alone selling price of those goods or services adjusted to reflect the circumstances of the contract. [606-10-25-12]

A contract modification is treated as the termination of the existing contract and the creation of a new contract (prospective treatment) if the remaining performance obligations are distinct from the goods or services transferred on or before the date of the contract modification and the change to the price of the contract does not reflect the entity’s stand-alone selling price of those goods or services adjusted to reflect the circumstances of the contract. [IFRS 15.21(a)]

Like IFRS, a contract modification is treated as the termination of the existing contract and the creation of a new contract (prospective treatment) if the remaining performance obligations are distinct from the goods or services transferred on or before the date of the contract modification and the change to the price of the contract does not reflect the entity’s stand-alone selling price of those goods or services adjusted to reflect the circumstances of the contract. [606-10-25-13(a)]

If the modification to the contract does not add distinct goods or services, then the entity accounts for the modification on a combined basis with the original contract, as if the additional goods or services were part of the initial contract – i.e. a cumulative catch-up adjustment. The modification is recognised as either an increase or reduction in revenue at the date of modification. [IFRS 15.21(b)]

Like IFRS, if the modification to the contract does not add distinct goods or services, then the entity accounts for the modification on a combined basis with the original contract, as if the additional goods or services were part of the initial contract – i.e. a cumulative catch-up adjustment. The modification is recognised as either an increase or reduction in revenue at the date of modification. [606-10-25-13(b)]

**Licensing of intellectual property**

If a licence of intellectual property (IP) is not distinct from the other promised goods or services in the contract, then an entity recognises revenue for the single performance obligation when or as the combined goods or services are transferred to the customer. [IFRS 15.554–555]

If a licence is distinct from the other promised goods or services in the contract, and is therefore a separate performance obligation, then the entity applies the guidance applicable to licences to determine whether the licence is a performance obligation satisfied over time (i.e. a ‘right to access’ the IP) or at a point in time (i.e. a ‘right to use’ the IP). [IFRS 15.556]

The nature of the licence is a right to access if all of the following criteria are met (otherwise it is a right to use):
- the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the IP to which the customer has rights;
- the rights granted by the licence directly expose the customer to any positive or negative effects of the entity’s activities that significantly affect the IP; and
- those activities do not result in the transfer of a good or a service to the customer as those activities occur. [IFRS 15.558, B61]

Like IFRS, if a licence of intellectual property (IP) is not distinct from the other promised goods or services in the contract, then an entity recognises revenue for the single performance obligation when or as the combined goods or services are transferred to the customer. [606-10-55-56 – 55-57]

Like IFRS, if a licence is distinct from the other promised goods or services in the contract, and is therefore a separate performance obligation, then the entity applies the guidance applicable to licences to determine whether the licence is a performance obligation satisfied over time (i.e. a ‘right to access’ the IP) or at a point in time (i.e. a ‘right to use’ the IP). [606-10-55-58]

Unlike IFRS, to determine whether an entity’s promise to provide a right to access or a right to use, an entity considers the nature of the IP to which the customer will have rights. IP is classified into either of the following:
- **Functional IP**: IP that has significant stand-alone functionality (e.g. the ability to process a transaction, perform a function or task, or be played or aired).
- **Symbolic IP**: IP that is not functional IP. [606-10-55-59]
As an exception to the general requirements, for sales- or usage-based royalties that are attributable to a licence of intellectual property, revenue is recognised at the later of:
- when the subsequent sale or usage occurs; and
- the satisfaction or partial satisfaction of the performance obligation to which some or all of the sales- or usage-based royalty has been allocated. [IFRS 15.B63]

**Sale or transfer of non-financial assets not part of entity’s ordinary activities**

When an entity sells or transfers a non-financial asset that is not an output of its ordinary activities, it derecognises the asset when control of that asset transfers to the recipient, using the guidance on transfer of control in the new standard. [IAS 16.69, 38.114, 40.67]

**Other issues**

**Sale with a right of return**

When an entity makes a sale with a right of return, it initially recognises the following:
- **Revenue**: measured at the gross transaction price, less the expected level of returns calculated using the guidance on estimating variable consideration and the constraint;
- **Refund liability**: measured at the expected level of returns – i.e. the difference between the cash or receivable amount and the revenue as measured above;
- **Asset**: measured with reference to the carrying amount of the products expected to be returned, less the expected recovery costs (including potential decreases in the value to the entity of returned products); and
- **Adjustment to cost of sales**: measured as the carrying amount of the products sold less the asset as measured above. [IFRS 15.B21, B23, B25]

The entity updates its measurement of the refund liability and asset at each reporting date for changes in expectations about the amount of the refunds, and recognises:
- adjustments to the refund liability as revenue; and
- adjustments to the asset as an expense. [IFRS 15.B24–B25]

The guidance does not apply to:
- exchanges by customers of one product for another of the same type, quality, condition and price; and
- returns of faulty goods or replacements, which are instead evaluated under the guidance on warranties (see below). [IFRS 15.B26–B27]

Like IFRS, as an exception to the general requirements, for sales- or usage-based royalties that are attributable to a licence of intellectual property, revenue is recognised at the later of:
- when the subsequent sale or usage occurs; and
- the satisfaction or partial satisfaction of the performance obligation to which some or all of the sales- or usage-based royalty has been allocated. [606-10-55-65]

**Sale or transfer of non-financial assets not part of entity’s ordinary activities**

Like IFRS, when an entity sells or transfers a non-financial asset that is not an output of its ordinary activities, it derecognises the asset when control of that asset transfers to the recipient, using the guidance on transfer of control in the new standard. Unlike IFRS, this guidance also applies to the sale of entities that are an in-substance non-financial asset. [610-20]

**Other issues**

**Sale with a right of return**

Like IFRS, when an entity makes a sale with a right of return, it initially recognises the following:
- **Revenue**: measured at the gross transaction price, less the expected level of returns calculated using the guidance on estimating variable consideration and the constraint;
- **Refund liability**: measured at the expected level of returns – i.e. the difference between the cash or receivable amount and the revenue as measured above;
- **Asset**: measured with reference to the carrying amount of the products expected to be returned, less the expected recovery costs (including potential decreases in the value to the entity of returned products); and
- **Adjustment to cost of sales**: measured as the carrying amount of the products sold less the asset as measured above. [606-10-55-23, 55-25, 55-27]

Like IFRS, an entity updates its measurement of the refund liability and asset at each reporting date for changes in expectations about the amount of the refunds, and recognises:
- adjustments to the refund liability as revenue; and
- adjustments to the asset as an expense. [606-10-55-26 – 55-27]

Like IFRS, the guidance does not apply to:
- exchanges by customers of one product for another of the same type, quality, condition and price; and
- returns of faulty goods or replacements, which are instead evaluated under the guidance on warranties (see below). [606-10-55-28 – 55-29]
Warranties
A warranty is considered a performance obligation if the customer has an option to purchase the good or service with or without the warranty. In that case, the entity allocates a portion of the transaction price to the performance obligation for the service. [IFRS 15.B29]

When a warranty is not sold separately, the warranty (or part thereof) may still be a performance obligation, if the warranty (or part thereof) provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. A warranty that only covers the compliance of a product with agreed-upon specifications (an ‘assurance warranty’) is accounted for under the provisions standard (see chapter 3.12). [IFRS 15.B29–B30]

Principal vs agent considerations
When other parties are involved in providing goods or services to an entity’s customer, the entity determines whether the nature of its promise is a performance obligation to provide the specified good or services itself, or to arrange for them to be provided by another party – i.e. whether it is a principal or an agent. [IFRS 15.B34]

If the entity is a principal, then revenue is recognised on a gross basis – corresponding to the consideration to which the entity expects to be entitled. If the entity is an agent, then revenue is recognised on a net basis – corresponding to any fee or commission to which the entity expects to be entitled. [IFRS 15.B35–B36]

An entity is acting as a principal when it obtains control of the specified good or service in advance of transferring this good or service to the customer (but not only momentarily). [IFRS 15.B35]

The following are indicators that an entity controls a specified good or service before it is transferred to the customer:
– the entity is primarily responsible for providing the specified good or service;
– the entity has discretion in establishing the price for the specified good or service; and
– the entity has inventory risk. [IFRS 15.B37]

Warranties
Like IFRS, a warranty is considered a performance obligation if the customer has an option to purchase the good or service with or without the warranty. In that case, like IFRS, the entity allocates a portion of the transaction price to the performance obligation for the service. [606-10-55-31]

Like IFRS, when a warranty is not sold separately, the warranty (or part thereof) may still be a performance obligation, if the warranty (or part thereof) provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. A warranty that only covers the compliance of a product with agreed-upon specifications (an ‘assurance warranty’) is accounted for under the contingencies Codification Topic (see chapter 3.12). [606-10-55-31 – 55-32]

Principal vs agent considerations
Like IFRS, when other parties are involved in providing goods or services to an entity’s customer, the entity determines whether the nature of its promise is a performance obligation to provide the specified good or services itself, or to arrange for them to be provided by another party – i.e. whether it is a principal or an agent. [606-10-55-36]

Like IFRS, if the entity is a principal, then revenue is recognised on a gross basis – corresponding to the consideration to which the entity expects to be entitled. Like IFRS, if the entity is an agent, then revenue is recognised on a net basis – corresponding to any fee or commission to which the entity expects to be entitled. [606-10-55-37 – 55-38]

Like IFRS, an entity is acting as a principal when it obtains control of the specified good or service in advance of transferring this good or service to the customer (but not only momentarily). [606-10-55-39]

Like IFRS, the following are indicators that an entity controls the specified good or service before it is transferred to the customer:
– the entity is primarily responsible for providing the specified good or service;
– the entity has discretion in establishing the price for the specified good or service; and
– the entity has inventory risk. [606-10-55-39]
Customer options for additional goods or services

When an entity grants the customer an option to acquire additional goods or services, that option gives rise to a performance obligation in the contract if the option provides a material right that the customer would not receive without entering into that contract. In such cases, a portion of the transaction price is allocated to the option on a relative stand-alone selling price basis. [IFRS 15.B40, B42]

If the goods or services that the customer has a material right to acquire are similar to the original ones in the contract (e.g. when the entity has an option to renew the contract), then an entity may, as a practical alternative, allocate the transaction price to the optional goods or services with reference to the goods or services expected to be provided and the corresponding consideration expected to be received. [IFRS 15.B43]

Customers’ unexercised rights (breakage)

An entity recognises a prepayment received from a customer as a contract liability, and recognises revenue when the promised goods or services are transferred in the future. However, a portion of the contract liability recognised may relate to contractual rights that the entity does not expect to be exercised (i.e. a breakage amount). [IFRS 15.B44–B45]

If the entity expects to be entitled to a breakage amount, then revenue is recognised in proportion to the pattern of rights exercised by the customer. If the entity does not expect to be entitled to a breakage amount, then revenue is recognised when the likelihood of the customer exercising its remaining rights becomes remote. [IFRS 15.B46]

The assessment of whether an entity expects to be entitled to a breakage amount depends on whether it is ‘highly probable’ that recognising breakage will not result in a significant reversal of the cumulative revenue recognised. [IFRS 15.B46]

Non-refundable up-front fees

An entity assesses whether a non-refundable up-front fee relates to the transfer of a promised good or service to the customer. If the related activity does not result in the transfer of a promised good or service to the customer, then the up-front fee is an advance payment for performance obligations to be satisfied in the future and is recognised as revenue when those future goods or services are provided. [IFRS 15.B48–B51]

Customer options for additional goods or services

Like IFRS, when an entity grants the customer an option to acquire additional goods or services, that option gives rise to a performance obligation in the contract if the option provides a material right that the customer would not receive without entering into that contract. In such cases, a portion of the transaction price is allocated to the option on a relative stand-alone selling price basis, like IFRS. [US 606-10-55-42, 55-44]

Like IFRS, if the goods or services that the customer has a material right to acquire are similar to the original ones in the contract (e.g. when the entity has an option to renew the contract), then an entity may, as a practical alternative, allocate the transaction price to the optional goods or services with reference to the goods or services expected to be provided and the corresponding consideration expected to be received. [US 606-10-55-45]

Customers’ unexercised rights (breakage)

Like IFRS, an entity recognises a prepayment received from a customer as a contract liability, and recognises revenue when the promised goods or services are transferred in the future. However, like IFRS, a portion of the contract liability recognised may relate to contractual rights that the entity does not expect to be exercised (i.e. a breakage amount). [US 606-10-55-42]

Like IFRS, if the entity expects to be entitled to a breakage amount, then revenue is recognised in proportion to the pattern of rights exercised by the customer. Like IFRS, if the entity does not expect to be entitled to a breakage amount, then revenue is recognised when the likelihood of the customer exercising its remaining rights becomes remote. [US 606-10-55-48]

Like IFRS, the assessment of whether an entity expects to be entitled to a breakage amount depends on whether it is ‘probable’ that recognising breakage will not result in a significant reversal of the cumulative revenue recognised. Although ‘probable’ rather than ‘highly probable’ is used under US GAAP, the term ‘highly probable’ was used by the IASB with the intention of converging with the term ‘probable’ as used in the US GAAP version of the new standard; therefore, differences of interpretation are not expected. [US 606-10-55-48]

Non-refundable up-front fees

Like IFRS, an entity assesses whether a non-refundable up-front fee relates to the transfer of a promised good or service to the customer. Like IFRS, if the related activity does not result in the transfer of a promised good or service to the customer, then the up-front fee is an advance payment for performance obligations to be satisfied in the future and is recognised as revenue when those future goods or services are provided. [US 606-10-55-50 – 55-53]
Onerous contracts
Onerous contracts are accounted for under the provisions standard (see chapter 3.12)

Presentation
An entity presents a contract liability or a contract asset in its statement of financial position when either party to the contract has performed. The entity performs by transferring goods or services to the customer, and the customer performs by paying consideration to the entity. Any unconditional rights to consideration are presented separately as a receivable. [IFRS 15.106]

Disclosures
The new standard contains extensive disclosure requirements designed to enable users of the financial statement to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The disclosures cover the following:
- disaggregation of revenue;
- contract balances;
- performance obligations;
- significant judgements made; and
- costs to obtain or fulfil a contract. [IFRS 15.110, 114–128, B87–B89]

There are no exemptions from the disclosure requirements in the new standard.
## 4.3 Government grants

*(IAS 20, IAS 41, SIC-10)*

### Overview

- **Government grants** are recognised when there is reasonable assurance that the entity will comply with the relevant conditions and the grant will be received. Government grants that relate to the acquisition of an asset, other than a biological asset measured at fair value less costs to sell, are recognised in profit or loss as the related asset is depreciated or amortised.

- If a government grant is in the form of a non-monetary asset, then both the asset and the grant are recognised either at the fair value of the non-monetary asset or at a nominal amount.

- Unconditional government grants related to biological assets measured at fair value less costs to sell are recognised in profit or loss when they become receivable; conditional grants for such assets are recognised in profit or loss when the required conditions are met.

- Interest is imputed on low-interest or interest-free loans from a government.

### Definitions

**Government grants** are transfers of resources to an entity by a government entity in return for compliance with certain past or future conditions related to the entity’s operating activities. *(IAS 20.3)*

Government assistance is not considered a government grant if the assistance cannot reasonably have a value placed on it, or is a transaction with a government body that cannot be distinguished from the normal operating transactions of the entity. *(IAS 20.3, 34–38)*

## 4.3 Government grants

### Overview

- Unlike IFRS, there is no specific US GAAP guidance on the accounting for grants from governments to profit-oriented entities. However, US practice may look to IFRS as a source of non-authoritative guidance.

- Unlike IFRS, a contributed non-monetary asset is recognised at fair value if fair value can be measured reliably.

- Like IFRS, contributions from government of biological assets are recognised initially at fair value when they become unconditionally receivable; however, unlike IFRS, there is a specific requirement for fair value to be reliably measurable and there is no specific guidance on whether this amount should be recognised in profit or loss or in equity. Like IFRS, conditional grants for such assets are recognised when the required conditions are met.

- Unlike IFRS, interest may not always be imputed on low-interest or interest-free loans from a government.

### Definitions

Unlike IFRS, US GAAP has specialised industry accounting requirements applicable to not-for-profits entities that receive government grants. However, US GAAP for profit-oriented entities does not define government grants; nor is there specific guidance applicable to government grants. However, US practice may look to IFRS as a source of non-authoritative guidance.
Recognition and measurement

Government grants are recognised when there is reasonable assurance that the entity will comply with the relevant conditions and the grant will be received. [IAS 20.7]

Grants that relate to the acquisition of an asset are recognised in profit or loss as the asset is depreciated or amortised. These grants are recognised either as a reduction in the cost of the asset or as deferred income that is amortised as the related asset is depreciated or amortised; the elected presentation format is applied consistently to all government grants related to assets. [IAS 8.13, 20.17, 24]

A grant that is compensation for expenses or losses already incurred, or for which there are no future related costs, is recognised in profit or loss in the period in which it becomes receivable. [IAS 20.20]

If some or all of a government grant becomes repayable unexpectedly, then the repayment is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [IAS 20.32]

Non-monetary grants

If a government grant is in the form of a non-monetary asset, then an entity chooses an accounting policy, to be applied consistently, to recognise the asset and grant at either the fair value of the non-monetary asset or at a nominal amount. [IAS 20.23]

Unlike IFRS, a contributed non-monetary asset is recognised at fair value if fair value can be measured reliably (see chapter 5.7).

Grants related to biological assets

As an exception to the general recognition principle, an unconditional government grant related to biological assets that are measured at fair value less costs to sell (see chapter 3.9) is recognised in profit or loss when it becomes receivable. If the government grant is conditional, then it is recognised in profit or loss when the required conditions are met. [IAS 41.34–35]

Unlike IFRS, an unconditional contribution from government related to biological assets is initially recognised at fair value (see chapter 3.9), but only if fair value can be measured reliably, unlike IFRS. Unlike IFRS, there is no specific guidance on whether this amount should be recognised in profit or loss or in equity for profit-oriented entities, and therefore differences may arise in practice. Like IFRS, a conditional grant is not recognised until the required conditions are met. [968-605-25-8, 25-11]

Low-interest loans

Low-interest or interest-free loans from a government are initially measured at fair value and interest expense is recognised on the loan subsequently under the effective interest method. [IAS 20.10A, 39.43, AG64]

Unlike IFRS, interest may not always be imputed on low-interest or interest-free loans from a government.
Overview

– ‘Short-term employee benefits’ are employee benefits that are expected to be settled wholly within 12 months of the end of the period in which the services have been rendered, and are accounted for using normal accrual accounting.

– ‘Post-employment benefits’ are employee benefits that are payable after the completion of employment (before or during retirement).

– A ‘defined contribution plan’ is a post-employment benefit plan under which the employer pays fixed contributions into a separate entity and has no further obligations. All other post-employment plans are ‘defined benefit plans’.

– Contributions to a defined contribution plan are accounted for on an accrual basis.

– Accounting for defined benefit plans involves the following steps:
  - determining the present value of the defined benefit obligation by applying an actuarial valuation method;
  - deducting the fair value of any plan assets;
  - adjusting the amount of the deficit or surplus for any effect of limiting a net defined benefit asset to the asset ceiling; and
  - determining service costs, net interest and remeasurements of the net defined benefit liability (asset).

Overview

– Unlike IFRS, US GAAP does not contain specific guidance on short-term employee benefits other than compensated absences. However, accrual accounting principles are generally applied in accounting for short-term employee benefits.

– Unlike IFRS, post-employment benefits are divided into ‘post-retirement benefits’ (provided during retirement) and ‘other post-employment benefits’ (provided after the cessation of employment but before retirement). The accounting for post-employment benefits depends on the type of benefit provided, unlike IFRS.

– Like IFRS, a ‘defined contribution plan’ is a post-retirement benefit plan under which the employer pays specified contributions into a separate entity and has no further obligations. All other post-retirement plans are ‘defined benefit plans’. However, unlike IFRS, other post-employment benefit plans do not have to be classified as either defined contribution or defined benefit plans.

– Like IFRS, contributions to a defined contribution plan are accounted for on an accrual basis.

– Accounting for defined benefit plans involves the following steps:
  - determining the present value of the defined benefit obligation by applying an actuarial valuation method, which differs in some respects from IFRS;
  - deducting the fair value of any plan assets, like IFRS;
  - unlike IFRS, there is no adjustment for any effect of limiting a net defined benefit asset to the asset ceiling; and
  - determining service costs, net interest and remeasurements of the net defined benefit liability (asset), which in a number of cases differ from IFRS in terms of measurement, recognition and presentation.
Overview (continued)

- The projected unit credit method is used to determine the present value of the defined benefit obligation and the related current service cost and, if applicable, any past service cost.

- To qualify as plan assets, assets need to meet specific criteria, including a requirement that they be unavailable to the entity’s creditors (even in bankruptcy).

- Insurance policies issued to the sponsor meet the definition of plan assets if they are issued by a party unrelated to the entity and meet certain other criteria. Insurance policies issued to the plan meet the definition of plan assets if they are transferable and meet certain other criteria.

- Assets that meet the definition of plan assets, including qualifying insurance policies, and the related liabilities are presented on a net basis in the statement of financial position.

- If a defined benefit plan is in surplus, then the amount of any net asset recognised is limited to the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan (the ‘asset ceiling’).

- Minimum funding requirements to cover existing shortfalls give rise to a liability if payments under the requirement would create a surplus in excess of the asset ceiling.

- Benefits are attributed to periods of service in accordance with the plan’s benefit formula unless that formula is back-end loaded, in which case straight-line attribution is used instead.

- Curtailments and other plan amendments are recognised at the same time as the related restructuring or related termination benefits if these events occur before the curtailment or other plan amendments occur.

Overview (continued)

- The liability and expense are generally measured actuarially under the projected unit credit method for pay-related plans, like IFRS; and under the traditional unit credit method (projected unit credit method without future increases in salary) for certain cash balance plans, unlike IFRS.

- Like IFRS, to qualify as plan assets, assets need to meet specific criteria. However, unlike IFRS, in general there is no requirement to affirmatively demonstrate that the assets would be unavailable to the entity’s creditors in bankruptcy.

- Like IFRS, plan assets include insurance policies issued to the plan by the sponsor or a related party of the sponsor if the policies are transferable.

- Like IFRS, assets that meet the definition of plan assets and the related liabilities are presented on a net basis in the statement of financial position.

- Unlike IFRS, the recognition of an asset in respect of a defined benefit plan is not restricted.

- Unlike IFRS, the funded status is recognised as a liability if the plan is underfunded; the liability is not subject to additional adjustments related to minimum funding requirements.

- Like IFRS, benefits are attributed to periods of service in accordance with the plan’s benefit formula unless that formula is back-end loaded, in which case a straight-line attribution is used instead.

- Unlike IFRS, curtailment gains are recognised when they occur. Also unlike IFRS, curtailment losses are recognised when they are probable.
Overview (continued)

- ‘Multi-employer plans’ are post-employment plans that pool the assets contributed by various entities that are not under common control to provide benefits to employees of more than one entity. Such plans are classified as defined contribution or defined benefit plans following the above definitions. However, if insufficient information is available to permit defined benefit accounting, then the plan is treated as a defined contribution plan and additional disclosures are required.

- If defined contribution plan accounting is applied to a multi-employer defined benefit plan and there is an agreement that determines how a surplus in the plan would be distributed or a deficit in the plan funded, then an asset or liability that arises from the contractual agreement is recognised.

- There is no specific guidance on the application of defined benefit accounting to plans that would be defined contribution plans except that they contain minimum benefit guarantees. In our view, a minimum benefit guarantee causes a plan to be a defined benefit plan.

- ‘Termination benefits’ are employee benefits provided as a result of either an entity’s decision to terminate an employee’s employment before the normal retirement date or an employee’s decision to accept an offer of benefits in exchange for the termination of employment.

- A termination benefit is recognised at the earlier of the date on which the entity recognises costs for a restructuring that includes the payment of termination benefits and the date on which the entity can no longer withdraw the offer of the termination benefits.

- ‘Other long-term employee benefits’ are all employee benefits other than short-term benefits, post-employment benefits and termination benefits.

- The expense for other long-term employee benefits, calculated on a discounted basis, is usually accrued over the service period. The computation is similar to defined benefit plans.

Overview (continued)

- Like IFRS, ‘multi-employer plans’ are post-retirement plans that pool the assets contributed by various entities to provide benefits to the employees of more than one entity. However, unlike IFRS, all multi-employer plans are accounted for as defined contribution plans, supplemented with additional disclosures.

- Unlike IFRS, even if there is an agreement that determines how the surplus in a multi-employer plan would be distributed or a deficit in the plan funded, an asset or liability is not recognised until the liability is assessed or the refund received.

- Unlike IFRS, there is specific guidance on the application of defined benefit accounting to certain plans that would be defined contribution plans except that they contain minimum benefit guarantees. Depending on the form of the minimum guarantee, the plan would be accounted for as a defined benefit plan or as a cash balance plan.

- Unlike IFRS, termination benefits are categorised into different types of benefits: ongoing benefit arrangements, contractual terminations, special terminations and one-time terminations.

- Unlike IFRS, there is not a single model for the recognition of termination benefits, and the timing of recognition depends on the category of termination benefit.

- Unlike IFRS, US GAAP does not distinguish between long- and short-term employee benefits.

- Like IFRS, the expense for long-term employee benefits is accrued over the service period; however, the computation may differ from IFRS.
This chapter deals with employee benefits provided under formal plans and agreements between an entity and its employees, under legislation or through industry arrangements, including those provided under informal practices that give rise to constructive obligations.

**Short-term employee benefits**

‘Short-term employee benefits’ are those benefits (other than termination benefits) that are expected to be settled wholly within 12 months of the end of the period in which the employees render the related service, and are accounted for using normal accrual accounting. [IAS 19.8–11]

**Short-term paid absences**

An entity accrues the obligation for paid absences if the obligation both relates to employees’ past services and accumulates. A liability is recognised whether or not the employees are entitled to payment for unused benefits if they leave. However, whether the employee may leave before they use their entitlement impacts the measurement of the benefit. [IAS 19.13, 15–16]

**Profit-sharing and bonus plans**

A provision is recognised for the expected cost of bonus or profit-sharing plans if an entity has a present legal or constructive obligation and a reliable estimate of the obligation can be made. [IAS 19.19]

The amount provided is the best estimate of the undiscounted amount that the entity expects to pay. If payment is conditional (e.g. on the employee remaining in service), then the conditions and the possibility of forfeiture are taken into account in measuring the obligation. [IAS 19.20, BC55]

**Low-interest loans**

Loans given to employees at lower than market interest rates are measured at fair value – i.e. the present value of the anticipated future cash flows discounted using a market interest rate (see chapter 7B). In our view, the employee benefit is the difference between the fair value of the loan and the amount advanced to the employee. [IAS 39.43]

**Post-employment benefits**

‘Post-employment benefits’ are employee benefits (other than termination benefits and short-term employee benefits) that are payable after completion of employment (before or during retirement) – e.g. pensions, lump-sum payments on retirement and medical benefits after employment. [IAS 19.5(b), 8]

This chapter deals with employee benefits provided under formal plans and agreements between an entity and its employees, under legislation or through industry arrangements, including informal practices that give rise to obligations through substantive plans.

**Short-term employee benefits**

Unlike IFRS, US GAAP does not contain specific guidance on short-term employee benefits other than compensated absences – e.g. vacation accruals. However, accrual accounting principles are generally applied in accounting for short-term employee benefits, which is likely to be the same as IFRS in practice.

**Compensated absences**

Like IFRS, an employer accrues the obligation for paid absences if the obligation both relates to employees’ past services and vests or accumulates. Like IFRS, a liability for the expected benefit is recognised whether or not the benefits are vesting. Whether the employee may leave before they use the non-vested benefit impacts the measurement of the benefit, like IFRS. [710-10-25-1]

**Profit-sharing and bonus plans**

Like IFRS, a provision is recognised for the expected cost of bonus or profit-sharing plans if a reliable estimate of the obligation can be made. However, unlike IFRS, there is no requirement for there to be a legal or constructive obligation; notwithstanding this difference, we would not generally expect differences from IFRS in practice. [712-10-25-4]

Like IFRS, the amount provided for is the best estimate of the amount that the entity expects to pay in cash. Like IFRS, if payment is conditional (e.g. on the employee remaining in service), then the conditions and the possibility of forfeiture are taken into account in measuring the obligation. [712-10-25-4]

**Low-interest loans**

Like IFRS, loans granted to employees at lower than market interest rates are measured at fair value – i.e. the present value of the anticipated future cash flows discounted using a market interest rate (see chapter 7B). Like IFRS, the employee benefit is the difference between the fair value of the loan and the amount advanced to the employee.

**Post-employment and post-retirement benefits**

Unlike IFRS, ‘post-employment benefits’ include only benefits payable after employment but before retirement; ‘post-retirement benefits’ are benefits payable after retirement. [712, 715]
Post-employment benefit plans include both formal arrangements and informal practices that give rise to constructive obligations. [IAS 19.61]

All post-employment benefits are accounted for under a single set of requirements. [IAS 19]

**Defined benefit vs defined contribution plans**

Post-employment plans are classified as either defined contribution or defined benefit plans. The classification determines the accounting treatment. [IAS 19.27]

A post-employment plan is classified as a defined contribution plan if the entity pays fixed contributions into a separate entity (a fund) and will have no further obligation (legal or constructive) to pay further amounts if the fund has insufficient assets to pay all employee benefits relating to current and prior service. All other post-employment plans are defined benefit plans. [IAS 19.8]

**Severance payments**

Amounts that are payable on cessation of employment, regardless of the reason for the employee’s leaving, are post-employment benefits rather than termination benefits. The normal principles apply in determining whether such payments give rise to defined benefit or defined contribution plans. [IAS 19.164]

Like IFRS, post-employment and post-retirement benefit plans include both arrangements in formal plans and informal arrangements that constitute substantive plans. [712-10-15-3, 715-10-15-3]

Unlike IFRS, US GAAP distinguishes between post-employment (after employment but before retirement) benefits and post-retirement (during retirement) benefits. Additionally, the accounting and reporting requirements for post-employment and post-retirement benefits differ depending on the type of benefit provided. The discussion that follows is based on post-retirement plans, with additional information on post-employment plans when appropriate. [712, 715]

**Defined benefit vs defined contribution plans**

Like IFRS, post-retirement benefits are classified as either defined contribution or defined benefit plans. However, unlike IFRS, post-employment benefit plans are not required to be classified as defined contribution or defined benefit plans; instead, they are accounted for based on the type of benefit, and therefore differences from IFRS may arise in practice. [712-10, 715-20, 715-70]

US GAAP uses the term ‘projected benefit obligation’ for defined benefit pension plans and the term ‘accumulated postretirement benefit obligation’ for non-pension defined benefit plans. This chapter uses the generic term ‘defined benefit obligation’ for ease of comparison.

Like IFRS, a post-retirement plan is classified as a defined contribution plan if the entity pays specified contributions into a separate entity and will have no further obligation (legal or constructive) to pay further amounts. However, unlike IFRS, the definition of a defined contribution plan generally requires the plan to provide an individual account for each participant’s assets. All other post-retirement plans are defined benefit plans. [715-70-05]

**Severance payments**

Under US GAAP, severance payments that are part of an ongoing benefit arrangement are post-employment rather than post-retirement benefits. Therefore, unlike IFRS, they are not classified as either defined benefit or defined contribution plans, and differences from IFRS may arise in practice. Severance payments that are part of a pension plan or post-retirement benefit plan are recognised when they are probable and reasonably estimable; therefore, differences from IFRS may arise in practice. [712-10-5, 715-30, 715-60]
4 Specific items of profit or loss and OCI

4.4 Employee benefits

Minimum benefit guarantees

In certain cases, a plan that would otherwise be a defined contribution plan contains minimum benefit guarantees – e.g. the employer may guarantee a minimum return on the investment or contributions. IFRS does not contain specific guidance on such plans, except for certain guaranteed minimum returns on plan assets. In our view, a minimum benefit guarantee causes a plan to be a defined benefit plan.

Multi-employer and multiple-employer plans

‘Multi-employer plans’ are plans that pool the assets contributed by various entities that are not under common control to provide benefits to the employees of more than one entity. [IAS 19.8]

There are no specific requirements for the classification of multi-employer plans. Such plans are classified and accounted for in the same way as single-employer plan – i.e. as a defined contribution or a defined benefit plan – considering the characteristics of the scheme and the obligation of the employer, except as outlined below. [IAS 19.32]

If insufficient information is available for a multi-employer defined benefit plan to be accounted for in accordance with the requirements for defined benefit plans, then it is treated as a defined contribution plan except that:

- an asset or liability for any surplus or deficit is recognised if there is a contractual agreement that determines how a surplus in the plan would be distributed or a deficit in the plan funded; and
- additional disclosures are required. [IAS 19.34, 37]

A liability that arises from the wind-up of a multi-employer defined benefit plan, or the entity’s withdrawal from a multi-employer defined benefit plan, is recognised and measured in accordance with the provisions standard (see chapter 3.12). [IAS 19.39]

Minimum benefit guarantees

Like IFRS, under US GAAP plans that provide a minimum benefit guarantee are generally defined benefit plans. For some benefit arrangements determined to be non-pay-related defined benefit plans – e.g. cash balance plans with fixed interest crediting rates – the plan’s benefit obligation does not include the impact of expected future salary increases, which may differ from practice under IFRS. [715-30-35-71]

Multi-employer and multiple-employer plans

Under US GAAP, a ‘multi-employer plan’ is a plan to which two or more unrelated employers contribute, usually under one or more collective bargaining agreements. A characteristic of multi-employer plans is that assets contributed by one participating employer may be used to pay the benefits of employees of another participating employer, like IFRS. [715-80]

Unlike IFRS, if a plan is determined to be a multi-employer plan, then the employer accounts for the plan like a defined contribution plan, supplemented with additional disclosures. [715-80-35]

Unlike IFRS, even if there is an agreement that determines how the surplus in a multi-employer plan would be distributed or a deficit in the plan funded, an asset or liability is not recognised until the liability is assessed or the refund received. [715-80-35]

Like IFRS, if withdrawal from a multi-employer plan is probable and would result in the employer having an obligation to the plan for a portion of the plan’s unfunded benefit obligation, then the employer recognises a liability for the withdrawal funding amount. However, because of differences in the meaning of ‘probable’, the liability may be recognised at a date different from IFRS (see chapter 3.12). [715-80-35-2]
Plans that allow participating employers to pool their assets for investment purposes while maintaining separate accounts for the purposes of benefit payments (multiple-employer plans) do not share actuarial risks and therefore are not considered multi-employer plans. Therefore, each employer within the plan would account for the portion related to their employees as a defined contribution plan or a defined benefit plan based on the general requirements on classifying plans. For defined benefit plans, each employer accounts for its respective share of the assets and liabilities of the plan following the general principles for single-employer plans. [IAS 19.8, 38]

Group plans
Defined benefit plans in which entities (sub-groups) under common control share risks are group plans rather than multi-employer plans. Group plans are classified as either a defined contribution plan or a defined benefit plan in accordance with the terms of the plan. The accounting for defined benefit group plans in sub-group financial statements depends on whether there is a contractual agreement or stated policy for charging the net defined benefit cost to individual group entities. [IAS 19.40–41]

State plans
State plans are accounted for in the same way as multi-employer plans – i.e. they are classified as defined contribution or defined benefit plans, as appropriate. [IAS 19.43, 45]

Accounting for defined contribution plans
An entity accounts for its contributions to a defined contribution plan on an accrual basis. An asset or liability may result from advance payments or payments due, respectively, to a defined contribution fund. [IAS 19.51]

Accounting for defined benefit plans
Accounting for defined benefit plans involves the following steps.
- Determining the present value of the defined benefit obligation by applying an actuarial valuation method.
- Deducting the fair value of any plan assets.
- Adjusting the amount of the deficit or surplus for any effect of limiting a net defined benefit asset to the asset ceiling.
- Determining service costs (current, past and settlement) and net interest (to be recognised in profit or loss), and remeasurements of the net defined benefit liability (asset) to be recognised in OCI. [IAS 19.57]

Like IFRS, a ‘multiple-employer plan’ is intended to allow participating employers to pool their assets for investment purposes while maintaining separate accounts for the purposes of benefit payments. Like IFRS, multiple-employer plans are accounted for by each employer as defined benefit plans or defined contribution plans based on the general requirements on classifying plans. Like IFRS, for defined benefit plans, each employer accounts for its respective share of the assets and liabilities of the plan following the general principles for single-employer plans. [715-60-20, 715-60-35-131]

Group plans
Unlike IFRS, defined benefit plans in which entities (sub-groups) under common control share risks are generally considered multi-employer plans in the financial statements of the subsidiary entity. Accordingly, the subsidiary sub-group records expenses each period based on any contributions being made to the parent entity. In certain cases, the subsidiary sub-group records an allocated portion of costs from the parent; any difference between cumulative costs recognised and cumulative funding recorded as a liability to the parent for future contributions, or as a capital contribution from the parent. [715-30-55-2, 55-64, 715-80-55-2]

State plans
Like IFRS, the employer determines the substance of its obligation under a state plan to determine whether the plan is a defined contribution or a defined benefit plan.

Accounting for defined contribution plans
Like IFRS, an entity accounts for its contributions to a defined contribution plan on an accrual basis. Like IFRS, an asset or liability may result from advance payments or payments due, respectively, to a defined contribution fund. [715-70-35]

Accounting for defined benefit plans
Accounting for defined benefit plans involves the following steps.
- Determining the present value of the defined benefit obligation by applying an actuarial valuation method, like IFRS;
- Deducting the fair value of any plan assets, like IFRS;
- Unlike IFRS, there is no adjustment for any effect of limiting a net defined benefit asset to the asset ceiling.
- Determining service costs (current, past and settlement) and net interest (to be recognised in profit or loss) and remeasurements of the net defined benefit liability (asset). There are a number of differences from IFRS in the measurement and recognition of these items, which are discussed below.
The net defined benefit liability (asset) recognised in the statement of financial position is determined as follows.

- **Step 1:** Present value of the defined benefit obligation minus the fair value of any plan assets equals the deficit or surplus in the defined benefit plan.

- **Step 2:** Adjust for any effect of limiting a net defined benefit asset to the asset ceiling (see below). [IAS 19.9, 63-64]

Benefits are attributed to periods of service in accordance with the plan’s benefit formula unless that formula is back-end loaded, in which case straight-line attribution is used instead. [IAS 19.70]

Benefits are attributed from the date on which service by the employee first leads to benefits under the plan until the date from which further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases. [IAS 19.70, 73]

**Actuarial valuation method**

The projected unit credit method is used to determine the present value of the defined benefit obligation. [IAS 19.67]

Contribution-based promises are defined benefit plans with a promised return on actual or notional contributions that is based on either or both of the following features:

- a guaranteed return of a fixed amount or rate; and/or
- a benefit that depends on future asset returns. [IU 05-14]

Because these plans are defined benefit plans, the projected unit credit method generally applies to the measurement of the related defined benefit obligation. However, in our experience, in some jurisdictions entities predominantly apply a methodology under which benefits that depend on future asset returns are measured at the fair value of the related assets. [IU 05-14]

The actuarial assumptions represent the entity’s best estimates of the future variables that will determine the ultimate cost of settling the defined benefit obligation and are unbiased and mutually compatible. The financial assumptions are based on current market expectations of future events. Also, the assumptions take into account estimated future salary increases and include any future changes in state benefits that affect benefits payable under the plan and for which there is reliable evidence that the change will occur. [IAS 19.75-80, 87]

Unlike IFRS, each assumption is a best estimate assumption, which means that it is judged on its own in the absence of other assumptions. The financial assumptions are based on current market expectations and reflect estimated future salary increases, like IFRS. However, unlike IFRS, anticipated future changes in state benefits that may affect benefits payable under the plan are not reflected until they are enacted. [715-30-35-42, 715-60-35-71]
The calculation takes into account not only the stated plan benefits, but also any constructive obligations. [IAS 19.87]

The obligation is discounted using a high-quality corporate bond rate, or a government bond rate if there is an insufficiently deep high-quality corporate bond market. The depth of the market for high-quality corporate bonds is assessed at the currency level. The currency and maturity of the bonds need to be consistent with the currency and maturity of the defined benefit obligation. If bonds with a maturity that matches the maturity of the obligation are not available, then an appropriate discount rate is estimated by extrapolating interest rates on shorter-term bonds using the yield curve and considering any available evidence about likely longer-term interest rates. [IAS 19.83, 86]

In practice, an entity often uses a single weighted-average discount rate to measure the defined benefit obligation, reflecting the estimated timing and amount of benefit payments and the currency in which the benefits are to be paid. In such cases, the entity also uses a single rate to calculate current service cost and interest cost. However, in our view, in measuring the defined benefit obligation, current service cost and interest cost, an entity might instead use different weighted-average discount rates derived from the same yield curve for different categories of plan members (e.g. active members and pensioners) or separately for each member in the plan, in order to match more closely the expected timing of the benefit payments for each category. [IAS 19.85]

The net benefit liability (asset) is measured as at the reporting date. For practical reasons, the detailed valuation of the defined benefit obligation may be prepared before the end of the reporting period. In this case, the results of the valuation are updated for any material transactions and changes in circumstances up to the end of the reporting period. [IAS 19.58-59]

Taxes payable by the plan on contributions relating to service before the reporting date or on benefits resulting from that service are distinguished from all other taxes payable by the plan. An actuarial assumption is made about the first type of taxes, which are taken into account in measuring current service cost and the defined benefit obligation. All other taxes payable by the plan are included in the return on plan assets. [IAS 19.8, 76(b)(vi), 130]

Like IFRS, the calculation takes into account stated plan benefits as well as any obligations that constitute the substantive plan. [715-30-35-34, 715-60-35-48]

Like IFRS, the obligation is discounted using a high-quality corporate bond rate; however, unlike IFRS, there is no guidance for situations in which the corporate bond market is not deep, although in practice the government bond rate is typically used in those circumstances. Also, like IFRS, the currency and maturity of the bonds match the currency and maturity of the pension obligation. Like IFRS, if bonds with a maturity that matches the maturity of the obligation are not available, then an appropriate discount rate is estimated by extrapolating interest rates on bonds using the yield curve and considering any available evidence about likely longer-term interest rates, or based on an appropriately adjusted high-quality bond index. However, US GAAP has additional guidance on the determination of the high-quality bond rate, and therefore differences from IFRS may arise in practice. [715-30-35-43 – 35-44, 715-60-35-79, 35-81]

In practice, an entity often measures the defined benefit obligation using spot rates on an appropriate yield curve reflecting the estimated timing and amount of benefit payments and the currency in which the benefits are to be paid, like IFRS. From that information, a single weighted-average rate is computed (and disclosed) as the discount rate used to measure the obligation. In our view, current service cost and interest cost may be measured using either the single weighted-average discount rate for the entire obligation, or different weighted-average discount rates, derived from the same yield curve for different categories of plan members (e.g. active members and pensioners or separately for each member in the plan), like IFRS. However, in our view spot rates may also be used, derived from the same yield curve, applied to each projected cash flow, unlike IFRS.

Like IFRS, plan assets and benefit obligations are measured as at the employer’s reporting date. Unlike IFRS, US GAAP provides a practical expedient whereby plan assets and benefit obligations may be measured at the month-end that is closest to the reporting date of the sponsor and adjusted for certain specific, identified transactions when the sponsor’s year does not end on the last day of a month. [715-30-35-62, 35-63A, 715-60-35-121]

Unlike IFRS, the income tax effects from plan assets are included in the determination of the return on plan assets.
Plan assets

‘Plan assets’ comprise:

- assets held by a legally separate fund, which:
  - can be used solely to pay or fund employee benefits;
  - are not available to the employer’s creditors – even in the event of bankruptcy; and
  - cannot be returned to the entity except as reimbursement for employee benefits paid or when the fund is in surplus; and
- qualifying insurance policies, which are insurance policies issued to the sponsor by an unrelated entity, the proceeds from which:
  - can be used solely to pay or fund defined benefit obligations;
  - are not available to the employer’s creditors – even in the case of bankruptcy; and
  - cannot be returned to the entity except as reimbursement for employee benefits paid or when the proceeds are surplus to requirements. [IAS 19.8]

In our view, plan assets also include insurance policies issued to the plan by the sponsor or a related party of the sponsor if the policies are transferable and the other criteria for treatment as assets held by a legally separate fund are met (see above).

Plan assets include transferable financial instruments issued by the reporting entity – including by its subsidiaries – if the criteria for treatment as plan assets are met (see above). Plan assets exclude contributions receivable from the reporting entity and other financial instruments issued by the reporting entity and held by the fund that cannot be transferred to third parties. In our view, if financial instruments issued by associates and joint ventures are not transferable, then we believe that an entity as an accounting policy choice can still treat them as plan assets because such investees are not part of the group. Other plan assets – i.e. those not issued by the reporting entity – are not required to be transferable. [IAS 19.8, 114, BC177]

Plan assets are measured at fair value (see chapter 2.4). This overrides the requirements of other standards that would otherwise apply to these assets. [IAS 19.57a(ii), 113]

Plan assets

Like IFRS, ‘plan assets’ comprise assets held by a legally separate fund, which:

- can be used solely to pay or fund employee benefits;
- are not available to the employer’s creditors – even in the event of bankruptcy; and
- cannot be returned to the entity except as reimbursement for employee benefits paid or when the proceeds are surplus to requirements. [715-30-55-35]

However, unlike IFRS:

- companies are not required to affirmatively demonstrate that plan assets are not legally isolated from the employer’s creditors in bankruptcy; however, if the provisions of a trust provide that assets are available to creditors in the event of bankruptcy (such as in most grantor or rabbi trusts), then the assets would not qualify as plan assets, like IFRS; and
- insurance policies can be plan assets only if they are held by the plan. [715-30-55-36]

Like IFRS, plan assets include insurance policies issued to the plan by the sponsor or a related party if the policies are transferable.

Like IFRS, financial instruments – e.g. shares, bonds and intra-group insurance contracts – issued by the reporting entity need to be transferable to qualify as plan assets. Like IFRS, plan assets exclude contributions receivable from the employer and other non-transferable financial instruments issued by the employer to the fund. Other plan assets – i.e. those not issued by the reporting entity – are not required to be transferable, like IFRS. [715-30-20, 715-30-55-35]

Like IFRS, plan assets are primarily measured at fair value (see chapter 2.4); such measurement overrides the requirements of other Codification topics/subtopics that would otherwise apply to these assets. Unlike IFRS, plan assets used in plan operations, if any, are measured at cost less accumulated depreciation. [715-30-35-50, 715-60-35-107]
If the timing and amount of payments under a qualifying insurance policy exactly match some or all of the benefits payable under a plan, then the present value of the related obligation is determined and is deemed to be the fair value of the insurance policy. Generally, the fair value of such insurance policies held by the fund is determined in the same way — i.e. matching that of the related obligation. [IAS 19.115]

The employer offsets qualifying plan assets against the related obligation to employees; it does not consolidate the fund that holds the plan assets. [IAS 19.57(a)(iii), 113]

The costs of managing plan assets reduce the return on plan assets. No specific requirements regarding the accounting for other administration costs are provided. However, an entity should recognise administration costs (except for the costs of handling medical claims) when the administration services are provided. Therefore, the inclusion of such costs in the measurement of the defined benefit obligation is not allowed. In our view, they should instead be recognised as an expense in profit or loss. [IAS 19.8, 76(b)(iii), 130, BC125–127 1.88]

### Defined benefit cost

The cost of defined benefit plans is made up of the following components (except to the extent that another standard requires or permits its inclusion in the cost of an asset):

- service cost, recognised in profit or loss, which comprises:
  - current service cost;
  - past service cost, resulting from plan amendments or curtailments; and
  - the gain or loss on settlements;
- net interest on the net defined benefit liability (asset), recognised in profit or loss; and
- remeasurements of the net defined benefit liability (asset), recognised in OCI. [IAS 19.120]

Unlike IFRS, there is no special guidance for qualifying insurance policies. Accordingly, the obligation is not measured by reference to the fair value of the insurance policy. Also, unlike IFRS, insurance policies can be plan assets only if they are held by the plan.

Like IFRS, the employer offsets qualifying plan assets against the related obligation to employees; it does not consolidate the fund that holds the plan assets. [715-30-25, 715-60-25]

Like IFRS, the costs of managing plan assets reduce the return on plan assets. An entity should recognise administration costs as an expense when the administration services are provided, like IFRS. [715-30-35-50, 715-60-35-107]

### Defined benefit cost

The periodic cost of defined benefit plans is made up of the following (except to the extent that another Codification topic/subtopic requires or permits its inclusion in the cost of an asset):

- current service cost recognised in profit or loss, like IFRS;
- interest cost on the obligation recognised in profit or loss, like IFRS;
- expected return on plan assets recognised in profit or loss, like IFRS (although the amount differs from IFRS);
- actuarial gains and losses recognised in OCI, like IFRS (although measured differently), and subsequently reclassified to profit or loss, unlike IFRS;
- prior (past) service costs recognised in OCI, unlike IFRS, and subsequently reclassified to profit or loss, unlike IFRS;
- any gain or loss on curtailment included in profit or loss, like IFRS (although the amount and timing of the recognition may differ from IFRS); and
- any gain or loss on settlement recognised in profit or loss, like IFRS (although the settlement amount may differ from IFRS). [715-30-35, 715-60-35]

See forthcoming requirements.

### Current service cost

The ‘current service cost’ is the increase in the present value of the defined benefit obligation resulting from employee service in the current period. It is determined using the same actuarial methodology and assumptions as are used in determining the present value of the defined benefit obligation. [IAS 19.8, 67]
It is unclear where interest that accumulates on service cost should be presented in the financial statements. In our view, it should be recognised in profit or loss and it would be appropriate for it to be classified as part of service cost. For a discussion of where service cost and net interest cost are presented, see below.

### Past service cost
Past service cost is the change in the present value of the defined benefit obligation, in respect of prior periods’ service, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (see below). [IAS 19.8, 102, 104]

### Amendments
Past service cost (positive or negative) as a result of a plan amendment is recognised in profit or loss immediately, at the earliest of the following:
- when the plan amendment occurs;
- when the related restructuring costs are recognised, if the plan amendment arises as part of a restructuring; and
- when the related termination benefits are recognised, if the plan amendment is linked to termination benefits. [IAS 19.8, 103, 106]

### Curtailments
A ‘curtailment’ occurs when a significant reduction in the number of employees covered by the plan takes place. A curtailment may arise from an isolated event, such as the closing of a plant, discontinuance of an operation or termination or suspension of a plan. [IAS 19.105]

A curtailment gives rise to past service cost and is recognised at the earliest of the following:
- when the curtailment occurs;
- when the related restructuring costs are recognised, if the curtailment arises as part of a restructuring; and
- when the related termination benefits are recognised, if the curtailment is linked to termination benefits. [IAS 19.8, 103]

Unlike IFRS, US GAAP requires entities to classify all components of net periodic benefit cost together. Practice varies as to whether supplemental disclosures include interest on service cost as part of service cost or interest cost. [715-30-35-4, 715-60-35-9]

### Prior service cost
Like IFRS, prior (past) service cost is the change in the present value of the obligation, in respect of prior periods’ service, due to changes in benefit entitlement including the introduction or changes to a defined benefit plan. Unlike IFRS, a curtailment differs from a prior service cost. [715-30-35-10, 715-60-35-12]

### Amendments
Unlike IFRS, prior service cost related to a plan amendment is initially recognised in full in OCI in the reporting period of the amendment. Further, unlike IFRS, it is amortised from accumulated OCI into employee benefit cost over the average remaining working lives (to full eligibility for non-pension benefits) of active participants in the plan unless substantially all participants are inactive (i.e. retired), in which case the prior service cost is amortised into employee benefit cost over the remaining life expectancy of participants. [715-30-35-11, 715-60-35-13]

Like IFRS, if benefits are reduced, then those changes result in a negative prior service cost (credit). Unlike IFRS, a negative prior service cost is first offset against any existing positive prior service cost in accumulated OCI, with any excess amortised to employee benefit cost on the same basis as positive prior service cost. [715-30-35-17]

### Curtailments
Like IFRS, a ‘curtailment’ is 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. [715-30-20-Curtailment]

Unlike IFRS, curtailment losses are recognised when they are probable and curtailment gains are recognised when they occur.
Gains or losses from curtailments are recognised in profit or loss. [IAS 19.103]

Settlements

A ‘settlement’ is a transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that are set out in the terms of the plan and included in the actuarial assumptions. Lump sum cash payments to participants in exchange for their rights to ongoing payments is not a settlement if provided for in the terms of the plan. [IAS 19.8, 111]

In our view, an increase or a decrease in contingent benefits – e.g. plan benefits contingent on the funding level of the plan – that does not arise from a plan amendment is not a plan settlement or past service cost, but rather a potential outcome that was contemplated as part of the original pension plan. Therefore, the change should be accounted for as a remeasurement (actuarial gain or loss).

A gain or loss on settlement is recognised in profit or loss, calculated as the difference between:

- the present value of the defined benefit obligation being settled, as determined on the date of settlement; and
- the settlement price, including any plan assets transferred and any payments made directly by the entity in connection with the settlement. [IAS 19.109]

Settlements

Like IFRS, gains and losses from curtailments of defined benefit obligations are recognised in profit or loss. Unlike IFRS, when a curtailment occurs, prior service cost associated with years of service no longer expected to be rendered is recognised in profit or loss. Additionally, a decrease (increase) in the benefit obligation that exceeds the net actuarial gain (loss) is recognised in profit or loss, unlike IFRS. [715-30-35-79, 35-92, 715-60-35-151, 35-164]

Like IFRS, gains and losses from settlements of defined benefit obligations are recognised in profit or loss. However, unlike IFRS (for which it is unnecessary), guidance is provided on the allocation of actuarial gains and losses and prior service costs in determining the amount of the settlement gain or loss. Unlike IFRS, the maximum gain or loss subject to recognition in profit or loss when a pension obligation is settled is the net gain or loss included in accumulated OCI, plus any remaining unrecongnised net transition amount from the initial application of the Codification Topic included in accumulated OCI. That maximum amount includes any gain or loss first measured at the time of settlement. The maximum amount is recognised in profit or loss if the entire benefit obligation is settled. If only part of the benefit obligation is settled, then the employer recognises in profit or loss a pro rata portion of the maximum amount that is equal to the percentage reduction in the benefit obligation. If the purchase of a participating annuity contract constitutes a settlement, then the maximum gain (but not the maximum loss) is reduced by the cost of the participation before determining the amount to be recognised in profit or loss. [715-30-35-79, 35-92, 715-60-35-151, 35-164]
There is no specific guidance in IFRS, but in our view, an entity should choose an accounting policy, to be applied consistently, on whether or not the ‘settlement price’ used in calculating the gain or loss on settlement would include the effect of limiting a net defined benefit asset to the asset ceiling that arises from remeasuring the net defined benefit asset before determining the gain or loss.

An entity remeasures the net benefit liability (asset) using the current fair value of plan assets and current actuarial assumptions – e.g. current market interest rates or current market prices – before determining the gain or loss on the plan amendment, curtailment or settlement. [IAS 19.99]

**Net interest**

‘Net interest’ is the change during the period in the net defined benefit liability (asset) that arises from the passage of time. It is determined by applying the discount rate used to measure the defined benefit obligation at the start of the annual period to the net defined benefit liability (asset) at the start of the annual period, taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. [IAS 19.8, 123]

Unlike IFRS, instead of net interest, an entity recognises:
- interest cost on the defined benefit liability, which is determined by applying the discount rate used to measure the defined benefit obligation at the start of the annual period to the defined benefit liability at the start of the annual period; and
- expected return on plan assets, which is determined by applying the expected long-term rate of return on plan assets to the market-related value of the plan assets at the beginning of the period. [715-30-35-81, 715-60-35-151]

**Interest cost and expected return on plan assets**

Unlike IFRS, the expected return on plan assets reflects the best estimate at the beginning of the period of future market returns on plan assets over the life of the obligation.

**Remeasurements**

Remeasurements of the net defined benefit liability (asset) comprise:
- actuarial gains and losses, which arise on the defined benefit obligation;
- the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and
- any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset). [IAS 19.8, 127]

Actuarial gains and losses arise from changes in the present value of the defined benefit obligation as a result of:
- experience adjustments – i.e. the effects of differences between the previous actuarial assumptions and the actual outcome; and
- the effects of changes in actuarial assumptions. [IAS 19.8, 128]

Unlike IFRS, US GAAP does not have an asset ceiling, so an adjustment to the settlement amount is not necessary.

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**Actuarial gain or loss**

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The return on plan assets comprises interest, dividends and other income derived from the plan assets, as well as realised and unrealised gains or losses on the plan assets, less:

- any costs of managing plan assets; and
- any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the present value of the defined benefit obligation. [IAS 19.8]

Remeasurements of the net defined benefit liability (asset) are recognised in full in OCI in the reporting period during which they arise and are not reclassified to profit or loss in a subsequent period. However, the entity may transfer cumulative amounts recognised through OCI to another component of equity. [IAS 19.122]

Unlike IFRS, actuarial gains and losses arising in the period are recognised immediately in OCI to the extent that they are not recognised in employee benefit cost (see below). Unlike IFRS, employers can elect to amortise from accumulated OCI into employee benefit cost the amount of actuarial gains and losses in excess of the ‘corridor’ amount. The corridor is 10 percent of the greater of the defined benefit obligation and the market-related value of plan assets at the beginning of the period; the ‘market-related value’ is a calculated amount that includes deferred gains and losses that differs from fair value. The difference between the market-related value and the fair value of plan assets is recognised as a component of the expected return on plan assets over a period of five years or less, unlike IFRS. The corridor is calculated and applied separately for each plan. [715-30-35-18, 715-60-35-23]

Unlike IFRS, the net cumulative (unamortised) actuarial gain or loss at the beginning of the period in excess of the corridor is amortised into employee benefit cost on a straight-line basis over the expected average remaining working lives of the employees participating in the plan or, if substantially all participants are inactive, over the remaining life expectancy of participants; generally, US GAAP is explicit that the calculation needs to be based on active employees in the plan. Unlike IFRS, an entity is permitted to recognise actuarial gains and losses in employee benefit cost using any systematic and rational method that results in faster recognition than using the corridor method. [715-30-35-18, 715-60-35-23]

Any balance is recognised as a component of OCI for the reporting period, and remains in accumulated OCI until it is reclassified to employee benefit cost; an entity is also permitted to recognise all actuarial gains and losses immediately in profit or loss, unlike IFRS. However, recognition in OCI without any reclassification to employee benefit cost is not permitted, unlike IFRS. [715-30-35-18, 715-60-35-23]
Presentation of service cost and net interest

The employee benefits standard does not specify where service cost and net interest on the net defined benefit liability (asset) are presented. It also does not specify whether an entity presents service cost and net interest separately or as components of a single item of income or expense. An entity therefore chooses an approach, to be applied consistently, for the presentation of service cost and net interest on the net defined benefit liability (asset) in profit or loss. [IAS 19.134, BC201, 1.45]

Asset ceiling

If a plan is in surplus, then the amount recognised as an asset in the statement of financial position is limited to the ‘asset ceiling’. This is the present value of any economic benefits available to the entity in the form of a refund from the plan or a reduction in future contributions to the plan. [IAS 19.8, 64]

An economic benefit is available to an entity if, in accordance with the terms of the plan and applicable statutory requirements, it is realisable during the life of the plan or on settlement of the plan liabilities. [IFRIC 14.7–8]

The economic benefit available as a refund of a plan surplus is measured as the amount of the surplus at the reporting date less any associated costs, and is available only if an entity has an unconditional right to such a refund during the life of the plan, on gradual settlement of plan liabilities, or on plan wind-up. [IFRIC 14.11, 13–14]

The economic benefit available as a reduction in future contributions is measured as follows.

- If there is no minimum funding requirement for contributions relating to future service, then as the present value of the future service cost to the entity for each year over the shorter of the expected life of the plan and the expected life of the entity.
- If there is a minimum funding requirement for contributions for future services, then as the sum of:
  - any prepaid amount that reduces future minimum funding requirement contributions for future service; and
  - the present value of the estimated future service cost to the entity in each year less the estimated minimum funding requirement contributions that would be required for future service in the given year if there were no prepayment of future minimum funding requirement contributions. This amount cannot be less than zero. [IAS 19.64, IFRIC 14.16, 20, 22]

Presentation of cost components

Unlike IFRS, the cost components of defined benefit post-retirement plans recognised in profit or loss or capitalised to an eligible asset (see above) are reported as a net amount of compensation cost. See forthcoming requirements. [715-20-50, 715-30-35-3, 715-60-35-9]

Asset ceiling

Unlike IFRS, the funded status (the difference between the fair value of plan assets and the defined benefit obligation) is recognised as an asset if the plan is overfunded (i.e. the measured amount of plan assets exceeds the measured amount of plan liabilities); the asset is not subject to additional adjustments related to an asset ceiling or a minimum funding requirement. [715-30-25, 715-60-25]

Unlike IFRS, there is no requirement to evaluate whether an economic benefit is available to an entity; the funded status (see above) is recognised as an asset if the plan is overfunded. [715-30-25, 715-60-25]
A liability is recognised for contributions payable to fund an existing shortfall with respect to service already received under a minimum funding requirement if the contributions payable are not expected to be available as a refund or reduction in future contributions after they are paid into a plan. [IFRIC 14.23-24]

**Insured benefits**

If employee benefits are insured, then the accounting treatment depends on the nature of the obligation retained by the employer. [IAS 19.46]

If an employer purchases an insurance policy from an unrelated third party and in so doing settles its legal and constructive obligations under a defined benefit plan, then the purchase of the insurance policy is treated as a settlement of some or all of the employer’s obligations. [IAS 19.46, 49, 112]

If the employer retains an indirect obligation – e.g. if actuarial risk will be transferred back to the employer by way of increased premiums, or the employer retains an obligation to pay the benefits through a plan – then the plan continues to be treated as a defined benefit plan. The insurance policy is treated as a plan asset or as a separate asset, depending on whether it is a qualifying insurance policy (see above). [IAS 19.48]

**Current salary policies**

An employer may purchase insurance policies each period to settle all of its defined benefit obligations. In this case, recognising as an expense the cost of the policies bought – in effect, defined contribution accounting – will have the same effect as applying defined benefit accounting and recognising a settlement gain or loss, although the disclosure requirements for defined benefit plans may still be relevant. [IAS 19.46]

However, an insurance policy may not cover all of the employer’s defined benefit obligations. If the employer has an obligation to make payments if the insurer does not pay all future employee benefits related to employee service in the current and prior periods, then in our view the resultant plan should be accounted for as a defined benefit plan, even if some of the obligations have been settled and are no longer recognised. [IAS 19.46]

Unlike IFRS, the funded status – the defined benefit obligation minus the fair value of the plan assets – is recognised as a liability if the plan is underfunded; the liability is not subject to additional adjustments related to an asset ceiling or a minimum funding requirement. [715-30-25, 715-60-25]

**Insured benefits**

Like IFRS, if employee benefits are insured, then the accounting treatment depends on the nature of the obligation retained by the employer.

Like IFRS, if annuity contracts purchased from an insurance company are irrevocable and involve the transfer of significant risk from the employer to the insurance company then, to the extent covered by the annuity contract, the cost of current benefits is the cost of purchasing the contracts in recognising the settlement of the obligation. [715-30-35-53, 715-60-35-109]

Like IFRS, if the substance of the contract with the insurance company is such that the employer remains subject to all or most of the risks and rewards associated with the defined benefit obligation and any assets transferred to the insurance company, then that contract does not qualify as an annuity contract and a settlement has not occurred. Like IFRS, the insurance policy is treated as a plan asset or as a separate asset, depending on whether the insurance policy is held by the plan or, unlike IFRS, by the employer (see above). [715-30-35-59, 715-60-35-120]

**Current salary policies**

If all the benefits attributed by the plan’s benefit formula to service in the current period are covered by the purchase of nonparticipating annuity contracts, then the cost of the contracts determines the service cost component of pension cost for that period, similar to defined contribution accounting, like IFRS. Benefits covered by the annuity contracts are excluded from the benefit obligation and the annuity contract is excluded from plan assets, like IFRS. [715-30-35-53]

Benefits beyond those covered under nonparticipating annuity contracts are accounted for as defined benefit plans, which would generally be like the treatment under IFRS. [715-30-35-55]
Reimbursement rights

If an entity will be reimbursed for expenditures required to settle a defined benefit obligation, but the reimbursement right does not give rise to a plan asset, then it is recognised as a separate asset when recovery is virtually certain. [IAS 19.116]

Reimbursement rights are measured at fair value and the changes in fair value are accounted for in the same way as the changes in the fair value of plan assets (see above). Remeasurements arising on reimbursement rights are recognised in OCI. [IAS 19.116]

Other long-term employee benefits

‘Other long-term employee benefits’ are all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits. Such benefits may include accumulating annual leave that can be carried forward and used more than 12 months after the end of the annual reporting period in which the employees render the related services, paid long-service leave, other long-service benefits (e.g. a bonus or extra salary after 20 years of service) and profit-sharing and other bonus schemes that are not expected to be settled wholly within 12 months of the end of the annual reporting period in which the employee services were received by the entity. [IAS 19.8, 153]

Other long-term employee benefits that are defined benefit plans are accounted for in a manner similar to post-employment defined benefit plans, except that the components of the defined benefit cost are not disaggregated and are recognised in profit or loss. [IAS 19.155–156]

Deferred compensation contracts are accounted for in the same way as other long-term employee benefits. [IAS 19.153]

Reclassifications

Reclassification of a short-term employee benefit as long-term need not occur if the entity’s expectations of the timing of settlement change temporarily. However, the benefit is reclassified if the entity’s expectations of the timing of settlement change other than temporarily, or the characteristics of the benefit change – e.g. from a non-accumulating to an accumulating benefit. [IAS 19.10]

Reimbursement rights

Unlike IFRS, if an entity will be reimbursed for expenditures required to settle a defined benefit obligation but the reimbursement right does not give rise to a plan asset, then it is recognised when recovery is probable (likely to occur) to the extent that benefits cost has been incurred. [965-10-05-6]

Reimbursement rights in respect of post-retirement healthcare plans are measured at the present value of the expected reimbursement amount; however, we would not expect differences from IFRS to arise in practice. Unlike IFRS, reimbursements may be recognised immediately in employee benefit cost or initially in OCI depending on the type of reimbursement and whether or not the reimbursement is coming from a governmental body. [715-60-35-137 – 35-138]

Other long-term employee benefits

Unlike IFRS, US GAAP does not distinguish between long- and short-term employee benefits.

Like IFRS, other long-term employee benefits are accounted for in a manner similar to post-employment benefits if there is a plan in place. If a plan is not in place, then other long-term benefits are recognised over the period during which service is rendered. In addition, unlike IFRS, for post-employment benefits actuarial gains and losses and past service costs may, but are not required to, be recognised in the same manner as for defined benefit pension plans. [712-10-35-1]

Unlike IFRS, deferred compensation contracts with individual employees that are not equivalent to a post-retirement benefit plan are accounted for individually on an accrual basis in accordance with the terms of the underlying contract. [710-10-25-9]

Reclassifications

Unlike IFRS, US GAAP does not contain specific guidance on short-term employee benefits other than compensated absences, and there is no distinction between long- and short-term employee benefits.
Termination benefits

‘Termination benefits’ are those benefits provided in exchange for termination of an employee’s employment as a result of either an entity’s decision to terminate that employment before the normal retirement date or an employee’s decision to accept an offer of benefits in exchange for termination (see chapter 3.12).

[IAS 19.8, 159]

An obligation for termination benefits is regarded as arising from the termination and not from the employee’s service. An entity recognises a liability and an expense for termination benefits at the earlier of:
- when it recognises costs for a restructuring in the scope of the provisions standard that includes the payment of termination benefits; and
- when it can no longer withdraw the offer of those benefits. [IAS 19.165]

The entity can no longer withdraw the offer when it has communicated to the affected employees a plan of termination meeting all of the following criteria:
- actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made;
- the plan identifies:
  - the number of employees whose employment is to be terminated;
  - their job classifications or functions and their locations (although the plan need not identify these for individual employees); and
  - the expected completion date; and
- the plan establishes the termination benefits that employees will receive in sufficient detail so that employees can determine the type and amount of benefits they will receive when their employment is terminated. [IAS 19.167]

If the termination benefits are payable as the result of an employee’s decision to accept an offer of benefits in exchange for the termination of employment – i.e. to take voluntary redundancy – then the entity can no longer withdraw the offer of termination benefits at the earlier of:
- when the employee accepts the offer; and
- when a restriction – such as a legal, regulatory or contractual requirement – on the entity’s ability to withdraw the offer takes effect. [IAS 19.166]

Under IFRS, if the benefit is conditional on future services being provided, then it is not a termination benefit. [IAS 19.162]

Termination benefits

Unlike IFRS, US GAAP distinguishes four types of termination benefits: ongoing benefit arrangements, contractual terminations, special terminations and one-time terminations (see chapter 3.12). [420-10, 712-10]

Unlike IFRS, the recognition of termination benefits depends on whether it is a one-time benefit, a contractual benefit, or a benefit payment pursuant to a plan. The criteria for recognition of one-time benefits are similar to IFRS (see below). Contractual termination benefits and benefits payable pursuant to a plan are recognised when it is probable that the benefits will be paid and the amounts can be reasonably estimated, unlike IFRS. [420-10-25-4, 712-10-25-1 – 25-4]

The criteria that need to be met under US GAAP before an obligation for one-time termination benefits is recognised are similar to the criteria under IFRS on when an entity can no longer withdraw the offer of termination benefits payable as a result of an entity’s decision to terminate an employee’s employment. However, unlike IFRS, there also is a criterion that management with the appropriate authority to approve the action commits to the plan. In addition, unlike IFRS, one-time termination benefits cannot be recognised earlier if they are related to a restructuring. [420-10-25-4]

Unlike IFRS, special termination benefits are distinguished from one-time termination benefits. Special termination benefits are generally additional benefits offered for a short period of time to induce voluntary termination or early retirement and are recognised when the employee irrevocably accepts the offer and the amount can be reasonably estimated. [712-10-25-1]

Like IFRS, for one-time termination benefits, if future service beyond legally mandated minimums (which is unlike IFRS) is required, then the cost of the termination benefit is recognised ratably over the employees’ remaining service period. [420-10-25-9]
Benefits forming part of an ongoing arrangement or contractual termination arrangement are subject to the general requirements for the recognition of termination benefits.

For a discussion of the recognition of other costs associated with a restructuring, including voluntary redundancies, see chapter 3.12.

**Forthcoming requirements**

There are no forthcoming requirements under IFRS.

The employee benefits standard does not specify where service cost and net interest on the net defined benefit liability (asset) are presented. It also does not specify whether an entity presents service cost and net interest separately or as components of a single item of income or expense. An entity therefore chooses an approach, to be applied consistently, for the presentation of service cost and net interest on the net defined benefit liability (asset) in profit or loss. Employee benefit costs capitalised as part of the cost of assets such as inventories or property, plant and equipment include ‘the appropriate proportion’ of both service cost and net interest components. [IAS 19.120–121, 134, BC201, 1.45]

Unlike IFRS, costs related to an ongoing benefit arrangement or contractual termination benefit arrangement are recognised when they are probable and reasonably estimable. [712-10-25-2]

For a discussion of the recognition of other costs associated with a restructuring, including voluntary redundancies, see chapter 3.12.

**Forthcoming requirements**

Amendments to the employee benefits Codification Topic are effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted as of the beginning of an annual period for which financial statements have not been issued or made available for issuance. [ASU 2017-07]

Unlike IFRS, there are specific presentation requirements under US GAAP. The service cost component of net benefit cost is presented in the same line item or items as other compensation cost is reported. Other components of net benefit cost are presented separately from the service cost component and outside operating income, if a subtotal is presented. Unlike IFRS, only the service cost component is eligible for capitalisation, when applicable. [715-20-45-3A, 715-30-36-7A, 715-60-35-10A]
### Overview

- Goods or services received in a share-based payment transaction are measured using a fair value-based measure.

- Goods are recognised when they are obtained and services are recognised over the period in which they are received.

- Equity-settled transactions with employees are generally measured based on the grant-date fair value of the equity instruments granted.

- ‘Grant date’ is the date on which the entity and the employee have a shared understanding of the terms and conditions of the arrangement.

- Equity-settled transactions with non-employees are generally measured based on the fair value of the goods or services obtained. The measurement date is the date on which the goods or services are received, which means that there may be multiple measurement dates.

- An intrinsic value approach is permitted only in the rare circumstance that the fair value of the equity instruments cannot be estimated reliably.

### US (Topic 718, Subtopic 505-50)

- Like IFRS, goods or services received in a share-based payment transaction are measured using a fair value-based measure.

- Like IFRS, goods are recognised when they are obtained and services are recognised over the period in which they are received.

- Like IFRS, equity-classified transactions with employees are generally measured based on the grant-date fair value of the equity instruments granted.

- Like IFRS, ‘grant date’ is the date on which the entity and the employee have a shared understanding of the terms and conditions of the arrangement. However, unlike IFRS, employees should also begin to benefit from or be adversely affected by changes in the entity’s share price.

- Unlike IFRS, equity-classified share-based payment transactions with non-employees are measured based on the fair value of the goods or services received or the fair value of the equity-based instruments issued, whichever is more reliably measurable. Unlike IFRS, the measurement date is the earlier of the date on which performance is complete and when completion of performance is probable because there is a sufficiently large disincentive for failure to perform.

- Unlike IFRS, an intrinsic value approach is permitted only in the rare circumstance that the fair value of the equity instruments cannot be estimated reliably. However, unlike IFRS, non-public entities may apply an intrinsic value approach for liability-classified share-based payments as an accounting policy election.
Overview (continued)

For equity-settled transactions, an entity recognises a cost and a corresponding increase in equity. The cost is recognised as an expense unless it qualifies for recognition as an asset.

Market conditions for equity-settled transactions are reflected in the initial measurement of fair value. There is no true-up if the expected and actual outcomes differ because of market conditions.

Like market conditions, non-vesting conditions are reflected in the initial measurement of fair value and there is no subsequent true-up for differences between the expected and the actual outcome.

Service and non-market performance conditions for equity-settled transactions are not reflected in the initial measurement of fair value, but are considered in estimating the number of instruments that are expected to vest. Initial estimates of the number of equity-settled instruments that are expected to vest are adjusted to current estimates and ultimately to the actual number of equity-settled instruments that vest unless differences are due to market conditions.

For cash-settled transactions, an entity recognises a cost and a corresponding liability. The cost is recognised as an expense unless it qualifies for recognition as an asset.

Overview (continued)

Like IFRS, for equity-classified transactions an entity recognises a cost and a corresponding increase in equity, and the cost is recognised as an expense unless it qualifies for recognition as an asset.

Like IFRS, market conditions for equity-classified transactions are reflected in the initial measurement of fair value and there is no true-up if the expected and actual outcomes differ because of market conditions.

Unlike IFRS, the concept of ‘non-vesting conditions’ is separated into two separate concepts: post-vesting restrictions and other conditions. Post-vesting restrictions are reflected in the initial measurement of fair value and there is no subsequent true-up for differences between the expected and the actual outcome, like IFRS. However, unlike IFRS, other conditions require the award to be liability-classified, irrespective of the settlement provisions of the award.

Unlike IFRS, for public business entities, an entity makes an accounting policy election to account for the effect of forfeitures using one of the following approaches.

- **True-up approach.** Like IFRS, the effect of service conditions and (non-market) performance conditions on vesting is estimated at grant date, but it is not reflected in the grant-date fair value itself. Subsequently, these estimates are trued up for differences between the number of instruments expected to vest and the actual number of instruments vested, like IFRS.

- **Actual approach.** Unlike IFRS, the effect of forfeitures is recognised as they occur, and previously recognised compensation cost is reversed in the period that the award is forfeited.

Like IFRS, other entities apply the true-up approach (see forthcoming requirements).

Like IFRS, for liability-classified transactions, an entity recognises a cost and a corresponding liability, and the cost is recognised as an expense unless it qualifies for recognition as an asset.
Overview (continued)

– The liability is remeasured, until settlement date, for subsequent changes in the fair value of the liability. The remeasurements are recognised in profit or loss.

– Modification of an equity-settled share-based payment results in the recognition of any incremental fair value but not in any reduction in fair value. Replacements are accounted for as modifications.

– When a cash-settled share-based payment transaction is modified such that it becomes equity-settled, in our view the entity may account for the modification by either:
  - analogising to the principles on the modification of equity-settled share-based payments; or
  - as a settlement and a replacement of a share-based payment. See forthcoming requirements.

– Cancellation of a share-based payment results in accelerated recognition of any unrecognised cost.

– Classification of grants in which the entity has the choice of equity or cash settlement depends on whether the entity has the ability and intent to settle in shares.

– Grants in which the employee has the choice of equity or cash settlement are accounted for as compound instruments. Therefore, the entity accounts for a liability component and an equity component separately.

– Awards with graded vesting, for which the only vesting condition is service, are accounted for as separate share-based payment arrangements.

Overview (continued)

– Like IFRS, the liability is remeasured, until settlement date, for subsequent changes in the fair value of the liability. Unlike IFRS, remeasurements are generally recognised as compensation cost, which is eligible for capitalisation.

– Like IFRS, the modification of an equity-classified share-based payment results in the recognition of any incremental fair value but not in any reduction in fair value unless the modification is an ‘improbable-to-probable’ modification, unlike IFRS. Like IFRS, replacements are accounted for as modifications.

– Unlike IFRS, when a public business entity modifies a liability-classified share-based payment transaction such that it becomes equity-classified, it measures the equity-classified award at its fair value and recognises any gain or loss in profit or loss. Unlike IFRS, other entities measure the equity-classified award based on the previous carrying amount of the liability plus any incremental compensation from the modification (see forthcoming requirements).

– Like IFRS, cancellation of a share-based payment by the entity results in accelerated recognition of any unrecognised cost. Unlike IFRS, cancellation by the counterparty does not change recognition of the compensation cost.

– Like IFRS, the classification of grants in which the entity has the choice of equity or cash settlement depends on whether the entity has the ability and intent to settle in shares.

– Unlike IFRS, an award for which the employee has the choice of equity or cash settlement is generally liability-classified in its entirety unless the award is a ‘combination’ award, which might be treated like a compound instrument.

– Awards with graded vesting, for which the only vesting condition is service, can be accounted for ratably over the longest vesting tranche, unlike IFRS; or as separate share-based payment arrangements, like IFRS.
Overview (continued)

There is specific guidance on group share-based payment arrangements, which are accounted for in each group entity’s financial statements based on their own perspectives.

Scope
Transactions settled in shares or other equity instruments are referred to as ‘equity-settled share-based payment transactions’. Transactions that create an obligation to deliver cash or other assets are referred to as ‘cash-settled share-based payment transactions’. [IFRS 2.A]

An entity may grant a share-based payment without any specifically identifiable goods or services being received in return, in which case other circumstances may indicate that goods or services have been received. In other cases, there may be specifically identifiable goods or services received in exchange for the share-based payment. If the identifiable consideration received appears to be less than the fair value of the equity instruments granted or liability incurred, then this typically indicates that other consideration (i.e. unidentifiable goods or services) has also been (or will be) received. [IFRS 2.2, 13A]

If the entity does not settle in its own equity instruments but in a payment of cash or other assets, then the amount should be based on the price (or value) of its equity instruments for the transaction to qualify as a share-based payment. Judgement is required in determining whether an award is based on the price of the entity’s shares, although we would generally expect a high degree of correlation between the calculation of the award and the share price. [IFRS 2.A]

Transactions with employees or other parties in their capacity as shareholders are outside the scope of IFRS 2. [IFRS 2.2, 4]

Overview (continued)

Unlike IFRS, US GAAP does not contain specific guidance on group share-based payment arrangements, which may give rise to differences in practice.

Scope
Under US GAAP, most but not all transactions settled in shares or other equity instruments are ‘equity-classified share-based payment transactions’. Most but not all transactions that create an obligation to deliver cash or other assets are ‘liability-classified (cash-settled) share-based payment transactions’. The principle difference between IFRS and US GAAP in classifying share-based payment transactions is that US GAAP focuses on whether an equity relationship is created through the award, whereas IFRS focuses on the form of settlement of the award.

The share-based payment Codification Topic applicable to non-employee awards would generally apply to transactions in which an entity cannot specifically identify the goods and services received in return for a share-based payment award. However, unlike IFRS, US GAAP has no specific guidance for such circumstances and the measurement model for non-employee awards differs in certain respects from IFRS, so differences may arise in practice. [505-50]

If the entity does not settle in its own equity instruments but in a payment of cash or other assets, then the amount should be based, at least in part, on the price (or value) of its equity instruments for the transaction to qualify as a share-based payment. Accordingly, there may be a lower threshold for being in the scope of the Codification Topic, which may give rise to differences from IFRS in practice. [718-10-15-3]

Like IFRS, transactions with employees or other parties in their capacity as shareholders are outside the scope of the Codification Topic. However, US GAAP has more guidance in this area, which can result in transactions being accounted for as share-based payments under US GAAP that are not under IFRS. [718-10-15-4]
The following share-based payment transactions are covered by other IFRSs and are therefore outside the scope of the share-based payment standard:
– share-based consideration paid in a business combination (see chapter 2.6), in a combination of entities under common control (see chapter 5.13) or in connection with the contribution of a business on the formation of a joint venture (see chapter 3.6);
– share-based consideration for certain commodity contracts that are in the scope of the financial instruments standards (see chapter 7.1); and
– the issue of equity instruments in return for financial instruments of equal fair value (see chapter 7.1). [IFRS 2.5–6]

In our view, the following are also outside the scope of the share-based payment standard:
– the acquisition of NCI after control is obtained (see chapter 2.5);
– the acquisition of associates (see chapter 3.5); and
– the acquisition of a joint controlling interest in a joint venture (see chapter 3.5).

The employer may pay employees an amount of cash to cover social taxes and/or income taxes related to share-based payment transactions in addition to the share-based payment arrangement. In our view, if the cash payment is not based on the price or value of the entity’s shares, then this portion of the plan should be treated as an employee benefit (see chapter 4.4). If the cash payment is based on the value of the entity’s shares, then it may be appropriate to treat this portion of the plan as a cash-settled share-based payment transaction. [IFRS 2.1]

If the employer is the obligor for the tax, then the employer recognises the cost and a liability. In our view, an entity should choose an accounting policy, to be applied consistently, to treat the employer’s obligation to pay the taxes either as a provision (see chapter 3.12) or as a share-based payment transaction.

Like IFRS, if the employer is the obligor for the tax, then the employer recognises the cost and a liability. Unlike IFRS, an entity would normally recognise a liability to pay taxes based on the contingencies Codification Topic (see chapter 3.12), which may result in differences from IFRS in the timing of recognition. [IFRS 3.12]
An arrangement may provide for a cash payment to be made that is based on the share price of an entity, but is subject to a cap. In our view, the arrangement should be accounted for as a cash-settled share-based payment if the payment is expected to be largely based on the entity’s share price; otherwise, it should be accounted for as an employee benefit (see chapter 4.4). There is no guidance on arrangements that provide for settlement in equity subject to a monetary cap, and practice may vary.

All employee share purchase plans are considered compensatory. The share-based payment standard does not permit exemptions for purchase plans with small discounts and/or broad-based plans offered to all employees.

Classification of share-based payment transactions

Generally, the classification as cash- or equity-settled is based on the entity’s obligation to the counterparty (i.e. whether the entity is or can be required to settle in equity instruments or settle in cash) and the entity’s intended settlement method. However, classification is not affected by how an entity obtains the shares that it will use to settle its obligations. [IFRS 2.B49]

A share-based payment transaction in which the employees are granted the right to shares that are redeemable (e.g. shares that are redeemable on cessation of employment) at the employees’ option is a cash-settled share-based payment arrangement. [IFRS 2.31]

In our view, an award that is net share settled, sometimes referred to in practice as cashless exercise, would be viewed as equity-settled as long as the recipient has no ability to require a cash payment for the equity instruments tendered. A transaction that is settled in a variable number of shares is generally classified as an equity-settled share-based payment transaction. [IFRS 2.BC106]

An arrangement may provide for a cash payment to be made that is based on the share price of an entity, but is subject to a cap. Like IFRS, the arrangement should be accounted for as a liability-classified share-based payment if the payment is expected to be largely based on the entity’s share price; otherwise, it should be accounted for as an employee benefit (see chapter 4.4). Unlike IFRS, share-based payments that are settled in shares but are subject to a monetary cap are evaluated to determine whether the payoff is predominantly tied to the value of the entity’s shares (in which case the award is equity-classified) or to a fixed monetary payoff (in which case the award is liability-classified). [718-10-25]

Unlike IFRS, employee share purchase plans are considered non-compensatory if certain conditions are met. However, in practice many employee share purchase plans are compensatory. [718-50-25-1]

Classification of share-based payment transactions

The classification as liability or equity is based on both the entity’s obligation to the counterparty (i.e. whether the entity is or can be required to settle in equity instruments or settle in cash) and the intended settlement method, like IFRS. However, unlike IFRS, it is also based on whether the arrangement creates an equity relationship with the counterparty such that the recipient is exposed to the risks and rewards of share price movements as a shareholder. Like IFRS, classification is not affected by how an entity obtains the shares that it will use to settle its obligations. [718-10-25-3–25-4]

For public entities, a share-based payment transaction settled in shares that are mandatorily redeemable is liability-classified, like IFRS. However, unlike IFRS, if the employee is subject to risks and rewards of ownership for at least six months following vesting (or exercise for share options) and awards are redeemable at fair value at the redemption date, the awards are equity-classified. SEC registrants are required to present a portion of such an award’s value in ‘temporary equity’ (i.e. between total liabilities and equity), unlike IFRS. Also unlike IFRS, for certain non-public entities such awards are equity-classified because the redeemable share is classified as equity (see chapter 7.3). [718-10-25, 480-10-30, 480-10-S99-3A]

Like IFRS, cashless exercise can result in an award being equity-classified as long as the recipient has no ability to require a cash payment for the equity instruments tendered. However, unlike IFRS, cashless exercise should also create an equity relationship such that the recipient is exposed to the risks and rewards of share price movements as a shareholder. Unlike IFRS, an award is classified as a liability if it is for a fixed monetary amount settleable in a variable number of shares. [718-10-25-3]
In our view, a payment that is settled in equity instruments is a share-based payment, provided that no scope exemption applies, even if the design of the payment is to grant shares with a value equal to a certain cash amount.

Some share-based arrangements may allow the employer to net-settle the award for the number of shares required to settle the tax obligation. In our view, if the entity is acting simply as an agent for the employee and therefore bears no risk associated with the shares, then the settlement of the tax obligation via a sale by the employer of a portion of the shares does not mean that the tax portion is a cash-settled share-based payment. If in contrast the entity is not acting simply as an agent (i.e. it bears risk associated with the shares), then in our view the tax portion should be classified as a cash-settled share-based payment and the remainder should be classified as equity-settled. See forthcoming requirements.

When the entity has the choice of whether to settle in cash or by issuing shares, classification as equity-settled is appropriate if the entity has the intent and a substantive ability to settle in shares and has no past practice of settling in cash. [IFRS 2.41]

There is no specific guidance on the classification of a share-based payment in which equity instruments are cash-settleable only on the occurrence or non-occurrence of a contingent event. In our view, if an entity issues a share-based payment that is contingently cash-settleable and the contingency is not within the control of the entity or the counterparty, then the entity should determine whether to classify the share-based payment as cash- or equity-settled based on the liability recognition criteria of the provisions standard. Based on the classification guidance in that standard (see chapter 3.12), we believe that in determining whether a liability to the employee exists, the contingent feature would affect the classification only if the contingent event is probable (i.e. more likely than not). [IAS 37.14]

Like IFRS, a payment that is settled in equity instruments is a share-based payment, provided that no scope exemption applies. However, unlike IFRS, if the design of the payment is to grant shares with a value equal to a fixed cash amount that is settled by issuing a variable number of shares, then it is classified as a liability. [718-10-25-7]

Some share-based arrangements may allow the employer to net-settle the award for the number of shares required to settle the tax obligation. Unlike IFRS, the accounting under US GAAP is not determined by a principal/agent analysis. If the award can be net-settled for up to the maximum statutory tax withholding amount (no more than the minimum statutory tax withholding amount for entities other than public business entities), then the award is equity-classified in its entirety if it otherwise qualifies for equity classification. If the award can be net-settled for an amount in excess of the maximum statutory tax withholding (in excess of the minimum statutory tax withholding amount for entities other than public business entities), then the entire award is liability-classified. See forthcoming requirements for entities other than public business entities. [718-10-25-18]

Like IFRS, equity-classification is appropriate if the entity has the intent and a substantive ability to settle in shares and has no past practice of settling in cash. However, unlike IFRS, the award needs to create an equity relationship between the counterparty and the entity. As such, awards settled in equity for a fixed monetary amount and awards that vest on the achievement of an ‘other’ condition are liability-classified, unlike IFRS. [718-10-25]

Like IFRS, if the contingent events are outside the control of the entity, then the employer should consider whether the occurrence of the contingent event is probable of occurring. If the occurrence of the contingent event is not probable, then the award is equity-classified, assuming that it otherwise qualifies for equity classification. However, unlike IFRS, such awards (or a portion thereof) are presented in temporary equity if the entity is an SEC registrant, regardless of the event’s likelihood of occurring. In addition, ‘probable’ has a different meaning under IFRS, so differences may arise in situations in which the likelihood is greater than more likely than not, but less than probable. [480-10-5-99-3A]
There is no specific guidance on the classification of share-based payment arrangements that are denominated in a currency other than the issuing entity’s functional currency. In our view, the classification should be based on what form of consideration the entity is providing to the employees (e.g. shares or cash) as for other compensation arrangements. In our view, in determining the grant-date fair value of the foreign currency-denominated option, the exercise price should be translated into the entity’s functional currency at the exchange rate on that date. We believe that the grant-date fair value should not be remeasured for subsequent changes in exchange rates.

Equity-settled transactions with employees

Conditions

Conditions that determine whether the counterparty receives the share-based payment are separated into vesting conditions and non-vesting conditions. ‘Vesting conditions’ are all conditions that determine whether the entity receives the services that entitle the counterparty to the share-based payment, and may be differentiated further between service and performance conditions. ‘Performance conditions’ are either market conditions or non-market performance conditions. All other conditions are considered non-vesting conditions. [IFRS 2.IG4A, IG24]

‘Service conditions’ require the employees to complete a specified period of service. The service requirement can be explicit or implicit. [IFRS 2.A, BC171A, BC346]

‘Performance conditions’ require the counterparty to (1) complete a specified period of service – i.e., a service condition; and (2) meet specified performance targets while the counterparty is rendering the services. Performance conditions are either market conditions or non-market performance conditions.

- Non-market performance conditions: Vesting or exercisability of an equity instrument is related to specific performance targets associated with an entity’s own operations or activities, or the operations or activities of another entity in the same group – e.g., a specified increase in profit or EPS target.

Unlike IFRS, share-based payment arrangements that are denominated in a currency other than the issuing entity’s functional currency are equity-classified only if they otherwise qualify as equity and the award either:
- is granted to an employee of an entity’s foreign operations and contains a fixed exercise price denominated in the foreign operation’s functional currency or the currency in which the employee’s pay is denominated; or
- contains an exercise price denominated in the currency of a market in which a substantial portion of the entity’s equity securities trade. [718-10-25-14 – 25-14A]

For equity-classified awards in which the exercise price is denominated in the same currency as the currency in which the share price is quoted, the grant-date fair value is measured in that currency. If the exercise price is denominated in a currency different from the currency in which the share price is quoted, then the grant-date fair value measurement includes the current exchange rate and the volatility of the exchange rate against the entity’s functional currency as additional inputs to the valuation model. In either case, the grant-date fair value is not remeasured for subsequent changes in exchange rates, like IFRS. [718-10-25-14 – 25-14A]

Equity-settled transactions with employees

Conditions

Conditions that determine whether the employee receives the share-based payment are separated into vesting conditions, like IFRS, and post-vesting restrictions, unlike IFRS. Conditions that determine whether the employee receives the share-based payments are vesting conditions, which are service conditions (like IFRS), performance conditions (which are generally like non-market performance conditions under IFRS), market conditions (which are like market performance conditions under IFRS) or ‘other’ conditions (unlike IFRS). [718-10-20]

Like IFRS, ‘service conditions’ require employees to complete a specific period of service. [718-10-20]

‘Performance conditions’ relate to both (1) an employee’s rendering service for a specified period, like IFRS; and (2) the achievement of a specified performance target that is defined solely with reference to the employer’s operations (e.g. EPS targets), which is like a non-market performance condition under IFRS. Unlike IFRS, the assessment period for performance conditions can be longer than an explicit or implicit service condition, which can result in differences in the measurement of the grant-date fair value of awards and the attribution of compensation cost. [718-10-30-28]
Market conditions: Vesting or exercisability of an equity instrument is related to the market price (or value) of the entity’s equity instruments (or the equity instruments of another entity in the same group). Examples include attaining a specified share price or achieving a specified target that is based on the market price of the entity’s equity instruments relative to a stock-exchange index, or an index of market prices of equity instruments of other entities. [IFRS 2.A]

IFRS 2 does not explicitly define a non-vesting condition, but does illustrate the following three types of non-vesting conditions:

- conditions that the entity can choose to meet (e.g. continuation of the plan by the entity);
- conditions that the counterparty can choose to meet (e.g. participation in a share purchase programme by paying monthly contributions or transfer restrictions after vesting); and
- conditions that neither the entity nor the counterparty can choose to meet (e.g. an award can be exercised only when the price of gold does not exceed a specified price). [IFRS 2.BC171B, BC364, IG24]

‘Market conditions’ relate to achieving a target share price or specified amount of intrinsic value, or a specified growth in the entity’s share price compared with a similar equity security or index of equity securities. Market conditions under US GAAP are defined similarly to market conditions under IFRS, and, like IFRS, market conditions affect grant-date fair value. [718-10-20]

Like IFRS, US GAAP does not define non-vesting conditions. Under US GAAP, the three types of post-vesting restrictions illustrated under IFRS would be treated as follows:

- conditions that the entity can choose to meet (e.g. continuation of the plan by the entity) – generally, such conditions would be ignored in the recognition and measurement of a share-based payment award unless the conditions were such that there was not a shared understanding of the award, so differences from IFRS may arise in practice;
- conditions that the counterparty can choose to meet (e.g. participation in a share purchase programme by paying monthly contributions) – such conditions would be ignored in the recognition and measurement of a share-based payment award, which may result in differences from IFRS; or transfer restrictions after vesting – such conditions would be incorporated into the grant-date fair value, like IFRS; or
- conditions that neither the entity nor the counterparty can choose to meet (e.g. an award can be exercised only when the price of gold does not exceed a specified price) – unlike IFRS, such conditions would be treated as ‘other’ vesting conditions, resulting in the award being liability-classified. [718-10-25-13]

An award can require the counterparty to meet a performance target in addition to a service condition, with a performance assessment period shorter or longer than the service period. In such instances, in order for the target to be a vesting condition, the period of achieving the performance target:

- cannot extend beyond the end of the service period (including any implicit service period); but
- may start before the service period on condition that the commencement date of the performance target is not substantially before the commencement of the service period. [IFRS 2.A]

The performance target is a non-vesting condition if the performance assessment period extends beyond the end of the service period. [IFRS 2.A]
If an exit event is required to occur during the service period, then it is a non-market performance condition. Conversely, if the exit event applies after the counterparty has become entitled to the share-based payment, then it is a non-vesting condition. [IFRS 2.A]

The entity recognises a share-based payment if the exit event that is a non-market performance condition is more likely than not to be achieved. [IFRS 2.15]

Who is an employee
Employees and others providing similar services are defined as individuals who render personal services to the entity and either:
– they are regarded as employees for legal or tax purposes;
– they work for the entity under its direction in the same way as individuals who are regarded as employees for legal or tax purposes; or
– the services rendered are similar to those rendered by employees. [IFRS 2.A]

The term ‘employee’ encompasses all management personnel – i.e. those persons having authority and responsibility for planning, directing and controlling the activities of the entity, including non-executive directors. [IFRS 2.A]

The requirements for transactions with employees are also applied to transactions with individuals who may not be employees, but provide personal services similar to the services provided by an employee. [IFRS 2.11, A]

Recognition
If the employee is not required to satisfy a specified vesting condition before becoming unconditionally entitled to the instruments granted, then the equity instruments vest immediately. There is no specific guidance in IFRS on whether a fully vested deeply out-of-the-money award contains an implied market condition, and practice may vary. [IFRS 2.14]

Like IFRS, an exit event that is required to occur during the service period is an example of a performance condition. Unlike IFRS, if the exit event applies after the counterparty has become entitled to the share-based payment, then the event is still a performance condition. [718-10-20, 718-10-30-28]

Under US GAAP, ‘probable’ means likely, which is a higher threshold than more likely than not. Additionally, US practice is that an IPO or a change in control are not generally deemed probable of occurring before they actually occur, resulting in later recognition of the cost in comparison to IFRS. [450-20-20]

Who is an employee
An employee is an individual over whom the grantor of a share-based award exercises or has the right to exercise sufficient control to establish an employer-employee relationship based on common law. Although common law includes many of the same characteristics as under IFRS, differences from IFRS may arise in practice. [718-10-20]

Like IFRS, the term ‘employee’ encompasses all management personnel – i.e. those persons having authority and responsibility for planning, directing and controlling the activities of the entity. Although non-executive directors do not meet the definition of common law employees, there is an exception that generally results in them being treated as employees, like IFRS, as long as certain conditions are met. However, differences can arise when preparing Group financial statements and non-executive directors are compensated for service at multiple levels within the group. [718-10-55-91]

The requirements for transactions with employees are also applied to transactions with individuals who may not be employees, but who provide personal services similar to the services provided by an employee. However, US GAAP provides specific requirements that must be met for ‘leased’ employees to be treated as employees, which may create differences from IFRS in practice. [718-10-20]

Recognition
Like IFRS, if an employee is not required to satisfy a specified vesting condition before becoming unconditionally entitled to the award, then the equity instruments vest immediately. Unlike IFRS, US GAAP specifies that the grant of a fully vested deeply out-of-the-money award contains an implied market condition and a service period must be derived for the award. [718-10-20, 10-38]
If the equity instruments do not vest until the employee completes a period of service, then the entity presumes that services are to be provided in the future. The entity accounts for the services as they are received during the vesting period. [IFRS 2.15, IGEx1, IGEx2, IGEx5, IGEx8]

**Modified grant-date method**

The modified grant-date method is used to recognise and measure equity-settled share-based payment transactions. Under this method, the fair value of the equity instruments is measured at grant date, with some true-up for instruments that do not vest (commonly known as ‘forfeiture’). [IFRS 2.19-20, IG9]

**Vesting conditions**

Market conditions are reflected as an adjustment (discount) to the initial estimate of fair value of the instrument to be received at grant date. There is no true-up for differences between estimated and actual vesting due to market conditions. [IFRS 2.21, IG24]

The effect of service conditions and non-market performance conditions on vesting is estimated at grant date, but it is not reflected in the grant-date fair value itself. Instead, it is reflected in attribution, so that the accounting for the share-based payment is based on the number of equity instruments for which the service and non-market performance conditions are expected to be met. Subsequently, these estimates are trued up for differences between the number of instruments expected to vest and the actual number of instruments vested. [IFRS 2.20, IG24]

Under the modified grant-date method, the estimated share-based payment cost is trued up for forfeiture due to an employee failing to meet the service condition. For grant dates on or after 1 July 2014, failure to complete the service period, regardless of the reason – i.e. whether an employee resigns voluntarily or is dismissed by the employer – results in the service condition not being met. [IFRS 2.A, BC368]

Like IFRS, if the equity instruments do not vest until the employee completes a period of service, then the entity presumes that services are to be provided in the future. The entity accounts for the services as they are received during the requisite service (vesting) period, like IFRS. [718-10-35]

**Modified grant-date method**

Like IFRS, the modified grant-date method is used to recognise and measure equity-classified share-based payment transactions. Under this method, like IFRS, the fair value of the equity instruments is measured at grant date, with some true-up for instruments that do not vest (commonly known as ‘forfeiture’). [718-10-30-2 – 30-11]

**Vesting conditions**

Under US GAAP, a market condition is treated as an exercisability condition. However, like IFRS, market conditions are reflected as an adjustment (discount) to the initial estimate of fair value of the instrument to be received at grant date. Like IFRS, there is no true-up for differences between estimated and actual vesting due to market conditions. [718-10-30-14, 30-15]

Unlike IFRS, for public business entities, an entity makes an accounting policy election to account for the effect of forfeitures using one of the following approaches.

- **True-up approach.** Like IFRS, the effect of service conditions and (non-market) performance conditions on vesting is estimated at grant date, but it is not reflected in the grant-date fair value itself. Subsequently, these estimates are trued up for differences between the number of instruments expected to vest and the actual number of instruments vested, like IFRS.
- **Actual approach.** Unlike IFRS, the effect of forfeitures is recognised as they occur, and previously recognised compensation cost is reversed in the period that the award is forfeited. [718-10-35-3]

Like IFRS, other entities apply the true-up approach (see forthcoming requirements). [718-10-30-11 – 30-13]

Like IFRS, under the modified grant-date approach, the estimated share-based payment cost is trued up for forfeiture due to an employee failing to provide the requisite service (e.g. if the employee resigns before the end of the vesting period). Like IFRS, forfeiture accounting also applies if the employer terminates the services of the employee and therefore prevents the required service from being provided. [718-10-35-3]

Unlike IFRS, the termination of an employee that resulted in the forfeiture of share-based awards is not considered to be a cancellation of the awards. [718-10-20]
Similarly, if an employee may be prevented from providing services due to the sale of an operation that results in the termination of employment, then this is considered a forfeiture for grant dates on or after 1 July 2014. [IFRS 2.A, BC368]

Equity-settled transactions are not remeasured subsequent to grant date for fair value changes, unlike cash-settled share-based payments. [IFRS 2.16]

**Multiple vesting conditions**

In our view, in a share-based payment that is subject to both market and non-market performance conditions, the grant-date fair value used to measure the share-based payment should reflect the probability of not achieving the market condition.

In our view, if the non-market performance condition is not satisfied in a share-based payment that is subject to both market and non-market performance conditions, then the entity should true up the cumulative share-based payment cost to zero.

Some share-based payment arrangements may require the satisfaction of both a service condition and at least one of two performance conditions (e.g. one market condition or one non-market performance condition) for the share-based payment arrangement to vest. Such arrangements with multiple vesting conditions are sometimes referred to as containing ‘multiple interactive vesting conditions’.

In our view, a switching approach should be followed by analogy for a grant with multiple interactive vesting conditions. At grant date, the entity should estimate the fair value of the equity instruments for each possible outcome and account for the share-based payment based on the most likely outcome at each reporting date. [IFRS 2.15, 21, IGEx4]

**Non-vesting conditions**

Like market conditions, non-vesting conditions are reflected in measuring the grant-date fair value of the share-based payment and there is no true-up for differences between the expected and actual outcome of non-vesting conditions. [IFRS 2.21A, IG24]

Like IFRS, if an employee is prevented from providing services due to a sale of an operation that results in the termination of employment, then it is considered a forfeiture (unless the transaction is a spin-off, unlike IFRS).

Like IFRS, equity-classified transactions are not remeasured for subsequent changes in the fair value of the award, unlike liability-classified share-based payments. [718-10-35]

**Multiple vesting conditions**

In a share-based payment that is subject to both market and performance conditions, the grant-date fair value used to measure the share-based payment reflects the probability of not achieving the market condition. However, depending on the nature of the interaction between the conditions, differences from IFRS may arise in practice. [718-10-30-15]

Like IFRS, if the performance condition is not satisfied in a share-based payment that is subject to both market and performance conditions, then the entity should true up the cumulative share-based payment cost to zero. [718-10-25-21]

Some share-based payment arrangements may require the satisfaction of both a service condition and at least one of either a performance or a market condition for the share-based payment arrangement to vest. Under US GAAP, the recognition and measurement depend on whether the conditions are ‘or’ or ‘and’ conditions (i.e. whether only one or both conditions must be met).

Unlike IFRS, there is specific guidance on accounting for awards with multiple interactive vesting conditions. Under US GAAP, if it is an ‘or’ condition (i.e. the award should satisfy either the performance or the market condition), then the entity estimates which condition is expected to be achieved, with compensation cost based on the most likely outcome. Like IFRS, the entity reassesses each period and ‘switches’ or adjusts the cumulative compensation cost based on the most likely outcome at each reporting date. [718-10-35, 55-69 – 55-79, 718-10-55-93 – 55-106]

**Non-vesting conditions**

Unlike IFRS, US GAAP does not define non-vesting conditions and the accounting depends on whether the condition is a post-vesting restriction, in which case the condition is incorporated into the grant-date fair value (like IFRS) or an ‘other’ vesting condition, in which case the award is liability-classified (unlike IFRS). [718-10-26-13, 30-10]
If either the entity or the counterparty can choose whether to meet a non-vesting condition and one chooses not to do so during the vesting period, then the failure to meet the condition is treated as a cancellation. Under cancellation accounting, the amount of the cost that would otherwise have been recognised over the remainder of the vesting period is generally recognised immediately in profit or loss. [IFRS 2.28(a), 28A]

If neither the entity nor the counterparty can choose whether to meet a non-vesting condition, then there is no change to the accounting if the non-vesting condition is not satisfied, and the entity continues to recognise the compensation cost over the vesting period. [IFRS 2.21A, IG24]

**Determination of grant date**

The determination of grant date is important because this is the date at which the fair value of equity instruments granted is measured. Usually, the grant date is also the date when recognition of the employee services received begins. [IFRS 2.11]

‘Grant date’ is the date on which the entity and the employee agree to a share-based payment arrangement, and requires that the entity and the employee have a shared understanding of the terms and conditions of the arrangement. If a grant is made subject to approval – e.g. by a board of directors – then the grant date is normally when that approval is obtained. [IFRS 2.A, IG1]

For the employer and the employee to ‘agree’ to a share-based payment transaction, there must be both an offer and an acceptance of that offer. The grant date is not reached until there is acceptance of the offer. The acceptance may be explicit (e.g. by signing a contract) or implicit (e.g. by starting to render services). [IFRS 2.IG2]

If the entity can choose whether to meet a condition such as continuation of the plan and the entity chooses not to do so during the vesting period, then the action by the entity is treated as a cancellation, like IFRS. Under cancellation accounting, the amount of the cost that would otherwise have been recognised over the remainder of the vesting period is recognised immediately in profit or loss, like IFRS.

Unlike IFRS, conditions that the counterparty can choose to meet (e.g. participation in a share purchase programme by paying monthly contributions) are ignored and treated as notification of intent not to exercise, resulting in continuing recognition of cost over the requisite service period. [718-50-35-2]

Conditions that neither the entity nor the counterparty can choose to meet (e.g. an award can be exercised only when the price of gold exceeds a specified price) are treated as ‘other’ vesting conditions, resulting in the award being liability-classified, unlike IFRS. [718-10-25-13]

**Determination of grant date**

Like IFRS, grant date is the date on which the fair value of the equity instruments granted is measured. Usually, grant date is also the date on which recognition of the employee services received begins. However, unlike IFRS, US GAAP has explicit guidance on when the service inception date precedes the grant date. [718-10-20, 25-6]

The ‘grant date’ is the date on which the employer and employee have a mutual understanding of the terms and conditions of the award, like IFRS. However, unlike IFRS, the employee also must begin to benefit from or be adversely affected by changes in the employer’s share price, which results in differences in practice from IFRS for certain awards. Like IFRS, the grant date cannot occur before approval is obtained unless approval is perfunctory. [718-10-25-5, 718-10-55-81 – 55-83]

The definition of the grant date does not require explicit employee acceptance; however, for broad-based awards there needs to be employee notification of the award within a reasonable period of time of the decision to grant awards. As a result, differences from IFRS may arise in practice. [718-10-55-81 – 55-82]
In our view, there will not generally be ‘agreement on terms and conditions’ if the outcome is based primarily on subjective factors – e.g. if the number of shares to be awarded is a discretionary determination of a compensation committee at the end of the service period.

**Determination of vesting period**

The ‘vesting period’ is the period during which all of the specified vesting conditions are to be satisfied for the employees to be unconditionally entitled to the equity instrument. This is normally the period between grant date and vesting date. [IFRS 2.A]

If the grant date occurs after service commencement date, then the entity estimates the grant-date fair value of the equity instruments for the purpose of recognising the services from service commencement date until grant date. Once the grant date has been established, the entity revises its earlier estimates. [IFRS 2.IG4]

It is possible for the service commencement date to be before the award is approved. [IFRS 2.IG4]

**Graded vesting**

In some situations, the equity instruments granted vest in instalments over the specified vesting period. Assuming that the only vesting condition is service from the grant date to the vesting date of each tranche, each instalment is accounted for as a separate share-based payment arrangement and there will be different fair values and vesting periods for each tranche. [IFRS 2.IG11]

Like IFRS, there will not generally be ‘agreement on terms and conditions’ if the outcome is primarily based on subjective factors – e.g. if the number of shares to be awarded is a discretionary determination of a compensation committee at the end of the service period. However, the evaluation of whether the factors are sufficiently subjective to preclude the conclusion that a grant date has occurred requires judgement, and therefore differences from IFRS may arise in practice. [718-10-20]

**Determination of requisite service period**

The ‘requisite service period’ is the period during which an employee is required to provide service in exchange for an award. Normally, the period between grant date and vesting date is the requisite service period, like IFRS; however, because there are differences in guidance on the service inception date, grant date and vesting conditions, differences from IFRS can arise in practice. [718-10-20, 718-10-35]

Like IFRS, when the grant date occurs after the service inception date, the entity estimates the grant-date fair value of the equity instruments for the purpose of recognising the services from service inception date until grant date. Each period until the grant date has been established, the entity revises its earlier estimates, like IFRS. [718-10-35-6, 718-10-55-108]

Like IFRS, the service inception date can occur before the award is approved. However, because US GAAP has explicit guidance on when a service inception date precedes a grant date, differences from IFRS may arise in practice. [718-10-55-108]

**Graded vesting**

US GAAP allows entities with equity instruments vesting in tranches based only on service conditions to make an accounting policy election to recognise compensation cost either:

- based on each separately vesting tranche (graded vesting), like IFRS; or
- ratably over the period of the longest vesting tranche, subject to a ‘floor’ that the minimum amount of cumulative compensation cost recognised is not less than the portion of the award vested to date, unlike IFRS. [718-10-35-8, 718-10-55-108]

Unlike IFRS, regardless of which attribution policy is chosen, the entity may also choose to determine a separate grant-date fair value for each tranche or to value the entire award using a single grant-date fair value measure. [718-10-30-3]
**Determination of the type of equity instruments granted**

In an employee share purchase plan (ESPP), the employees are usually entitled to purchase shares at a discounted price. [IFRS 2.IG17]

In our view, the predominant feature of the share-based payment arrangement determines the accounting for the entire fair value of the grant – either as an ESPP or as an option plan.

In our view, the principal characteristic of an ESPP is the right to buy shares at a discount to current market prices. ESPPs that grant short-term fixed purchase prices do not have significant option characteristics, because they do not allow the grant holder to benefit from volatility. We believe that ESPPs that provide a longer-term option to buy shares at a specified price are, in substance, option plans, and should be accounted for as such. [IFRS 2.B4–B41]

**Measurement**

**Determining the fair value of equity instruments granted**

Share-based payment transactions with employees are measured with reference to the fair value of the equity instruments granted. [IFRS 2.11]

The fair value of the equity instruments granted is determined as follows.
- If market prices are available for the equity instruments granted, then the estimate of fair value is based on these market prices.
- If market prices are not available for the equity instruments granted, then the fair value of equity instruments granted is estimated using a valuation technique. [IFRS 2.16–17]

Post-vesting restrictions are included in the grant-date measurement of fair value to the extent that the restriction affects the price that a knowledgeable, willing market participant would pay for the equity instrument granted. [IFRS 2.B3, B10, IU 11-06]

The share-based payment standard generally requires the use of the fair value-based method, except in rare cases when fair value cannot be estimated reliably. In these cases, the instrument would be measured at intrinsic value subject to remeasurement until settlement. [IFRS 2.16–17, 24]

**Determination of the type of equity instruments granted**

Like IFRS, in an employee share purchase plan (ESPP), the employees are usually entitled to purchase shares at a discounted price. [718-50-55-22]

Like IFRS, the predominant feature of the share-based payment arrangement determines the accounting for the entire fair value of the grant. [718-10-15-3]

Unlike IFRS, ESPPs with an option feature are treated as a grant of a share option and not a share, regardless of the length of the option period. Unlike IFRS, if a small discount (normally 5 percent or less) is offered and certain other conditions are met, then such awards are treated as non-compensatory – i.e. compensation cost is not recognised. [718-50-25, 50-30-1 – 30-3]

**Measurement**

**Determining the fair value of equity instruments granted**

Like IFRS, share-based payment transactions with employees are measured with reference to the fair value of the equity instruments granted. [718-10-30]

Like IFRS, the fair value of the equity instruments granted is determined as follows.
- If market prices are available for the equity instruments granted, then the estimate of fair value is based on these market prices.
- If no market prices are available for the equity instruments granted, then the fair value of equity instruments granted is estimated using a valuation technique. [718-10-30]

Like IFRS, post-vesting restrictions are included in the grant-date measurement of fair value if the shares obtained on exercise are restricted beyond the vesting period. However, as explained under performance conditions, unlike IFRS, performance conditions with assessment periods that are longer than the service period are not considered post-vesting restrictions, so differences can arise in practice for those types of awards. [718-10-30]

Like IFRS, US GAAP generally requires the use of the fair value-based method, except in the rare circumstances that fair value cannot be estimated reliably. In these cases, the instrument would be measured at intrinsic value subject to remeasurement until settlement, like IFRS. However, unlike IFRS, US GAAP allows non-public entities to measure share-based awards using the calculated-value method, if certain restrictive conditions are met. [718-10-30-2, 30-20 – 30-22]
**Dividends**

If the employees are not entitled to dividends declared during the vesting period, then the fair value of these equity instruments is reduced by the present value of dividends expected to be paid compared with the fair value of equity instruments that are entitled to dividends. [IFRS 2.B34]

In our view, forfeitable dividends should be treated as dividend entitlements during the vesting period. If the vesting conditions are not met, then any true-up of the share-based payment would automatically recognise the profit or loss effect of the forfeiture of the dividend because the dividend entitlements are reflected in the grant-date fair value of the award.

In our view, two approaches are acceptable in accounting for non-forfeitable dividends. [IFRS 2.B31–B36]

One approach is to treat non-forfeitable dividends as a dividend entitlement during the vesting period in determining the grant-date fair value of the share-based payment. The value of the dividend right is reflected in the grant-date fair value of the share-based payment, and therefore increases the cost of the share-based payment. If the share-based payment does not vest, then in our view the total amount previously recognised as a share-based payment cost should be split into: (1) the value for the non-forfeitable dividends; and (2) the balance of the share-based payment. We believe that only the balance of the share-based payment cost (the amount excluding the non-forfeitable dividends) would be subject to any true-up for failure to satisfy vesting conditions in order to reflect the benefit retained by the employee.

The other approach is to view non-forfeitable dividends as a payment for services with vesting conditions different from the vesting conditions of the underlying share-based payment. Under this approach, the dividend rights would be considered to be a benefit (e.g. under the employee benefits standard – see chapter 4.4) rather than a share-based payment, because dividends are unlikely to be based on the price or value of the entity’s equity instruments.

**Dividends**

Like IFRS, if the employees are not entitled to dividends declared during the vesting period, then the fair value of these equity instruments is reduced by the present value of dividends expected to be paid compared with the fair value of equity instruments that are entitled to dividends. [718-10-55-23]

Under US GAAP, forfeitable dividends are included in the measure of the grant-date fair value of the award, like IFRS. If the vesting conditions are not met, then any true-up of the share-based payment would automatically recognise the profit or loss effect of the forfeiture of the dividend because the dividend entitlements are reflected in the grant-date fair value of the award, like IFRS. [718-10-55-45]

Unlike IFRS, non-forfeitable dividends paid on awards that are expected to vest are charged to retained earnings, whereas non-forfeitable dividends paid on awards expected to be forfeited are recognised as additional compensation cost. The estimate of compensation cost for non-forfeitable dividends on awards not expected to vest is revised throughout the vesting period and ultimately trued up to the actual number of forfeitures. [718-10-55-45]
Cash-settled transactions with employees

Cash-settled share-based payment transactions result in a liability, generally an obligation to make a cash payment, based on the price of the equity instrument (e.g. share price). For cash-settled share-based payment transactions with employees, the services received and the liability incurred are initially measured at the fair value of the liability at grant date, and the liability is remeasured until settlement. The entity recognises the service received and the liability to pay for those services, as the employees render service during the vesting period. [IFRS 2.30–33]

At each reporting date, and ultimately at settlement date, the fair value of the recognised liability is remeasured. Remeasurements during the vesting period are recognised immediately to the extent that they relate to past services, and spread over the remaining vesting period (together with the initial fair value of the liability) to the extent that they relate to future services. The total net cost recognised in respect of the transaction is the amount paid to settle the liability. [IFRS 2.IG19, 30, 32]

Remeasurements after the vesting period are recognised immediately in full in profit or loss. [IFRS 2.33]

Only the grant-date fair value of the arrangement may qualify for asset recognition under other IFRSs. Accordingly, the remeasurement of the liability is recognised in profit or loss. However, there is no guidance on whether the remeasurement should be presented as an employee cost or as finance income or finance costs. In our view, an entity should choose an accounting policy, to be applied consistently, between these presentations. [IFRS 2.IG19, BC252–BC255]

Market conditions and non-market performance conditions

All terms and conditions are considered in determining the fair value of a cash-settled share-based payment. [IFRS 2.33]

Liability-classified transactions with employees

Like IFRS, liability-classified share-based payment transactions result in a liability measured at fair value at grant date. However, as described above, the circumstances under which an award is liability-classified differ from awards being classified as cash-settled under IFRS. Like IFRS, for liability-classified share-based payment transactions with employees, the services received and the liability incurred are initially measured at the fair value of the liability at grant date, and the liability is remeasured until settlement. The entity recognises the service received and the liability to pay for those services, as the employees render service during the vesting period, like IFRS. [718-10-35]

Unlike IFRS, non-public entities are permitted to elect to measure liability-classified awards using intrinsic value rather than fair value. [718-30-30-2]

Like IFRS, at each reporting date, and ultimately at settlement date, the fair value of the recognised liability is remeasured. Like IFRS, remeasurements during the vesting period are recognised immediately to the extent that they relate to past services, and spread over the remaining vesting period (together with the initial fair value of the liability) to the extent that they relate to future services. The total net cost recognised in respect of the transaction is the amount paid to settle the liability, like IFRS. [718-10-30-3, 30-35-2]

Like IFRS, remeasurements after the vesting period are recognised immediately in full in profit or loss. [718-30-35-2]

Like IFRS, entities may use only the grant-date fair value of the arrangement as the basis for capitalisation under other Codification topics/subtopics. Unlike IFRS, entities may also choose a policy, to be applied consistently, of considering both the grant-date fair value of the arrangement and the remeasurement of the liability during the vesting period as the basis for capitalisation, if appropriate, under the relevant Codification topic. Unlike IFRS, the remeasurement is presented as an employee cost. [718-30-35-2, 718-10-S99, SAB Topic 14F]

Market conditions and performance conditions

Like IFRS, all terms and conditions, subject to specified exceptions (e.g. reload features and vesting conditions) are considered in determining the fair value of a cash-settled share-based payment. [718-10-35-5]
In our view, an entity should choose an accounting policy, to be applied consistently to all cash-settled share-based payments, to measure the fair value of a cash-settled liability taking into account either:

- only market and non-vesting conditions; or
- all vesting and non-vesting conditions, including service conditions and non-market performance conditions. See forthcoming requirements.

Grants of equity instruments that are redeemable are classified as cash-settled share-based payments under certain conditions, depending on which party has the option to redeem. [IFRS 2.31]

In our view, for a grant of options to acquire redeemable shares, the settlement of the share-based payment occurs only on redemption of the shares and not on exercise of the options. An entity therefore should recognise compensation cost and a corresponding cash-settled liability equal to the grant-date fair value of the options; this liability should be remeasured at each reporting date. At the date on which the option is exercised, the fair value of the share, and therefore of the liability recognised for the redeemable shares, will be equal to the sum of the exercise price and the intrinsic value of the option. Once the option is exercised, we believe that the entity should remeasure the cash-settled liability at fair value through profit or loss until the shares are redeemed. [IFRS 2.30–31]

**Employee transactions with a choice of settlement**

**Employee’s choice**

If the employee has the choice of settlement, then the entity has granted a compound financial instrument that includes a liability component and an equity component. At the measurement date, the fair value of the compound instrument (the value of services to be received) is the sum of the values of the liability component and the equity component. The liability component is measured first. All of the fair value of the grant is recognised as a liability if the employee has to surrender the cash settlement right to receive the equity alternative with the same fair value. As a result, the incremental value of the equity component is zero, unless the employee receives a discount for choosing the equity alternative. [IFRS 2.35–38]

Unlike IFRS, an entity includes market and ‘other’ conditions as well as post-vesting restrictions in measuring the fair value of a liability-classified award. Service and performance conditions are not included in the fair value measurement. [718-30-30-1]

Unlike IFRS, an equity relationship has been established such that the employee is exposed to the economic risks and rewards of share ownership for a reasonable period of time (at least six months), then redeemable shares are equity-classified. However, unlike IFRS, SEC registrants may be required to classify the awards as temporary equity, between liabilities and equity, in the statement of financial position. [480-10-599, 718-10-25-9]

Unlike IFRS, grants of options to acquire redeemable shares may be equity-classified, depending on the circumstances. If the employee is required to hold the shares for at least six months after exercise before the shares are redeemed, and the award will be redeemed at fair value, then the award is equity-classified. Additionally, in certain circumstances, redeemable shares of non-public entities are classified as equity and, as such, options to acquire such redeemable shares are equity-classified. If the options are equity-classified, then there is no remeasurement of the award after grant date. [718-10-25-8 – 25-9]

**Employee transactions with a choice of settlement**

**Employee’s choice**

Unlike IFRS, if the employee has the choice of settlement, then the award is generally liability-classified in its entirety. Under US GAAP, combination awards – i.e. an award with two (or more) components in which exercise of one part does not cancel the other(s) – might be treated like a compound instrument. However, these situations are not necessarily the same as under IFRS, and there may be differences in practice. Like IFRS, if the employee has the choice of settlement and the payoffs are the same for both the equity and the cash settlement feature, then the entire amount is recognised as a liability. As an exception, unlike IFRS, if the employee is required to hold the shares for at least six months after exercise before settlement, and the award will be settled at fair value, then the award is equity-classified. [718-10-25]
**Entity’s choice**

If the entity has the choice of settlement, then it accounts for the transaction either as a cash-settled share-based payment or as an equity-settled share-based payment in its entirety. If the entity has a present obligation to settle in cash, then it accounts for the transaction as a cash-settled share-based payment; otherwise, it accounts for the transaction as an equity-settled share-based payment. [IFRS 2.41-43]

If the entity has the *stated intent to settle in equity instruments*, then it does not have a present obligation to settle in cash, unless it has a past practice of settling in cash or no ability to settle in equity instruments. [IFRS 2.41]

If the entity has the *stated intent to settle in cash*, then it has a present obligation to settle in cash, regardless of its past practice. [IFRS 2.41]

If the entity *does not have a stated intent*, then it classifies the transaction as cash-settled if it has either a past practice of settling in cash or no ability to settle in equity instruments; otherwise, the transaction is classified as equity-settled. [IFRS 2.41]

**Modifications and cancellations of employee transactions**

**Modifications that do not change the classification of an arrangement**

Modifications to equity-settled share-based payment transactions that *decrease* the fair value of the grant are generally ignored. When the fair value of the grant *increases* due to a modification, then the incremental fair value of the modified grant is accounted for in addition to the original grant. [IFRS 2.27, B43(a)]

If the modification increases the fair value of the share-based payment granted, then the incremental fair value is recognised over the remaining modified vesting period, whereas the balance of the grant-date fair value is recognised over the remaining original vesting period. [IFRS 2.843(a)]

**Entity’s choice**

Like IFRS, if the entity has the choice of settlement, then it accounts for the transaction either as a liability-classified share-based payment or as an equity-classified share-based payment in its entirety. Like IFRS, if the entity has a present obligation to settle in cash, then it accounts for the transaction as a liability-classified share-based payment; otherwise, it accounts for the transaction as an equity-classified share-based payment. [718-10-25-6 – 25-19]

Like IFRS, if the entity has the *stated intent to settle in equity instruments*, then it does not have a present obligation to settle in cash, unless it has a practice of settling in cash or no ability to settle in equity instruments. [718-10-25-15]

Like IFRS, if the entity has the *stated intent to settle in cash*, then it has a present obligation to settle in cash, regardless of its past practice. [718-10-25-15]

Like IFRS, if the entity *does not have a stated intent*, then it classifies the transaction as liability-classified if it has either a past practice of settling in cash or no ability to settle in equity instruments; otherwise, the transaction is classified as equity-classified, like IFRS. [718-10-25-15]

**Modifications and cancellations of employee transactions**

**Modifications that do not change the classification of an arrangement**

Like IFRS, modifications to equity-classified share-based payment transactions that decrease the fair value of the grant are generally ignored (see forthcoming requirements). When the fair value of the grant increases due to a modification, then the incremental fair value of the modified grant is accounted for in addition to the original grant, like IFRS. However, unlike IFRS, an ‘improbable-to-probable’ modification is accounted for as a new award. Depending on the facts and circumstances, this may result in a lower amount of compensation cost than the grant date fair value of the original award or a greater amount of compensation costs than the sum of the grant date fair value of the original award plus the incremental fair value, unlike IFRS. [718-20 35-3]

If the modification increases the fair value of the share-based payment granted, then the incremental value of the modified grant as compared with the fair value of the original grant at the date of modification is accounted for in addition to the grant-date fair value of the original grant. If the revised service period for the modified award is longer than the remaining portion of the original service period, then there is a policy choice to recognise the total amount of remaining compensation over the revised service period, unlike IFRS, or to account for the remaining amount of compensation for the original award over the remaining portion of the original service period and the incremental compensation from the modified award over the revised service period, like IFRS. [718-20 35-3, 55-98]
If the modification changes a market condition, then the impact of the change is treated as a change in the fair value of the award. [IFRS 2.B43(a), (c)]

If a modification increases the number of equity instruments granted, then the entity recognises the fair value of the additional equity instruments, measured at the date of modification. The additional share-based payment cost is attributed over the period from the date of modification to the end of the vesting period of the additional equity instruments. [IFRS 2.B43(b)]

If the modification changes a service condition or non-market performance condition in a manner that is beneficial to an employee, then the remaining grant-date fair value is recognised using the revised vesting expectations with true-up to actual outcomes. [IFRS 2.B43(c)]

Like IFRS, when an award with a market condition is modified, the probability of satisfying the original condition does not affect the recognition of compensation cost because the market condition has been incorporated into the grant-date fair value measurement and the impact of the change is treated as a change in the fair value of the award, like IFRS. [718-20 35-3, 55-108, 55-116]

Like IFRS, if a modification increases the number of equity awards granted (outside of a capital restructuring), then the entity will measure the fair value of the additional equity instruments at the date of modification. Also like IFRS, the incremental share-based payment cost is attributed over the period from the date of modification to the end of the vesting period of the additional equity instruments. [718-20 35-3, 35-6]

Like IFRS, if the modification changes a service condition or performance condition in a way that is beneficial to an employee, then the remaining grant-date fair value is recognised using the revised vesting expectations and requisite service period with true-up to actual outcomes. However, unlike IFRS, if the original award was improbable of vesting under its original terms, then the fair value at the date of the modification, which could be less than the original grant-date fair value, is recognised using the revised vesting expectations with true-up to actual outcomes. [718-20 35-3, 55-108, 55-116]

Under US GAAP, a modification for a performance condition of a share-based payment arrangement results in recognition of the grant-date fair value of the award if both the original and the modified performance conditions are probable of achievement, or of the fair value of the modified award if the modified performance condition is probable and the original performance condition was not probable of achievement at the date of the modification, which may result in differences from IFRS in practice. [718-20 55]

A package of modifications might include several changes to the terms of a grant, some of which are favourable to the employee whereas other changes are not. In our view, it is appropriate to net the effects of all modifications, provided that they are agreed as part of a package. If the net effect is beneficial, then we believe that this net effect is accounted for by applying the requirements for beneficial modifications to the net change. If the modification changes a market condition, then the impact of the change is treated as a change in the fair value of the award. [IFRS 2.B43(a), (c)]

If a modification increases the number of equity instruments granted, then the entity recognises the fair value of the additional equity instruments, measured at the date of modification. The additional share-based payment cost is attributed over the period from the date of modification to the end of the vesting period of the additional equity instruments. [IFRS 2.B43(b)]

If the modification changes a service condition or non-market performance condition in a manner that is beneficial to an employee, then the remaining grant-date fair value is recognised using the revised vesting expectations with true-up to actual outcomes. [IFRS 2.B43(c)]

Like IFRS, when an award with a market condition is modified, the probability of satisfying the original condition does not affect the recognition of compensation cost because the market condition has been incorporated into the grant-date fair value measurement and the impact of the change is treated as a change in the fair value of the award, like IFRS. [718-20 35-3, 55-108, 55-116]

Like IFRS, if a modification increases the number of equity awards granted (outside of a capital restructuring), then the entity will measure the fair value of the additional equity instruments at the date of modification. Also like IFRS, the incremental share-based payment cost is attributed over the period from the date of modification to the end of the vesting period of the additional equity instruments. [718-20 35-3, 35-6]

Like IFRS, if the modification changes a service condition or performance condition in a way that is beneficial to an employee, then the remaining grant-date fair value is recognised using the revised vesting expectations and requisite service period with true-up to actual outcomes. However, unlike IFRS, if the original award was improbable of vesting under its original terms, then the fair value at the date of the modification, which could be less than the original grant-date fair value, is recognised using the revised vesting expectations with true-up to actual outcomes. [718-20 35-3, 55-108, 55-116]

Under US GAAP, a modification for a performance condition of a share-based payment arrangement results in recognition of the grant-date fair value of the award if both the original and the modified performance conditions are probable of achievement, or of the fair value of the modified award if the modified performance condition is probable and the original performance condition was not probable of achievement at the date of the modification, which may result in differences from IFRS in practice. [718-20 55]

A package of modifications might include several changes to the terms of a grant, some of which are favourable to the employee whereas other changes are not. In our view, it is appropriate to net the effects of all modifications, provided that they are agreed as part of a package. If the net effect is beneficial, then we believe that this net effect is accounted for by applying the requirements for beneficial modifications to the net change. If the modification changes a market condition, then the impact of the change is treated as a change in the fair value of the award. [IFRS 2.B43(a), (c)]

If a modification increases the number of equity instruments granted, then the entity recognises the fair value of the additional equity instruments, measured at the date of modification. The additional share-based payment cost is attributed over the period from the date of modification to the end of the vesting period of the additional equity instruments. [IFRS 2.B43(b)]

If the modification changes a service condition or non-market performance condition in a manner that is beneficial to an employee, then the remaining grant-date fair value is recognised using the revised vesting expectations with true-up to actual outcomes. [IFRS 2.B43(c)]

Like IFRS, when an award with a market condition is modified, the probability of satisfying the original condition does not affect the recognition of compensation cost because the market condition has been incorporated into the grant-date fair value measurement and the impact of the change is treated as a change in the fair value of the award, like IFRS. [718-20 35-3, 55-108, 55-116]

Like IFRS, if a modification increases the number of equity awards granted (outside of a capital restructuring), then the entity will measure the fair value of the additional equity instruments at the date of modification. Also like IFRS, the incremental share-based payment cost is attributed over the period from the date of modification to the end of the vesting period of the additional equity instruments. [718-20 35-3, 35-6]

Like IFRS, if the modification changes a service condition or performance condition in a way that is beneficial to an employee, then the remaining grant-date fair value is recognised using the revised vesting expectations and requisite service period with true-up to actual outcomes. However, unlike IFRS, if the original award was improbable of vesting under its original terms, then the fair value at the date of the modification, which could be less than the original grant-date fair value, is recognised using the revised vesting expectations with true-up to actual outcomes. [718-20 35-3, 55-108, 55-116]

Under US GAAP, a modification for a performance condition of a share-based payment arrangement results in recognition of the grant-date fair value of the award if both the original and the modified performance conditions are probable of achievement, or of the fair value of the modified award if the modified performance condition is probable and the original performance condition was not probable of achievement at the date of the modification, which may result in differences from IFRS in practice. [718-20 55]

A package of modifications might include several changes to the terms of a grant, some of which are favourable to the employee whereas other changes are not. In our view, it is appropriate to net the effects of all modifications, provided that they are agreed as part of a package. If the net effect is beneficial, then we believe that this net effect is accounted for by applying the requirements for beneficial modifications to the net change.
Modifications that change the classification of an arrangement

Not all changes to the classification of a share-based payment arrangement are modifications. In our view, the factors to consider in determining whether the change is a modification include the following:

- whether the different possible outcomes were contemplated when the award was granted; and
- whether the change is triggered by the entity or by an event that is outside the entity’s control.

A change from equity-settled to cash-settled arising from a modification would occur if, for example, a cash alternative at the employee’s discretion is subsequently added to an equity-settled share-based payment that results in its reclassification as a financial liability. Such a modification leads to a reclassification, at the date of modification, of an amount equal to the fair value of the liability from equity to liability, apportioned for the service provided to date. [IFRS 2.27, IGEx9]

If the amount of the liability recognised on the modification date is less than the amount previously recognised in equity, then no gain is recognised for the difference between the amount recognised to date in equity and the apportioned fair value of the liability; that difference remains in equity. Subsequent to the modification, the entity continues to recognise the grant-date fair value of equity instruments granted as the cost of the share-based payment. However, any subsequent remeasurement of the liability (from the date of modification until settlement date) is also recognised in profit or loss. [IFRS 2.IGEx9]

If the amount of the liability recognised on the modification date is greater than the amount previously recognised as an increase in equity, then in our view two approaches are acceptable for recognising the excess liability. We believe that an entity should choose an accounting policy, to be applied consistently, to recognise either:

- the excess as an expense in profit or loss at the modification date; or
- the entire liability as a reclassification from equity and not recognise any loss in profit or loss. In our view, it is appropriate for no gain or loss to be recognised when a change in the terms of a compound instrument leads to reclassification as a financial liability provided that the liability at the date of modification is not greater than the fair value of the original equity-settled award at the date of modification.

Unlike IFRS, a change in the classification of a share-based payment award is a modification. [719-20-55-122]

Like IFRS, a modification may lead to a change in the classification of a share-based payment transaction. For example, a modification may change the classification from equity-classified to liability-classified. Such a modification leads to the recognition, at the date of modification, of an amount equal to the fair value of the liability, apportioned for the service provided to date, like IFRS. [718-20-55-123 – 55-133]

Like IFRS, if the amount of the liability recognised is less than the amount previously recognised in equity, then no gain is recognised for the difference between the amount recognised to date in equity and the apportioned fair value of the liability; that difference remains in equity, like IFRS. Subsequent to the modification, the entity continues to recognise the grant-date fair value of equity instruments granted as the cost of the share-based payment, like IFRS. Any subsequent remeasurement of the liability (from the modification date until settlement date) is only recognised in profit or loss if the subsequent fair value of the liability is in excess of the grant date fair value of the award, unlike IFRS. [718-20-55-127]

Unlike IFRS, if a modification results in a change in classification of an award from equity to liability, then cumulative compensation cost recognised is the greater of the grant-date fair value of the original award and the fair value of the modified liability award when it is settled. Therefore, unlike IFRS, any excess of the fair value of the award at the modification date over the amount in equity would be recognised in profit of loss at the date of the modification. [718-20-55-128]
A change from cash-settled to equity-settled arising from a modification would occur if, for example, a new equity-settled share-based payment arrangement is identified as a replacement of a cash-settled share-based payment arrangement. In our view, an entity should choose an accounting policy, to be applied consistently, to account for these modifications by either:

- analogising to the principles on the modification of equity-settled share-based payments; or
- as a settlement and a replacement of a share-based payment, so that the future share-based payment cost is based on the modification-date fair value of the award. See forthcoming requirements.

Unlike IFRS, for public business entities, to account for a modification from a liability-classified to an equity-classified share-based payment, at the modification date an entity:

- derecognises the liability for the original liability-classified share-based payment;
- measures the equity-classified share-based payment at its fair value as at the modification date and recognises that fair value to the extent that the services have been rendered up to that date; and
- immediately recognises the difference between the carrying amount of the liability and the amount recognised in equity in profit or loss. [718-20-55-135 – 55-138]

Unlike IFRS, for other entities, a modification to an award that results in the award changing from liability-classified to equity-classified is required to be accounted for based on a final measurement of the award as a liability plus incremental compensation, if any, arising from the modification (see forthcoming requirements). [718-20-55-135 – 55-138]

**Cancellations, replacements, settlements**

Cancellations or settlements of equity-settled share-based payments during the vesting period by the entity or by the counterparty are accounted for as accelerated vesting. The amount that would otherwise have been recognised for services received is recognised immediately. [IFRS 2.28(a), 28A, IGEx9A]

If an entity identifies a new equity-settled arrangement as a replacement for a cancelled equity-settled arrangement, then the entity accounts for the grant of replacement equity instruments as a modification of the original arrangement. If the entity does not make this identification, then both awards are accounted for separately. [IFRS 2.28(c)]

Like IFRS, if an entity identifies a new equity-classified arrangement as a replacement for a cancelled equity-classified arrangement, then the entity accounts for the grant of replacement equity instruments as a modification of the original arrangement. If the entity does not make this identification, then both awards are accounted for separately, like IFRS. [718-20-35-8, 35-9]

**Group share-based payment arrangements**

If a shareholder grants equity instruments, or a cash payment based on those equity instruments, of the reporting entity’s parent or another entity in the same group as the reporting entity to parties that have supplied goods or services to the reporting entity, then that grant is a group share-based payment transaction. [IFRS 2.3A]

US GAAP does not have specific guidance on group share-based payment arrangements. However, if the shareholder grants equity instruments, or a cash payment based on those equity instruments, of the reporting entity’s parent or another entity in the same group as the reporting entity to parties that have supplied goods or services to the reporting entity, then that grant is a group share-based payment transaction, like IFRS. [718-10-15]
A ‘common group share-based payment transaction involving shareholders’ arises when a parent grants its equity instruments to employees of a subsidiary as compensation for services provided by the employees to the subsidiary. Such a transaction is in the scope of the share-based payment standard in the financial statements of the subsidiary and from the perspective of the parent. [IFRS 2.3A, B52(a)]

If a reporting entity grants equity instruments of its parent or equity instruments of another entity in the same group as the reporting entity (or a cash payment based on those equity instruments) to parties that have supplied goods or services to the reporting entity, then such a transaction is in the scope of the share-based payment standard from the perspective of the reporting entity. [IFRS 2.3A, B52(b)]

If a reporting entity grants its own equity instruments, or a cash payment based on those equity instruments, to parties that have supplied goods or services to another entity in the group, then the transaction is in the scope of the share-based payment standard from the perspective of the reporting entity. [IFRS 2.3A]

A transaction in which the reporting entity receives services from its employees and the employees receive equity instruments of a shareholder that is not a group entity (e.g, an equity-accounted investee), or a cash payment based on those equity instruments, is outside the scope of the share-based payment standard from the perspective of the reporting entity. [IFRS 2.2A]

If a shareholder that is not a group entity settles by granting equity instruments of the receiving entity (or a cash payment based on those equity instruments), then the transaction is in the scope of the share-based payment standard from the perspective of the receiving entity. [IFRS 2.4A]

Classification of group share-based payment arrangements
If the entity either has an obligation to settle in its own equity instruments or has no obligation to settle, then the transaction is accounted for as equity-settled. A settling entity that is not a receiving entity classifies a share-based payment transaction as equity-settled if it settles in its own equity instruments; otherwise, it classifies the transaction as cash-settled. [IFRS 2.43A-C]

Like IFRS, if a reporting entity grants equity instruments of its parent or equity instruments of another entity in the same group as the reporting entity (or a cash payment based on those equity instruments) to parties that have supplied goods or services to another entity in the group, then the transaction is in the scope of the share-based payment Codification Topic from the perspective of the reporting entity. [718-10-15]

Share-based payments awarded to employees of an entity from other related parties or other economic interest holders are in the scope of the share-based payment Codification Topic unless the transfer is clearly for purposes other than compensation for goods or services received by the entity; therefore, differences from IFRS may arise in practice. The substance of such a transaction is that the economic interest holder makes a capital contribution to the reporting entity, and that entity makes a share-based payment to its employee in exchange for services rendered. [718-10-15]

Like IFRS, equity-classified share-based payment transactions made directly by shareholders on behalf of the entity are in the scope of the share-based payment Codification Topic from the perspective of the receiving entity. [718-10-15]
In a typical group share-based payment arrangement involving the parent and a subsidiary, separate classification assessments are made from the perspective of the consolidated financial statements of the parent and the consolidated financial statements (if any) of the subsidiary. Separate classification assessments are also made in any separate financial statements of the parent and/or subsidiary, which are outside the scope of this publication.

**Accounting for a group share-based payment arrangement**

A receiving entity that has no obligation to settle the transaction with the counterparty to the share-based payment transaction accounts for the transaction as equity-settled and recognises an expense (unless the goods or services received qualify for recognition as an asset) and an increase in its equity for the contribution received from the parent. [IFRS 2.B53]

Unlike IFRS, a receiving entity that has no obligation to settle the transaction with the counterparty to the share-based payment transaction generally accounts for the transaction in the same manner as the transaction is accounted for in the parent’s consolidated financial statements and, like IFRS, recognises an expense (unless the goods or services received qualify for recognition as an asset). The credit would be recognised as an increase in equity for the contribution received from the parent for equity-classified awards (like IFRS) or as either a credit to equity or a liability for liability-classified awards (unlike IFRS).

In our view, a settling entity with no direct or indirect investment in the entity receiving the services in a group share-based payment arrangement should recognise the cost of the share-based payment in equity as a distribution to its parent over the vesting period.

**Employee benefit trusts**

A plan sponsor may transfer or sell sufficient shares to enable a trust to meet obligations under share-based payment arrangements not only for current periods but also for future periods. In our view, the transfer of shares to an employee benefit trust does not represent a share-based payment transaction. Rather, the share-based payment arrangement is the arrangement between the employer and employees for which a grant date needs to be identified, generally based on the date on which the sponsor enters into an agreement with the employees.

Unlike IFRS, in a typical group share-based payment arrangement involving the parent and a subsidiary, the classification assessment is made only from the perspective of the consolidated financial statements of the parent.

**Accounting for a group share-based payment arrangement**

Unlike IFRS, a receiving entity that has no obligation to settle the transaction with the counterparty to the share-based payment transaction generally accounts for the transaction in the same manner as the transaction is accounted for in the parent’s consolidated financial statements and, like IFRS, recognises an expense (unless the goods or services received qualify for recognition as an asset). The credit would be recognised as an increase in equity for the contribution received from the parent for equity-classified awards (like IFRS) or as either a credit to equity or a liability for liability-classified awards (unlike IFRS).

Like IFRS, a settling entity with no direct or indirect investment in the entity receiving the services in a group share-based payment arrangement should recognise the cost of the share-based payment in equity as a distribution to its parent. There is no guidance whether the amount should be recorded as a distribution when granted, over the vesting period or upon vesting, so practice may vary from IFRS.

**Employee benefit trusts**

Like IFRS, the transfer of shares to an employee benefit trust does not represent a share-based payment transaction. The accounting for some employee benefit trusts is addressed in the compensation Codification Topic applicable to ESOPs, in some cases the employee benefit trust may need to be consolidated under the consolidation Codification Topic, so differences from IFRS may arise in practice. [710-10-05-8, 718-10-15-7]
Repurchase by the parent
A parent may be required to repurchase shares of a subsidiary that were acquired by employees of the subsidiary through a share-based payment arrangement. If the subsidiary only has an obligation to deliver its own equity instruments, then we believe that the arrangement should be classified as equity-settled in the subsidiary’s financial statements. However, the arrangement should be classified as cash-settled in the consolidated financial statements of the parent because the parent has an obligation to settle in cash based on the subsidiary’s shares.

Presentation in equity
If equity instruments of a subsidiary have been granted to a counterparty (who is not part of the consolidated reporting entity) in a share-based payment transaction, then the credit entry in equity in the consolidated financial statements of the parent is allocated to NCI. [IFRS 10.A]

Share-based payments with non-employees
Similar recognition requirements are applied to share-based payment transactions with employees and non-employees, although different measurement requirements apply. [IFRS 2.13]

For equity-settled share-based payment transactions with non-employees, there is a rebuttable presumption that the fair value of the goods or services obtained can be measured reliably. If the presumption is rebutted (in rare cases), then the entity measures the fair value of the goods or services obtained with reference to the fair value of the equity instruments granted (i.e. like an employee grant). [IFRS 2.13]

Repurchase by the parent
A parent may be required to repurchase shares of a subsidiary that were acquired by employees of the subsidiary through a share-based payment arrangement. Unlike IFRS, if the award is liability-classified in the consolidated financial statements of the parent, then the subsidiary likewise would account for the cost using the remeasurement requirements for liability-classified awards, although the credit may be recognised in equity. Like IFRS, the arrangement would be liability-classified in the consolidated financial statements of the parent if it meets these requirements; however, as discussed above, obligations to repurchase shares issued pursuant to a share-based payment arrangement do not necessarily result in the award being liability-classified, so differences from IFRS can arise in practice.

Presentation in equity
Practice varies for the timing of recognising equity instruments of a subsidiary that have been granted to a counterparty in a share-based payment arrangement. Some companies allocate the credit entry in equity in the consolidated financial statements of the parent to NCI as the compensation cost is recorded, like IFRS, while some companies record the credit to equity (additional paid in capital) until the award is vested for a share or exercised for a share option, unlike IFRS. [810-10-45-17A]

Share-based payments with non-employees
Unlike IFRS, awards to non-employees, including those providing services similar to employees, are accounted for using the non-employee model, which generally requires remeasurement of the awards throughout the service period rather than the modified grant-date method used for employee awards. [505-50-15, 718-10-20]

Unlike IFRS, equity-classified share-based payment transactions with non-employees are measured based on the fair value of the consideration received (goods or services obtained) or the fair value of the equity-based instruments issued, whichever is more reliably measurable. Generally, entities measure transactions with non-employees based on the fair value of the equity-based instruments because that value can be determined more reliably than the fair value of the goods and services obtained, which may result in differences from IFRS in practice. [505-50-30]
The fair value of the goods or services received is measured at the date on which the entity obtains the goods or the counterparty renders service. Therefore, a single agreement with a non-employee can have multiple measurement dates, one for each delivery of goods or services. [IFRS 2.13]

Unlike IFRS, the fair value of the goods or services obtained is measured at the earlier of the date on which the performance obligation is complete and when the performance commitment is reached; the ‘performance commitment’ is achieved when the completion of performance is probable because there is a sufficiently large disincentive for failure to perform. As contracts do not normally include a sufficiently large disincentive for failure to perform, the fair value of awards usually continues to be remeasured from the date of grant to the completion of the performance, irrespective of whether the award is share or cash settled. [505-50-30]

For cash-settled share-based payment transactions with non-employees, the liability is measured at its fair value. The liability is remeasured at each reporting date and ultimately at settlement date in the same way as cash-settled transactions with employees. [IFRS 2.30]

Unlike IFRS, if continued service by a non-employee is not required to retain an award once the service is complete or the non-employee award contains a market condition, classification is determined pursuant to other US GAAP literature that governs the classification of instruments that are outside the scope of the employee compensation literature. Also unlike IFRS, if the non-employee’s continued service is necessary to retain the award, there is accepted practice to either (1) support continued classification as liability or equity based on the principles applicable to employee awards, or (2) determine the classification pursuant to other US GAAP literature. As a result, differences between the classification of the award under IFRS and under other US GAAP literature could exist. [718-10-35-13(b)]

For cash-settled share-based payment transactions with non-employees, the liability is measured at its fair value. The liability is remeasured at each reporting date and ultimately at settlement date in the same way as cash-settled transactions with employees. [IFRS 2.30]

Unlike IFRS, service, performance and market conditions are required to be when awards are treated in a manner that is different from that for employee awards. [505-50-30, 505-50-35]

Forthcoming requirements

Effect of vesting conditions: cash-settled awards

Amendments to the share-based payment standard are effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

Forthcoming requirements

Effect of vesting conditions: liability-classified awards

There are no forthcoming requirements under US GAAP related to vesting conditions.
The amendments clarify that the accounting for the effects of vesting conditions on cash-settled share-based payment transactions follows the approach used for equity-settled share-based payments:
- market conditions and non-vesting conditions are included in measuring the fair value of a cash-settled award, and there is no true-up for differences between estimated and actual vesting; and
- service and non-market performance conditions are not included in measuring the fair value of a cash-settled award, and there is a true-up for differences between estimated and actual vesting. [IFRS 2.33A–33D]

**Effect of conditions on vesting: equity-settled awards**

There are no forthcoming requirements under IFRS related to the effect of conditions on vesting.

The effect of service conditions and non-market performance conditions on vesting is estimated at grant date, but it is not reflected in the grant-date fair value itself. Subsequently, these estimates are trued up for differences between the number of instruments expected to vest and the actual number of instruments vested. [IFRS 2.20]

**When modification accounting is required: equity-settled awards**

There are no forthcoming requirements under IFRS specifying when modification accounting is required.

There is no specific guidance under IFRS regarding when a modification does not result in modification accounting.

In measuring the fair value of a liability-classified share-based payment, an entity includes market, ‘other’ conditions and post-vesting restrictions, like IFRS; and, like IFRS, there is no true-up for differences between estimated and actual vesting. Like IFRS, service and performance conditions are not included in the fair value measurement. [718-30-30-1]

**Effect of conditions on vesting: equity-classified awards**

Amendments to the share-based payment Codification Topic are effective for annual periods beginning after 15 December 2017 for entities other than public business entities; early adoption is permitted. [ASU 2016-09]

An entity makes an accounting policy election to account for the effect of forfeitures using one of the following approaches.
- **True-up approach.** Like IFRS, the effect of service conditions and (non-market) performance conditions on vesting is estimated at grant date, but it is not reflected in the grant-date fair value itself. Subsequently, these estimates are trued up for differences between the number of instruments expected to vest and the actual number of instruments vested, like IFRS.
- **Actual approach.** Unlike IFRS, the effect of forfeitures is recognised as they occur, and previously recognised compensation cost is reversed in the period that the award is forfeited. [718-10-35-3]

**When modification accounting is required: equity-classified awards**

Amendments to the share-based payment Codification Topic are effective for annual periods beginning after 15 December 2017; early adoption is permitted. [ASU 2017-09]

Unlike IFRS, an entity does not account for the effects of a modification of an equity-classified award if the following are the same immediately before and after the modification:
- the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used);
- vesting conditions; and
- classification. [718-20-35-2A]
Modifications: cash- to equity-settled
Amendments to the share-based payment standard are effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

The amendments clarify that to account for a modification from a cash-settled to an equity-settled share-based payment, at the modification date an entity:
- derecognises the liability for the original cash-settled share-based payment;
- measures the equity-settled share-based payment at its fair value as at the modification date and recognises that fair value to the extent that the services have been rendered up to that date; and
- immediately recognises the difference between the carrying amount of the liability and the amount recognised in equity in profit or loss. [IFRS 2.B44A–B44C]

Statutory tax withholding
Amendments to the share-based payment standard are effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

A share-based payment transaction that the entity settles net by withholding a specified portion of the equity instruments to meet its statutory tax withholding requirements is classified as equity-settled in its entirety if the entire share-based payment would otherwise be classified as equity-settled without the net settlement feature. Any shares held in excess of the employee’s tax obligation associated with share-based payment are accounted for as cash-settled share-based payment. [IFRS 2.33E–33H]
4.6 Borrowing costs (IAS 23)

Overview

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset generally form part of the cost of that asset. Other borrowing costs are recognised as an expense.

- A ‘qualifying asset’ is one that necessarily takes a substantial period of time to be made ready for its intended use or sale. In our view, investments in subsidiaries and equity-accounted investees are not qualifying assets. Property, plant and equipment, internally developed intangible assets and investment property can be qualifying assets.

- Borrowing costs may include interest calculated using the effective interest method, certain finance charges and certain foreign exchange differences.

Scope

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense in the period in which they are incurred. [IAS 23.1, 8-9]

4.6 Financial income and expense (Topic 835)

Overview

- Like IFRS, interest costs that are directly attributable to the acquisition, construction or production of a qualifying asset generally form part of the cost of that asset. However, the amount of interest cost capitalised may differ from IFRS. Like IFRS, other interest costs are recognised as an expense.

- Like IFRS, property, plant and equipment – including that which would be investment property under IFRS – can be a ‘qualifying asset’. Unlike IFRS, an equity-method investee might be a qualifying asset. However, like IFRS, other investments cannot be qualifying assets. Unlike IFRS, internally developed intangible assets generally do not qualify for capitalisation and therefore will not be qualifying assets.

- Like IFRS, interest costs may include interest calculated using the effective interest method and certain finance charges; but not foreign exchange differences, unlike IFRS.

Scope

Like IFRS, interest costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Like IFRS, other borrowing costs are recognised as an expense in the period in which they are incurred. [FAS-10-30-1, 835-20-15-6 – 15-6]
Qualifying assets
A ‘qualifying asset’ is one that necessarily takes a substantial period of time to be made ready for its intended use or sale. Qualifying assets are generally those that are the subject of major development or construction projects. [IAS 23.5]

Investments, including in our view investments in subsidiaries and equity-accounted investees, are not qualifying assets. However, investment property may be a qualifying asset. [IAS 23.7]

Internally developed intangible assets may be qualifying assets.

The requirement to capitalise directly attributable borrowing costs is not required to be applied to:
- qualifying assets measured at fair value – e.g. an investment property measured using the fair value model; or
- inventories that are manufactured or produced in large quantities on a repetitive basis; however, other inventories that take a long time to produce may be qualifying assets (e.g. ships constructed for others). [IAS 23.4]

**Borrowing costs eligible for capitalisation**

Borrowing costs eligible for capitalisation may include:
- interest expense calculated using the effective interest method;
- finance charges in respect of finance leases (see chapter 5.1); and
- exchange differences to the extent that they are regarded as an adjustment to interest costs. [IAS 23.6]

Although the unwinding of a discount on decommissioning or restoration provisions is presented as a component of interest expense (see chapter 3.12), it is not a qualifying borrowing cost that is eligible for capitalisation. Instead, it is presented as a finance expense. [IAS 3780, IFRIC 1.8]

Qualifying assets
Under US GAAP, ‘qualifying assets’ are assets that are constructed or otherwise produced for an entity’s own use, including assets constructed or produced for the entity by others for which deposits or progress payments have been made, and assets intended for sale or lease that are constructed or otherwise produced as discrete projects (e.g. ships or real estate developments). Although the precise language under US GAAP differs from that under IFRS, we generally would not expect differences in practice. [835-20-15-5 – 15-6]

Unlike IFRS, qualifying assets include equity-method investees when the investee has activities in progress necessary to start its planned principal operations, provided that the investee’s activities include the use of the funds to acquire qualifying assets for its operations. However, other investments cannot be qualifying assets, like IFRS. There is no concept of investment property under US GAAP (see chapter 3.4). However, assets that would be investment property under IFRS may be qualifying assets under US GAAP. [835-20-15-5 – 15-6]

Unlike IFRS, internally developed intangibles do not generally qualify for capitalisation (see chapter 3.3). However, capitalised software developed for internal use may be a qualifying asset. [350-40-30-1]

The requirements on interest costs are not applied to inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis, like IFRS; however, other inventories can be qualifying assets, like IFRS (e.g. ships constructed for others). Unlike IFRS, under US GAAP, the capitalisation of interest cost on assets measured at fair value through profit or loss is not addressed, but we generally would not expect differences in practice. [835-20-15-5 – 15-6]

**Interest costs eligible for capitalisation**

Like IFRS, in addition to interest cost calculated using the effective interest method, interest costs eligible for capitalisation include finance charges in respect of finance leases (see chapter 5.1). Unlike IFRS, foreign exchange differences are not eligible for capitalisation. [835-30-35-2, 35-5]

Like IFRS, the unwinding of a discount on decommissioning or restoration provisions (asset retirement obligations) is not a qualifying interest cost that is eligible for capitalisation. However, unlike IFRS, it is presented as a component of operating expense (see chapter 3.12). [410-20-45-1, 835-20-15-7]
The borrowing costs that are capitalised are those that would otherwise have been avoided if the expenditure on the qualifying asset had not been made. This includes interest on borrowings taken specifically for the purpose of obtaining the qualifying asset (specific borrowings) and costs of other borrowings that could have been repaid if expenditure on the asset had not been incurred (general borrowings). [IAS 23.9–10]

In our view, the amount of borrowing costs to be capitalised should be calculated on a pre-tax basis.

Borrowing costs may include foreign exchange differences to the extent that these differences are regarded as an adjustment to interest costs. There is no further guidance on the conditions under which foreign exchange differences may be capitalised and judgement is required to apply the requirements to the particular circumstances of the entity. [IAS 23.6, 11, IU 01-08]

Calculating the amount of borrowing costs to capitalise

Specific borrowings

The amount of specific borrowing costs capitalised is net of investment income on any temporary investment of funds pending expenditure on the asset. [IAS 23.12]

General borrowings

To the extent that the interest costs to be capitalised relate to financing that is part of the entity’s general borrowings, the weighted-average interest cost applicable to borrowings outstanding during the period (excluding the interest on any borrowings specific to any qualifying assets) is applied to the expenditure on the asset. In our view, the weighted-average accumulated expenditure on the asset during the period, reduced by any progress payments or grants received in respect of the asset, may be used in calculating the amount on which interest is capitalised. [IAS 23.14]

The amount of interest capitalised may not exceed the actual interest incurred by the entity. [IAS 23.14]

Like IFRS, the interest costs that are capitalised are those that would otherwise have been avoided if the expenditure on the qualifying asset had not been made. Like IFRS, the interest costs that are capitalised include interest on borrowings made specifically for the purpose of obtaining the qualifying asset (specific borrowings) and costs of other borrowings that could have been repaid if expenditure on the asset had not been incurred (general borrowings). [835-20-30-2 – 30-7]

Like IFRS, the amount of interest costs to be capitalised is calculated on a pre-tax basis. [835-20-30-2 – 30-7]

Unlike IFRS, foreign exchange differences on the debt principal are not eligible for capitalisation even if they are regarded as an adjustment to interest costs. [835-20-15-7]

Calculating the amount of interest costs to capitalise

Specific borrowings

Unlike IFRS, interest income on any temporary investment of funds pending expenditure on the asset is not generally offset against interest costs in determining either the capitalisation rates or limitations on the amount of interest to be capitalised. However, offsetting is required in certain circumstances involving tax-exempt borrowings that are restricted externally, like IFRS. [835-20-30-10]

General borrowings

Like IFRS, the amount capitalised is determined by multiplying the capitalisation rate by the accumulated expenditure on the asset during the period. However, unlike IFRS, there is specific additional guidance on the calculation of a capitalisation rate, which may result in differences in practice. Like IFRS, the capitalisation rate is based on the rates applicable to borrowings outstanding during the period. [835-20-30-3]

Like IFRS, the amount of interest capitalised may not exceed the actual interest incurred by the entity. [835-20-30-6]
**Period of capitalisation**

Capitalisation begins when the entity first meets all of the following conditions:
- expenditure for the asset is being incurred;
- borrowing costs are being incurred; and
- activities that are necessary to prepare the asset for its intended use or sale are in progress. [IAS 23.17]

Capitalisation of interest is suspended during extended periods in which active development is interrupted. There is no guidance on what length of time is considered an ‘extended’ delay. Capitalisation may continue during a temporary delay or during a period when substantial administrative or technical work is being carried out. [IAS 23.20–21]

Capitalisation ceases when the activities necessary to prepare the asset for its intended use or sale are substantially complete. [IAS 23.22]

Like IFRS, capitalisation begins when the entity first meets all of the following conditions:
- expenditure for the asset is being incurred;
- interest costs are being incurred; and
- activities that are necessary to prepare the asset for its intended use or sale are in progress. [835-20-25-2 – 25-3]

Like IFRS, if the entity suspends substantially all activities related to the acquisition of the asset, then capitalisation ceases until activities are resumed. However, brief interruptions in activities, interruptions that are externally imposed and delays that are inherent in the asset acquisition process do not require cessation of interest capitalisation. Although the precise language under US GAAP differs from IFRS, we generally would not expect differences in practice. [835-20-25-4]

Like IFRS, capitalisation ceases when the asset is substantially complete and ready for its intended use. [835-20-25-5]
5 Special topics

5.1 Leases

Overview

- The leasing guidance applies to property, plant and equipment and other assets, with only limited exclusions.

- An arrangement that at its inception can be fulfilled only through the use of a specific asset or assets, and that conveys a right to use that asset or assets, is a lease or contains a lease.

- A lease is classified as either a finance lease or an operating lease. In respect of lessors, there is a sub-category of finance lease for manufacturer or dealer lessors.

- Lease classification depends on whether substantially all of the risks and rewards incidental to ownership of the leased asset have been transferred from the lessor to the lessee.

- Lease classification is made at inception of the lease and is not revised unless the lease agreement is modified.

5.1 Leases

Overview

- Unlike IFRS, the lease accounting guidance applies only to property, plant and equipment.

- Like IFRS, an arrangement that at its inception can be fulfilled only through the use of a specific asset or assets, and which conveys a right to use that asset or assets, is a lease or contains a lease. However, certain aspects of identifying a lease differ from IFRS.

- Like IFRS, a lease is classified as either a capital (finance) lease or an operating lease. In respect of lessors, capital leases are categorised as direct financing leases or sales-type leases, which differ in certain respects from IFRS, or leveraged leases for which there is no equivalent in IFRS.

- Like IFRS, lease classification depends on whether substantially all of the risks and rewards incidental to ownership of the leased asset have been transferred from the lessor to the lessee. However, there are more detailed requirements than IFRS and, unlike IFRS, a lease that does not transfer substantially all of the rewards incidental to ownership of the leased asset can be a capital lease in certain circumstances.

- Like IFRS, lease classification is made at inception of the lease and is not revised unless the lease agreement is modified.
Overview (continued)

- A lease of land with a building is treated as two separate leases: a lease of the land and a lease of the building; the two leases may be classified differently.

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

- Under a finance lease, the lessor derecognises the leased asset and recognises a finance lease receivable, and the lessee recognises the leased asset and a liability for future lease payments.

- Under an operating lease, both parties treat the lease as an executory contract. Both the lessor and lessee recognise the lease payments as income or expense over the lease term. The lessor recognises the leased asset in its statement of financial position, whereas the lessee does not.

- Lessors and lessees recognise incentives granted to a lessee under an operating lease as a reduction in lease rental income or expense over the lease term.

- Immediate gain recognition from the sale and leaseback of an asset depends on whether the leaseback is classified as a finance or an operating lease and, if the leaseback is an operating lease, whether the sale takes place at fair value.

- A series of linked transactions in the legal form of a lease is accounted for based on the substance of the arrangement; the substance may be that the series of transactions is not a lease.

- Special requirements for revenue recognition apply to manufacturer or dealer lessors granting finance leases.

Overview (continued)

- Unlike IFRS, a lease of land with a building is treated as two separate leases only if the fair value of the land is at least 25 percent of the fair value of the leased property as a whole. Like IFRS, the two leases may be classified differently.

- Unlike IFRS, a lease of land is generally classified as an operating lease unless title transfers to the lessee.

- Under a capital lease, the lessor generally derecognises the leased asset and recognises a lease receivable, and the lessee recognises the leased asset and a liability for future lease payments, like IFRS. However, special accounting requirements, which differ from IFRS, apply to lessors in respect of leveraged leases.

- Like IFRS, under an operating lease, both parties treat the lease as an executory contract. Both the lessor and lessee recognise the lease payments as income or expense over the lease term, like IFRS. The lessor recognises the leased asset in its statement of financial position, whereas the lessee does not, like IFRS.

- Like IFRS, lessors and lessees recognise incentives granted under an operating lease as a reduction in lease rental income or expense over the lease term.

- Unlike IFRS, US GAAP does not generally permit immediate gain recognition on sale-leaseback transactions unless the leaseback is considered to be ‘minor’.

- Unlike IFRS, US GAAP contains specific requirements for revenue recognition that apply to sales-type leases. However, these requirements differ from IFRS in respect of the discount rate used to calculate revenue.
Scope
The accounting for leases is in the scope of a single standard and related interpretations. The standard deals with all leases except for:
- leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources; and
- licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights. [IAS 172]

Additionally, the following items are excluded from the measurement requirements of the leasing standard:
- biological assets held by lessees under finance leases and biological assets provided by lessors under operating leases (see chapter 3.9); and
- investment property provided by lessors under operating leases, and property held by lessees that is accounted for as investment property (see chapter 3.4). [IAS 172]

Introduction
A lease is an agreement whereby the lessor conveys to the lessee the right to use an asset for an agreed period of time in return for a payment or series of payments. Lease accounting applies to agreements that meet the definition of a lease under IFRS, regardless of their legal name or definition. [IAS 17, 4, 6, IFRIC 4.4]

The accounting treatment for a lease does not depend on which party has legal ownership of the leased asset, but rather on which party bears the risks and rewards incidental to ownership of the leased asset. [IAS 17.7]

Classification of a lease
A ‘finance lease’ is a lease that transfers substantially all of the risks and rewards incidental to ownership of the leased asset from the lessor to the lessee; title to the asset may or may not transfer under such a lease. An ‘operating lease’ is a lease other than a finance lease. [IAS 174, 7-8]

The classification of a lease is determined at its inception and is not revised unless the lease agreement is modified (see below). [IAS 17.13]

Scope
The accounting for leases under US GAAP is addressed in a Codification Topic that contains extensive guidance in comparison to IFRS on the accounting for leases. Unlike IFRS, the leasing Codification Topic does not apply to assets other than land and depreciable assets (i.e. property, plant and equipment, including property that would be investment property under IFRS). [840-10-15]

Unlike IFRS, there are no exclusions from the measurement requirements of the leasing Codification Topic for leases of assets within its scope.

Introduction
Like IFRS, a lease agreement is an arrangement that conveys the right to use property, plant and equipment in return for a payment or series of payments. Like IFRS, lease accounting applies to arrangements other than those explicitly in the form of a lease that convey the right to use specifically identified property, plant and equipment as long as the definition of a lease is met. [840-10-15-3 – 15-9, 840-10-20]

Like IFRS, the accounting treatment for a lease does not depend on which party has legal ownership of the leased asset, but rather on which party bears the risks and rewards incidental to ownership of the leased asset. However, there are more detailed requirements under US GAAP than IFRS. [840-10-10-1]

Classification of a lease
The criteria for determining whether a lease is a capital (finance) lease to a lessee are generally the same as under IFRS; however, unlike IFRS, US GAAP provides explicit quantitative thresholds that define when certain of these criteria are met (see below). Under US GAAP, a lease that does not transfer substantially all of the rewards incidental to ownership of the leased asset can be a capital (finance) lease in certain circumstances, unlike IFRS. In addition, unlike IFRS, there are additional criteria applied only by the lessor under US GAAP. [840-10-25-1, 25-42]

Like IFRS, the classification of a lease is determined at its inception and is not revised unless the lease agreement is modified; however, the guidance on subsequent changes in classification differs from IFRS in some respects (see below). [840-10-25-1, 25-42, 35-4]
IFRS does not have different types of finance leases. However, there is specific guidance for manufacturer or dealer lessors (see below). [IAS 1738, 42-46]

Indicators of a finance lease and definitions
IFRS includes a series of indicators that individually or in combination normally lead to classification as a finance lease. However, lease classification is ultimately based on an overall assessment of whether substantially all of the risks and rewards incidental to ownership of the asset have been transferred from the lessor to the lessee. [IAS 178–10]

If legal ownership of the asset ultimately transfers to the lessee, either during or at the end of the lease term, then the agreement will usually be classified as a finance lease. [IAS 1710(a)]

A purchase option that, at inception of the lease, is considered reasonably certain to be exercised normally results in a lease being classified as a finance lease. [IAS 1710(b)]

If the lease term is for the major part of the economic life of the leased asset, then the agreement is normally classified as a finance lease. IFRS does not define what is meant by the “major part” of an asset’s economic life and no quantitative threshold is provided. In our view, although the 75 percent threshold under US GAAP may be a useful reference point, it does not represent a bright line or automatic cut-off point under IFRS. We believe that it is necessary to consider all relevant factors when assessing the classification of a lease and it is clear that some leases may be for the major part of an asset’s economic life even if the lease term is, for example, less than 75 percent of the economic life. [IAS 1710(c)]

The lease term includes the non-cancellable period of the contract, plus any renewal periods if at inception of the lease it is reasonably certain that the lessee will renew the lease. In our view, if it is believed that a lessee will be economically compelled to renew a lease, then this indicates that renewal is reasonably certain. [IAS 174]

Lessors have to determine which of three types of capital leases an arrangement is: sales-type, direct financing or leveraged. The differences between the accounting for these leases under IFRS and US GAAP are discussed below. [840-10-25-43, 840-30-05-4]

Criteria for a capital (finance) lease and definitions
Unlike IFRS, US GAAP includes four criteria, any of which being met results in classification as a capital lease by the lessee. If at least one of the four criteria is met, then the lessor applies two additional criteria to determine whether to classify a lease as a capital lease, unlike IFRS. [840-10-25-1, 25-42]

Unlike IFRS, if the lease transfers ownership to the lessee, either during or at the end of the lease term, then the lease is always classified as a capital lease by the lessee; the lessor applies the two additional criteria described below. [840-10-25-1a]

Unlike IFRS, if the lease contains a purchase option for which exercise is reasonably assured, then the lease is always classified as a capital lease by the lessee; the lessor applies the two additional criteria described below. [840-10-25-1b]

Unlike IFRS, if the lease term is equal to or greater than 75 percent of the estimated economic life of the leased asset, then the lease is always classified as a capital lease by the lessee; the lessor applies the two additional criteria described below. This criterion does not apply to the classification of leases when the asset is in the last 25 percent of its total economic life at lease inception. [840-10-25-1c]

Under US GAAP, the lease term includes the fixed non-cancellable term of the lease plus:
- all periods covered by bargain renewal options;
- all periods for which failure to renew the lease imposes a penalty on the lessee in such amount that a renewal appears, at inception of the lease, to be reasonably assured;
- all periods covered by ordinary renewal options during which a guarantee by the lessee of the lessor’s debt or a loan from the lessee to the lessor directly or indirectly related to the leased property is expected to be in effect or outstanding;
IFRS compared to US GAAP

Like IFRS, if it is believed that a lessee will be economically compelled to renew a lease, then this indicates that renewal is reasonably certain.

The lease term is assumed not to extend beyond the date on which a bargain purchase option becomes exercisable. Because US GAAP has more extensive guidance and considerations for determining the lease term, differences from IFRS may arise in practice.

If at inception of the lease the present value of the minimum lease payments amounts to substantially all of the fair value of the leased asset, then the agreement is normally classified as a finance lease. IFRS does not define what is meant by ‘substantially all’ and no quantitative threshold is provided. In our view, although the 90 percent threshold under US GAAP may provide a useful reference point, it does not represent a bright line or automatic cut-off point under IFRS. We believe that it is necessary to consider all relevant factors in assessing the classification of a lease and it is clear that some leases may meet this criterion even if the present value of the minimum lease payments is less than 90 percent of the fair value of the leased asset at inception of the lease.

The lessor applies the same indicators in classifying a lease as the lessee. [IAS 17.10(d)]

Minimum lease payments are those payments that the lessee is or can be required to make to the lessor over the lease term (excluding contingent rent). Minimum lease payments include:

- for the lessee, residual values guaranteed by the lessee or a party related to the lessee; and
- for the lessor, residual values guaranteed by any third party (including the lessee) unrelated to the lessor provided that the party is financially capable of fulfilling the obligations under the guarantee. [IAS 17.4]

Unlike IFRS, if at inception of the lease the present value of the minimum lease payments amounts to at least 90 percent of the fair value of the asset (less any investment tax credit retained by the lessor), then the lease is always classified as a capital lease by the lessee; the lessor applies the two additional criteria described below. This criterion does not apply to the classification of leases when the asset is in the last 25 percent of its total economic life at lease inception. [840-10-25-1d]

Like IFRS, the lessor applies the same capitalisation criteria as the lessee as a starting point to classifying a lease. However, unlike IFRS, if the lease meets at least one of the four criteria, then the lessor applies two additional tests, both of which need to be met for the lease to be classified as a capital lease:

- collectibility of the minimum lease payments is reasonably predictable; and
- no important uncertainties surround the amount of unreimbursable costs yet to be incurred by the lessor under the lease. [840-10-25-42]

Like IFRS, minimum lease payments are those payments that the lessee is or can be required to make to the lessor over the lease term (excluding contingent rent). Minimum lease payments include:

- for the lessee, any guarantee by the lessee of the residual value at the expiration of the lease term, whether or not payment of the guarantee constitutes a purchase of the leased asset, like IFRS; however, a guarantee by the lessee of the lessor’s debt is not a minimum lease payment;
Both a lessee and a lessor include in minimum lease payments the exercise price of a purchase option over the leased asset held by the lessee if it is reasonably certain at inception of the lease that the purchase option will be exercised (i.e. a bargain purchase option). [IAS 17.4]

Minimum lease payments exclude contingent rentals (see below). [IAS 17.4]

Minimum lease payments exclude costs for services and taxes to be paid by and reimbursed to the lessor. [IAS 17.4]

Initial direct costs are costs, incurred by either the lessor or the lessee, that are incremental and directly attributable to negotiating and arranging a lease. They include commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging a lease. They exclude internal overhead costs such as those incurred by a sales and marketing team. [IAS 17.4, 24, 38]

If a leased asset is so specialised that only the lessee can use it without major modification, then the agreement is normally classified as a finance lease. An asset built to the lessee’s specifications may be a specialised asset. However, a machine that could be used by other entities in the same industry as the lessee would not be considered a specialised asset even if it had some degree of customisation. [IAS 17.10(e)]

The following are additional indicators that a contract may be a finance lease:
- the lessee can cancel the lease and the lessor’s losses associated with the cancellation are borne by the lessee;
- gains or losses from fluctuations in the fair value of the residual fall to the lessee; or
- the lessee can extend the lease at a rent that is substantially lower than the market rent. [IAS 17.11]
Other classification issues

Evaluations of risks and rewards

IFRS does not address how to consider probability in assessing whether a lease transfers substantially all of the risks and rewards incidental to ownership of an asset. In our view, an assessment of the risks and rewards should use a probability-weighted approach, taking into account who is more likely to be exposed to the expected risks and achieve the expected benefits, and not just the relative proportions of the risks and rewards.

Land leases

A lease involving land is classified as an operating or finance lease with reference to the general indicators used for lease classification (see above). In determining the lease classification, an important consideration is that land normally has an indefinite economic life. However, the fact that the lease term is normally shorter than the economic life of the land does not necessarily mean that a lease of land is always an operating lease; the other classification requirements are also considered. Ultimately, the lease classification is based on an overall assessment of whether substantially all of the risks and rewards incidental to ownership of the asset have been transferred from the lessor to the lessee. [IAS 17.15A]

Land and building leases

The classification of a lease that contains both land and building elements is determined for each element as a finance or an operating lease in accordance with the leasing standard, unless the value of the land at inception of the lease is immaterial or it is clear that both elements are either finance leases or operating leases. However, in determining whether the land element is an operating or a finance lease, a key consideration is that land typically has an indefinite economic life (see above). [IAS 17.15A–17, BC9–BC11]

Leases involving only part of a building

There is no specific guidance on accounting for leases involving only part of a building.

Other classification issues

Evaluations of risks and rewards

Unlike IFRS, US GAAP provides explicit quantitative thresholds for determining whether a lease transfers substantially all of the risks and rewards incidental to ownership of an asset (see above). These quantitative thresholds are based on absolute amounts and are not limited to reasonably possible outcomes (e.g. the significance of a guarantee to expected residual losses). However, assessing whether the lessee is expected to be economically compelled to exercise purchase or renewal options requires probability-based judgements. [840-10-25-1]

Land leases

Unlike IFRS, leases involving land need to transfer ownership to the lessee by the end of the lease term to qualify as a capital lease for the lessor. This condition is met if an agreement provides for the transfer of title for no consideration or a nominal amount at or shortly after the end of the lease term. For a lessee to classify a lease of land as a capital lease, either the lease needs to contain a bargain purchase option or title to the land needs to transfer to the lessee by the end of the lease term. In all other cases, leases of land are classified as operating. [840-10-25-1a, 25-37]

Land and building leases

Unlike IFRS, leases of land and buildings that do not involve either the transfer of title or a bargain purchase option are separated between the land component and the building component unless the value of the land is less than 25 percent of the total fair value of the leased property. Unlike IFRS, if separation is required, then the minimum lease payments attributable to the land component of the transaction are calculated by multiplying the fair value of the land at inception of the lease by the lessee’s incremental borrowing rate. [840-10-25-21 – 25-22]

Leases involving only part of a building

Unlike IFRS, for a lease involving only a part of a building, the lessor accounts for the lease as an operating lease if either cost or fair value is not objectively determinable. If fair value and cost are objectively determinable, then the lessor accounts for the lease based on land and building lease accounting (see above). [840-10-25-23 – 25-24]

The lessee accounts for the lease based on land and building lease accounting (see above) if the fair value is objectively determinable, and classifies the lease based on the criterion related to lease term if the fair value is not objectively determinable. [840-10-25-23 – 25-24]
Up-front payment for operating land leases
A lessee may acquire a long-term right of use of land for an up-front payment. The classification of such a lease as operating or finance is made with reference to the general indicators used for lease classification (see above). In our view, an up-front payment made to obtain the right to use the land that is classified as an operating lease should be capitalised as a lease prepayment and recognised over the lease term as an operating lease expense.

Long-term land leases
Under US GAAP, a long-term right of use of land with an up-front payment is an operating lease unless the lease transfers ownership of the land to the lessee by the end of the lease term. The up-front payment made to obtain the right to use the land is recognised as a lease prepayment and is recognised over the lease term as an operating lease expense, like IFRS. [840-10-25-1a – 25-1b]

Property interest held under operating leases
A lessee may elect to classify a property interest held under an operating lease as an investment property, if the property would otherwise meet the definition of investment property and if the lessee applies the fair value model to all of its investment property (see chapter 3.4). If the lessee makes this election for a given property interest, then the lessee accounts for that property interest as if it were a finance lease. [IAS 17, 40.6]

Unlike IFRS, US GAAP does not contain the concept of ‘investment property’ (see chapter 3.4). Such property is accounted for under the general requirements for property, plant and equipment and the lease is classified as an operating or capital lease following the requirements outlined above.

Subsequent changes to classification
Leases are not reclassified for changes in estimates (e.g. of the economic life or residual value of the leased asset) or changes in circumstances (e.g. default by the lessee). [IAS 17.13]

If the terms of the lease are modified other than by renewing the lease, then the modified agreement may have to be treated as a new lease agreement, which may be classified differently from the original agreement. The leasing standard requires a two-step test.
- The first step is to determine whether a modification results in a new lease agreement; the test is whether the lease would have been classified differently if the modified terms had been in effect at inception of the lease. If the modified terms (e.g. changes to the lease payments) would have resulted in a different classification based on the original estimates and circumstances, then the modified agreement is regarded as a new lease agreement.
- In the second step, the ‘new’ agreement is classified in accordance with its modified terms, based on estimates determined at the modification date – i.e. the date of commitment by the parties to the modified terms of the lease. [IAS 1713]
The requirement to reconsider the classification of a lease at inception of the original lease when there is a change in the provisions of the lease need not apply when there is a renewal of the lease. However, difficulties may arise in applying this exception, resulting from either:

– a lack of clarity with respect to the meaning of ‘renewing the lease’; or
– a lack of guidance on the required accounting when renewing the lease and meeting the exception to modification accounting. [IAS 17.13]

In our view, this exception applies whenever a lessee exercises a renewal option that exists in a lease agreement in accordance with the terms existing in the original lease agreement. Conversely, in our view if a lessee and lessor agree to renew a lease but also to change other provisions of the lease at the same time, then this exception does not apply.

**Accounting for leases**

**Lessee**

**Finance lease**

At commencement of the finance lease, the leased asset and the lease liability are recognised at the lower of:

– the fair value of the leased asset at inception of the lease; and
– the present value of the minimum lease payments at inception date for the lease term. [IAS 17.20]

Initial direct costs of the lessee are capitalised as an addition to the cost of the asset. [IAS 17.20, 24]

The discount rate used in determining the present value of the minimum lease payments is the interest rate implicit in the lease, if it is known to the lessee. Otherwise, the lessee uses its incremental borrowing rate. [IAS 17.20]

The ‘interest rate implicit in the lease’ is the discount rate that, at inception of the lease, causes the aggregate present value of:

– the minimum lease payments; and
– the unguaranteed residual value

Unlike IFRS, US GAAP explicitly states that a renewal or extension of the lease pursuant to terms in the original agreement is treated as a new lease unless the renewal or extension was included in the original lease term (e.g. a bargain renewal option). [840-10-25-1, 25-42, 35-4]

**Accounting for leases**

**Lessee**

**Capital (finance) lease**

Like IFRS, at commencement of the capital lease, the leased asset and the lease liability are recognised at the lower of:

– the fair value of the leased asset at inception of the lease; and
– the present value of the minimum lease payments at inception of the lease;

however, this calculation differs in certain respects from IFRS. [840-30-30-1 – 30-3]

In practice, initial direct costs incurred by the lessee are generally added to the carrying amount of the leased asset. However, differences from IFRS may arise in practice.

Unlike IFRS, a lessee computes the present value of the minimum lease payments using the lower of the interest rate implicit in the lease, if it is known to the lessee, and the lessee’s incremental borrowing rate. Like IFRS, if the interest rate implicit in the lease is not known to the lessee, then the lessee uses its incremental borrowing rate. [840-10-25-31]

The ‘interest rate implicit in the lease’ is the discount rate that, at inception of the lease, causes the aggregate present value of:

– the minimum lease payments from the lessor’s perspective, which is more precise than IFRS in that it specifies that the calculation is from the lessor’s perspective; and
– the unguaranteed residual value, like IFRS,
to be equal to the sum of:
– the fair value of the leased asset; and
– any initial direct costs of the lessor. [IAS 174]

The interest expense is determined so that a constant periodic rate of interest is recognised on the outstanding balance of the liability. [IAS 17.25]

The asset under a finance lease is depreciated in accordance with the depreciation policy used for comparable owned assets (see chapter 3.2), over the shorter of the period of the asset’s useful life and the lease term. An interest in land held under a finance lease is normally depreciated over the life of the lease. However, if at inception of the lease it is reasonably certain that the lessee will obtain ownership of the asset by the end of the lease term, then the asset is depreciated over the expected useful life of the asset. [IAS 17.27]

Operating lease
A lessee under an operating lease does not recognise the leased asset in its statement of financial position; nor does it recognise a liability for rentals in respect of future periods. The only exception is a property interest held under an operating lease that is accounted for as investment property (see chapter 3.4 and above). A lessee under an operating lease recognises rent expense on a straight-line basis over the lease term, or on another systematic basis if it is more representative of the time pattern of benefits to the lessee. [IAS 17.19, 33]

Lease incentives granted to the lessee to enter into an operating lease are recognised as reductions of rental expense over the lease term on the same recognition basis as the rental payments. [SIC-15.3, 5]

Unlike IFRS, initial direct costs of the lessor are not included in determining the interest rate implicit in the lease. [840-10-20]

Operating lease
Like IFRS, a lessee under an operating lease does not recognise the leased asset in its statement of financial position; nor does it recognise a liability for rentals in respect of future periods. However, unlike IFRS there is no concept of investment property and the usual lease classification criteria apply. Like IFRS, a lessee under an operating lease recognises rent expense on a straight-line basis over the lease term, or on another systematic basis if it is more representative of the time pattern in which the asset is physically employed. [840-20-25-1 – 25-5]

Like IFRS, lease incentives granted to the lessee are recognised as reductions of rental expense over the term of the lease on the same recognition basis as the rental payments. [840-20-25-6]
There is no specific guidance on the treatment of periodic rent reviews to adjust the lease payments up to prevailing market rates. However, in our view, for leases that are subject to these periodic adjustments, any lease incentive should be spread over the entire lease term rather than the shorter period until the next market adjustment.

**Lessor**

**Manufacturer or dealer lessors**

A finance lease of an asset by a manufacturer or dealer results in two types of income: initial selling profit, and finance income over the lease term. There is no specific definition of a manufacturer or dealer lessor. [IAS 1743]

Manufacturer or dealer lessors recognise the selling margin in profit or loss for the period by applying their normal accounting policy for outright sales. Costs incurred in connection with negotiating and arranging a lease are recognised as an expense in profit or loss when the selling profit is recognised, which is generally at commencement of the lease. [IAS 1742, 46]

The sales revenue recognised at commencement of the lease term by the manufacturer or dealer lessor is the fair value of the asset or, if it is lower, the present value of the minimum lease payments computed using a market rate of interest. Lease receipts are allocated between interest income and reduction of the investment so as to produce a constant rate of return on the net investment. [IAS 1739–40, 44]

If manufacturer or dealer lessors quote below-market interest rates, then selling profit is restricted to the amount that would have been earned if a market rate of interest had been charged. [IAS 1745]

**Non-manufacturer or dealer finance leases**

Other finance leases are those entered into by lessors other than a manufacturer or dealer lessor; there is no specific definition of such leases.

Initial direct costs are included in the finance lease receivable, rather than being capitalised separately. [IAS 1738]

Unlike IFRS, there is a specific requirement to treat adjustments to prevailing market rates as contingent rentals that are included in rental expense as they are incurred. Like IFRS, lease incentives are spread over the entire lease term. [840-20-25-2]

**Lessor**

**Sales-type leases**

Like IFRS, a sales-type lease results in an initial selling profit and finance income over the lease term. Unlike IFRS, a ‘sales-type lease’ is specifically defined as one in which a lessor’s cost, or carrying amount if it is different from cost, differs from the fair value of the leased property; see further guidance below related to real estate leases in these circumstances. [840-10-25-43a]

Like IFRS, sales-type lessors recognise the selling margin in profit or loss for the period by applying their normal accounting policy for outright sales. Like IFRS, initial direct costs are recognised as an expense in profit or loss at commencement of the lease. [840-30-25-6 – 25-6]

Unlike IFRS, the sales revenue recognised at commencement of the lease term by the sales-type lessor is the present value of the minimum lease payments. Unlike IFRS, US GAAP requires the discount rate used in determining the present value of the minimum lease payments to be the interest rate implicit in the lease. Like IFRS, lease receipts are allocated between interest income and reduction of the investment so as to achieve a constant periodic rate of return on the net investment. [840-30-30-8 – 30-10, 35-22]

Unlike IFRS, there is no adjustment to the sales price to reflect a market rate of interest.

**Direct financing lease**

Unlike IFRS, a direct financing lease is specifically defined as a capital lease other than a leveraged lease in which a lessor’s cost equals the fair value of the leased property. [840-10-25-43b]

Like IFRS, initial direct costs incurred by the lessor in respect of a direct financing lease are included as a component of the net investment in the lease. [840-30-30-11]
Initially, the lessor recognises a finance lease receivable at the amount of its net investment, which comprises the present value of the minimum lease payments and any unguaranteed residual value accruing to the lessor. Initial direct costs are included in the calculation of the finance lease receivable because the interest rate implicit in the lease used for discounting the minimum lease payments takes initial direct costs incurred into consideration. [IAS 17:36–38]

The minimum lease payments are discounted using the interest rate implicit in the lease (see above). [IAS 17:38]

Over the lease term, the lessor accrues interest income on the net investment. The receipts under the lease are allocated between the net investment and finance income to produce a constant rate of return on the net investment. [IAS 17:39–40]

**Leveraged leases**

IFRS does not include the concept of leveraged leases. Leases are classified as operating leases or finance leases. There are no other lease accounting models, and no exceptions to the general requirements of those models relating to the manner in which the lessor finances its business.

**Operating lease**

A lessor under an operating lease continues to recognise the leased asset in its statement of financial position, and accounts for it in the same way as other assets of the same type – e.g. property, plant and equipment is accounted for as discussed in chapter 3.2. [IAS 17:49]

Future contractual rental payments from the lessee are recognised as receivables over the lease term as the payments become receivable. [IAS 17:49]

Like IFRS, the lessor initially recognises a finance lease receivable at the amount of its net investment, which comprises the initial direct costs capitalised, the present value of the future minimum lease payments receivable and any unguaranteed residual accruing to the lessor. [840-30-30-6, 30-11]

The gross investment in the lease (i.e. minimum lease payments and unguaranteed residual value) is discounted using the interest rate implicit in the lease; this calculation differs from IFRS (see above). However, after taking into account the recognition of capitalised initial direct costs in profit or loss over the lease term under US GAAP, the net effect on profit or loss is likely to be similar to IFRS. [840-30-30-9]

Like IFRS, lease receipts are allocated between interest income and reduction of the investment so as to achieve a constant periodic rate of return on the net investment. Like IFRS, US GAAP requires the periodic rate of return to be based on the net investment in the lease. [840-30-35-23]

**Leveraged leases**

A ‘leveraged lease’ is a type of direct financing lease in which, broadly, the lessor finances a substantial portion of its net investment in the lease on a non-recourse basis with a third party long-term lender, and the lessor’s net investment in the lease declines and rises during the lease term. There are special accounting requirements for leveraged leases, but the key features are that the net investment in the lease is presented net of the non-recourse financing obligation and income is recognised at a constant periodic rate of return based on post-tax cash flows in the periods during which there is a positive net investment in the lease. This accounting is different from the general lessor accounting under IFRS. [840-10-25-43c, 840-30-30-14]

**Operating lease**

Like IFRS, a lessor under an operating lease continues to recognise the leased asset in its statement of financial position and accounts for it as property, plant and equipment (see chapter 3.2). [840-20-45-2]

Like IFRS, future contractual rental payments from the lessee are recognised as receivables over the lease term as the payments become receivable. [840-20-25-1]
Initial direct costs incurred by the lessor in arranging an operating lease are added to the carrying amount of the leased asset. These initial direct costs are recognised as an expense on the same basis as the lease income (see below). [IAS 17.52]

**Lease income recognition by the lessor**

For a finance lease, the lessor recognises finance income in a pattern that reflects a constant periodic rate of return on the lessor’s net investment in the lease. [IAS 17.39–40]

For an operating lease, the lessor generally recognises income on a straight-line basis over the lease term. It may be possible to recognise lease income using another systematic basis if that is more representative of the time pattern in which the benefit of the leased asset is diminished. [IAS 17.50, SIC-15.3–4]

Lease incentives granted to the lessee to enter into the operating lease are recognised as reductions of rental income over the term of the lease on the same recognition basis as the rental receipts. [SIC-15.3–4]

**Specific application issues**

**Contingent rent**

Minimum lease payments do not include contingent rent amounts. IFRS does not contain specific guidance on how to account for rent that was considered contingent at inception of the lease but is confirmed subsequently (e.g. following an upwards-only rent review on a property lease). One approach is to account for such a change prospectively by revising the minimum lease payments over the remaining term of the lease. This adjustment would impact both the disclosure of minimum lease payments and revenue and expense recognition; it would not trigger reconsideration of the lease classification. Alternatively, the confirmed rentals may be accounted for in the periods in which they are incurred.

Like IFRS, initial direct costs incurred by the lessor are deferred and recognised over the life of the lease. However, unlike IFRS, the deferred initial direct costs are not added to the carrying amount of the leased asset; instead, they are presented separately in the statement of financial position. [840-20-35-2]

**Lease income recognition by the lessor**

Like IFRS, for a capital lease, the lessor recognises finance income in a pattern that reflects a constant periodic rate of return on the lessor’s net investment in the lease. [840-30-35-22]

Like IFRS, if the lease is an operating lease, then rental receipts are recognised as revenue on a straight-line basis unless another systematic basis is more representative of the time pattern in which the asset is physically employed. [840-20-25-1]

Like IFRS, lease incentives granted to the lessee to enter into the operating lease are recognised as reductions of rental income over the term of the lease on the same recognition basis as the rental receipts. [840-20-25-6]

**Specific application issues**

**Contingent rent**

Like IFRS, minimum lease payments do not include contingent rent amounts. However, unlike IFRS, there is specific guidance in US GAAP on how to account for such amounts. Contingent rent is recognised by the lessee as rent expense when achievement of the specified target that triggers the contingent rent is considered probable. Contingent rent is recognised as rental income by the lessor only when the specified condition that triggers the lessor’s right to receive contingent rent has been met. Unlike IFRS, contingent rent remains so classified even if amounts are confirmed subsequently (e.g. following an upward-only rent review). The determination of whether the lease payment is contingent requires significant judgement. Therefore, differences from IFRS may arise in practice even if the policy chosen under IFRS corresponds to the principles under US GAAP. [840-10-25-4 – 25-5, 25-35, 840-30-25-3]

**Sale-and-leaseback transactions**

When a sale-and-leaseback results in a finance lease, any gain on the sale is deferred and recognised as income over the lease term; there is no guidance on the classification of the amortised gain in profit or loss. In our view, it is acceptable to present the amortisation of the deferred gain as a reduction of depreciation expense, because the transaction is in substance a finance transaction. No loss is recognised unless the asset is impaired. [IAS 17.59–60]

**Sale-leaseback transactions**

Like IFRS, when a sale-leaseback transaction results in a capital lease, any gain on the sale is generally deferred and amortised in proportion to the amortisation of the leased asset. Like IFRS, there is no guidance on the classification of the amortised gain in the income statement, although in practice the amortisation is generally presented as an adjustment to depreciation expense on the leased asset. No loss is recognised unless the asset is impaired, like IFRS. [840-40-25-3, 35-1]
If the leaseback is classified as an operating lease, then any gain is recognised immediately if the sale-and-leaseback terms are clearly at fair value. Otherwise, the sale and leaseback are accounted for as follows.

- If the sale price is at or below fair value, then that excess is deferred and amortised over the period for which the asset is expected to be used.
- If the sale price exceeds fair value, then the gain or loss is recognised immediately.
- If the fair value of the asset is less than the carrying amount of the asset at the date of the transaction, then that difference is recognised immediately as a loss on the sale. [IAS 17:61–63]

Unlike IFRS, US GAAP does not generally permit immediate gain recognition if the leaseback is classified as an operating lease, unless the leaseback is minor; generally, only an ‘excess’ gain is recognised in profit or loss and any ‘non-excess’ gain or loss on the sale is deferred and amortised in proportion to rental expense if the lease is an operating lease. Also, if the fair value at the time of the transaction is less than the carrying amount of the property, then a loss is recognised immediately for the amount of the difference, like IFRS. [840-40-25-3, 35-1]

There are no special requirements for sale-and-leaseback transactions involving real estate.

Unlike IFRS, US GAAP contains separate requirements for a sale-leaseback transaction involving real estate. Such a sale-leaseback transaction is accounted for as a sale only if the transaction meets certain criteria regarding:

- the extent of the buyer’s investment in the property being sold;
- whether the seller’s receivable is subject to future subordination;
- whether the seller has continuing involvement with the property after the sale; and
- whether the seller-lessee will use the property actively during the lease term.

These criteria are different from those used for assessing sales of real estate (see chapter 4.2). Similar to other leasing transactions, additional criteria apply to ‘build-to-suit’ leases that, if they are not met, result in the lessee being the accounting owner of the property. If the transaction does not qualify as a sale, then it is accounted for either as a deposit or as a financing. [840-40-15-5 – 55-16]

Linked transactions in the legal form of a lease

A series of linked transactions may be in the legal form of a lease without transferring the right of use of the asset from the lessor to the lessee. These transactions may be entered into to generate tax savings or to generate fees. Transactions in the legal form of a lease are considered to be ‘linked’ if the individual transactions cannot be understood without reference to the series as a whole. In these cases, the series of transactions is accounted for as a single transaction. [SIC-27]

Linked transactions in the legal form of a lease

Unlike IFRS, there is no explicit requirement that a series of linked transactions in the legal form of a lease be accounted for based on the substance of the arrangement. However, although there is no specific requirement to combine transactions, reference to the discussion above about when a lease would be deemed to exist even though none is identified in the contractual arrangements may result in the combining of transactions.
Lease transactions not in the form of a lease

Lease accounting can apply to arrangements that explicitly or implicitly convey the right to use specifically identified assets, but that are not in the contractual form of a lease. [IFRIC 4.1]

An arrangement conveys the right to use the asset if the purchaser (lessee) obtains the ability or right to control the use of a specific asset. The right to use an asset is transferred if any of the following conditions is met.
- The purchaser has the ability or right to control the asset, including to direct how others should operate the asset, while at the same time obtaining or controlling more than an insignificant amount of the asset’s output.
- The purchaser has the ability or right to control physical access to the asset, while obtaining or controlling more than an insignificant amount of the asset’s output.
- The possibility that another party will take more than an insignificant amount of the asset’s output during the term of the arrangement is remote, and the price paid by the purchaser for the output is neither a contractually fixed price per unit of output nor the market price per unit of output. [IFRIC 4.9]

In our view, the exemption for fixed or market prices under the last condition above should be applied narrowly and only for arrangements in which a buyer clearly pays for the actual output. However, we believe that this exemption may be met if:
- the total contract volume and the total contract price are determined at inception of the contract, because in this case the price per unit is fixed on a total contract basis; or
- the price is fixed in real terms.

Leases between related parties

There is no specific guidance on accounting for leases between related parties and the general requirements outlined above apply equally to such leases.

Lease transactions not in the form of a lease

Like IFRS, lease accounting can apply to arrangements that explicitly or implicitly convey the right to use specifically identified property, plant and equipment, but that are not in the contractual form of a lease. However, unlike IFRS, these requirements apply only if the subject asset is property, plant and equipment. [840-10-15-3, 15-6]

Like IFRS, an arrangement conveys the right to use the asset if the purchaser (lessee) obtains the ability or right to control the use of a specific asset. Like IFRS, the right to use an asset is transferred if any of the following conditions is met.
- The purchaser has the ability or right to operate the asset or to direct how others should operate the asset, while at the same time obtaining or controlling more than a minor amount of the asset’s output.
- The purchaser has the ability or right to control physical access to the asset, while obtaining or controlling more than a minor amount of the asset’s output.
- The possibility that another party will take more than a minor amount of the asset’s output during the term of the arrangement is remote, and the price paid by the purchaser for the output is neither a contractually fixed price per unit of output nor the market price per unit of output at the time of delivery of the output. [840-10-15-6]

Although IFRS uses the term ‘insignificant amount’ and US GAAP uses the term ‘minor amount’, we would not generally expect differences in practice to arise from the application of those terms.

Unlike IFRS, under US GAAP the ‘fixed price per unit’ criterion is strictly applied, such that the price per unit cannot be considered fixed per unit if it varies during the term of the arrangement for any reason (e.g. on the basis of volume or time of delivery) unless the total consideration to be paid over the term of the arrangement and the total units of output over the term of the arrangement are known at inception of the arrangement. [840-10-15-6]

Leases between related parties

Unlike IFRS, US GAAP specifies that the classification and accounting for leases between related parties is the same as for similar leases between unrelated parties, unless it is clear that the terms of the transaction have been significantly affected by the fact that the lessee and lessor are related. In such cases, the classification and accounting are modified as necessary to recognise the economic substance of the transaction rather than the legal form, which may give rise to differences from IFRS in practice. [840-10-25-26]
Forthcoming requirements

A new leases standard is effective for annual periods beginning on or after 1 January 2019; early adoption is permitted if IFRS 15 is also adopted.

The new leases standard is discussed in chapter 5.1A.

Forthcoming requirements

A new leases Codification Topic is effective for annual periods beginning after 15 December 2018 (public business entities) or after 15 December 2019 (other entities); early adoption is permitted.

The new leases Codification Topic is discussed in chapter 5.1A.
5.1A Leases

Overview of forthcoming requirements

– The new standard is effective for annual periods beginning on or after 1 January 2019. Early adoption is permitted if the new revenue standard is also adopted (see chapter 4.2A).

– The new standard applies to leases of property, plant and equipment and other assets, with limited exclusions.

– A contract is or contains a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

– Lessees apply a single on-balance sheet lease accounting model, except for leases to which they elect to apply the recognition exemptions for short-term leases or leases of low-value assets.

– A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make future lease payments.

Overview of forthcoming requirements

– The new Codification Topic is effective for annual periods beginning after 15 December 2018 (public business entities) or after 15 December 2019 (other entities). Early adoption is permitted.

– The new Codification Topic applies to leases of property, plant and equipment. Unlike IFRS, the scope excludes leases of inventory, leases of assets under construction and all leases of intangible assets.

– Like IFRS, a contract is or contains a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

– Unlike IFRS, there is a dual classification on-balance sheet lease accounting model for lessees: finance leases and operating leases. Classification is determined by pass/fail tests intended to determine whether the lessee obtains control of the use of the underlying asset as a result of the lease. Classification is made at commencement of the lease and is reassessed only if there is a lease modification and that modification is not accounted for as a separate lease. Like IFRS, the on-balance sheet accounting does not apply to short-term leases for which the lessee elects the recognition exemption; however, the definition of ‘short-term’ differs in some respects from IFRS. Unlike IFRS, there is no exemption for leases of low-value assets.

– Like IFRS, a lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make future lease payments.
Overview of forthcoming requirements (continued)

- After initial recognition, a lessee measures the lease liability at amortised cost using the effective interest method. The lease liability is also remeasured to reflect lease modifications and changes in the lease payments, including changes caused by a change in an index or rate.

- A lessee measures the right-of-use asset at cost less accumulated depreciation and accumulated impairment losses, except when it applies the alternative measurement models for revalued assets and investment property.

- Lessors classify leases as either finance or operating leases.

- Lease classification by lessors is made at inception of the lease and is reassessed only if there is a lease modification and that modification is not accounted for as a separate lease. The classification depends on whether substantially all of the risks and rewards incidental to ownership of the underlying asset have been transferred, based on the substance of the arrangement.

- Under a finance lease, a lessor derecognises the underlying asset and recognises a net investment in the lease. A manufacturer or dealer lessor recognises the selling margin in a finance lease by applying its normal accounting policy for outright sales.

Overview of forthcoming requirements (continued)

- Like IFRS, after initial recognition a lessee measures the lease liability at amortised cost using the effective interest method. The lease liability is also remeasured to reflect lease modifications and changes in the lease payments, like IFRS; however, unlike IFRS, this does not include changes caused by a change in an index or rate unless the lease liability is remeasured for another reason.

- For a finance lease, a lessee measures the right-of-use asset at cost less accumulated amortisation and accumulated impairment losses, like IFRS. For an operating lease, unless the right-of-use asset has been impaired, a lessee amortises the right-of-use asset as a balancing amount that together with accretion on the lease liability generally produces straight-line total lease expense, unlike IFRS. Unlike IFRS, a lessee cannot revalue right-of-use assets, and there is no alternative measurement model for leases of investment property.

- Lessors classify leases as either finance or operating leases. However, unlike IFRS, finance leases are further classified as sales-type leases or direct financing leases.

- Lease classification by lessors is made at commencement of the lease, unlike IFRS. In addition, unlike IFRS, the classification is determined by a series of pass/fail tests intended to determine whether the lessee obtains control of the use of the underlying asset as a result of the lease. Like IFRS, classification is reassessed only if there is a lease modification and that modification is not accounted for as a separate lease.

- Like IFRS, under a sales-type or direct financing lease, a lessor derecognises the underlying asset and recognises a net investment in the lease. Unlike IFRS, any selling margin in a direct financing lease is recognised over the lease term. In addition, unlike IFRS, there is specific guidance on collectibility that may affect timing of recognition of income for a sales-type lease and require classification of a lease as operating that would otherwise be classified as direct financing.
Overview of forthcoming requirements (continued)

- Under an operating lease, the lessor recognises the lease payments as income over the lease term, generally on a straight-line basis. The lessor recognises the underlying asset in its statement of financial position.

- There is specific guidance on accounting for lease modifications by lessees and lessors.

- In a sale-and-leaseback transaction, the seller-lessee first determines if the buyer-lessor obtains control of the asset based on the new revenue standard (see chapter 4.2A). If not, then the transaction is accounted for as a financing.

- In a sub-lease, the intermediate lessor accounts for the head lease and the sub-lease as two separate contracts. An intermediate lessor classifies a sub-lease by reference to the right-of-use asset arising from the head lease.

The requirements in this chapter are forthcoming from the new standard on leases.

The new leases standard is effective for annual periods beginning on or after 1 January 2019. Early adoption is permitted if the new revenue standard is also adopted (see chapter 4.2A). [IFRS 16.C1]

On transition, a lessee can apply either a full retrospective approach, or a modified retrospective approach with one or more practical expedients. A lessor is not required to make any adjustments on transition, except for intermediate lessors in a sub-lease. [IFRS 16.C3–C20]

Overview of forthcoming requirements (continued)

- Like IFRS, under an operating lease, the lessor recognises the lease payments as income over the lease term, generally on a straight-line basis. Like IFRS, the lessor recognises the underlying asset in its statement of financial position. Unlike IFRS, there is specific guidance on collectibility that may result in operating lease income being recognised on a cash basis (i.e. rather than on a straight-line basis).

- There is specific guidance on accounting for lease modifications by lessees and lessors, which differs in some respects from IFRS.

- Like IFRS, in a sale-leaseback transaction the seller-lessee first determines if the buyer-lessor obtains control of the asset based on the new revenue Codification Topic (see chapter 4.2A). However, unlike IFRS, additional considerations apply if there is a seller-lessee repurchase option or if the leaseback would be classified as a finance lease by the seller-lessee (sales-type lease by the buyer-lessor). Like IFRS, if the transaction does not qualify for sale accounting, then it is accounted for as a financing.

- Like IFRS, in a sub-lease transaction, the intermediate lessor accounts for the head lease and the sub-lease as two separate contracts. Unlike IFRS, an intermediate lessor classifies a sub-lease by reference to the underlying asset.

The requirements in this chapter are forthcoming from the new Codification Topic on leases.

The new Codification Topic is effective for annual periods beginning after 15 December 2018 (public business entities) or 15 December 2019 (other entities). Early adoption is permitted. [842-10-65-1]

On transition, both lessees and lessors apply a modified retrospective approach with two sets of practical expedients available. [842-10-65-1]
Scope
The standard deals with all leases, including leases of right-of-use assets in a sub-lease, except for:
– leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (see chapter 5.11);
– leases of biological assets held by a lessee (see chapter 3.9);
– service concession arrangements (see chapter 5.12);
– licences of intellectual property granted by a lessor in the scope of the new revenue standard (see chapter 4.2A); and
– rights held by a lessee under licensing agreements in the scope of the standard on intangible assets for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights. [IFRS 16.3]

A lessee may, but is not required to, apply the new leases standard to leases of intangible assets other than the rights described in the final bullet point above. [IFRS 16.4]

Identification of a lease
A lease is a contract, or part of a contract, that conveys the right to control the use of an identified asset for a period of time in exchange for consideration. An assessment of whether a contract is, or contains, a lease is made at inception of the contract and if its terms and conditions subsequently change. [IFRS 16.9, 11, A]

A contract relates to an identified asset if:
– the asset is specified, either explicitly or implicitly;
– the asset is physically distinct or the customer has the right to receive substantially all of the capacity of the asset; and
– the supplier has no substantive substitution right throughout the period of use. [IFRS 16.B9, B13, B20]

A contract conveys the right to control the use of an identified asset if the customer has the following rights throughout the period of use:
– to obtain substantially all of the economic benefits from using the identified asset; and
– to direct the use of the identified asset. [IFRS 16.B9]

A customer has the right to direct the use of an identified asset only when:
– the customer has the right to direct how and for what purpose the asset is used throughout the period of use; or
– leases of inventory (see chapter 3.8), unlike IFRS; and
– leases of assets under construction when the lessee does not control the asset before the lease commencement date, unlike IFRS. [842-10-15-1, 853-10-25-2]

Unlike IFRS, all leases of intangible assets are excluded from the scope of the new leases Codification Topic. [842-10-15-1]

Identification of a lease
Like IFRS, a lease is a contract, or part of a contract, that conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Like IFRS, an assessment of whether a contract is, or contains, a lease is made at inception of the contract and if its terms and conditions subsequently change. [842-10-15-2 – 15-3, 15-6]

Like IFRS, a contract relates to an identified asset if:
– the asset is specified, either explicitly or implicitly;
– the asset is physically distinct or the customer has the right to receive substantially all of the capacity of the asset; and
– the supplier has no substantive substitution right throughout the period of use. [842-10-15-4, 15-9, 15-16]

Like IFRS, a contract conveys the right to control the use of an identified asset if the customer has the following rights throughout the period of use:
– to obtain substantially all of the economic benefits from using the identified asset; and
– to direct the use of the identified asset. [842-10-15-4]
all relevant decisions about how and for what purpose the asset is used are predetermined and:
- the customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those operating instructions; or
- the customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use. [IFRS 16.B24, B26]

Lease and non-lease components

If a contract is or contains a lease, then the lessee and lessor account for each lease component separately from non-lease components. [IFRS 16.12, B32–B33]

A lessee separates lease and non-lease components and allocates the consideration in the contract based on relative stand-alone prices. If an observable stand-alone price is not readily available, then the lessee makes an estimate, maximising the use of observable information. IFRS does not provide specific guidance for lessees on suitable methods for estimating the stand-alone selling price. [IFRS 16.13–14]

A lessee may elect, by class of underlying asset, not to separate lease components from any associated non-lease components. A lessee that makes this election accounts for the lease component and the associated non-lease component(s) as a single lease component. [IFRS 16.15]

A lessor always separates lease and non-lease components and allocates the consideration in the contract in accordance with the requirements of the new revenue standard – i.e. according to the stand-alone selling prices of the goods and services included in each component (see chapter 4.2A). [IFRS 16.17]

Like IFRS, a lessee may elect, by class of underlying asset, not to separate lease components from any associated non-lease components. Like IFRS, a lessee that makes this election accounts for the lease component and the associated non-lease component(s) as a single lease component. [842-10-15-37]

Like IFRS, a lessor always separates lease and non-lease components and allocates the consideration in the contract in accordance with the requirements of the new revenue Codification Topic – i.e. according to the stand-alone selling prices of the goods and services included in each component (see chapter 4.2A). [842-10-15-38]

Definitions

Lease term

Sometimes, the terms of a lease are enforceable only during a specified period. In this situation, the ‘lease term’ is the non-cancellable (i.e. enforceable) period of the lease, together with:
- optional renewable periods if the lessee is reasonably certain to extend; and
- periods after an optional termination date if the lessee is reasonably certain not to terminate at that date. [IFRS 16.18]
When determining the lease term, an entity considers all relevant facts and circumstances that create an economic incentive making it reasonably certain that the lessee will exercise an option to renew or forfeit an option to terminate early. [IFRS 16.B37]

The lease term includes periods during which the lessor has the unilateral right to terminate the lease, because the lessor can enforce its rights under the agreement during that period. [IFRS 16.B35]

A lease is no longer ‘enforceable’ (i.e. the lease term ends) when both the lessee and lessor have the right to terminate it without agreement from the other party with no more than an insignificant penalty. [IFRS 16.B34]

Variable payments that depend on performance or use of the underlying asset are not included in the lease payments. Such variable payments are excluded from the initial measurement of the lease liability and right-of-use asset. [IFRS 16.A, 24, 27 38(b), BC169]

If a lessee provides a residual value guarantee, then it includes in the lease payments the amount that it expects to pay under that guarantee. [IFRS 16.A, 27]

A lessee determines whether it is reasonably certain that it will exercise a purchase option using an approach similar to the one that it uses to assess whether it expects to exercise a renewal option (see above). [IFRS 16.27(d), B37]

For the lessor, lease payments also include any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee. [IFRS 16.A, 70]

When determining the lease term, an entity considers all relevant economic factors, like IFRS. [842-10-55-26]

Like IFRS, the lease term includes periods during which the lessor has the unilateral right to terminate the lease, because the lessor can enforce its rights under the agreement during that period. [842-10-30-1, 55-24]

Like IFRS, a lease is no longer ‘enforceable’ (i.e. the lease term ends) when both the lessee and lessor have the right to terminate it without agreement from the other party with no more than an insignificant penalty. [842-10-55-23]

Lease payments

Like IFRS, both the lessee and the lessor include the following in the lease payments:
- fixed payments (including in-substance fixed payments) less any lease incentives;
- variable lease payments that depend on an index or a rate;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease, if the lease term reflects the assessment that the lessee will exercise an option to terminate the lease.

[IFRS 16.A, 27, 70]

Like IFRS, variable payments that depend on performance or use of the underlying asset are not included in the lease payments. Such variable payments are excluded from the initial measurement of the lease liability and right-of-use asset. [842-10-30-5, 30-6(a), 842-20-25-5(b), 30-5, ASU 2016-12.BC209]

If a lessee provides a residual value guarantee, then it includes in the lease payments the amount probable of being owed under that guarantee, like IFRS. [842-10-30-5]

Like IFRS, a lessee determines whether it is reasonably certain that it will exercise a purchase option using an approach similar to the one that it uses to assess whether it expects to exercise a renewal option (see above). [842-10-30-5]

Unlike IFRS, for the lessor, lease payments exclude any residual value guarantees (whether provided by the lessee or by another unrelated third party). However, the residual value guarantees are included in the calculation of the lease receivable for sales-type and direct financing leases. This results in similar outcomes in how a residual value guarantee affects a lessor’s net investment in a lease under IFRS and US GAAP. [842-10-30-5, 842-30-30-1 – 30-2]
There is no explicit guidance on payments by the lessee to the owners of a special purpose entity for structuring the transaction.

**Discount rate**

The interest rate implicit in the lease is the rate that causes the present value of the lease payments and the unguaranteed residual value to equal the sum of:
- the fair value of the underlying asset; and
- any initial direct costs of the lessor. [IFRS 16.A]

The lessee’s incremental borrowing rate is the rate that a lessee would have to pay on the commencement date of the lease for a loan of a similar term, and with a similar security, to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. [IFRS 16.A]

**Initial direct costs**

Initial direct costs are incremental costs of obtaining a lease that would not otherwise have been incurred, except for such costs incurred by manufacturer or dealer lessors in connection with finance leases. [IFRS 16.A]

Initial direct costs include commissions and payments made by a potential lessee to an existing tenant to vacate the property so that the potential lessee can obtain the lease. They exclude allocations of internal overhead costs (e.g. those incurred by a sales and marketing team or a purchase team). Legal fees and internal costs that are incremental and directly attributable to negotiating and arranging a lease are considered initial direct costs only if they are contingent on the origination of a lease. [IFRS 16.A]

**Accounting for leases – Lessor**

**Classification of a lease**

A lessor classifies each lease as either an operating lease or a finance lease. [IFRS 16.61, B53]

Unlike IFRS, US GAAP is explicit that lease payments include payments by the lessee to the owners of a special purpose entity for structuring the transaction. [842-10-30-5]

**Discount rate**

The interest rate implicit in the lease is the rate that causes the present value of the lease payments and the unguaranteed residual value to equal the sum of:
- the fair value of the underlying asset, like IFRS; and
- only initial direct costs of the lessor that are deferred; although this wording differs from IFRS, the overall accounting for initial direct costs is the same (see below). [842 Glossary]

The lessee’s incremental borrowing rate is the rate that a lessee would have to pay to borrow, on a collateralised basis and over a similar term, an amount equal to the lease payments in a similar economic environment, like IFRS. [842 Glossary]

**Initial direct costs**

Like IFRS, initial direct costs are incremental costs of obtaining a lease that would not otherwise have been incurred. However, they exclude such costs incurred in connection with sales-type leases that give rise to manufacturer/dealer profit or loss (i.e. where the fair value of the asset differs from its carrying amount). In general, the IFRS identification of costs by manufacturer or dealer lessors in connection with finance leases (see below) results in the same population of costs under IFRS and US GAAP. [842 Glossary, 842-30-25-1(c)]

Like IFRS, initial direct costs include commissions and payments made by a potential lessee to an existing tenant to vacate the property so that the potential lessee can obtain the lease. They exclude the costs that would have been incurred regardless of whether the lease was obtained, including allocations of general overheads, as well as legal fees and internal costs that are not contingent on the origination of a lease, like IFRS. [842-10-30-9 – 30-10]

**Accounting for leases – Lessor**

**Classification of a lease**

Unlike IFRS, a lessor classifies each lease as either an operating lease, sales-type lease or direct financing lease. [842-10-25-2 – 25-3]
A ‘finance lease’ is a lease that transfers substantially all of the risks and rewards incidental to ownership of an underlying asset; title to the asset may or may not transfer under such a lease. An ‘operating lease’ is a lease other than a finance lease. [IFRS 16.62, 65]

The population of ‘sales-type’ and ‘direct financing’ leases is generally equivalent to the population of finance leases under IFRS. However, US GAAP distinguishes between leases that:
- effectively transfer control – i.e. the ability to direct the use and obtain substantially the remaining benefits – of the underlying asset to the lessee (sales-type leases); and
- transfer substantially all of the risks and rewards incidental to ownership of an underlying asset to the lessee and one or more third parties unrelated to the lessor (direct financing leases).

An ‘operating lease’ is a lease other than a sales-type or direct financing lease, like IFRS. [842-10:25-2 – 25-3]

Unlike IFRS, when title to the asset transfers by the end of the lease term, the lease is a sales-type lease. [842-10:25-2]

Unlike IFRS, the classification of a lease is determined at its commencement. Like IFRS, the classification is not revised unless the lease is modified and that modification is not accounted for as a separate lease (see below). [842-10:25-1]

Lessors have to determine which of two types of finance lease an arrangement is: sales-type or direct financing. The differences between the accounting for these leases under IFRS and US GAAP are discussed below. [842-10:25-2 – 25-3]

Criteria for a sales-type or direct financing lease
The criteria for determining whether a lease is a sales-type lease are generally the same as the indicators of a finance lease under IFRS. However, unlike IFRS, the US GAAP criteria function as pass/fail tests and each one is determinative. Also unlike IFRS, the ‘lease term’ and ‘lease payments’ criteria may be evaluated using “bright-line” thresholds (see more below). [842-10:25-2 – 25-3, 55-2]

Indicators of a finance lease
IFRS includes the following series of indicators that individually or in combination normally lead to classification as a finance lease:
- the lease transfers ownership of the underlying asset to the lessee by the end of the lease term;
- the lessee holds a purchase option that is considered reasonably certain to be exercised;
- the lease term is for the major part of the (remaining) economic life of the underlying asset;
- the present value of the lease payments amounts to substantially all of the fair value of the underlying asset; and
- the underlying asset is so specialised that only the lessee can use it without major modification. [IFRS 16.63]

However, lease classification is ultimately based on an overall assessment of whether substantially all of the risks and rewards incidental to ownership of the underlying asset have been transferred. [IFRS 16.61, 63, 65]
IFRS does not define what is meant by the ‘major part’ of an asset’s economic life and no quantitative threshold is provided. In our view, although the optional 75 percent approach under US GAAP may be a useful reference point, it does not represent a bright line or automatic cut-off point under IFRS.

IFRS does not define what is meant by ‘substantially all’ and no quantitative threshold is provided. In our view, although the optional 90 percent approach under US GAAP may provide a useful reference point, it does not represent a bright line or automatic cut-off point under IFRS.

The following are additional indicators that an arrangement may be a finance lease:
- the lessee can cancel the lease but the lessor’s losses associated with the cancellation are borne by the lessee;
- gains or losses from fluctuation in the fair value of the residual fall to the lessee; or
- the lessee can extend the lease at a rent that is substantially lower than the market rent. [IFRS 16.64]

### Classification issues related to land

#### Land leases

A lease of land is classified as an operating or finance lease with reference to the general indicators used for lease classification (see above). In determining the lease classification, an important consideration is that land normally has an indefinite economic life. However, the fact that the lease term is normally shorter than the economic life of the land does not necessarily mean that a lease of land is always an operating lease; the other classification requirements are also considered. Ultimately, the lease classification is based on an overall assessment of whether substantially all of the risks and rewards incidental to ownership of the asset have been transferred from the lessor to the lessee. [IFRS 16.B55]

#### Land and building leases

When a lease includes both land and a building, a lessor assesses the classification of the two leases separately: a lease of the land and a lease of the building, unless the value of the land at inception of the lease is immaterial or it is clear that both elements are either finance leases or operating leases. [IFRS 16.B55–B57]

Unlike IFRS, in determining whether the lease term is for the major part of the economic life of the underlying asset, a threshold of 75 percent or more of the remaining economic life of the asset may, but is not required to, be used. This criterion does not apply when the asset is at or near the end of its economic life (e.g. within the last 25 percent of its total economic life). [842-10-25-2, 55-2]

Unlike IFRS, in determining whether the present value of the lease payments and any residual value guarantee equals or exceeds ‘substantially all’ of the underlying asset’s fair value, a threshold of 90 percent or more of the asset’s fair value may, but is not required to, be used. [842-10-25-2, 55-2]

Unlike IFRS, if the answer to all of the criteria is ‘no’ and therefore the lease is not classified as a sales-type lease, then the lease is classified as a direct financing lease if both of the following criteria are met:
- the present value of the following equals or exceeds substantially all of the underlying asset’s fair value (see above):
  - the lease payments; and
  - any residual value guarantee (from the lessee or an unrelated third party); and
- it is probable that the lessor will collect the lease payments plus any amount necessary to satisfy a residual value guarantee. [842-10-25-3, 55-2]

### Classification issues related to land

#### Land leases

A lease of land is classified with reference to the same pass/fail tests as other assets, which differ in some respects from IFRS (see above). Like IFRS, the fact that land normally has an indefinite economic life will influence the analysis; however, unlike IFRS, that influence only extends to the ‘lease term’ criterion – it does not factor into any overriding assessment of a principle as it does under IFRS.

#### Land and building leases

For leases that include a land element, the right to use the land is considered a separate lease component unless the accounting effect of separately accounting for the land element would be ‘insignificant’ (e.g. lease classification would not differ for either element or the amount that would be allocated to the land component would be insignificant), like IFRS. [842-10-15-29]
Manufacturer or dealer lessors

A finance lease of an asset by a manufacturer or dealer results in two types of income: initial selling profit, and finance income over the lease term. There is no definition of a manufacturer or dealer lessor. [IFRS 16.71–72, 74]

Manufacturer or dealer lessors recognise the selling margin in profit or loss for the period by applying their normal accounting policy for outright sales. [IFRS 16.71–72]

Costs incurred in connection with negotiating and arranging a lease (which are excluded from the definition of initial direct costs – see above) are recognised as an expense in profit or loss when the selling profit is recognised, which is generally at the commencement date of the lease term. [IFRS 16.74]

The sales revenue recognised at commencement of the lease term by the manufacturer or dealer lessor is the fair value of the asset or, if it is lower, the present value of the lease payments computed using a market rate of interest. [IFRS 16.71]

If manufacturer or dealer lessors quote below-market interest rates, then selling profit is restricted to the amount that would have been earned if a market rate of interest was charged. [IFRS 16.73]

Lease receipts are allocated between finance income and reduction of the investment so as to produce a constant rate of return on the net investment. [IFRS 16.75–76]

Other finance leases

Other finance leases are those entered into by lessors other than a manufacturer or dealer lessor; there is no specific definition of these leases.

Initially, the lessor recognises a finance lease receivable at an amount equal to its net investment in the lease, which comprises the present value (using the rate implicit in the lease) of:

- the lease payments; and
- any unguaranteed residual value accruing to the lessor. [IFRS 16.67–68]

Sales-type leases

Like IFRS, a sales-type lease results in two types of income: initial selling profit, and finance income over the lease term. Unlike IFRS, a sales-type lease is a lease that meets specific criteria (see above). [842-30-25-1]

Initial direct costs are either:

- expensed at lease commencement (if the fair value of the underlying asset does not equal its carrying amount), like IFRS; or
- deferred and included in the net investment in the lease (if the fair value of the underlying asset equals its carrying amount), unlike IFRS. [842-30-25-1]

The sales revenue recognised by the sales-type lessor is the lower of:

- the fair value of the underlying asset at the commencement date, like IFRS;
- and
- the sum of the lease receivable and any lease payments prepaid by the lessee; the lease receivable is discounted using the interest rate implicit in the lease, unlike IFRS. [842-30-30-1, 45-4]

Unlike IFRS, there is no adjustment to the selling profit if the lessor quotes below-market interest rates.

Like IFRS, lease receipts are allocated between interest income and reduction of the investment so as to produce a constant rate of return on the net investment. [842-30-35-1]

Direct financing leases

Unlike IFRS, a direct financing lease is a lease that meets specific criteria (see above). [842-30-25-1 – 25-2]

Initially, the lessor recognises a net investment in the lease, which comprises:

- like IFRS, the present value (using the rate implicit in the lease) of:
  - lease payments; and
  - any portion of the estimated residual value at the end of the lease term that is guaranteed (either by the lessee or by a third party unrelated to the lessor), less
- unlike IFRS, any selling profit on the lease (see below). [842-30-30-1 – 30-2]
Initial direct costs are included in the measurement of the net investment in the lease because the interest rate implicit in the lease used for discounting the lease payments takes initial direct costs incurred into consideration. [IFRS 16.69]

A finance lessee may recognise a gain or loss on commencement of a finance lease. However, only a manufacturer or dealer lessee recognises revenue and cost of sales.

Over the lease term, the lessor accrues finance income on the net investment. Lease receipts are allocated between finance income and reduction of the net investment so as to produce a constant rate of return on the net investment. [IFRS 16.75–76]

**Leveraged leases**

IFRS does not include the concept of leveraged leases. All leases other than those entered into by manufacturers or dealers are accounted for under the requirements for other finance leases (see above).

Like IFRS, initial direct costs incurred by the lessor are deferred and recognised over the life of the lease. Unlike IFRS, initial direct costs are recognised as a separate asset (not included in the carrying amount of the underlying asset). [842-30-25-11]

The lessor generally recognises income on a straight-line basis over the lease term. The lessor recognises lease income using another systematic basis if that is more representative of the time pattern in which the benefit of the underlying asset is diminished. [IFRS 16.81]

Lease incentives granted to the lessee are recognised as reductions of rental income over the term of the lease. [IFRS 16.81, A]

Like IFRS, the new leases Codification Topic does not include the concept of leveraged leases. However, unlike IFRS, leveraged leases under the old leases Codification Topic (see chapter 5.1) that have commenced before the effective date of the new Codification Topic are grandfathered and exempt from applying the new requirements unless they are modified on or after the effective date. [842-10-65-1]

Like IFRS, a lessor under an operating lease continues to recognise the leased asset in its statement of financial position and accounts for it in the same way as other assets of the same type – i.e. as property, plant and equipment (see chapter 3.2). [IFRS 16.88]

Initial direct costs incurred by the lessor are added to the carrying amount of the underlying asset. These initial direct costs are recognised as an expense on the same basis as the lease income. [IFRS 16.83]

The lessor generally recognises income on a straight-line basis over the lease term. Like IFRS, the lessor recognises lease income using another systematic basis if that is more representative of the time pattern in which the benefit of the underlying asset is expected to be derived from the use of the underlying asset. [842-30-25-11]

Like IFRS, lease incentives granted to the lessee are recognised as reductions of rental income over the term of the lease. [842-30-25-11]

Unlike IFRS, any selling profit in a direct financing lease is recognised as a reduction in the measurement of the net investment in the lease, and is instead recognised over the lease term. Any selling loss is recognised at lease commencement, like IFRS. [842-30-25-8]

Like IFRS, over the lease term the lessor accrues interest income on the net investment in the lease. Like IFRS, lease receipts are allocated between interest income and reduction of the net investment so as to produce a constant rate of return on the net investment. [842-30-35-1]
**Accounting for leases – Lessee**

A lessee applies a single lease accounting model under which it recognises all leases on-balance sheet at the commencement date, except leases to which it elects to apply the recognition exemptions (see below). A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. [IFRS 16.22]

**Recognition exemptions**

A lessee can elect not to apply the lessee accounting model to leases with a lease term of 12 months or less (i.e. short-term leases). This election is made by class of underlying asset. [IFRS 16.5(a), 8]

A lease that contains a purchase option is not a short-term lease. [IFRS 16.A]

A lessee can elect not to apply the lessee accounting model to leases for which the underlying asset is of low value when it is new, even if the effect is material in aggregate. This election is made on a lease-by-lease basis. [IFRS 16.5(b), 8]

A lessee does not apply the low-value exemption to a lease of an individual asset in either of the following scenarios:

- if the underlying asset is highly dependent on, or highly inter-related with, other assets; or
- if the lessee cannot benefit from the underlying asset on its own or together with other readily available resources, irrespective of the value of that underlying asset. [IFRS 16.B5]

The low-value exemption also does not apply to a head lease of an asset that is sub-leased or that is expected to be sub-leased. [IFRS 16.B7]

If a lessee elects either or both recognition exemptions, then it recognises the related lease payments as an expense on either a straight-line basis over the lease term or another systematic basis if that basis is more representative of the pattern of the lessee’s benefit. [IFRS 16.6]

**Accounting for leases – Lessee**

Unlike IFRS, a lessee classifies a lease as a finance lease or an operating lease using the same classification criteria as lessors for a sales-type lease (see above). [842-10-25-2]

Both classifications result in the lessee recognising a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments, like IFRS. However, unlike IFRS, there are differences between the two models relating to subsequent measurement.

**Recognition exemptions**

Like IFRS, a lessee can elect not to apply the lessee accounting model to leases with a lease term of 12 months or less (i.e. short-term leases). This election is made by class of underlying asset. [842 Glossary, 842-20-25-2 – 25-3]

Unlike IFRS, a lease that contains a purchase option can qualify as a short-term lease if the lessee is not reasonably certain to exercise its option to purchase the underlying asset. [842 Glossary]

Unlike IFRS, there is no exception for leases for which the underlying asset is of low value.

If a lessee elects the short-term lease exemption, then it recognises the related lease payments as an expense on a straight-line basis over the lease term, which is more restrictive than IFRS. [842-20-25-2]
If a lessee elects the short-term lease exemption and the lease term changes subsequently (e.g. because the lessee exercises an option not previously included in the determination of the lease term), then the lease is considered to be a new lease, which may or may not qualify as a short-term lease. [IFRS 16.7]

Initial measurement
The lease liability is initially measured at the present value of the future lease payments calculated using the interest rate implicit in the lease if it is readily determinable. If the lessee cannot readily determine that rate, then it uses its incremental borrowing rate. [IFRS 16.26]

IFRS does not include guidance for non-public business entities. All lessees therefore apply the discount rate guidance in the new leases standard.

A lessee initially measures the right-of-use asset at cost that includes the following:
– the amount of the initial measurement of the lease liability (see above);
– any lease payments made at or before the commencement date, less any lease incentives received;
– any initial direct costs incurred by the lessee; and
– an estimate of the dismantling, removal and restoration costs to be incurred by the lessee based on the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period. [IFRS 16.23–24]

Subsequent measurement
There is a single model for lessee accounting.

Single model
After initial recognition, the lease liability is measured at amortised cost using the effective interest method. [IFRS 16.36]

Unlike IFRS, if the lease term changes such that the remaining lease term does not extend more than 12 months from the end of the previously determined lease term, the lease still qualifies as a short-term lease. [842-20-25-3]

Initial measurement
Like IFRS, the lease liability is initially measured at the present value of the future lease payments calculated using the interest rate implicit in the lease if it is readily determinable. If the lessee cannot readily determine that rate, then it uses its incremental borrowing rate, like IFRS. [842-20-30-1 – 30-3]

Unlike IFRS, non-public business entity lessees can elect as an accounting policy to use a risk-free rate. [842-20-30-3]

Like IFRS, a lessee initially measures the right-of-use asset at a cost that includes the following:
– the amount of the initial measurement of the lease liability (see above);
– any lease payments made at or before the commencement date, less any lease incentives received; and
– any initial direct costs incurred by the lessee. [842-20-30-6]

Like IFRS, the initial measurement of the right-of-use asset also includes an estimate of the dismantling, removal and restoration costs to be incurred by the lessee based on the terms and conditions of the lease. However, unlike IFRS, there is no exception when those costs are incurred to produce inventories. Like IFRS, the lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period. [410-20-35-1, 35-8]

Subsequent measurement
Unlike IFRS, there is a dual model for lessee accounting under US GAAP: finance leases and operating leases. Initial recognition and measurement are the same for both, but there are differences in the subsequent accounting.

Finance leases
Like IFRS, after initial recognition, the lease liability is measured at amortised cost using the effective interest method. [842-20-35-1]
A lessee remeasures the lease liability to reflect changes in the lease payments by discounting the revised lease payments using:

- an unchanged discount rate when:
  - the amount expected to be payable under a residual value guarantee changes;
  - future lease payments change to reflect market rates (e.g., based on a market rent review) or a change in an index or rate (other than in floating interest rates) used to determine lease payments; or
  - the variability of payments is resolved so that they become in-substance fixed payments; and
- a revised discount rate when:
  - future lease payments change as a result of a change in floating interest rates;
  - the lease term changes; or
  - the assessment of the exercise of a purchase option changes.[IFRS 16.40–43, B42]

Like IFRS, a lessee remeasures the lease liability to reflect changes in the lease payments by discounting the revised lease payments using:

- an unchanged discount rate when:
  - the amount probable of being owed under a residual value guarantee changes;
  - the variability of payments is resolved so that they become fixed payments; and
- a revised discount rate when:
  - the lease term changes; or
  - the assessment of the exercise of a purchase option changes.[IFRS 16.40–43, B42]

Unlike IFRS, a lessee does not remeasure the lease liability for changes in future lease payments arising from changes in an index or rate unless the lease liability is remeasured for another reason—e.g., the lease term changes. Instead, after initial recognition, such variable lease payments are recognised as they are incurred.[842-10-35-6]

A lessee subsequently measures right-of-use assets at cost less accumulated depreciation and accumulated impairment losses, unless it applies:

- the revaluation model; or
- the right-of-use asset meets the definition of investment property and the lessee accounts for its investment property under the fair value model (see chapter 3.4).[IFRS 16.29–30, 34–35, IAS 40.40A]

Unlike IFRS, a lessee always measures right-of-use assets at cost less accumulated amortisation and accumulated impairment losses.[842-10-35-7]

A lessee adjusts the carrying amount of the right-of-use asset for remeasurement of the lease liability arising from a change in lease payments, unless the carrying amount has already been reduced to zero or the change relates to variable lease payments that do not depend on an index or rate.[IFRS 16.30(b), 38(b), 39]

Like IFRS, a lessee adjusts the carrying amount of the right-of-use asset for remeasurement of the lease liability arising from a change in lease payments, unless the carrying amount has already been reduced to zero or the change relates to variable lease payments that do not depend on an index or rate.[842-20-35-4]

Operating leases

After lease commencement, a lessee measures the lease liability at the present value of the unpaid lease payments discounted at the discount rate for the lease established at the commencement date. An exception to this general principle occurs when the rate is updated as a result of a lease remeasurement (which is the same as for finance leases) or a modification that is not accounted for as a separate contract (see below).[842-20-35-3]
After lease commencement, a lessee measures the right-of-use asset as follows, unless it has been impaired (see below):
- lease liability carrying amount;
- plus unamortised initial direct costs;
- plus or minus prepaid (accrued) lease payments; and
- the unamortised balance of lease incentives received. [842-20-35-3]

Alternatively, the carrying amount of an operating lease right-of-use asset can be determined based on the carrying amount of the right-of-use asset less accumulated amortisation. Under this method, amortisation each period is calculated as the difference between the straight-line lease cost for the period (which includes the amortisation of initial direct costs) and the periodic accretion of the lease liability using the effective interest method.

Once a right-of-use asset has been impaired (see below), its post-impairment carrying amount is subsequently amortised on a straight-line basis unless another systematic basis is more representative of the pattern in which the lessee expects to consume the future economic benefits. [842-20-35-10]

### Depreciation and impairment of right-of-use asset

A right-of-use asset is depreciated in accordance with the depreciation requirements for property, plant and equipment (see chapter 3.2).

If ownership of the underlying asset is transferred to the lessee, or the lessee is reasonably certain to exercise a purchase option, then the depreciation period runs to the end of the useful life of the underlying asset. Otherwise, the depreciation period runs to the earlier of:
- the end of the useful life of the right-of-use asset; or
- the end of the lease term. [IFRS 16.32]

A lessee applies the impairment standard to determine whether a right-of-use asset is impaired and to account for any impairment (see chapter 3.10). After recognition of an impairment loss, the future depreciation charges for the right-of-use asset are adjusted to reflect the revised carrying amount. [IFRS 16.33, IAS 36.33]

### Amortisation and impairment of right-of-use asset

A right-of-use asset is amortised as explained above, which differs from IFRS because of the additional operating lease model under US GAAP. In particular, the amortisation of operating lease right-of-use assets does not conform to the amortisation for any owned tangible or intangible assets under US GAAP.

Like IFRS, if ownership of the underlying asset is transferred to the lessee, or the lessee is reasonably certain to exercise a purchase option, then the amortisation period runs to the end of the useful life of the underlying asset. Otherwise, the amortisation period runs to the earlier of:
- the end of the useful life of the right-of-use asset; or
- the end of the lease term. [842-20-35-8]

A lessee applies the impairment Codification Subtopic to determine whether a right-of-use asset is impaired and to account for any impairment, which differs in some respects from IFRS (see chapter 3.10). Like IFRS, after recognition of an impairment loss, the future amortisation charges for the right-of-use asset are adjusted to reflect the revised carrying amount. [842-20-25-7, 35-9 – 35-10]
**Lease modifications**

A ‘lease modification’ is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease – e.g. adding or terminating the right to use one or more underlying assets. [IFRS 16.A]

**Lessor**

A lessor in a finance lease accounts for a lease modification as a separate lease if both of the following conditions exist:
- the modification increases the scope of the lease by adding the right to use one or more underlying assets; and
- the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract. [IFRS 16.79]

If the modification is not a separate lease, then the lessor accounts for a modification to a finance lease as follows:
- if the lease would have been classified as an operating lease if the modification had been in effect at the inception date, then the lessor:
  - accounts for the lease modification as a new lease from the effective date of the modification; and
  - measures the carrying amount of the underlying asset as the net investment in the original lease immediately before the effective date of the lease modification; or otherwise
- applies the requirements of the new financial instruments standard. [IFRS 16.80]

**Lease modifications**

Like IFRS, a ‘lease modification’ is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease – e.g. adding or terminating the right to use one or more underlying assets. [842 Glossary]

**Lessor**

Like IFRS, a lessor in a sales-type or direct financing lease accounts for a lease modification as a separate contract (lease) if both of the following conditions exist:
- the modification grants the lessee an additional right of use that was not included in the original contract; and
- the lease payments increase commensurate with the stand-alone price for the additional right of use, as adjusted for the particular circumstances of the contract. [842-10-25-8]

If the modification is not a separate contract, then the lessor accounts for a modification to a sales-type lease as follows.
- Like IFRS, if the modified lease is an operating lease, then the lessor measures the carrying amount of the underlying asset as equal to the carrying amount of the net investment in the original lease immediately before the modification. However, unlike IFRS, the assessment of whether the modified lease is an operating lease occurs at the modification date, based on the facts and circumstances at that date.
- Unlike IFRS, if the modified lease is a sales-type or direct financing lease, then the lessor measures the initial net investment in the modified lease as equal to the carrying amount of the net investment in the original lease immediately before the modification. [842-10-25-17]

If the modification is not a separate contract, then the lessor accounts for a modification to a direct financing lease as follows.
- Like IFRS, if the modified lease is an operating lease, then the lessor measures the carrying amount of the underlying asset as equal to the carrying amount of the net investment in the original lease immediately before the modification. However, unlike IFRS, the assessment of whether the modified lease is an operating lease occurs at the modification date, based on the facts and circumstances at that date.
- Unlike IFRS, if the modified lease is a sales-type lease, then the lessor accounts for the lease in accordance with the guidance on sales-type leases (see above) such that a selling profit or selling loss is recognised. The commencement date of the modified lease is treated as the date of modification.
A lessor accounts for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease. [IFRS 16.87]

Lessee

A lessee accounts for a modification as a separate lease if both conditions mentioned above for a lessor exist. [IFRS 16.44]

For a lease modification that is not a separate lease, at the effective date of the modification, the lessee accounts for the lease modification by remeasuring the lease liability using a discount rate determined at that date and:

- for lease modifications that decrease the scope of the lease, the lessee decreases the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease, and recognises a gain or loss that reflects the proportionate decrease in scope; and
- for all other lease modifications, the lessee makes a corresponding adjustment to the right-of-use asset. [IFRS 16.45–46]

Unlike IFRS, if the modified lease is a direct financing lease, then the lessor measures the initial net investment in the modified lease as equal to the carrying amount of the net investment in the original lease immediately before the modification. [842-10-25-16]

If the modification is not a separate contract (see above), then the lessor accounts for a modification to an operating lease as follows.

- Like IFRS, if the modified lease is an operating lease, then the lessor accounts for the lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the modified lease.
- Unlike IFRS, if the modified lease is a sales-type or direct financing lease, then the lessor derecognises any deferred rent liability or accrued rent asset and adjusts the selling profit (loss) accordingly, which is deferred for a direct financing lease (see above). [842-10-25-15]

Lessee

A lessee accounts for a modification to a finance or operating lease as a separate contract if both conditions mentioned above for a lessor exist, which are like IFRS. [842-10-25-8]

Like IFRS, if the modification is not a separate contract, at the effective date of the modification, then the lessee accounts for the lease modification by remeasuring the lease liability using a discount rate determined at that date and:

- for lease modifications that decrease the scope of the lease, the lessee decreases the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease, and recognises a gain or loss that reflects the proportionate decrease in scope; and
- for all other lease modifications, the lessee makes a corresponding adjustment to the right-of-use asset. [842-10-25-11 – 25-13]

Unlike IFRS, if the original lease is a finance lease, the modification is not a separate contract and the modified lease is an operating lease, then the right-of-use asset is measured in accordance with the guidance for the initial recognition of a new operating lease (see above). The corresponding difference is accounted for as a rent prepayment or lease incentive. [842-10-25-14]
Specific application issues

Sale-and-leaseback transactions
For both the seller-lessee and buyer-lessee, the accounting for a sale-and-leaseback transaction depends on whether the initial transfer of the underlying asset from the seller-lessee to the buyer-lessor is a sale. The parties apply the new revenue standard to determine whether a sale has taken place (see chapter 4.2A). [IFRS 16.99]

If the seller-lessee has a substantive option to repurchase the underlying asset, then the transfer is not a sale. [IFRS 16.99, BC262(c), 15.BC427]

Both parties account for a transaction that does not qualify for sale accounting as a financing in the scope of the new financial instruments standard. [IFRS 16.103]

If the transaction qualifies for sale accounting, then:
– the buyer-lessee recognises the underlying asset and applies the lessor accounting model to the leaseback; and
– the seller-lessee derecognises the underlying asset and applies the lessee accounting model to the leaseback. [IFRS 16.100]

The seller-lessee measures the right-of-use asset at the retained portion of the previous carrying amount (i.e. at cost). It recognises only the amount of any gain or loss related to the rights transferred to the buyer-lessee. [IFRS 16.100]

Adjustments are required if the sale is not at fair value or lease payments are off-market. [IFRS 16.101–102]

Other issues

Sale-leaseback transactions
Like IFRS, for both the seller-lessee and buyer-lessee, the accounting for a sale-leaseback transaction depends on whether the initial transfer of the underlying asset from the seller-lessee to the buyer-lessee is a sale. Like IFRS, the new revenue Codification Topic applies to determine whether a sale has taken place (see chapter 4.2A). [842-40-25-1]

Unlike IFRS, if the seller-lessee has a substantive option to repurchase an underlying asset that is not real estate, then the transfer may be a sale if:
– the strike price to repurchase the asset is its fair value at the date of exercise; and
– assets that are substantially the same as the underlying asset are readily available. [842-40-25-3]

Unlike IFRS, if the leaseback would be classified as a finance lease by the seller-lessee (or as a sales-type lease by the buyer-lessee), then sale recognition is automatically precluded. [842-40-25-2]

Like IFRS, both parties account for a transaction that does not qualify for sale accounting as a financing. [842-40-25-5]

Like IFRS, if the transaction qualifies for sale accounting, then:
– the buyer-lessee recognises the underlying asset and applies the lessor accounting model to the leaseback; and
– the seller-lessee derecognises the underlying asset and applies the lessee accounting model to the leaseback. [842-40-25-4]

Unlike IFRS, the seller-lessee measures the right-of-use asset at the discounted present value of the lease payments as it would for any other lease (subject to any adjustments described below). Unlike IFRS, it recognises a gain or loss for the difference between the sale proceeds (subject to any adjustments described below) and the carrying amount of the underlying asset. [842-40-30-1]

Like IFRS, adjustments are required if the sale is not at fair value or lease payments are off-market. [842-40-30-2 – 30-3]
**Sub-leases**

A ‘sub-lease’ is a transaction in which a lessee (or ‘intermediate lessor’) grants a right to use the underlying asset to a third party, and the lease (or “head lease”) between the original lessor and lessee remains in effect. The intermediate lessor accounts for the head lease and the sub-lease as two different contracts. [IFRS 16.A, 3]

An intermediate lessor classifies the sub-lease as a finance lease or as an operating lease with reference to the right-of-use asset arising from the head lease. [IFRS 16.B58]

**Leases between related parties**

There is no specific guidance on accounting for leases between related parties and the general requirements outlined above apply.

**Sub-leases**

Like IFRS, a ‘sub-lease’ is a transaction in which a lessee (or ‘intermediate lessor’) grants a right to use the underlying asset to a third party, and the lease (or “head lease’) between the original lessor and lessee remains in effect. The intermediate lessor accounts for the head lease and the sub-lease as two different contracts. [842 Glossary]

Unlike IFRS, an intermediate lessor classifies the sub-lease as a finance lease or as an operating lease with reference to the underlying asset, which may frequently result in different sublease classification between IFRS and US GAAP. [842-10-25-2 – 25-3]

**Leases between related parties**

Unlike IFRS, an entity accounts for a lease between related parties on the basis of the legally enforceable terms and conditions of the lease. If a sale-leaseback transaction is between related parties, then neither party makes an adjustment for off-market terms. [842-10-55-12, 842-40-30-4]
5.2 Operating segments

(Grant Thornton) (IFRS 8)

Overview

- Segment disclosures are required by entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market.

- Segment disclosures are provided about the components of the entity that management monitors in making decisions about operating matters (the ‘management approach’).

- Such components (operating segments) are identified on the basis of internal reports that the entity’s chief operating decision maker (CODM) regularly reviews in allocating resources to segments and in assessing their performance.

- The aggregation of operating segments is permitted only when the segments have ‘similar’ economic characteristics and meet a number of other criteria.

- Reportable segments are identified based on quantitative thresholds of revenue, profit or loss or total assets.

- The amounts disclosed for each reportable segment are the measures reported to the CODM, which are not necessarily based on the same accounting policies as the amounts recognised in the financial statements.

(US) (Topic 280)

Overview

- Like IFRS, segment disclosures are required by entities whose debt or equity securities are traded in a public market, or that are in the process of issuing such securities.

- Like IFRS, the Codification Topic is based on a ‘management approach’, which requires segment disclosures based on the components of the entity that management monitors in making decisions about operating matters.

- Like IFRS, such components (operating segments) are identified on the basis of internal reports that the entity’s chief operating decision maker (CODM) regularly reviews in allocating resources to segments and in assessing their performance.

- Like IFRS, the aggregation of operating segments is permitted only when the segments have ‘similar’ economic characteristics and meet a number of other criteria.

- Like IFRS, reportable segments are identified based on quantitative thresholds of revenue, profit or loss or total assets.

- Like IFRS, the amounts disclosed for each reportable segment are the measures reported to the CODM, which are not necessarily based on the same accounting policies as the amounts recognised in the financial statements.
**Overview (continued)**

- As part of the disclosures, an entity reports a measure of profit or loss for each reportable segment and, if reported to the CODM, a measure of total assets and liabilities for each reportable segment.

- Disclosures are required for additions to non-current assets, with certain exceptions.

- Reconciliations between total amounts for all reportable segments and financial statement amounts are disclosed with a description of reconciling items.

- General and entity-wide disclosures include information about products and services, geographic areas, major customers, the factors used to identify an entity’s reportable segments, and the judgements made by management in applying the aggregation criteria. Such disclosures are required even if an entity has only one segment.

- Comparative information is normally revised for changes in reportable segments.

**Scope**

The disclosure of segment information is required by those entities whose debt or equity instruments are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or that file, or are in the process of filing, their financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market. [IFRS 8.2]

Segment disclosures are made in the notes to the financial statements. [IFRS 8.20]

**Overview (continued)**

- Like IFRS, as part of the disclosures, an entity reports a measure of profit or loss for each reportable segment. Unlike IFRS, an entity is also required to disclose a measure of total assets for each reportable segment in all cases. In addition, unlike IFRS, there is no requirement to disclose information about liabilities.

- Like IFRS, disclosures are required for additions to long-lived assets, with certain exceptions. However, the exceptions differ in certain respects from IFRS.

- Like IFRS, reconciliations between total amounts for all reportable segments and financial statement amounts are disclosed, with a description of reconciling items.

- Like IFRS, general and entity-wide disclosures are required, including information about products and services, geographic areas, major customers and factors used to identify an entity’s reportable segments. Such disclosures are required even if an entity has only one segment, like IFRS. However, unlike IFRS, there is no explicit requirement to disclose the judgements made by management in applying the aggregation criteria.

- Like IFRS, comparative information is normally revised for changes in operating segments.

**Scope**

Like IFRS, the disclosure of segment information is required by entities whose debt or equity securities are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or that are in the process of issuing such securities. [280-10-15]

Like IFRS, segment disclosures are made in the notes to the financial statements. [280-10-50]
Objective
The objective of the operating segments standard is the disclosure of information that enables users of an entity’s financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates. [IFRS 8.1]

Management approach
Segment disclosure is based on the components of the entity that the CODM monitors in making decisions about operating matters (the ‘management approach’). [IFRS 8.BC4, BC10]

Components are identified as operating segments on the basis of internal reports that the entity’s CODM regularly reviews in allocating resources to segments, and in assessing their performance. [IFRS 8.BC4, BC10]

The term ‘CODM’ refers to a function, rather than to a specific title. [IFRS 8.7]

Identification of operating segments
An ‘operating segment’ is a component of an entity:
– that engages in business activities from which it may earn revenues and incur expenses;
– whose operating results are reviewed regularly by the CODM; and
– for which discrete information is available. [IFRS 8.5]

The different stages in a vertically integrated operation may each be considered an operating segment if they meet the above definition of an operating segment – i.e. a segment is not required to have external revenues. [IFRS 8.5(a)]

Entities that have a ‘matrix’ form of organisation whereby business components are managed in more than one way (e.g. geographically and by products or services) determine operating segments consistent with the objective of the standard (see above) if more than one set of components is reviewed by the CODM. [IFRS 8.10]

Objective
Like IFRS, the objective of requiring disclosures about segments of an entity and related information is to provide information about the different types of business activities in which an entity engages and the different economic environments in which it operates, to help users. [280-10-10-1]

Management approach
Like IFRS, segment disclosure is based on the components of the entity that the CODM monitors in making decisions about operating matters (the ‘management approach’). [280-10-50]

Like IFRS, components (operating segments) are identified on the basis of internal reports that the entity’s CODM regularly reviews in allocating resources to segments, and in assessing their performance. [280-10-50-1]

Like IFRS, the ‘CODM’ refers to a function, rather than to a specific title. [280-10-50-6]

Identification of operating segments
Like IFRS, an ‘operating segment’ is a component of an entity:
– that engages in business activities from which it may earn revenues and incur expenses;
– whose operating results are reviewed regularly by the CODM; and
– for which discrete information is available. [280-10-50-1]

Like IFRS, the different stages in a vertically integrated operation may each be considered an operating segment if they meet the above definition of an operating segment – i.e. a segment is not required to have external revenues. [280-10-50-2]

Unlike IFRS, entities that have a ‘matrix’ form of organisation whereby business components are managed in more than one way (e.g. geographically and by products or services) determine operating segments based on products and services if more than one set of components is reviewed by the CODM. [280-10-50-9]
Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the objective of the standard (see above), the segments have similar economic characteristics and the segments are similar in each of the following areas:

- the nature of the products and services;
- the nature of the production processes;
- the type or class of customer for their products and services;
- the methods used to distribute their products or provide their services; and
- if applicable, the nature of the regulatory environment – e.g. banking, insurance or public utilities. [IFRS 8.12]

### Identification of reportable segments

A reportable segment is based on quantitative thresholds, compared with the combined total for all operating segments rather than with consolidated amounts. A ‘reportable segment’ is any operating segment that represents 10 percent or more of:

- revenue, both internal and external, from all operating segments;
- the greater in absolute value of the total profit of all operating segments reporting a profit, and the total loss of all operating segments reporting a loss; or
- total assets from all operating segments. [IFRS 8.13]

An operating segment below the quantitative size thresholds (see above) may be:

- designated as a reportable segment despite its size;
- combined with other operating segments that fall below the size thresholds if they have similar economic characteristics and share most of the additional aggregation criteria (see above); or
- combined and disclosed in an ‘all other segments’ category that is separate from other reconciling items, together with all other operating segments that fall below the size thresholds and for which neither of the above presentation options is selected. [IFRS 8.13–14, 16]

Total external revenue of the identified reportable segments needs to be 75 percent or more of total consolidated revenue. If not, then additional operating segments are required to be reported separately from ‘other segments’ until at least 75 percent of total consolidated revenue is accounted for by reportable segment. [IFRS 8.15]

Like IFRS, two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the objective of the Codification Topic (see above), the segments have similar economic characteristics and the segments are similar in each of the following areas:

- the nature of the products and services;
- the nature of the production processes;
- the type or class of customer for their products and services;
- the methods used to distribute their products or provide their services; and
- if applicable, the nature of the regulatory environment – e.g. banking, insurance or public utilities. [280-10-50-11]

### Identification of reportable segments

Like IFRS, a reportable segment is based on quantitative thresholds, compared with the combined total for all operating segments rather than with consolidated amounts. Like IFRS, a ‘reportable segment’ is any operating segment that represents 10 percent or more of:

- revenue, both internal and external, from all operating segments;
- the greater in absolute value of the total profit of all operating segments reporting a profit, and the total loss of all operating segments reporting a loss; or
- total assets from all operating segments. [280-10-50-12]

Like IFRS, an operating segment below the quantitative size thresholds (see above) may be:

- designated as a reportable segment despite its size;
- combined with other operating segments that fall below the size thresholds if they have similar economic characteristics and share most of the additional aggregation criteria (see above); or
- combined and disclosed in an ‘all other segments’ category that is separate from other reconciling items, together with all other operating segments that fall below the size thresholds and for which neither of the above presentation options is selected. [280-10-50-13 – 50-19]

Like IFRS, total external revenue of the identified reportable segments needs to be 75 percent or more of total consolidated revenue. If not, then additional operating segments are required to be reported separately from ‘other segments’ until at least 75 percent of total consolidated revenue is accounted for by reportable segment, like IFRS. [280-10-50-14]
Disclosure
An entity discloses the factors used to identify reportable segments and the judgements made by management in applying the aggregation criteria. The latter includes:

- a brief description of operating segments that have been aggregated; and
- the economic indicators that have been assessed in determining that the operating segments have similar economic characteristics. [IFRS 8.22]

An entity reports a measure of profit or loss for each reportable segment, and a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the CODM. [IFRS 8.23]

Additionally, the following disclosures are required for each reportable segment if such amounts are included in the measure of segment profit or loss reviewed by the CODM or are otherwise provided regularly to the CODM, even if they are not included in that measure of segment profit or loss:

- revenue, distinguishing between external customers and inter-segment sales;
- interest revenue and expense;
- depreciation and amortisation, and other non-cash items;
- material items of income and expense disclosed in accordance with the standard on the presentation of financial statements;
- the share of results and carrying amount of equity-accounted investees (see chapter 3.5);
- income tax; and
- additions to non-current assets (including tangible and intangible assets), other than financial instruments, deferred tax assets, post-employment benefit assets and rights under insurance contracts. [IFRS 8.23–24]

The following entity-wide disclosures are required, based on the financial information used to produce the entity’s financial statements:

- revenue from external customers for each product/service or each group thereof;
- revenue from external customers, and non-current assets, by geographic area; and
- revenue from each major customer and the segment(s) reporting the revenue. [IFRS 8.32–34]

Disclosure
Like IFRS, an entity discloses the factors used to identify reportable segments; however, unlike IFRS, there is no explicit requirement under US GAAP to disclose the judgements made by management in applying the aggregation criteria. [280-10-50-21]

Like IFRS, an entity reports a measure of profit or loss and, unlike IFRS, an entity is required to report total assets for each reportable segment regardless of whether such a measure is reported to the CODM. Unlike IFRS, there is no requirement to disclose information about liabilities by reportable segment. [280-10-50-20 – 50-26]

Additionally, the following disclosures for all reportable segments are required if such specified amounts are included in the measure of segment profit or loss reviewed by the CODM or are otherwise provided regularly to the CODM, even if they are not included in that measure of segment profit or loss:

- revenue, distinguishing between external customers and inter-segment sales, like IFRS;
- interest revenue and expense, like IFRS;
- depreciation and amortisation, and other non-cash items, like IFRS;
- unusual items of income and expense disclosed in accordance with US GAAP, which may differ from IFRS;
- the share of results and carrying amount of equity-method investees (see chapter 3.5), like IFRS;
- income tax, like IFRS; and
- additions to long-lived assets other than:
  - financial instruments and deferred tax assets, like IFRS;
  - deferred policy acquisition costs, long-term customer relationships of a financial institution, mortgage and other servicing rights, unlike IFRS. [280-10-50-22, 50-26]

The following entity-wide disclosures are required, based on the financial information used to produce the entity’s financial statements:

- revenue from external customers for each product/service or each group thereof, like IFRS;
- revenue from external customers by geographic area, like IFRS;
- long-lived tangible assets by geographic area, which is narrower than the IFRS requirement in respect of non-current assets; and
- revenue from each major customer and the segment(s) reporting the revenue, like IFRS. [280-10-50-38 – 50-42]
A reconciliation is required between the total of all reported segments, including ‘other’ segments, and the amounts reported in the financial statements, including all adjustments to reconcile internal reports for segment disclosures to the financial statement information reported in accordance with IFRS. [IFRS 8.28]

**Change in identification of segments**

A change in the composition of segments requires the revision of comparative information unless the information is not available and the cost to develop it would be excessive. If comparative segment information is not presented on the new basis, then segment information is presented on both the old and the new bases in the period in which segment composition changes, unless the necessary information is not available and the cost to develop it would be excessive. [IFRS 8.29–30]

Like IFRS, a reconciliation is required between the total of all reported segments, including ‘other’ segments, and the amounts reported in the financial statements, including all adjustments to reconcile internal reports for segment disclosures to the financial statement information reported in accordance with US GAAP. [280-10-50-30 – 50-31]

**Change in identification of segments**

Like IFRS, a change in the composition of segments requires the revision of comparative information unless the information is not available and the cost to develop it would be excessive. If comparative segment information is not presented on the new basis, then segment information is presented on both the old and the new bases in the period in which segment composition changes unless it is impracticable to do so, like IFRS. [280-10-50-17, 50-34 – 50-36]
5.3 Earnings per share

Overview

– Basic and diluted EPS are presented by entities whose ordinary shares or potential ordinary shares are traded in a public market or that file, or are in the process of filing, their financial statements for the purpose of issuing any class of ordinary shares in a public market.

– Basic and diluted EPS for both continuing operations and profit or loss are presented in the statement of profit or loss and OCI, with equal prominence, for each class of ordinary shares that has a differing right to share in the profit or loss for the period.

– Separate EPS information is disclosed for discontinued operations, either in the statement of profit or loss and OCI or in the notes to the financial statements.

– Basic EPS is calculated by dividing the profit or loss attributable to holders of ordinary equity of the parent by the weighted-average number of ordinary shares outstanding during the period.

– To calculate diluted EPS, profit or loss attributable to ordinary equity holders, and the weighted-average number of shares outstanding, are adjusted for the effects of all dilutive potential ordinary shares.

– Potential ordinary shares are considered dilutive only if they decrease EPS or increase loss per share from continuing operations. In determining whether potential ordinary shares are dilutive or anti-dilutive, each issue or series of potential ordinary shares is considered separately, rather than in aggregate.

Overview

– Like IFRS, basic and diluted EPS are presented by entities whose common shares or potential common shares are traded in a public market or that file, or are in the process of filing, their financial statements for the purpose of issuing any class of common shares in a public market.

– Like IFRS, basic and diluted EPS for both continuing operations and net income are presented in the statement that reports profit or loss, with equal prominence, for each class of common shares.

– Like IFRS, separate EPS information is disclosed for discontinued operations either in the statement that reports profit or loss or in the notes to the financial statements.

– Like IFRS, basic EPS is calculated by dividing the earnings attributable to holders of ordinary equity of the parent by the weighted-average number of common shares outstanding during the period.

– Like IFRS, diluted EPS is calculated based on profit or loss available to common shareholders and the weighted-number of shares outstanding, adjusted for the effects of all dilutive potential common shares.

– Like IFRS, potential ordinary shares are considered dilutive only if they decrease EPS or increase loss per share from continuing operations. Like IFRS, in determining whether potential ordinary shares are dilutive or anti-dilutive, each issue or series of potential ordinary shares is considered separately, rather than in aggregate.
Overview (continued)

– Contingently issuable ordinary shares are included in basic EPS from the date on which all necessary conditions are satisfied. When they are not yet satisfied, such shares are included in diluted EPS based on the number of shares that would be issuable if the reporting date were the end of the contingency period.

– If a contract may be settled in either cash or shares at the entity’s option, then the presumption is that it will be settled in ordinary shares and the resulting potential ordinary shares are used to calculate diluted EPS.

– If a contract may be settled in either cash or shares at the holder’s option, then the more dilutive of cash and share settlement is used to calculate diluted EPS.

– For diluted EPS, diluted potential ordinary shares are determined independently for each period presented.

– When the number of ordinary shares outstanding changes, without a corresponding change in resources, the weighted-average number of ordinary shares outstanding during all periods presented is adjusted retrospectively for both basic and diluted EPS.

– Adjusted basic and diluted EPS based on alternative earnings measures may be disclosed and explained in the notes to the financial statements.

Overview (continued)

– Like IFRS, contingently issuable common shares are included in basic EPS from the date on which all necessary conditions are satisfied. Like IFRS, when they are not satisfied, such shares are included in diluted EPS based on the number of shares that would be issuable if the reporting date were the end of the contingency period.

– If a contract may be settled in either cash or shares at the entity’s option, then the general presumption is that it will be settled in common shares and the resulting potential common shares are used to calculate diluted EPS, like IFRS. However, unlike IFRS, this presumption may be overcome if the entity has existing practice or a stated policy of settling in cash.

– Like IFRS, if a contract may be settled in either cash or shares at the holder’s option, then the more dilutive of cash and share settlement is used to calculate diluted EPS.

– Unlike IFRS, the computation of diluted EPS for year-to-date (including annual) periods is based on the weighted average of incremental shares included in each interim period making up the year-to-date period.

– Like IFRS, when the number of common shares outstanding changes, without a corresponding change in resources, the weighted-average number of common shares outstanding during all periods presented is adjusted retrospectively.

– Like IFRS, entities may choose to present basic and diluted other per-share amounts that are not required under US GAAP only in the notes to the financial statements. However, cash flow per share may not be presented. Additionally, SEC regulations restrict the use of ‘non-GAAP’ measures in filings by SEC registrants, which is more restrictive than IFRS.
Scope

Basic and diluted EPS are presented by entities whose ordinary shares or potential ordinary shares are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or that file, or are in the process of filing, their financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of ordinary shares in a public market. [IAS 33.2]

An ‘ordinary share’ is an equity instrument that is subordinate to all other classes of equity instruments. Ordinary shares participate in profit for the period only after other types of shares such as preference shares have participated. [IAS 33.5–6]

If an entity voluntarily presents EPS information, then that data is calculated and presented in accordance with the EPS standard. [IAS 33.3]

If an entity has more than one class of ordinary shares, then EPS is disclosed for each class of ordinary shares; this is sometimes referred to as the ‘two-class’ method of calculating EPS. The two-class method is also required for computing EPS if an entity has equity instruments other than ordinary shares that participate in dividends with ordinary shareholders based on a predetermined formula (participating equity instruments). To determine profit or loss attributable to ordinary equity holders, profit or loss for the period is allocated to the different classes of ordinary shares and participating equity instruments. This allocation is made in accordance with the rights of the other class to participate in distributions if the entire profit or loss were distributed. In our view, an entity is not required to present separate EPS information for participating preference shares that are not considered to be a separate class of ordinary shares. [IAS 33.6, 66, A13–A14]

Presentation and disclosure

EPS figures are presented for all periods presented. [IAS 33.67]

Basic and diluted EPS for both continuing operations attributable to ordinary equity holders of the parent entity and profit or loss attributable to ordinary equity holders of the parent entity are presented in the statement of profit or loss and OCI for each class of ordinary shares, with equal prominence for all periods. [IAS 33.66]

Disclosure of separate EPS information is required for discontinued operations, if relevant, either in the statement of profit or loss and OCI or in the notes to the financial statements. [IAS 33.68–68A]

Scope

Like IFRS, basic and diluted EPS are presented by entities whose common shares or potential common shares are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or that file, or are in the process of filing, their financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of common shares in a public market. [260-10-15-2]

‘Common stock’ (common shares) is a stock that is subordinate to all other stock of the issuer, like ordinary shares under IFRS. [ASC Master Glossary]

Like IFRS, if an entity voluntarily presents EPS information, then that data is calculated and presented in accordance with the EPS Codification Topic. [260-10-15-3]

Like IFRS, entities with more than one class of common shares present EPS for each class of common shares using the two-class method. Like IFRS, the two-class method is required to compute EPS when an entity has securities other than common shares that participate in dividends with common shareholders (participating securities). Also like IFRS, the disclosure of EPS is not required for participating securities that are not common shares. However, US GAAP has more detailed guidance on participating securities so differences from IFRS may arise in practice. [260-10-45-60]

Presentation and disclosure

Like IFRS, EPS figures are presented for all periods presented. [260-10-45-7]

Like IFRS, basic and diluted EPS for both continuing operations attributable to ordinary equity holders of the parent entity and net income attributable to ordinary equity holders of the parent entity are presented in the statement that reports profit or loss for each class of common shares, with equal prominence for all periods. [260-10-45-2]

Like IFRS, disclosure of separate EPS information is required for discontinued operations, either in the statement that reports profit or loss or in the notes to the financial statements. [260-10-45-3]
An entity discloses a reconciliation of the earnings used in the basic and diluted EPS calculations to profit or loss attributable to the parent entity for each period presented. [IAS 33.70]

EPS information based on alternative measures of earnings may also be disclosed and explained in the notes to the financial statements (see chapter 5.8); presentation in the statement of profit or loss and OCI is not permitted. Other per-share amounts are calculated using the same denominator as determined in accordance with the EPS standard. An entity indicates the basis for determining the earnings amount, which is consistent over time, and the earnings used are reconciled to a line item that is reported in the statement of profit or loss and OCI. [IAS 33.73–73A]

**Basic EPS**

‘Basic EPS’ is the profit or loss attributable to ordinary equity holders of the parent entity for the period, divided by the weighted-average number of ordinary shares outstanding during the period. [IAS 33.10, 19, 66]

**The numerator (earnings)**

The profit or loss attributable to ordinary equity holders of the parent entity (i.e. after allocation to NCI) is the profit or loss adjusted for the post-tax amounts of dividends on preference shares that are classified as equity. Profit or loss is also adjusted for gains or losses on the settlement of preference shares, and other similar effects of preference shares classified as equity, including the amortisation of the premium or discount on the original issue of preference shares and the effect of payments to induce conversion. [IAS 33.12–18]

Cumulative preference dividends are deducted from earnings attributable to ordinary equity holders, irrespective of whether they are declared. Non-cumulative preference dividends are not deducted unless they have been declared by the reporting date. [IAS 33.14, A14a]

To determine the profit or loss attributable to ordinary equity holders, profit or loss for the period is allocated to the different classes of ordinary shares and participating equity instruments in accordance with their rights to participate in the undistributed earnings. [IAS 33.A14]

An entity discloses a reconciliation of the earnings used in the basic and diluted EPS calculations to income from continuing operations; generally, this has the same overall effect as the reconciliation under IFRS. [260-10-50-1(a)]

Like IFRS, entities may choose to present basic and diluted other per-share amounts that are not required under US GAAP. However, cash flow per share may not be presented, unlike IFRS. An entity that chooses to disclose other per-share amounts should compute those amounts in accordance with the requirements that apply to EPS calculations and those other per-share amounts may be disclosed only in the notes to the financial statements, like IFRS. Additionally, SEC regulations restrict the use of ‘non-GAAP’ measures in filings by SEC registrants (see chapter 5.8), which is more restrictive than IFRS. [260-10-45-5 – 45-6]

**Basic EPS**

Like IFRS, ‘basic EPS’ is the profit or loss attributable to common shareholders of the parent entity for the period, divided by the weighted-average number of common shares outstanding during the period. [260-10-45-10]

**The numerator (earnings)**

Like IFRS, profit or loss attributable to common shareholders is income (or loss) from continuing operations or net income (or loss) attributable to the controlling shareholders (i.e. after allocation to NCI) less: dividends declared or accumulated on preferred shares, changes in the carrying amount of redeemable preferred shares, differences between the amount paid to redeem preferred shares and the carrying amount of those shares, and consideration to induce conversion of convertible preferred shares. [260-10-45-11 – 45-11A]

Cumulative dividends on preferred shares are either deducted from income available to common shareholders, irrespective of whether they are declared, like IFRS, or such securities are treated as participating securities, unlike IFRS. Like IFRS, non-cumulative dividends are not deducted unless they have been declared by the reporting date except if the preferred shares are determined to be participating securities. [260-10-45-11]

Like IFRS, to determine the income available to common shareholders, undistributed income for the period is allocated to common shares and participating securities in accordance with their rights to participate in the undistributed income. However, US GAAP has more detailed guidance on participating securities so differences from IFRS may arise in practice. [260-10-45-60B]
In our view, the profit or loss for the purpose of calculating basic EPS should be adjusted for any non-forfeitable dividends and any undistributed earnings attributable to unvested shares or shares subject to recall, in accordance with their participating rights.

The denominator (weighted-average number of shares outstanding)
Share transactions that occur during the reporting period are included in the calculation of the weighted-average number of shares from the date of the transaction. [IAS 33.21]

Treasury shares
Treasury shares are not treated as outstanding ordinary shares in computing the weighted-average number of shares outstanding. [IAS 33.IE2]

Assets held by employee benefit plans may include an entity’s own shares (see chapter 4.4). An entity’s ordinary shares that are qualifying plan assets held by its employee benefit plan and netted against the employee benefit obligation are not the entity’s treasury shares. However, if an entity’s own shares held by its employee benefit plan do not meet the definition of plan assets, then they are presented as treasury shares even though the plan is not consolidated by the employer; in this case, in our view these shares should not be considered as outstanding shares when calculating EPS (see chapter 4.4).

Contingently issuable ordinary shares
Contingently issuable ordinary shares are ordinary shares that are issuable for little or no cash or other consideration on the satisfaction of specified conditions in a contingent share agreement. Contingently issuable shares are included in the calculation of the weighted-average number of shares outstanding from the date on which the conditions are met. [IAS 33.5, 24]

Shares that are issuable solely after the passage of time are not considered contingently issuable because the passage of time is a certainty. Instead, they are treated as outstanding for the purpose of calculating basic EPS from the date on which the right to the shares comes into existence. [IAS 33.24]

Unvested shares and unvested employee share options that require only service for vesting cannot be contingently issuable shares (see below). In contrast, unvested shares and unvested employee share options that do not only require service as a vesting condition, but instead include performance conditions, are treated as contingently issuable shares if they are issuable for little or no cash or other consideration. [IAS 33.5, 21(g), 24]

Unlike IFRS, US GAAP specifies that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of EPS under the two-class method. [260-10-45-61A]

The denominator (weighted-average number of shares outstanding)
Like IFRS, share transactions that occur during the reporting period are included in the calculation of the weighted-average number of shares from the date of the transaction. [260-10-45-10]

Treasury shares
Like IFRS, treasury shares are not treated as outstanding shares in computing the weighted-average number of shares outstanding. [260-10-45-10]

Like IFRS, an entity’s ordinary shares that are qualifying plan assets held by an employee benefit plan and netted against the employee benefit obligation are not treasury shares. Like IFRS, if shares do not meet the definition of plan assets, then they are presented as treasury shares and therefore not as outstanding shares (see chapter 4.4).

Contingently issuable shares
Like IFRS, contingently issuable shares are common shares that are issuable for little or no cash or other consideration on the satisfaction of specified conditions in a contingent share agreement. Like IFRS, contingently issuable shares are included in the calculation of the weighted-average number of shares from the date on which the conditions are met. [260-10-45-13]

Like IFRS, shares that are issuable solely after the passage of time are treated as outstanding for the purpose of calculating basic EPS from the date on which the right to the shares comes into existence. They are not considered contingently issuable because the passage of time is a certainty, like IFRS. [260-10-45-13]

Like IFRS, unvested shares and unvested employee share options that require only service for vesting cannot be contingently issuable shares. In contrast, unvested shares and unvested employee share options that do not only require service as a vesting condition, but instead include performance conditions or market conditions, are treated as contingently issuable shares, like IFRS; however, unlike IFRS, this is regardless of whether they are issuable for little or no cash or other consideration. [260-10-45-30]
Unvested shares and unvested employee share options

Unvested shares that require service as a vesting condition are included in the calculation of basic EPS when the service condition is met. Unvested share options that are issuable for little or no further consideration after vesting are included in the calculation of basic EPS only once the required vesting conditions have been met. [IAS 33.21(g), 48]

Partly paid shares

If ordinary shares are not fully paid, then they are treated as a fraction of ordinary shares for the purposes of basic EPS. The fraction is calculated as the degree to which they are entitled to participate in dividends during the period relative to the dividend participation rights of a fully paid ordinary share. [IAS 33.A15]

Ordinary shares subject to recall

If ordinary shares are subject to recall, then they are not considered as outstanding and are excluded from the calculation of basic EPS until the date on which they are no longer subject to recall. In our view, shares that are subject to repurchase due to a written put option or a forward purchase contract should be excluded from the basic EPS, similar to shares subject to recall. However, the calculation of diluted EPS may require adjustment for the shares subject to recall, the written put or the forward, see below. [IAS 33.24, A13-A14]

Diluted EPS

Diluted EPS is calculated by adjusting the profit or loss attributable to ordinary equity holders of the parent entity (the numerator) and the weighted-average number of shares outstanding (denominator), used in the basic EPS calculation, for the effects of all dilutive potential ordinary shares (see below) that were outstanding during the reporting period. [IAS 33.30–31]

The effects of potential ordinary shares are reflected in diluted EPS only when they are dilutive – i.e. when inclusion in the calculation would decrease EPS, or increase the loss per share, from continuing operations. [IAS 33.41]

When considering whether potential ordinary shares are dilutive or anti-dilutive, and therefore whether to bring them into the diluted EPS calculation, each issue or series of potential ordinary shares is considered separately. [IAS 33.42, 44]

Unvested shares and unvested employee share options

Like IFRS, unvested shares are not included in basic EPS before vesting, unless they are deemed to be participating securities, unlike IFRS. Under US GAAP, share options are not included in basic EPS until the option has been exercised, unless they are deemed to be participating securities, which can give rise to differences from IFRS in practice. [260-10-45-28A]

Partly paid shares

Like IFRS, if common shares are not fully paid, then they are treated as a fraction of common shares for the purposes of basic EPS. The fraction is calculated as the degree to which they are entitled to participate in dividends during the period relative to the dividend participation rights of a fully paid common share, like IFRS. [260-10-55-23]

Common shares subject to recall

Like IFRS, if common shares are subject to recall, then they are not considered as outstanding and are excluded from the calculation of basic EPS until the date on which they are no longer subject to recall. Like IFRS, shares that are subject to repurchase due to a written put option or a forward purchase contract should be excluded from the basic EPS, similar to shares subject to recall. Unlike IFRS, mandatorily redeemable common shares and the shares underlying a forward contract that requires physical settlement by repurchase of a fixed number of common shares, in exchange for cash, are excluded from the denominator of diluted EPS calculations. [260-10-45-13, 45, 480-10-45-4]

Diluted EPS

Like IFRS, diluted EPS is calculated by adjusting the numerator, and the weighted-average number of shares outstanding (denominator), used in the basic EPS calculation for the effects of all dilutive potential common shares (see below) that were outstanding during the reporting period. [260-10-45-16]

Like IFRS, potential common shares are reflected in diluted EPS only when they are dilutive – i.e. when inclusion in the calculation would decrease EPS, or increase the loss per share, from continuing operations. [260-10-10-2]

Like IFRS, when considering whether potential common shares are dilutive or anti-dilutive, and therefore whether to bring them into the diluted EPS calculation, each type of potential common share is considered separately. [260-10-45-17]
Dilutive potential ordinary shares are determined independently for each period presented. The number of dilutive potential ordinary shares included in the annual (or year-to-date) period is not equal to a weighted average of the dilutive potential ordinary shares included in each interim computation. IFRS does not provide specific guidance on the exclusion of potential shares when there is a loss from continuing operations for the year-to-date period. [IAS 33.37]

Contingently issuable shares are determined independently for each period presented, not a weighted average of dilutive potential ordinary shares included in each interim period. [IAS 33.52]

### Adjustments to basic EPS

**Earnings**

To calculate diluted earnings, subject to the exception mentioned below in relation to certain share-based payment costs, the numerator used for the calculation of basic EPS is adjusted for the post-tax effect of any dividends, interest and other items related to the dilutive potential ordinary shares that are deducted in arriving at profit or loss attributable to ordinary equity holders, and any other changes in income or expense that would result from the assumed conversion of dilutive potential ordinary shares. For further discussion of adjustments to the diluted EPS numerator, see below (Contracts that may be settled in ordinary shares or cash). [IAS 33.33–35]

In our view, the numerator should not be adjusted for equity-settled share-based payment costs when calculating diluted EPS. However, if there is a remeasurement expense from a liability of a cash-settled share-based payment that may also be settled in shares, then the numerator is adjusted for that amount when calculating diluted earnings. [IAS 33.58–59]

**Weighted-average number of shares**

The denominator (the weighted-average number of ordinary shares) used for the calculation of basic EPS is adjusted for the weighted-average number of ordinary shares that would be issued on conversion of all the dilutive potential ordinary shares. Dilutive potential ordinary shares are deemed to have been converted into ordinary shares at the beginning of the period or, if later, on the date of the issue of the potential ordinary shares. [IAS 33.36]

Unlike IFRS, the computation of diluted EPS for year-to-date (including annual) periods is based on the weighted average of the incremental shares included in each interim period for that year-to-date period. However, when there is a loss from continuing operations for the year-to-date period, potential shares would not be included. [260-10-55-3, 55-3B]

Unlike IFRS, the number of contingent shares included in the computation of diluted EPS for year-to-date (including annual) periods is based on the weighted average of the incremental contingent shares included in each interim period for that year-to-date period. [260-10-45-49]

### Adjustments to basic EPS

**Earnings**

Like IFRS, to calculate diluted earnings for convertible securities, the numerator used for the calculation of basic EPS is adjusted for the post-tax effect of any dividends, interest and income or expense items related to the dilutive potential common shares that were outstanding during the period. This is referred to as the ‘if-converted’ method under US GAAP. For further discussion of adjustments to the diluted EPS numerator, see below (Contracts that may be settled in common shares or cash). [260-10-45-40]

Like IFRS, the numerator is not adjusted for share-based payment costs when calculating diluted EPS. Unlike IFRS, the numerator is not adjusted for a remeasurement expense from a liability-classified share-based payment expense because the remeasurement is part of the share-based payment cost. [260-10-45-29]

**Weighted-average number of shares**

Like IFRS, the denominator used for the calculation of basic EPS is adjusted for the shares that would be issued on conversion of the convertible securities or the issue of the dilutive potential common shares. Like IFRS, conversion is assumed as of the beginning of the period or the date on which the securities were issued, if this is later. [260-10-45-40ci]
Options, warrants and other potential ordinary shares
To calculate diluted EPS, the entity assumes that dilutive share options, warrants and their equivalents are exercised so that ordinary shares are issued. For options, warrants and similar instruments, dilution is computed using the treasury share method, with only the bonus element of the issue reflected in diluted EPS. The treasury share method assumes that the proceeds (exercise price) from exercising the option are used to buy back shares at the average market price of a share during the period. The bonus element is the difference between the number of ordinary shares that would be issued at the exercise price and the number of ordinary shares that would have been bought back at the average market price. [IAS 33.45–46]

Options, warrants and other potential ordinary shares issued subject to conditions – e.g. performance-based employee share options – may be contingently issuable potential ordinary shares (see below). Options, warrants and other potential ordinary shares issued subject to only service (time) conditions are treated as outstanding potential shares from grant date and are considered in the diluted EPS calculation. [IAS 33.48]

In applying the treasury share method, an entity adjusts the exercise price of potential ordinary shares to include the fair value of goods or services that will be recognised as a cost in future periods (i.e. the future share-based payment arrangements are included within assumed proceeds). [IAS 33.47A, IESA]

If an entity has purchased options on its own shares, then these are excluded from diluted EPS. [IAS 33.62]

Written put options and forward purchase contracts are included in diluted EPS if they are dilutive (i.e. they are ‘in the money’). If the contracts are in the money during the period, then the potential dilutive effect on EPS is calculated as follows:

Options, warrants and other potential common shares
Like IFRS, the entity assumes that dilutive share options, warrants and similar instruments (e.g. forward contracts to issue shares) are exercised at the beginning of the period. Like IFRS, the effect of dilution is calculated using the treasury share method for written call options, warrants and similar instruments, with only the ‘incremental shares’ reflected in diluted EPS. Like IFRS, the treasury share method assumes that the proceeds (exercise price) from exercising the option are used to buy back common shares at the average market price during the period. The incremental shares – that is, the number of common shares that would be issued if the option, warrant or equivalent instrument were exercised less the number of common shares assumed repurchased – are added to the denominator. [260-10-45-23]

Like IFRS, options, warrants and other potential ordinary shares issued subject to conditions – e.g. performance-based employee share options – may be contingently issuable potential ordinary shares (see below). Like IFRS, share-based payment awards that vest based only on service are considered outstanding potential shares from grant date and are considered in the diluted EPS calculation. [260-10-45-28A, 45-31]

Like IFRS, in calculating diluted EPS under the treasury share method an entity adjusts the exercise price of potential ordinary shares to include the fair value of goods and services that will be received in future periods. For example, for options that vest on satisfaction of a service condition, an entity adjusts the exercise price of potential common shares to include the average unrecognised compensation cost of the awards. Additionally, US GAAP has more specific guidance on the treatment of estimated forfeitures of share-based payment awards under the treasury share method than IFRS, so differences in practice can occur. [260-10-45-29, 45-29A]

Like IFRS, if an entity has purchased options on its own shares, then these are excluded from diluted EPS. [260-10-45-37]

Like IFRS, written put options and forward purchase contracts are included in diluted EPS if they are dilutive (i.e. they are ‘in the money’). Like IFRS, if those contracts are in the money during the reporting period, the potential dilutive effect of a forward purchase contract (other than a forward purchase contract that requires physical settlement in exchange for cash, unlike IFRS – see above) or a written put option is calculated as follows:
5 Special topics

5.3 Earnings per share

– assume that at the beginning of the period sufficient ordinary shares will be issued at the average market price during the period to raise the funds required to satisfy a written put/forward purchase;
– assume that the proceeds from the issue are used to satisfy the written put/forward purchase; and
– include the incremental ordinary shares – i.e. the difference between the number of ordinary shares assumed issued and the number of ordinary shares received from buying back ordinary shares – in the calculation of diluted EPS. [IAS 33.63]

Partly paid shares

To the extent that partly paid shares are not entitled to participate in dividends during the period, they are treated as options or warrants, with the unpaid balance being regarded as the exercise price. [IAS 33.A16]

Contracts that may be settled in ordinary shares or cash

If a contract can be settled in either cash or shares, then it is a potential ordinary share. If settlement in ordinary shares or cash is at the entity’s option, then the entity presumes that the contract will be settled in ordinary shares. [IAS 33.58]

IFRS is not specific about situations in which cash settlement is presumed for an instrument accounted for as equity (or share settlement for an instrument accounted for as an asset or liability).

– assume that at the beginning of the period sufficient common shares will be issued at the average market price during the period to raise the funds required to satisfy a written put/forward purchase;
– assume that the proceeds from the issue are used to satisfy the written put/forward purchase; and
– include the incremental common shares – i.e. the difference between the number of common shares assumed issued and the number of common shares received from buying back common shares – in the calculation of diluted EPS. [260-10-45-35]

Partly paid shares

Like IFRS, any partly paid shares not entitled to participate in dividends during the period are treated as options or warrants, with the unpaid balance being regarded as the exercise price. [260-10-55-23]

Contracts that may be settled in common shares or cash

Like IFRS, if a contract can be settled in either cash or shares, then it is a potential common share. If settlement in cash or shares is at the entity’s option, then the entity generally presumes settlement in shares, like IFRS. However, unlike IFRS, existing practice or stated policy of settling in cash may provide a reasonable basis to overcome the presumption of share settlement. [260-10-45-45-46]

Like IFRS, for a share-settleable contract that is reported as an asset or liability, or has an equity component and a liability component, the numerator should be adjusted for changes in profit or loss that would have resulted during the period if the contract had been wholly classified as an equity instrument. An entity would not include any incremental shares under the treasury share or reverse treasury share methods if the numerator adjustment would cause the inclusion of those incremental shares to be anti-dilutive. [260-10-45-46]

Unlike IFRS, US GAAP requires that when cash settlement is presumed for an instrument accounted for as equity (or share settlement for an instrument accounted for as an asset or liability), the EPS numerator should be adjusted for the amounts that would have been recognised in profit or loss for the period if the instrument had been accounted for as an asset or liability. Because there is no specific guidance under IFRS, differences from IFRS may arise in practice. [260-10-55-32]
For contracts that may be settled in ordinary shares or cash at the holder’s option, the entity uses the more dilutive of cash settlement and share settlement in calculating diluted EPS. [IAS 33.60]

**Convertible securities**

Convertible securities are assumed to be converted at the beginning of the period, or date of issue if later. The numerator is adjusted as described above and the shares issuable are included in the denominator, if the effect is dilutive. [IAS 33.36]

IFRS does not provide specific guidance on the diluted EPS treatment of contingently convertible debt securities with a market price trigger – e.g. debt instruments that contain a conversion feature that becomes exercisable on an entity’s share price reaching a predetermined price – and practice may vary.

IFRS does not provide specific guidance on the diluted EPS treatment of convertible debt instruments that require the issuer to settle the principal amount of the instrument in cash on conversion and permit the issuer to settle the intrinsic value of the conversion option by delivering net shares on conversion, so practice may vary.

**Contingently issuable shares**

Contingently issuable shares are defined as ordinary shares issuable for little or no cash or other consideration on the satisfaction of specified conditions in a contingent share agreement. If the conditions are satisfied at the reporting date, then they are included in diluted EPS (if they are dilutive) from the later of the beginning of the reporting period and the date of the contingent share agreement. If the conditions are not satisfied, then the number of contingently issuable shares included in diluted EPS is based on the number of shares that would be issuable if the reporting date were the end of the contingency period. [IAS 33.5, 52]

Shares awarded as a share-based payment award that vest on satisfaction of a performance condition (see chapter 4.5) are contingently issuable shares for the purposes of computing diluted EPS. [IAS 33.52]

Like IFRS, for contracts that may be settled in cash or shares at the holder’s option, the entity uses the more dilutive of cash settlement and share settlement in calculating dilutive EPS. [260-10-55-36]

**Convertible securities**

Like IFRS, convertible securities are assumed to be converted at the beginning of the period, or date of issue if later. The numerator is adjusted as described above and the shares issuable are included in the denominator, if the effect is dilutive, like IFRS. This is referred to as the ‘if-converted’ method under US GAAP. [260-10-45-40(i)]

Unlike IFRS, US GAAP specifies that contingently convertible debt securities with a market price trigger should always be included in diluted EPS computations (if they are dilutive), regardless of whether the market price trigger has been met. That is, the treatment for diluted EPS does not differ because of a contingent market price trigger. [260-10-45-44]

Unlike IFRS, US GAAP specifies that the if-converted method is not applied to convertible debt instruments that require the issuer to settle the principal amount of the instrument in cash on conversion and permit the issuer to settle the intrinsic value of the conversion option by delivering net shares on conversion. For those securities, there would be no adjustment to the numerator in the diluted EPS calculation and the incremental shares included in the denominator would be determined in a manner akin to the treasury share method (see above). [260-10-45-45, 55-84 – 55-84A]

**Contingently issuable shares**

Like IFRS, contingently issuable shares are defined as shares issuable for little or no cash consideration on the satisfaction of certain conditions under a contingent stock agreement. In addition, like IFRS, if all necessary conditions have been satisfied by the reporting date, then those shares are included in diluted EPS from the later of the beginning of the reporting period and the date of the contingent share agreement. If the conditions are not satisfied, then the number of contingently issuable shares included in diluted EPS is based on the number of shares that would be issuable if the reporting date were the end of the contingency period, like IFRS. [260-10-20, 45-48]

Like IFRS, share-based payment awards that vest on satisfaction of a performance or market condition (see chapter 4.5) are contingently issuable shares for the purposes of computing diluted EPS. [260-10-45-31]
Contingencies related to earnings targets
If shares are contingently issuable based on achieving or maintaining a specified amount of earnings or a similar target (e.g. cost savings), and the entity attains the specified amount of earnings but is also required to maintain the level of earnings for an additional period after the reporting date, then shares are considered only in the calculation of the diluted EPS. The number of additional shares included in diluted EPS is based on the number of ordinary shares that would be issued if the amount of earnings at the reporting date were the amount of earnings at the end of the contingency period. [IAS 33.53]

Contingencies related to price levels
If the number of ordinary shares that are contingently issuable depends on the future market price of the ordinary shares and the effect is dilutive, then the calculation of diluted EPS is based on the number of ordinary shares that would be issued if the market price at the reporting date were the market price at the end of the contingency period. As described above, IFRS does not provide specific guidance on the diluted EPS treatment of contingently convertible debt securities with a market price trigger – e.g. debt instruments that contain a conversion feature that becomes exercisable on an entity’s share price reaching a predetermined price – and practice may vary. [IAS 33.54]

Retrospective adjustment
The current- and prior-period figures for basic and diluted EPS are adjusted for transactions that, other than the conversion of potential ordinary shares, adjust the number of ordinary shares outstanding without a corresponding change in resources (e.g. bonus share issue or share consolidation or split). Basic and diluted EPS are also adjusted for a bonus issue, share split or reverse share split that occurs after the reporting date but before the financial statements are authorised for issue. The number of ordinary shares is adjusted as if the event had occurred at the beginning of the earliest period presented. [IAS 33.26–29 64]

The conversion of potential ordinary shares does not result in a retrospective adjustment to EPS. [IAS 33.26, 65]

Contingencies related to earnings targets
Unlike IFRS, if an issue of common shares is contingent on attaining a specified level of earnings at a future date, then the number of shares included in diluted EPS is based on actual earnings to date, assuming no future earnings at the reporting date. [260-10-45-51]

Contingencies related to price levels
Like IFRS, if an issue of common shares is contingent on attaining or maintaining a specified market price of shares at a future date, and the effect is dilutive, then the number of shares included in diluted EPS is based on the number of common shares that would be issued if the market price at the reporting date were the market price at the end of the contingency period. As described above, this guidance does not apply to contingently convertible debt securities with a market price trigger, which are always included in diluted EPS computations (if they are dilutive), regardless of whether the market price trigger has been met. [260-10-45-44, 45-52]

Retrospective adjustment
Like IFRS, retrospective adjustment of EPS information for transactions that adjust the number of shares without a corresponding change in resources such as share splits, reverse share splits, share dividends and rights issues is required even if these occur after the reporting date but before the financial statements are issued or available for issue (for certain non-public entities). Like IFRS, the number of common shares is adjusted as if the event had occurred at the beginning of the earliest period presented. [260-10-55-12]

Like IFRS, the conversion of potential common shares – e.g. the conversion of convertible debt into common shares – does not result in a retrospective adjustment to EPS. [260-10-45-21]
IFRS does not provide specific guidance on the determination of EPS for distributions in which the shareholder can elect to receive either a cash dividend or a share dividend of equal value – i.e. there is no bonus element to the share dividend. In our view, in such cases the entity is exchanging shares and receiving a corresponding amount in resources – i.e. shares are issued as a dividend in exchange for an equal value of cash savings. The shareholder has given up the fair value of the cash dividend; therefore, we believe that there is a corresponding change in resources. As a result, the shares issued would be factored into the calculation of EPS on a prospective basis, with no restatement of prior-period EPS. Conversely, we believe that if the fair value of a share dividend received exceeds the fair value of the cash alternative, then there is a bonus element that would need to be considered and EPS would be restated in prior periods for the bonus element portion.

Diluted EPS is not restated for any subsequent changes in assumptions made in calculating the effects of conversion of potential ordinary shares, such as the average market price or whether contingently issuable shares will be issued. [IAS 33.65]

EPS figures are not adjusted for ordinary share or potential ordinary share transactions that occur after the reporting date, other than those that adjust the number of shares outstanding without a corresponding change in resources. Instead, these events are disclosed in the financial statements. [IAS 33.64, 70]

Unlike IFRS, US GAAP requires an entity to account for the stock portion of a dividend in certain arrangements when a shareholder makes an election to receive cash or stock, subject to limitations on the amount of the dividend to be issued in cash and stock, as a stock issuance resulting in EPS being adjusted prospectively. [505-20-15-3A]

Like IFRS, diluted EPS is not restated for any subsequent changes in assumptions made in calculating the effects of conversion of potential ordinary shares, such as the average market price or whether contingently issuable shares will be issued. [260-10-45-21]

Like IFRS, EPS figures are not adjusted for common shares or potential common share transactions that occur after the reporting date other than those that adjust the number of shares outstanding without a corresponding change in resources. Instead, these events are disclosed in the financial statements, like IFRS. [260-10-50-2]
5.4 Non-current assets held for sale and discontinued operations

(IFRS 5, IFRIC 17)

Overview

- Non-current assets and some groups of assets and liabilities (‘disposal groups’) are classified as held-for-sale if their carrying amounts will be recovered principally through sale and specific criteria related to their sale are met.

- Non-current assets and some groups of assets and liabilities (‘disposal groups’) are classified as held-for-distribution when the entity is committed to distributing the asset or disposal group to its owners.

- The classification, presentation and measurement requirements that apply to items that are classified as held-for-sale generally also apply to a non-current asset or disposal group that is classified as held-for-distribution.

- Non-current assets (or disposal groups) held for sale are measured at the lower of their carrying amount and fair value less costs to sell, and are presented separately in the statement of financial position.

- Assets held for sale or distribution are not amortised or depreciated.

- The comparative statement of financial position is not re-presented when a non-current asset or disposal group is classified as held-for-sale.

5 Special topics

5.4 Non-current assets held for sale and discontinued operations

(Subtopic 205-20, Subtopic 360-10)

Overview

- Like IFRS, long-lived assets (or disposal groups) are classified as held-for-sale if specific criteria related to their sale are met.

- Unlike IFRS, there is no special designation for assets held for distribution.

- Unlike IFRS, there is no special designation for assets held for distribution.

- Like IFRS, long-lived assets (or disposal groups) held for sale are measured at the lower of their carrying amount and fair value less costs to sell, and are presented separately in the statement of financial position.

- Like IFRS, assets held for sale are not amortised or depreciated. Unlike IFRS, assets to be distributed to owners continue to be depreciated or amortised.

- Unlike IFRS, there is no specific guidance on whether the comparative statement of financial position is re-presented when a long-lived asset (or disposal group) is classified as held-for-sale.
Overview (continued)

– A ‘discontinued operation’ is a component of an entity that either has been disposed of or is classified as held-for-sale. Discontinued operations are limited to those operations that are a separate major line of business or geographic area, and subsidiaries acquired exclusively with a view to resale.

– Discontinued operations are presented separately in the statement of profit or loss and OCI, and related cash flow information is disclosed.

– The comparative statements of profit or loss and OCI and cash flow information is re-presented for discontinued operations.

Held for sale or held for distribution

The classification, presentation and measurement requirements for non-current assets or disposal groups held for sale also apply to those that are held for distribution to owners acting in their capacity as owners. Therefore, in general, the requirements discussed in this chapter in respect of non-current assets and disposal groups that are classified as held-for-sale also apply to those classified as held-for-distribution. [IFRS 5.6–8]

Unlike IFRS, there is no special designation for assets held for distribution to owners. As a consequence, the US GAAP requirements in this chapter apply only to long-lived assets held for sale.

A non-current asset or disposal group is classified as held-for-sale if certain criteria are met (see below). [IFRS 5.6–8]

A ‘disposal group’ is a group of assets to be disposed of together, by sale or otherwise, in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. [IFRS 5.A]

Like IFRS, a ‘disposal group’ is a group of assets to be disposed of together, including liabilities directly associated with those assets that will be transferred in the transaction. Unlike IFRS, a disposal may not necessarily occur in a single transaction. A disposal other than by sale may occur by abandonment, in an exchange measured based on the recorded amount of the non-monetary asset relinquished or in a distribution to owners in a spin-off; however, such disposals are not classified as held-for-sale before disposal. [205-20, 360-10-45-15]

The held-for-sale classification and presentation requirements apply to all non-current assets and disposal groups. [IFRS 5.2]

Unlike IFRS, the held-for-sale classification and presentation requirements do not apply to goodwill, servicing assets, certain financial instruments, deferred policy acquisition costs, deferred tax assets, long-lived assets to be distributed to owners and unproved oil and gas properties accounted for using the successful efforts method. [360-10-15-5]
The held-for-sale measurement requirements do not apply to the following: deferred tax assets (see chapter 3.13), employee benefit assets (see chapter 4.4), financial assets in the scope of the financial instruments standards (see chapter 7.1), investment property measured at fair value (see chapter 3.4) and insurance contracts (see chapter 8.1). [IFRS 5.2, 5]

Classification

A non-current asset (or disposal group) is classified as held-for-sale if the following criteria are met:
- the appropriate level of management is committed to a plan to sell the asset (or disposal group); if a plan for sale requires shareholder approval, then management should consider this in deciding whether the sale is ‘highly probable’;
- the asset (or disposal group) is available for immediate sale in its present condition, subject only to terms that are usual and customary for sales of such assets (or disposal groups);
- an active programme to locate a buyer and complete the plan to sell the asset (or disposal group) has been initiated;
- the sale of the asset (or disposal group) is highly probable and transfer of the asset (or disposal group) is expected to qualify for recognition as a completed sale within one year;
- the asset (or disposal group) is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and
- actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. [IFRS 5.6-8]

A non-current asset (or disposal group) is classified as held-for-distribution if the entity is committed to the distribution, which is when:
- the assets are available for immediate distribution in their present condition; and
- the distribution is highly probable. [IFRS 5.12A]

A non-current asset (or disposal group) can be classified as held-for-sale if the transaction is subject to shareholder approval based on a qualitative analysis of the substantiveness of the approval process. [IFRS 5.8]

Like IFRS, the held-for-sale measurement requirements do not apply to the following: deferred tax assets (see chapter 3.13), financial instruments (see chapter 7.1) and deferred insurance policy acquisition costs (see chapter 8.1). Unlike IFRS, the held-for-sale measurement requirements also do not apply to goodwill (see chapters 3.3 and 3.10), equity-method investees, servicing rights, unproved oil and gas properties accounted for using the full cost method and oil and gas properties accounted for using the full cost method (see chapter 5.11). However, they do apply to employee benefit assets and insurance contracts, unlike IFRS. [205-20-50-7, 360-10-15-5]

Classification

Like IFRS, a long-lived asset (or disposal group) is classified as held-for-sale if the following criteria are met:
- management, having the authority to approve the action, commits to a plan to sell the asset (or disposal group); however, unlike IFRS, if a plan for sale requires shareholder approval and this approval is substantive, then management does not have the authority to commit the entity to a plan to sell; this is stricter than the requirement under IFRS;
- the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups);
- an active programme to locate a buyer and other actions required to complete the plan to sell the asset (or disposal group) have been initiated;
- the sale of the asset (or disposal group) is probable and transfer of the asset (or disposal group) is expected to qualify for recognition as a completed sale within one year; although ‘probable’ rather than ‘highly probable’ is used under US GAAP, these are intended to be the same threshold so differences of interpretation are not expected;
- the asset (or disposal group) is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and
- actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. [360-10-45-9]

Unlike IFRS, there is no held-for-distribution designation; long-lived assets to be distributed to owners continue to be classified as held-and-used until they are disposed of. [360-10-45-15]

Unlike IFRS, unless shareholder approval is perfunctory – e.g. management holds sufficient shares to assure shareholder approval – shareholder approval is deemed to be substantive. [719-10-55-82]
The expectation for the sale to be completed within one year of the classification as held-for-sale may be extended in certain circumstances. [IFRS 5.9]

If an entity has committed to a sale plan involving the loss of control over a subsidiary, then all assets and liabilities of that subsidiary are classified as held-for-sale when the criteria for held-for-sale classification are met. [IFRS 5.8A]

A non-current asset (or disposal group) acquired exclusively with a view to its subsequent disposal is classified as held-for-sale if it meets the held-for-sale criteria or if it is highly probable that it will meet those criteria within a short period after acquisition, usually within three months. In our view, any non-current asset (or disposal group) that satisfies the criteria to be classified as held-for-sale at the date of its acquisition may be assumed to have been acquired exclusively with a view to its subsequent disposal. [IFRS 5.11, BC72]

Assets that are to be abandoned are not classified as held-for-sale. [IFRS 5.13]

Classification as held-for-sale or held-for-distribution is prohibited when the criteria are met only after the reporting date. Instead, disclosures are required in the notes to the financial statements. [IFRS 5.12, IAS 10.22(c)]

Statement of financial position comparatives are not re-presented to reflect the classification as held-for-sale or held-for-distribution at the current reporting date. [IFRS 5.40]

**Measurement**

Before classification as held-for-sale or held-for-distribution, non-current assets and the assets and liabilities in a disposal group are measured in accordance with the standards that normally apply to those items. [IFRS 5.18]

On initial classification as held-for-sale or held-for-distribution, the asset (or disposal group) is measured at the lower of its carrying amount and its fair value less costs to sell (or costs to distribute, as applicable). [IFRS 5.15–15A]

Immediately before each subsequent remeasurement of a disposal group, the carrying amounts of liabilities and any assets excluded from the measurement requirements of the held-for-sale standard are remeasured in accordance with other applicable IFRSs. [IFRS 5.19]

Like IFRS, the expectation for the sale to be completed within one year of the classification as held-for-sale may be extended in certain circumstances. [360-10-45-11]

Like IFRS, if an entity has committed to a sale plan involving the loss of control over a subsidiary, then all assets and liabilities of that subsidiary are classified as held-for-sale when the criteria for held-for-sale classification are met. [360-10-45-11]

Like IFRS, a non-current asset (or disposal group) acquired exclusively with a view to its subsequent disposal is classified as held-for-sale if it meets the held-for-sale criteria. Like IFRS, if it is probable that it will meet those criteria within a short period after acquisition (usually within three months), then it is classified as held-for-sale (see chapter 2.6). [360-10-45-12]

Like IFRS, assets that are to be abandoned are classified as held-and-used and are not classified as held-for-sale. [360-10-45-15]

Like IFRS, classification as held-for-sale is prohibited when the criteria are met only after the reporting date. Instead, disclosures are required in the notes to the financial statements, like IFRS. [360-10-45-13]

Unlike IFRS, there is no specific guidance on whether comparatives are re-presented to reflect the classification as held-for-sale at the current reporting date, and practice varies.

**Measurement**

Like IFRS, before classification as held-for-sale, long-lived assets and the assets and liabilities in a disposal group are measured in accordance with the guidance that normally applies to those items; however, the applicable standards applied may differ from IFRS, and therefore differences in practice may exist. [360-10-35-43]

Like IFRS, on initial classification as held-for-sale, the asset (or disposal group) is measured at the lower of its carrying amount and its fair value less costs to sell. Unlike IFRS, there is no held-for-distribution designation. [360-10-35-38, 35-43]

Like IFRS, immediately before each subsequent remeasurement of a disposal group, the carrying amounts of liabilities and any assets excluded from the measurement requirements of the held-for-sale Codification Subtopic are remeasured in accordance with other applicable Codification topics or subtopics. [360-10-35-39]
The asset (or disposal group) continues to be measured at the lower of carrying amount and fair value less costs to sell. Excluded assets are measured using the standards that normally apply to these items, even if such assets are part of a disposal group. However, the disposal group as a whole is measured in a manner consistent with non-current assets that are held for sale. [IFRS 5.4, 15, 19, 23]

The amount of any gain that can be recognised as a result of an increase in fair value less costs to sell before disposal is limited to the cumulative amount of impairment losses recognised in accordance with the held-for-sale standard and previously in accordance with the impairment standard (see chapter 3.10). Impairment losses allocated to goodwill are included in determining the maximum increase. [IFRS 5.20–22]

The reversal of any impairment loss is allocated to the assets in the disposal group that are subject to the measurement requirements of the held-for-sale standard, except for goodwill, pro rata with the carrying amounts of those assets. In our view, reversals of impairment losses on subsequent remeasurement may result in individual assets in the disposal group being measured at amounts above their carrying amount if the non-current assets had not been classified as held-for-sale. However, the disposal group as a whole continues to be remeasured at the lower of its carrying amount and fair value less costs to sell. [IFRS 5.15, 23, IAS 36.122]

Gains and losses in respect of assets classified as held-for-sale or held-for-distribution are recognised in profit or loss. [IFRS 5.37]

Any gain or loss not recognised before the date of sale is recognised on the derecognition of the non-current asset or disposal group. [IFRS 5.24]

Assets held for sale or distribution are not amortised or depreciated. [IFRS 5.25]

Like IFRS, the asset (or disposal group) is measured at the lower of carrying amount and fair value less costs to sell. Like IFRS, excluded assets are measured using the Codification topics/subtopics that normally apply to these items, even if such assets are part of a disposal group. However, the disposal group as a whole is measured in a manner consistent with non-current assets that are held for sale, like IFRS. [360-10-35-39 – 35-40]

Like IFRS, the amount of any gain that can be recognised as a result of an increase in fair value less costs to sell before disposal is limited to the cumulative amount of impairment losses recognised in accordance with the held-for-sale guidance; but unlike IFRS, not for any previously recognised impairment losses in accordance with the impairment Codification Subtopic (see chapter 3.10). Unlike IFRS, goodwill is evaluated separately from the disposal group for impairment (see chapter 3.10) and is not subject to impairment in connection with the classification as held-for-sale and is not included in determining the maximum gain that can be recognised. [360-10-35-20, 35-26, 35-28, 35-39 – 35-40, 45-43]

Like IFRS, gains and losses in respect of assets classified as held-for-sale are recognised in profit or loss. [360-10-35-40]

Like IFRS, any gain or loss not recognised before the date of sale is recognised on the derecognition of the asset or disposal group. [360-10-40-5]

Like IFRS, assets held for sale are not amortised or depreciated. Unlike IFRS, assets to be distributed to owners continue to be depreciated or amortised. [360-10-35-43, 45-15]
A disposal group continues to be consolidated while it is held for sale or distribution, even if it is a subsidiary that was acquired exclusively with a view to subsequent disposal. Accordingly, revenue (e.g. from the sale of inventory) and expenses (including interest) continue to be recognised, and a less detailed method of acquisition accounting (see chapter 2.6) applies to an acquired subsidiary. [IFRS 3.31, 5.33(b)]

Reclassification as held-for-use and changes in method of disposal
Non-current assets (or disposal groups) are reclassified from held-for-sale or from held-for-distribution to held-for-use if they no longer meet the criteria to be classified as held-for-sale or held-for-distribution. On reclassification as held-for-use, a non-current asset (or disposal group) is remeasured at the lower of its recoverable amount and the carrying amount before the asset (or disposal group) was classified as held-for-sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset not been classified as held-for-sale or held-for-disposition to owners. ‘Recoverable amount’ is the higher of the asset’s fair value less costs of disposal and its value in use (see chapter 3.10). [IFRS 5.26–27, 29]

Normally, reversals of impairments of goodwill are prohibited (see chapter 3.10). In our view, reclassification as held-for-use and the requirement to remeasure on reclassification may create one of the rare circumstances in which reversals of goodwill impairment are recognised. This may occur if the recoverable amount of goodwill exceeds its carrying amount as a result of impairment losses recognised in respect of the held-for-sale disposal group that were allocated to goodwill. [IFRS 5.27, IAS 36.124]

Any resulting adjustment is recognised in profit or loss unless the asset was measured at a revalued amount before its classification as held-for-sale, in which case the adjustment is recognised, in whole or in part, as a revaluation increase or decrease (see chapters 3.2 and 3.3). [IFRS 5.28]

Like IFRS, a disposal group continues to be consolidated while it is held for sale, even if it is a subsidiary that was acquired exclusively with a view to subsequent disposal. Therefore, like IFRS, revenue and expenses continue to be recognised; but, unlike IFRS, full acquisition accounting (see chapter 2.6) applies to an acquired subsidiary. [360-10-45-12]

Reclassification as held-for-use
Like IFRS, long-lived assets (or disposal groups) are reclassified from held-for-sale to held-for-use if they no longer meet the criteria to be classified as held-for-sale. However, unlike IFRS, on reclassification as held-for-use, a long-lived asset is measured at the lower of its fair value at the date of the decision not to sell, and the carrying amount before the asset was classified as held-for-sale adjusted for any depreciation or amortisation that would have been recognised had the asset not been classified as held-for-sale. Additionally, unlike IFRS, US GAAP is not specific regarding whether the carrying amount is adjusted for impairment losses that would have been recognised had the asset not been classified as held-for-sale. However, because the held-for-use model would apply once the asset has been reclassified, any impairment indicators would warrant an impairment test under the general impairment requirements (see chapter 3.10). [360-10-35-44, 45-6 – 45-7]

Unlike IFRS, the reclassification as held-for-use cannot include the reversal of goodwill impairment losses, which is consistent with the usual requirements (see chapter 3.10).

Any resulting adjustment is recognised in profit or loss. Unlike IFRS, the revaluation of long-lived assets is not permitted and therefore there are no exceptions from recognising adjustments in profit or loss. [360-10-45-7]
When an interest in an equity-accounted investee classified as held-for-sale or held-for-distribution is reclassified as held-for-use, the equity method (see chapter 3.5) is applied retrospectively from the date of its classification as held-for-sale and comparatives are re-presented. [IFRS 5.28, IAS 28.21]

Unlike IFRS, the equity method of accounting continues to apply as before as long as the investor holds significant influence. Unlike IFRS, equity-method investees are not classified as held-for-distribution.

If an entity changes the method of disposal of a non-current asset or disposal group – i.e. reclassifies them from held-for-distribution to held-for-sale (or vice versa) without any time lag – then it continues to apply held-for-distribution or held-for-sale accounting. At the time of the change in method, an entity measures the non-current asset or disposal group at the lower of its carrying amount and fair value less costs to sell/distribute and recognises any write-down or subsequent increase in their fair value less costs to sell/distribute. [IFRS 5.26A]

Unlike IFRS, there is no held-for-distribution designation; long-lived assets to be distributed to owners continue to be classified as held-and-used until they are disposed of. [360-10-45-15]

Presentation
Assets classified as held-for-sale are presented separately from other assets in the statement of financial position. [IFRS 5.38]

Like IFRS, assets classified as held-for-sale are presented separately from other assets in the statement of financial position. [360-10-45-14]

The assets within a disposal group are presented separately from other assets in the statement of financial position; similarly, the liabilities within a disposal group classified as held-for-sale are presented separately from other liabilities in the statement of financial position. The assets and liabilities of a disposal group cannot be offset, unless the offsetting requirements apply (see chapter 3.1). [IFRS 5.38, IAS 132-33]

Like IFRS, the major classes of assets and liabilities classified as held-for-sale or held-for-distribution are presented either in the statement of financial position or in the notes to the financial statements. [IFRS 5.5A, 38]

Unlike IFRS, the major classes of assets and liabilities classified as held-for-sale are presented either in the statement of financial position or in the notes to the financial statements. Unlike IFRS, there is no held-for-distribution designation (see above). [360-10-45-14]

The comparative statement of financial position is not re-presented to reflect the presentation of assets held-for-sale or held-for-distribution in the current period. [IFRS 5.40]

Unlike IFRS, in the period that a discontinued operation (see below) is disposed of or classified as held-for-sale, the statement(s) of financial position are adjusted to reflect that classification for all prior periods presented. Comparatives are not adjusted in other circumstances, like IFRS. [205-20-45-10]
Discontinued operations
Classification

A ‘discontinued operation’ is a component of an entity that either has been disposed of or is held for sale or for distribution to owners, and:
– represents a separate major line of business or geographic area of operations;
– is part of a co-ordinated single plan to dispose of a separate major line of business or geographic area of operations; or
– is a subsidiary acquired exclusively with a view to resale. [IFRS 5.32]

Like IFRS, a ‘component’ of an entity comprises operations and cash flows that can be distinguished clearly, both operationally and for financial reporting purposes, from the rest of the entity. [IFRS 5.31]

Although the standard refers to ‘a separate major line of business or geographic area of operations’, there is no reference to a strategic shift in operations.

There are no assets that are precluded from designation as a discontinued operation. [IFRS 5.2]

Classification as a discontinued operation occurs at the earlier of the dates on which:
– the entity actually has disposed of the operation; and
– the operation meets the criteria to be classified as held-for-sale or held-for-distribution to owners, or is a disposal group that has ceased to be used. [IFRS 5.13, 32]

Classification as a discontinued operation is prohibited if the criteria are met only after the reporting date. Instead, disclosures are required in the notes to the financial statements. [IFRS 5.BC66, IAS 10.22(b)]

Measurement

There are no recognition or measurement impacts from classifying an operation as discontinued. However, a discontinued operation will generally include non-current assets (or disposal group(s) held for sale or distribution to owners, the measurement requirements of which are described above.

Discontinued operations
Classification

Unlike IFRS, a discontinued operation is defined as either:
– a component of an entity that has been disposed of, meets the criteria to be classified as held-for-sale or has been abandoned or spun-off; and represents a strategic shift that has (or will have) a major effect on an entity’s operations and financial results; or
– a business or non-profit activity that, on acquisition, meets the criteria to be classified as held-for-sale. [205-20-45]

Like IFRS, a ‘component’ of an entity comprises operations and cash flows that can be distinguished clearly, both operationally and for financial reporting purposes, from the rest of the entity. [205-20-20]

Although the requirement for there to be a strategic shift that has (or will have) a major effect on an entity’s operations and financial results differs from IFRS, the examples in the discontinued operations Codification Subtopic include the disposal of a major line of business or major geographic area. Therefore, differences from IFRS may not be significant in practice. [205-20-45-1C]

Unlike IFRS, oil and gas properties accounted for using the full cost method are precluded from designation as a discontinued operation. [360-10-15-5]

Like IFRS, classification as a discontinued operation occurs at the earlier of the dates on which:
– the entity actually has disposed of the operation (including by distribution to owners); and
– the operation meets the criteria to be classified as held-for-sale or is a disposal group that has ceased to be used. [205-20-45-3]

Like IFRS, classification as a discontinued operation is prohibited if the criteria are met only after the reporting date. Instead, disclosures are required in the notes to the financial statements, like IFRS. [360-10-45-13]

Measurement

Like IFRS, there are no recognition or measurement impacts from classifying an operation as discontinued. Like IFRS, a discontinued operation will generally include long-lived assets (or disposal group(s)) held for sale, the measurement requirements of which are described above. [205-20-45-3]
5.4 Non-current assets held for sale and discontinued operations

Presentation
The results of discontinued operations are presented separately from continuing operations, as a single amount in the statement of profit or loss and OCI. An analysis of this single amount is presented either in the statement of profit or loss and OCI or in the notes to the financial statements. [IFRS 5.33–33A]

IFRS does not provide guidance on allocating interest to discontinued operations.

IFRS does not provide guidance on allocating general corporate overheads to a discontinued operation, but in our view revenues and expenses should not be presented as discontinued unless they will cease to be earned/incurred on disposal of the discontinued operation.

Net cash flow information attributable to operating, investing and financing activities of discontinued operations is required to be disclosed, either in the statement of cash flows or in the notes to the financial statements. Whatever method of presentation is chosen, the total cash flows from each of operating, investing and financing activities, including both continuing and discontinued operations, are disclosed in the statement of cash flows. [IFRS 5.33, IAS 7.10]

The analysis of the results presented in the statement of profit or loss and OCI and cash flow information is not required for a disposal group that is a newly acquired subsidiary that is classified as held-for-sale on acquisition. [IFRS 5.33(b)–(c)]

Presentation
Like IFRS, the results of discontinued operations are presented separately from continuing operations, as a single amount in the statement that reports profit or loss. An analysis of this single amount is presented either in the statement that reports profit or loss or in the notes to the financial statements, like IFRS. [205-20-45-3]

Unlike IFRS, there is a requirement to allocate to a discontinued operation interest on debt that is to be assumed by a buyer and interest on debt that is required to be repaid as a result of the disposal transaction. The allocation to discontinued operations of other interest is permitted but not required, which may result in differences from IFRS in practice. [205-20-45-6 – 45-7]

US GAAP prohibits the allocation of general corporate overheads to discontinued operations, which is likely to be the same as practice under IFRS. [205-20-45-9]

Like IFRS, cash flow information for discontinued operations is required to be disclosed. However, unlike IFRS, entities disclose either (1) the total operating and total investing cash flows of the discontinued operations; or (2) the depreciation, amortisation, capital expenditure and significant operating and investing non-cash items. [205-20-50]

In addition, unlike IFRS, for SEC registrants there are three alternatives for presenting this information:
- combine cash flows from discontinued operations with cash flows from continuing operations within each of the operating, investing and financing categories;
- separately identify cash flows from discontinued operations as a line item within each category; or
- present cash flows from discontinued operations separately, with disclosure of operating, investing and financing activities. [2005 AICPA Conf]

Unlike IFRS, there are no disclosure exemptions for a disposal group that is a newly acquired subsidiary that is classified as held-for-sale on acquisition. [360-10-50]
The comparative statement of profit or loss and OCI and cash flow information are re-presented each period so that the comparative information given in respect of discontinued operations includes all operations classified as discontinued at the current reporting date. [IFRS 5.34]

**Reclassification as continuing**
If the component ceases to be classified as held-for-sale, then the related operations are reclassified as continuing and comparatives are re-presented consistently. [IFRS 5.36]

Like IFRS, the comparative statements that include profit or loss and cash flow information are re-presented each period so that the comparative information given in respect of discontinued operations includes all operations classified as discontinued at the current reporting date. [205-20-45-3]

Unlike IFRS, US GAAP requires specific disclosures about entities’ continuing involvement with discontinued operations and disposals of individually significant components that do not qualify as discontinued operations. [205-20-50]

**Reclassification as continuing**
Like IFRS, if the component ceases to be classified as held-for-sale, then the related operations are reclassified as continuing and comparatives are re-presented consistently. [360-10-35-44, 45-6 – 45-7]
5.5 Related party disclosures (IAS 24)

Overview

- 'Related party relationships' are those involving control (direct or indirect), joint control or significant influence.

- Key management personnel and their close family members are parties related to an entity.

- There are no special recognition or measurement requirements for related party transactions.

- The disclosure of related party relationships between a parent and its subsidiaries is required, even if there have been no transactions between them.

- No disclosure is required in the consolidated financial statements of intra-group transactions eliminated in preparing those statements.

- Comprehensive disclosures of related party transactions are required for each category of related party relationship.

- Key management personnel compensation is disclosed in total and is analysed by component.

5.5 Related party disclosures (Topic 850)

Overview

- Like IFRS, ‘related party relationships’ are those involving control (direct or indirect), joint control or significant influence.

- Like IFRS, management and management’s immediate family members are parties related to an entity.

- Generally, there are no special recognition or measurement requirements for related party transactions; however, unlike IFRS, certain Codification topics/subtopics have specific guidance.

- Like IFRS, the disclosure of related party relationships between a parent and its subsidiaries is required, even if there have been no transactions between them.

- Like IFRS, no disclosure is required in the consolidated financial statements of intra-group transactions eliminated in preparing those statements.

- Like IFRS, comprehensive disclosures of related party transactions are required. However, unlike IFRS, there is no requirement for the disclosures to be grouped into categories of related parties.

- Unlike IFRS, management compensation is not required to be disclosed in the financial statements; however, SEC registrants are required to provide compensation information outside the financial statements for specified members of management and the board.
Overview (continued)

– In certain cases, government-related entities are allowed to provide less detailed disclosures of related party transactions.

Scope

Subject to a partial exemption for government-related entities (see below), related party disclosure requirements apply to all entities. [IAS 24.3, 25]

A government-related entity that applies IFRS is not exempt from providing related party disclosures; however, there is a partial exemption for transactions with other government-related entities. [IAS 24.25–26]

An entity may elect to apply modified disclosure requirements to transactions and outstanding balances, including commitments, with a government that has control, joint control or significant influence over the entity, or another entity that is under control, joint control or significant influence of the same government. [IAS 24.25–26]

The related parties standard does not establish any recognition or measurement requirements for related party transactions. Related party transactions are accounted for in accordance with the requirements of relevant IFRSs. [IAS 24.2]

Identification of related parties

Related party relationships are generally symmetrical – i.e. if B is related to C for the purposes of C’s financial statements, then C is related to B for the purposes of B’s financial statements.

The definition of a related party includes relationships involving direct and indirect control (including common control), joint control and significant influence. However, entities are not related parties simply because both are under significant influence of the same third party. [IAS 24.9, 11]

Overview (continued)

– Unlike IFRS, there is no partial disclosure exemption for government-related entities that prepare financial statements in accordance with US GAAP. However, such entities’ financial statements will often be prepared in accordance with US governmental accounting standards, rather than in accordance with US GAAP.

Scope

Unlike IFRS, related party disclosure requirements apply to all entities that prepare financial statements in accordance with US GAAP, without a partial exemption for government-related entities. [850-10-15]

A government-related entity that prepares US GAAP financial statements is not exempt from providing related party disclosures about transactions with other government-related entities. Unlike IFRS, there is no partial exemption for such entities. [850-10-15]

Unlike IFRS, full disclosure requirements apply to all entities that prepare financial statements in accordance with US GAAP. However, financial statements of government-related entities will often be prepared in accordance with US governmental accounting standards, rather than in accordance with US GAAP. [850-10-15-4]

Like IFRS, US GAAP does not establish any recognition or measurement requirements for related party transactions, which are accounted for in accordance with the requirements of relevant authoritative literature of US GAAP. However, in certain Codification topics/subtopics (e.g. leases) guidance is prescribed, which may result in differences from IFRS in practice.

Identification of related parties

Other than when an investor has an investment in an equity-method investee and an investment in a financial asset in separate entities that transact with each other, related party relationships are symmetrical. [850-10-20]

Like IFRS, the definition of related parties includes relationships involving direct and indirect control (including common control), joint control and significant influence. Unlike IFRS, entities that are under significant influence of the same third party could be related parties in certain circumstances. Also unlike IFRS, principal owners are defined as owners of record or known beneficial owners of more than 10 percent of the voting interests of an entity. [850-10-05, 850-10-20]
The definition of a related party includes subsidiaries of associates and joint ventures (see chapter 3.5). [IAS 24.9, 12]

Related parties are not restricted to legal entities. [IAS 24.9–10]

Like IFRS, the definition of a related party includes subsidiaries of equity-method investees (see chapter 3.5). [850-10-15.4]

Like IFRS, US GAAP does not restrict related parties to legal entities. [850-10-05, 850-10-20]

Unlike IFRS, US GAAP does not use the term ‘key management personnel’ for identifying related parties, but instead uses the term ‘management’, which, like IFRS, includes those individuals who are responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. US GAAP specifies that this normally includes members of the board of directors, the chief executive officer, chief operating officer, vice presidents of principal business functions, and other persons who perform similar policymaking functions. Although the wording of US GAAP is more prescriptive than IFRS, all of the individuals and entities identified under US GAAP are likely to be related parties under IFRS. [850-10-05, 850-10-20]

Like IFRS, the definition of related parties includes those family members whom a principal owner or member of management might control or influence or by whom they might be controlled or influenced because of a family relationship. However, US GAAP refers to these related parties as ‘immediate family members’ rather than as ‘close family members’. [850-10-05, 850-10-20]

Like IFRS, entities under control, joint control or significant influence of management (or their immediate family) are also related parties of the entity. Like IFRS, entities are not related parties simply because they have a director or other member of key management personnel in common, or because a member of key management personnel of one entity has significant influence over the other entity. [IAS 24.9, 11]

Entities under the control or joint control of key management personnel (or their close family members) are also related parties of the reporting entity. However, entities are not related parties simply because they have a director or other member of key management personnel in common, or because a member of key management personnel of one entity has significant influence over the other entity. [IAS 24.9, 11]

A post-employment benefit plan for employees of the reporting entity or any entity that is a related party of the reporting entity is considered to be a related party of the reporting entity. In our view, a multi-employer plan of which a reporting entity is one of the sponsoring entities is related to the reporting entity even if the reporting entity does not have significant influence or control over the multi-employer plan. [IAS 24.9]

Like IFRS, trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management, are related parties. Like IFRS, a multi-employer plan of which a reporting entity is one of the sponsoring entities is related to the reporting entity even if the reporting entity does not have significant influence or control over the multi-employer plan. [850-10-06]
Disclosure

All entities

Control relationships

Parent and subsidiary relationships are disclosed regardless of whether there have been any transactions between the parties. The reporting entity also discloses the name of its ultimate parent if it is not disclosed elsewhere in information published with the financial statements. If the ultimate controlling party of the reporting entity is a person or a group of persons, then the identity of that person or the group of persons and that relationship should be disclosed. [IAS 1.138(c), 24.13–15]

If neither the reporting entity’s parent nor the ultimate controlling party produces consolidated financial statements available for public use, then a reporting entity discloses the name of the next most senior parent to the reporting entity’s parent that produces financial statements available for public use. [IAS 24.13, 16]

An entity is not required to disclose relationships with other entities in a group if there have been no transactions with them. [IAS 24.18]

Transactions

Related party transactions that involve a transfer of resources, services or obligations are disclosed regardless of whether a price is charged. [IAS 24.18]

Management compensation

Key management personnel compensation, including non-executive directors, is disclosed in total and analysed into its components (short-term, post-employment, other long-term, termination and share-based benefits). [IAS 19.7, 24.9, 17–17A, 18A]

In addition to key management personnel compensation, a reporting entity also discloses information about other transactions with key management personnel. Such transactions are disclosed as a separate category of related party transactions. [IAS 24.18]

Unlike IFRS, US GAAP has no specific requirement to disclose the name of the parent, ultimate parent or next most senior parent that produces consolidated financial statements.

Unlike IFRS, if the reporting entity and one or more other entities are under common ownership or management control, and the existence of that control could result in operating results or a financial position of the reporting entity significantly different from those that would have been obtained if the entities were autonomous, then the nature of the control relationship is disclosed even if there are no transactions between the entities. [850-10-50]

Transactions

Like IFRS, related party transactions that involve a transfer of resources, services or obligations are disclosed regardless of whether a price is charged. [850-10-05]

Management compensation

Unlike IFRS, US GAAP does not require the disclosure of management compensation. SEC regulations, however, require disclosure (outside the financial statements) of the compensation of certain members of management and the board, as well as other specific disclosures; however, the type and classification of the information required by SEC regulations differs from the requirements under IFRS.

Like IFRS, US GAAP requires the disclosure of information about transactions, other than compensation arrangements and other similar transactions in the ordinary course of business, with management. Unlike IFRS, US GAAP does not require such disclosure as a separate category of related party transactions. [850-10-50]
**Other related party transactions**

Unless the partial exemption for government-related entities is applied, as a minimum, the following disclosures are provided if there have been transactions between related parties:

- the nature of the related party relationship and information about the transactions, including those to which no amounts were ascribed;
- the amount of the transactions;
- outstanding balances, including commitments, and their terms and conditions, (including whether outstanding balances are secured);
- the nature of the consideration to be provided and details of guarantees given or received; and
- any allowance for doubtful debts and any amounts written off during the period. [IAS 24.18–19, 25]

No disclosure is required in the consolidated financial statements in respect of intra-group transactions eliminated in preparing those statements. [IAS 24.4]

Disclosure is provided separately for each category of related party. [IAS 24.19]

Items of a similar nature may be disclosed in aggregate as long as the aggregation does not obscure the importance of individually significant transactions. [IAS 24.24]

Related party transactions are required to be disclosed regardless of whether they are entered into on terms equivalent to those in an arm’s length transaction. A reporting entity may include in its financial statements a statement that related party transactions were made on terms equivalent to those that prevail in an arm’s length transaction only if that statement can be substantiated. [IAS 24.21, 23]

**Other related party transactions**

The following disclosures of transactions between related parties are provided for all entities:

- the nature of the relationship(s) and a description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, like IFRS;
- the amount of the transactions, if any, like IFRS;
- the effects of any change in the method of establishing the terms of related party transactions from those used in the preceding period, unlike IFRS;
- amounts due from or to related parties as at each reporting date presented and, if they are not otherwise apparent, the terms and manner of settlement, like IFRS; and
- the nature of consideration to be collected or paid, and details of guarantees given or received, like IFRS. [850-10-50]

Unlike IFRS, there is no specific requirement to disclose allowances for doubtful debts that have been recognised in respect of balances owing from related party transactions.

Like IFRS, no disclosure is required in the consolidated financial statements in respect of intra-group transactions eliminated in preparing those statements. [850-10-50]

Although disclosure of related party transactions is required, disclosures of related party transactions are not required to be made for each category of related party relationship, unlike IFRS. [850-10-50]

Like IFRS, items of a similar nature may be disclosed in aggregate as long as the aggregation does not obscure the importance of individually significant transactions. [850-10-50]

Like IFRS, entering into related party transactions on terms equivalent to those in an arm’s length transaction does not eliminate related party disclosure requirements. Like IFRS, representations about transactions with related parties, if they are made, should not imply that the related party transactions were consummated on terms equivalent to those that prevail in an arm’s length transaction unless such representations can be substantiated. [850-10-50-5]
Government-related entities
An entity may elect to apply a partial exemption to disclosures about transactions and outstanding balances, including commitments, with a government that has control, joint control or significant influence over the reporting entity or another entity under control, joint control or significant influence of the same government. An entity applying the partial exemption is exempt from disclosing the information set out under ‘other related party transactions’ above. Instead, such an entity discloses:
– the name of the government and the nature of its relationship with the reporting entity;
– the nature and amount of individually significant transactions; and
– for other transactions that are collectively (but not individually) significant, a qualitative or quantitative indication of their extent. [IAS 24.25–26]

Government-related entities
Unlike IFRS, there is no partial exemption for government-related entities that prepare US GAAP financial statements. However, many government-related entities prepare financial statements in accordance with US governmental accounting standards, rather than in accordance with US GAAP. [ASO-10-15]
5.6 Investment entity consolidation exception

**Overview**

- Only an entity that meets the definition under IFRS can qualify as an ‘investment entity’.

- The definition of an investment entity requires an entity to meet certain criteria relating to its activities and its measurement and evaluation of the performance of its investments.

- In addition, an entity considers ‘typical’ characteristics in assessing whether it meets the definition of an investment entity.

- An investment entity measures all of its investment entity subsidiaries at fair value, with changes in fair value recognised in profit or loss. As an exception, an investment entity consolidates a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity’s investment activities.

- An investment entity prepares a complete set of financial statements in the usual way, including comparative information.

5.6 Investment company consolidation exception

**Overview**

- An entity that meets the definition under US GAAP can qualify as an ‘investment company’, like IFRS. However, unlike IFRS, an entity also qualifies as an investment company by virtue of being regulated under the Investment Company Act of 1940.

- Like IFRS, the definition of an investment company requires an entity to meet certain criteria relating to its activities and its evaluation of investments; however, these criteria differ from IFRS in certain respects. In addition, unlike IFRS, there is no criterion related to the measurement of an entity’s investments.

- In addition, an entity considers ‘typical’ characteristics in assessing whether it meets the definition of an investment entity, like IFRS; however, these characteristics differ from IFRS in certain respects.

- In general, an investment company measures investments in subsidiaries at fair value, with changes in fair value recognised in profit or loss, like IFRS. As an exception, an investment company consolidates a subsidiary that provides permitted investment-related activities but, unlike IFRS, only when the subsidiary provides investment-related services to the investment company only.

- Unlike IFRS, an investment company is required to provide only a statement of changes in net assets, a schedule of investments and financial highlights. In addition, unlike IFRS, there is no requirement to present comparative financial statements and US GAAP only requires a statement of cash flows in certain circumstances.
Overview (continued)

- The investment entity consolidation exception is mandatory for the parent of an investment entity that itself meets the definition of an investment entity.
- A parent that is not itself an investment entity consolidates all subsidiaries.

Scope

The investment entity consolidation exception is mandatory for an entity that meets the relevant criteria (see below). However, it does not apply to subsidiaries that are not themselves investment entities and whose main purpose and activities are providing services that relate to the investment entity’s investment activities, which continue to be consolidated (see below).

The investment entity guidance applies to all sectors.

Qualifying investment entities

An entity is an ‘investment entity’ if it meets the following three ‘essential’ tests.
- It obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services.
- It commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income or both.
- It measures and evaluates the performance of substantially all of its investments on a fair value basis. [IFRS 10.27, B85A–B85M]

Assessment of investment company status

An investment company has the following fundamental characteristics.
- Like IFRS, 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; and
  - commits to its investor(s) that its business purpose and only substantive activities are investing the funds solely for returns from capital appreciation, investment income or both.
- The entity or its affiliates do not obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income. Although the precise wording of US GAAP differs from IFRS, the overall concept is the same. [946-10-15-6]

Unlike IFRS, under US GAAP fair value management is not a fundamental characteristic; rather, it is a “typical” characteristic to be considered (see below).
An entity considers the following ‘typical’ characteristics in assessing whether it meets all three essential tests of the definition of an investment entity.

- It has more than one investment.
- It has more than one investor.
- It has investors that are not related parties.
- It has ownership interests in the form of equity or similar interests. [IFRS 10.28, B85N, IU 03-17]

The absence of one or more of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity, but indicates that additional judgement is required in determining whether the three essential tests are met. [IFRS 10.28, B85N, IU 03-17]

An entity reassesses its status if facts and circumstances indicate that there has been a change in any of the essential elements of the definition of an investment entity or in the typical characteristics. [IFRS 10.29]

A change in status is accounted for prospectively. The fair value of an investment at the date of the change in status is the investment’s initial carrying amount upon ceasing to be an investment entity. [IFRS 10.30, B100]

**Essential tests**

An investment entity obtains funds from investors to provide those investors with investment management services. As part of its activities, an investment entity is permitted to provide investment-related services to its investors – e.g. investment advisory services, investment management, investment support and administrative services – either directly or through a subsidiary. Even if the investment-related services are substantial and are also provided to third parties, this does not preclude an entity from qualifying as an investment entity. However, if an entity provides investment-related services to third parties, then it needs to assess whether it still qualifies as an investment entity by considering whether its provision of investment-related services to third parties is ancillary to its core investing activities and therefore does not change its business purpose (see below). [IFRS 10.27(a), B85C, BC240F, IU 03-17]

There is no specific restriction on the assets and liabilities that may be held by an investment entity, although significant assets or liabilities that are unrelated to its investment entity activities may raise questions about whether it has the essential elements of an investment entity (see above).

An entity considers the following ‘typical’ characteristics in assessing whether it meets the definition of an investment entity.

- It has more than one investment, like IFRS.
- It has more than one investor, like IFRS.
- It has investors that are not related parties of the parent (if there is a parent) or the investment manager, which is broader than IFRS.
- It has ownership interests in the form of equity or partnership interests, like IFRS.
- It manages substantially all of its investments on a fair value basis, which is an ‘essential’ test under IFRS (see above). [946-10-15-7]

Like IFRS, the absence of one or more of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity, but indicates that additional judgement is required in making that determination. [946-10-15-8]

An entity is required to reassess its status when there is a subsequent change in the purpose and design of the entity, like IFRS, or the entity is no longer regulated under the Investment Company Act of 1940. [946-10-25-1]

Like IFRS, a change in status is accounted for prospectively. Like IFRS, the fair value of an investment at the date of the change in status is the investment’s initial carrying amount upon ceasing to be an investment company. [946-10-25-2]

**Fundamental characteristics**

An investment company may provide investing-related services (e.g. investment advisory or transfer agent services) to other entities, directly or indirectly through an investment in an entity that provides those services, if those services are not substantive, which is more restrictive than IFRS. However, an investment company may provide substantive investing-related services, directly or indirectly through an investment in an entity that provides those services, if the substantive services are provided to the investment company only, which is more restrictive than IFRS. [946-10-55-5]

Unlike IFRS, an investment company should not have significant assets or liabilities that are unrelated to its investment company activities, unless they relate to permitted investing-related services provided to the investment company. [946-10-55-4]
Providing management services or strategic advice to an investee or providing financial support to an investee (e.g. through a loan, capital commitment or guarantee) is prohibited, unless these activities:
– do not represent a separate substantial business activity or a separate substantial source of income for the entity; and
– are undertaken to maximise the investment return from the investee.

[IFRS 10.B85D]

An investment entity commits to its investors that its business purpose is to invest for returns solely from capital appreciation and/or investment income. This commitment could, for example, be included in the offering memorandum, investor communications and/or other corporate or partnership documents.

[IFRS 10.27(b), B85B]

A documented potential exit strategy is required for substantially all investments that could be held indefinitely. [IFRS 10.B85F, BC247]

An entity is precluded from qualifying as an investment entity if it, or another member of the group containing the entity, obtains, or has the objective of obtaining, other benefits from its investments that are not available to other parties not related to the investee. This is because these benefits indicate that the entity is investing to earn benefits other than capital appreciation and/or investment income. [IFRS 10.B85I]

An investment entity measures and evaluates the performance of ‘substantially all’ of its investments on a fair value basis. To meet these requirements:
– fair value information is provided to investors; and
– key management personnel use fair value information as the primary basis for evaluating performance and making investment decisions. [IFRS 10.27(c), B85K]

In addition, to meet the performance measurement and evaluation criterion, the entity needs to account for its investments under the fair value model in all instances permitted by other standards, including:
– investment property;
– financial assets; and
– investments in associates and joint ventures. [IFRS 10.27(c), B85K–B85L]

Like IFRS, an investment company may provide management services or financial support to an investee as long as they do not represent a separate substantial business activity or separate substantial source of income and are undertaken to maximise returns from capital appreciation, investment income or both. [946-10-55-10]

Like IFRS, evidence of the entity’s business purpose and substantive activities may, for example, be included in the entity’s offering memorandum, publications distributed by the entity, and other corporate or partnership documents that indicate the investment objectives of the entity. [946-10-55-6]

Like IFRS, there is an exit strategy requirement. However, unlike IFRS, an exit strategy is not required for investments held only for returns from investment income. [946-10-55-7]

Like IFRS, an entity cannot be an investment company if the entity or its affiliates (which could differ from IFRS) 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. [946-10-55-8]

An investment company typically manages substantially all of its investments on a fair value basis, like IFRS. This includes an evaluation of whether fair value is a key component of any of the following:
– how the entity evaluates the performance of its investments;
– how the entity transacts with its investors; and
– how asset-based fees are calculated. [946-10-55-27 – 55-29]

Because the precise language under US GAAP differs from IFRS, it is possible that differences may arise in practice.

Unlike IFRS, there is no requirement for investments to be measured at fair value in order to meet the definition of an investment company. However, if it is determined that the entity meets the definition of an investment company, then its accounting policy will be to measure its investments at fair value. [946-320-35-1, 946-325-35-1]
Measurement
An investment entity is required to measure all of its investment entity subsidiaries at fair value through profit or loss. [IFRS 10.31–32]

As an exception, an investment entity consolidates a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity’s investment activities. [IFRS 10.32, B85E]

Components of the financial statements
An investment entity prepares a complete set of financial statements in the usual way (see chapter 2.1), including comparative information, except that they will not be consolidated financial statements, unless the investment entity has a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity’s investment activities (see above). In addition, although it is not required, many investment entities choose to present a statement of changes in net assets attributable to the holders of redeemable shares/units.

Parent of investment entity
The investment entity consolidation exception is mandatory for the parent of an investment entity that itself meets the definition of an investment entity. [IFRS 10.33]

The consolidation exception is not carried through to the consolidated financial statements of a parent that is not itself an investment entity – i.e. the parent is nevertheless required to consolidate all subsidiaries. [IFRS 10.33]

Measurement
In general, investments in subsidiaries are measured at fair value, with changes in fair value recognised in profit or loss, like IFRS. [946-229-45-1]

As an exception, an investment company consolidates a subsidiary that is an operating company that provides permitted investment-related activities but, unlike IFRS, only if that subsidiary provides such activities only to the investment company. [946-810-45-3]

Components of the financial statements
Unlike IFRS, an investment company is required to provide only a statement of changes in net assets, a schedule of investments and financial highlights. In addition, unlike IFRS, there is no requirement to present comparative financial statements and US GAAP only requires a statement of cash flows in certain circumstances. [346-205-45-1]

Parent of investment company
Unlike IFRS, consolidation by an investment company of an investment company subsidiary is not precluded and practice under US GAAP varies.

Unlike IFRS, for purposes of consolidating an investment company, a non-investment company parent retains the investment company accounting applied by the subsidiary investment company. [810-10-25-15]
5.7 Non-monetary transactions

Overview

- Exchanges of assets held for use are measured at fair value and result in the recognition of gains or losses, unless the transaction lacks commercial substance.

- Exchanged assets held for use are recognised based on historical cost if the exchange lacks commercial substance or if fair value cannot be measured reliably.

- Revenue is recognised for barter transactions unless the transaction is incidental to the entity’s main revenue-generating activities or the items exchanged are similar in nature and value. See forthcoming requirements.

- Property, plant and equipment contributed from customers that is used to provide access to a supply of goods or services is recognised as an asset if it meets the definition of an asset and the recognition criteria for property, plant and equipment. See forthcoming requirements.

Exchange of assets held for use

If the exchange of property, plant and equipment, intangible assets or investment property has commercial substance, then the transaction gives rise to a gain or loss. The cost of the asset acquired is generally equal to the fair value of the asset surrendered, adjusted for any cash transferred. [IAS 16.24, 38.45, 40.27]

Exchange of assets held for use

Like IFRS, exchanges of assets held for use are measured at fair value and result in the recognition of gains or losses, unless the transaction lacks commercial substance.

- Like IFRS, exchanged assets held for use are recognised based on historical cost if the exchange lacks commercial substance or if fair value cannot be measured reliably. Additionally, exchange transactions to facilitate sales to customers are recognised based on historical cost, unlike IFRS.

- Unlike IFRS, US GAAP does not require an exchange of dissimilar items in a barter transaction to be recognised as revenue. No revenue is recognised for barter transactions that facilitate sales to customers. US GAAP provides explicit guidance to support the fair value measurement of a barter revenue transaction, unlike IFRS. See forthcoming requirements.

- In accordance with general principles, property, plant and equipment that is used to provide access to a supply of goods or services would be recognised as an asset if it meets the definition of an asset and the recognition criteria for property, plant and equipment, like IFRS.
If an exchange of non-monetary assets lacks commercial substance, or if the fair value of neither the asset received nor the asset given up is reliably measurable, then no revenue or gain is recognised; instead, the acquired asset is recognised initially at the carrying amount of the asset surrendered. [IAS 16.24, 38.45, 40.27]

An exchange transaction has ‘commercial substance’ if:
– the configuration of the cash flows (i.e. the amount, timing and uncertainty) of the assets received and transferred are different; or
– the entity-specific value of the portion of the entity’s operation affected by the transaction changes as a result of the exchange; and
– the difference in both of the above situations is significant when compared with the fair value of the assets exchanged. [IAS 16.25, 38.46, 40.28]

Whether an exchange of assets results in the recognition of revenue or a gain depends on whether the transaction is part of the main revenue-generating activities of the entity (see chapter 4.2). [IAS 1.34, 18.7]

However, revenue is not recognised when assets of a similar nature and value are exchanged. [IAS 18.12]

There are specific requirements under IFRS for contributions of non-monetary assets in exchange for an interest in an equity-accounted investee (see chapter 3.5). [IAS 28.30–31]

**Exchange of goods and services**

**Advertising barter transactions**

Revenue from a barter transaction involving advertising obtained in an exchange of dissimilar advertising services is measured at the fair value of the advertising services given, provided that the fair value of those services given can be measured reliably. The measurement of advertising services given is considered to be ‘reliable’ if it is determined with reference to non-barter transactions that:
– involve advertising similar to that in the barter transaction;
– occur frequently;

Like IFRS, if an exchange of non-monetary assets lacks commercial substance, or if the fair value of neither the asset received nor the asset given up is determinable within reasonable limits, then no revenue or gain is recognised; instead, the acquired asset is recognised initially at the carrying amount of the asset surrendered. [845-10-30-3]

An exchange transaction has ‘commercial substance’ if:
– the configuration of the future cash flows (i.e. the amount, timing and uncertainty) of the assets received and transferred are significantly different, like IFRS; however, unlike IFRS, the difference need not be significant in relation to the fair value of the assets exchanged; or
– the entity-specific value of the assets received and transferred differs and the difference is significant when compared with the fair value of the assets exchanged, like IFRS. [845-10-30-4]

Like IFRS, whether an exchange of assets results in the recognition of revenue or a gain depends on whether the transaction is peripheral to the main activities of the entity; however, those requirements differ in certain respects from IFRS (see chapter 4.2). [CON 6.88]

In addition, unlike IFRS, US GAAP specifies that an exchange transaction of a product or property that is held for sale in the ordinary course of business for a product or property to be sold in the same line of business to facilitate sales to customers other than the parties to the exchange is accounted for at historical cost. [845-10-30-3]

Like IFRS, there are specific requirements under US GAAP for contributions of non-monetary assets in exchange for an interest in a non-controlling interest in an entity; however, those requirements differ in certain respects from IFRS (see chapter 3.5). [845-10-30-24 – 30-27]

**Exchange of goods and services**

**Advertising barter transactions**

Like IFRS, revenue from a barter transaction involving advertising is measured at the fair value of the advertising services given, provided that fair value is determinable based on the entity’s own historical practice of receiving cash or other consideration that is readily convertible to cash. Fair value is deemed to be ‘determinable’ in this regard only if done so with reference to similar non-barter (i.e. cash) transactions that:
– were in the same media and within the same advertising vehicle (e.g. same publication, same website, or same broadcast channel);
represent a predominant number of transactions and amount compared with all transactions to provide advertising that are similar to the advertising in the barter transaction;

– involve cash and/or other consideration that has a reliably measurable fair value – e.g., not only a swap of cash (see chapter 2.4); and

– do not involve the same counterparty as in the barter transaction. [SIC-31.5]

If an entity meets the above criteria, then revenue is recognised when the advertisement appears before the public – i.e., when the advertisement is shown (see chapter 4.2). See forthcoming requirements.

Other barter transactions

Revenue is recognised by an entity when goods or services are sold in exchange for dissimilar goods and services, unless the transaction is incidental to the entity’s main revenue-generating activities. Revenue is measured at the fair value of the goods or services received, adjusted for any cash or cash equivalents received or paid, unless the fair value cannot be measured reliably. In such cases, the revenue is measured at the fair value of the goods or services given up, adjusted for any cash or cash equivalents received or paid. However, when goods and services are exchanged for goods or services that are similar in nature and value, the exchange is considered a transaction that does not generate revenue. See forthcoming requirements. [IAS 1.34, 18.2 12]

– involved reasonably similar circulation, exposure or saturation within an intended market;

– were reasonably similar regarding timing (time of day, day of week, daily, weekly, 24 hours a day/7 days a week, and season of the year);

– were reasonably similar regarding prominence (page on website, section of periodical, location on page and size of advertisement);

– were reasonably similar regarding demographics of readers, viewers or customers; and

– were reasonably similar regarding duration (length of time advertising will be displayed). [605-20-25-14 – 25-18]

Because US GAAP provides additional requirements for evaluating recent cash transactions, differences from IFRS may arise in practice.

Like IFRS, if an entity meets the above criteria, then revenue is recognised when the advertisement appears before the public – i.e., when the advertisement is shown (see chapter 4.2). See forthcoming requirements.

Unlike IFRS, US GAAP does not require an exchange of dissimilar goods or services in a barter transaction to result in the recognition of revenue. Rather, under US GAAP, an entity considers the following. See forthcoming requirements.

– If the transaction is an exchange of a product or property held for sale in the ordinary course of business for a product or property to be sold in the same line of business to facilitate sales to customers other than parties to the exchange, then the transaction is measured at the carrying amount of the asset given up and there is no revenue, gain or loss recognition. Unlike IFRS, US GAAP has specific criteria for determining whether an exchange of inventory with the same party is recognised at fair value or the carrying amount of the inventory surrendered, and differences from IFRS may arise in practice.

– Additionally, if an exchange of non-monetary assets that would otherwise be based on recorded amounts involves some monetary consideration (referred to as ‘boot’), and the monetary consideration exceeds 25 percent of the fair value of the exchange, then the transaction is considered to be monetary and is recognised at fair value. As an exception, for a transaction involving an exchange of similar real estate that is considered a monetary transaction because boot is at least 25 percent of the fair value of the exchange, the consideration is allocated between the two components: a monetary portion and a non-monetary portion. [845-10-30-3, 30.6 – 30.8, 30.23]
Donated assets
If assets are transferred to the entity by the government, then such transfers normally meet the definition of a government grant (see chapter 4.3). [IAS 20.3]

Assets or resources transferred to an entity by a shareholder for no consideration are normally equity contributions that are recognised directly in equity (see chapter 7.3). [CF4.25(a)]

Transfers of assets from customers
Sometimes a customer transfers property, plant and equipment to an entity that will use the contributed assets to provide access to a supply of goods or services, either by providing a connection and/or by providing ongoing access to a supply of goods or services. IFRS contains specific guidance for the recipient in this situation. See forthcoming requirements. [IFRIC 18.4–5]

An entity that has received such a contribution recognises an asset only if it determines that the item contributed meets both the definition of an asset (see chapter 1.2) and the recognition criteria for property, plant and equipment (see chapter 3.2). If these criteria are met, then the asset is recognised at fair value. [CF 4.4, IAS 16.3, 24, IFRIC 18.9–11]

When an asset is recognised (at fair value) by the entity that receives the contribution, a corresponding amount is recognised as revenue (see chapter 4.2). [IFRIC 18.13–14]

Forthcoming requirements
The new revenue standard is effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

The specific guidance related to barter transactions (see above) and the guidance on transfers of assets from customers are replaced by the general principles of the revenue standard (see chapter 4.2A).

Donated assets
Unlike IFRS, US GAAP does not provide specific guidance on assets donated by government, which are accounted for in accordance with the requirements for other non-monetary transactions. [845-10-5-3, 5-6]

Like IFRS, assets or resources transferred to an entity by a shareholder for no consideration are normally equity contributions that are recognised directly in equity (see chapter 7.3). [845-10-5-4]

Transfers of assets from customers
Unlike IFRS, there is no specific guidance for transfers of property, plant and equipment for entities that receive such contributions from their customers, and general principles apply.

Like IFRS, in accordance with general principles, an entity that receives property, plant and equipment from customers recognises this item as an asset if it determines that the transferred item meets the definition of an asset (see chapter 1.2) and the recognition criteria for property, plant and equipment (see chapter 3.2).

Unlike IFRS, there is no explicit guidance in US GAAP on the initial recognition of such assets. However, we would expect the cost of such property, plant and equipment to be determined with reference to its fair value on initial recognition, like IFRS.

Forthcoming requirements
The new revenue Codification Topic is effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted but not before annual periods beginning after 15 December 2016.

Except for non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers, specific guidance related to barter transactions (see above) is replaced by the general principles of the revenue Codification Topic (see chapter 4.2A).
5.8 Accompanying financial and other information

Overview

- IFRS does not require supplementary financial and operational information to be presented.

- An entity considers its particular legal or regulatory requirements in assessing what information is disclosed in addition to that required by IFRS.

- IFRS practice statement Management Commentary provides a broad, non-binding framework for the presentation of management commentary.

In addition to disclosing additional information in the financial statements to achieve a fair presentation (see chapter 2.2), many entities provide further information to accompany the financial statements. Accompanying information may be provided either voluntarily or because of regulatory requirements.

Like IFRS, in addition to disclosing additional information in the financial statements to achieve a fair presentation (see chapter 2.1), many entities provide further information to accompany the financial statements. Accompanying information may be provided either voluntarily or because of regulatory requirements; in the US, many regulatory requirements relate to the securities exchanges and the SEC.

SEC requirements guide the content of additional information that is required to be included in the financial statements and outside the financial statements in regulatory filings of SEC registrants. Additional information required by the SEC on Form 10-K, 10-KSB or 20-F includes, but is not limited to:

- a ‘selected financial data summary’ table (minimum of five years);
- supplementary financial information (e.g. schedule of loans);
- quantitative and qualitative disclosures on market risk (see chapter 7.8);
IFRS is not based on any particular legal or regulatory framework. However, the IASB has published guidance in the form of IFRS practice statement *Management Commentary*, which is not an IFRS. Its objective is to help management provide useful management commentary in respect of financial statements prepared in accordance with IFRS.

Unlike IFRS, although companies outside the US apply US GAAP and US companies have operations outside the US, US GAAP has been developed to a substantial degree with the US legal and regulatory environment in mind. Unlike IFRS, SEC registrants are required to include management’s discussion and analysis (MD&A) in their annual reports filed with the SEC. For non-SEC registrants, US GAAP does not provide either mandatory or optional guidance on management commentary; however, some non-SEC registrants include an MD&A in their annual reports.

Like IFRS, there is no requirement in US GAAP for an MD&A. However, the SEC requires an MD&A of financial condition and results of operations and quantitative and qualitative disclosures about market risk to be included as part of a registrant’s annual and interim filings; however, the MD&A is not part of the financial statements.

Like IFRS, there is no requirement in US GAAP for the financial statements of other entities to be presented, either within or outside the reporting entity’s financial statements.

Like IFRS, there is no requirement in US GAAP for the financial statements of other entities to be presented. However, SEC regulations may require presentation of the financial statements of other related entities. These requirements vary depending on whether an entity is domestic or foreign, the filing is a periodic report (e.g. annual report) or for capital raising, and the significance of the other entity to the reporting entity. Examples of the financial statements that might be required include those of:
- significant acquirees;
- significant investees;
- guarantors;
- the entity unconsolidated; and
- entities that have significant restricted net assets.

Like IFRS, US GAAP does not limit the presentation of information outside the financial statements. However, unlike IFRS SEC rules define non-GAAP measures as numerical measures of financial performance, financial position or cash flows that (1) exclude amounts that are included in the most directly comparable measure calculated and presented in accordance with US GAAP or (2) include amounts that are excluded from the most directly comparable measure calculated and presented in accordance with US GAAP. SEC regulations prohibit the presentation of non-GAAP measures in the financial statements. Further, SEC regulations require non-GAAP measures that are presented outside the financial statements to be reconciled to the most relevant US GAAP measure. In addition, management should disclose why the measure is useful to investors (see chapter 4.1), unlike IFRS. [Reg-G, S-X]
Certain disclosures required by specific standards may be presented outside the financial statements with a cross-reference to those disclosures from the financial statements, as long as the accompanying information is available to users of the financial statements on the same terms as the financial statements and at the same time. In our view, if such information is presented outside the financial statements, then it should be marked clearly as being part of the disclosures required by IFRS and cross-referenced to the financial statements.

[IFRS 4.IG62, 7.B6, 14.31, IAS 34.16A]

Unlike IFRS, SEC Regulation S-K requires quantitative and qualitative disclosure about market risk related to certain financial instruments in the MD&A, which is not part of the financial statements and is expressly subject to the statutory safe harbour provisions of the Securities Act and the Exchange Act. Unlike IFRS, all information that is a part of the financial statements is included within the financial statements.
5.9 Interim financial reporting

 Overview

– Interim financial statements contain either a complete or a condensed set of financial statements for a period shorter than a financial year.

– At least the following are presented in condensed interim financial statements: condensed statement of financial position, condensed statement of profit or loss and OCI, condensed statement of changes in equity, condensed statement of cash flows, and selected explanatory notes.

– Other than income tax, items are recognised and measured as if the interim period were a discrete stand-alone period.

– Income tax expense for an interim period is based on an estimated average annual effective income tax rate.

– The accounting policies applied in the interim financial statements are generally those that will be applied in the next annual financial statements.

 Scope

An entity is not required to prepare interim financial statements in accordance with the interim reporting standard in order for its annual financial statements to comply with IFRS. [IAS 34.1]

5.9 Interim financial reporting

 Overview

– Like IFRS, interim financial statements contain either a complete or a condensed set of financial statements for a period shorter than a financial year.

– Like IFRS, at least the following are presented in condensed interim financial statements: condensed statement of financial position, condensed statement of comprehensive income, condensed statement of cash flows, and selected explanatory notes. However, unlike IFRS, a condensed statement of changes in equity is not required.

– Unlike IFRS, each interim period is viewed as an integral part of the annual period to which it relates.

– Like IFRS, income tax expense for an interim period is based on an estimated average annual effective income tax rate. However, US GAAP has more detailed guidance than IFRS.

– Like IFRS, the accounting policies applied in the interim financial statements are generally those that will be applied in the next annual financial statements.

 Scope

Like IFRS, the interim reporting Codification Topic does not mandate that interim financial statements be presented in order for the annual financial statements to comply with US GAAP. However, SEC regulations require domestic US registrants to prepare and file condensed interim financial statements, on a quarterly basis.
Sometimes a **complete** set of financial statements is published for an interim period, prepared in accordance with IFRS. The form and content of those financial statements comply with the requirements of full IFRS for annual financial statements (see chapter 2.2), although the recognition and measurement requirements of the interim reporting standard still apply, as well as the requirements for the presentation of comparatives. However, more commonly entities prepare a condensed set of financial statements in accordance with the interim reporting standard. [IAS 34.1–3, 7, 9, 19]

**Form and content of condensed interim financial statements**

Condensed interim financial statements include at least:
- a condensed statement of financial position as at the end of the current interim period and at the end of the immediately preceding financial year;
- a condensed statement of profit or loss and OCI for the current interim period and cumulatively for the year to date, and for the comparable interim periods (current and cumulative) of the immediately preceding financial year;
- a condensed statement of cash flows, cumulatively for the current year to date and for the comparable year-to-date period of the immediately preceding financial year;
- a condensed statement of changes in equity, cumulatively for the current year to date and for the comparable year-to-date period of the immediately preceding financial year; and
- certain explanatory notes. [IAS 34.8, 20]

Condensed interim financial statements include, at a minimum, each of the headings and subtotals that were included in the most recent annual financial statements. Additional line items are included if their omission would make the financial statements misleading. [IAS 34.10, IU 07-14]

Basic and diluted EPS are presented in the condensed interim statement of profit or loss and OCI for each class of ordinary shares of the parent entity, with equal prominence (see chapter 5.3). Although not required explicitly by the interim reporting standard, EPS for continuing operations may be material to an understanding of the interim period, in which case it is disclosed in addition to EPS for total operations in the condensed financial statements. [IAS 34.11–11A, 15]

Sometimes a **complete** set of financial statements is published for an interim period, prepared in accordance with US GAAP. Like IFRS, the form and content of those financial statements comply with the requirements of US GAAP for annual financial statements (see chapter 2.2). However, like IFRS, the recognition and measurement requirements of the interim reporting Codification Topic apply (in addition to SEC requirements for SEC registrants), as well as the requirements for the presentation of comparatives. More commonly, like IFRS, condensed financial statements are prepared. [270-10-50, 10-S99]

**Form and content of condensed interim financial statements**

Like IFRS, condensed interim financial statements include at least:
- a condensed statement of financial position as at the end of the current interim period and at the end of the immediately preceding financial year;
- a condensed statement of comprehensive income, for the current interim period and cumulatively for the year to date, and for the comparable interim periods (current and cumulative) of the immediately preceding financial year;
- a condensed statement of cash flows, cumulatively for the current year to date and for the comparable year-to-date period of the immediately preceding financial year; and
- certain explanatory notes. [270-10-50, 10-S99]

However, unlike IFRS, a condensed statement of changes in equity is not required to be presented, although significant changes in equity are disclosed. [270-10-50-4]

Unlike IFRS, the most recent annual financial statements do not establish a minimum requirement for the headings and subtotals to be included in the interim financial statements. SEC registrants are permitted to disclose only major captions, subject to limitations. [270-10-S99]

Unlike IFRS, both basic and diluted EPS are required to be presented in the condensed interim statement of comprehensive income for both continuing operations attributable to ordinary equity holders of the parent entity and net income attributable to ordinary equity holders of the parent entity for each class of common shares, with equal prominence (see chapter 5.3). [270-10-45, 270-25]
Entities with highly seasonal activities are encouraged to supplement the required disclosures with information for the 12-month period ending on the interim reporting date, as well as comparatives. [IAS 34.21]

An entity provides explanatory notes, including a description of any transactions and events that are significant to an understanding of the changes in its financial position and performance since the last annual reporting date. Entities are not required to repeat or provide insignificant updates to information already reported in the most recent annual financial statements. [IAS 34.15-15A]

Certain disclosures, if they are not included in the notes to interim financial statements, may be incorporated by cross-reference from the interim financial statements to another part of the interim financial report that is available to users of the interim financial statements on the same terms and at the same time as the interim financial statements. [IAS 34.16A]

**Recognition and measurement in condensed interim financial statements**

Generally, items are required to be recognised and measured as if the interim period were a discrete stand-alone period. However, the tax charge is based on the expected weighted-average effective rate for the full year. [IAS 34.29-30]

The conditions for recognising expenses and provisions are the same for interim financial statements as for annual financial statements. Therefore, losses, expenses and income are recognised as they are incurred and may not be anticipated (see chapter 3.12). Similarly, costs and income that are incurred or earned unevenly during the financial year are anticipated or deferred at the end of the interim reporting period only if it would also be appropriate to anticipate or defer that type of cost or income at the annual reporting date. [IAS 34.37, 39]

Like IFRS, US GAAP encourages entities that are subject to significant seasonal variations to supplement their required disclosures with information for the 12-month period ending on the interim reporting date, as well as comparatives. [270-10-45-11]

Like IFRS, an entity provides explanatory notes, including a description of any transactions and events that may be significant to an understanding of the current interim period. Entities are not required to repeat or provide insignificant updates to information already reported in the most recent annual financial statements, like IFRS. [270-10-50]

Unlike IFRS, disclosures related to the interim financial statements cannot be provided elsewhere in the interim financial report and cross-referenced in the interim financial statements. [270-10-550-2]

**Recognition and measurement in condensed interim financial statements**

Unlike IFRS, US GAAP is based on the notion that each interim period is an integral part of an annual period. Accordingly, although the results of each interim period are generally based on the accounting policies and practices used by an entity in preparing its annual financial statements, US GAAP allows for certain modifications at interim reporting dates so that the reported results for the interim period may relate better to the results of operations for the annual period – e.g. lower of cost and market adjustments for inventory (see chapter 3.8). The tax charge is based on the estimated annual effective rate, like IFRS. [270-10-45, 270-25]

Unlike IFRS, US GAAP permits certain principles and practices used in the preparation of the annual financial statements to be modified for the purposes of interim financial statements. Certain costs may be allocated to interim periods based on estimates of time expired, benefit received or other activity associated with the interim period – e.g. a proportionate amount of year-end bonuses based on an estimate of the annual amount. [270-10-45]
An entity is prohibited from reversing an impairment loss recognised in a previous interim period in respect of goodwill, an investment in an equity instrument classified as available-for-sale or a financial asset measured at cost (not amortised cost). [IFRIC 10.B]

**Assets measured at fair value**
The carrying amount of assets that are measured at fair value – e.g. investment property – is determined at the interim reporting date. The fair value assessment may involve a higher degree of estimation than is used for the annual financial statements. [IAS 34.IE.C7]

**Income tax expense**
The income tax expense or benefit for an interim period comprises both current tax and deferred tax.

The income tax expense recognised in each interim period is based on the best estimate of the weighted-average annual rate expected for the full year applied to the pre-tax income of the interim period. [IAS 34.30(c), IE.B12–B16]

The effective rate applied to the interim period reflects enacted or substantively enacted changes in tax rates (see chapter 3.13). [IAS 34.IE.B13]

If a change in tax rate is enacted or substantively enacted in an interim period, then an entity may recognise the effect of the change immediately in the interim period in which the change occurs. However, another acceptable approach is to spread the effect of a change in the tax rate over the remainder of the annual reporting period via an adjustment to the estimated annual effective income tax rate. [IAS 34.30(c), IE.B19]

Anticipated tax benefits from tax credits are generally reflected in computing the estimated annual effective tax rate when the credits are granted and calculated on an annual basis. However, if the credits relate to a one-off event, then they are recognised in the interim period in which the event occurs. [IAS 34.IE.B19]

Like IFRS, an entity is prohibited from reversing an impairment loss recognised in a previous interim period in respect of goodwill, an investment in an equity security classified as available-for-sale, or an investment measured at cost. However, unlike IFRS, an impairment loss recognised on an asset measured at amortised cost (e.g. a held-to-maturity security) or on an available-for-sale debt security would also not be reversed (see chapter 7.6). US GAAP also precludes the reversal of an impairment loss recognised on long-lived assets in a previous interim period, unlike IFRS. [320-10-35-34E, 350-20-35-13]

**Assets measured at fair value**
Like IFRS, the carrying amount of assets that are measured at fair value is determined at the interim reporting date. The fair value assessment for the purposes of interim financial statements is generally the same as is used for the annual financial statements, which may be stricter than the requirement under IFRS. Additionally, differences exist between IFRS and US GAAP in respect of the assets that are measured at fair value, which are discussed in other chapters of this publication – e.g. property, plant and equipment in chapter 3.2. [270-10-45-2]

**Income tax expense**
Like IFRS, the income tax expense or benefit for an interim period comprises both current tax and deferred tax. [740-270-25]

Like IFRS, income tax expense recognised in each interim period is based on the best estimate of the effective tax rate expected to be applicable for the full year applied to the pre-tax income of the interim period. [740-270-25]

Unlike IFRS, the effective rate applied to the interim period reflects only enacted tax rates (see chapter 3.13). [740-270-25]

Unlike IFRS, if a change in a tax rate is enacted in an interim period, then the effect of the change is required to be recognised in income from continuing operations immediately in the interim period of enactment. The entity would then evaluate and adjust the estimated annual effective tax rate for the change and apply any resultant change prospectively. [740-270-25]

Like IFRS, anticipated tax benefits from tax credits are generally reflected in computing the estimated annual effective tax rate when the credits are granted and calculated on an annual basis. However, if the credits relate to a significant, unusual or infrequent item reported separately or reported net of the related tax effect, then they are recognised in the interim period in which the event occurs, like IFRS. However, because more guidance exists under US GAAP, differences from IFRS may arise in practice. [740-270-30]
There are no specific criteria in addition to the general criteria for the recognition of a deferred tax asset in an interim period to be applied under IFRS.

If different income tax rates apply to different categories of income – e.g. capital gains – or to different tax jurisdictions, then a separate rate is applied to each category in the interim period, to the extent practicable. However, a weighted-average rate across jurisdictions and income categories may be used if it is a reasonable approximation of the effect of using more specific rates. [IAS 34.I.E.B14]

If management's estimate of the recoverability of unused tax losses changes during an interim period, then in our view it is acceptable for this change to be reflected in calculating the expected annual effective tax rate and apportioned between the interim periods.

In addition to applying the general criteria for the recognition of a deferred tax asset at each interim reporting date (see chapter 3.13), the tax benefits need to be expected to be (1) realised during the annual reporting period; or (2) recognisable as a deferred tax asset at the annual reporting date, unlike IFRS. Subject to these limitations, the estimated tax benefit of the loss is considered in determining the estimated effective tax rate for the year, like IFRS. Because of the greater level of detail under US GAAP, differences from IFRS may arise in practice. [740-270-30]

Unlike IFRS, the estimated annual effective tax rate is used to allocate expected annual income tax expense to interim periods. Generally, the expected annual effective tax rate includes the expected benefits from tax credits, statutory depletion, tax planning strategies, capital gain rates and alternative tax systems. An entity with multiple jurisdictions generally computes one overall effective rate; however, the ordinary income or loss and related tax or benefit in a jurisdiction is excluded if the entity anticipates an ordinary loss for which no benefit can be recognised in that jurisdiction or if the entity is unable to make an estimate of ordinary income or the related tax for the jurisdiction. [7 40-270-30-31]

Because there is a greater level of detail under US GAAP, particularly regarding special deduction items, differences from IFRS may arise in practice.

Accounting policies

The accounting policies followed in the interim financial statements are generally the same as those applied in the previous annual financial statements, except for changes in accounting policies made during the current financial year. [IAS 34.28]

Accounting principles

Like IFRS, the accounting principles (policies) followed in the interim report are generally the same as those applied in the previous annual financial statements, except for changes in accounting principles made during the current financial year. [270-10-45]
Any new or revised standard is applied to all interim periods within the annual period in which it is first adopted, unless the transitional requirements of the standard permit or require a different transition. [IAS 34.43]

Changes in accounting policy adopted after the first interim period are normally presented by restating the financial statements for the prior interim periods of the current annual reporting period as well as the comparative interim periods presented. [IAS 34.43–45]

Operating segments
The following segment information is disclosed in interim periods by an entity that is required to disclose segment information in its annual financial statements (see chapter 5.2):
- a measure of segment profit or loss;
- if included in the measure of segment profit or loss reviewed by, or otherwise provided regularly to, the chief operating decision maker (CODM):
  - revenues from external customers; and
  - inter-segment revenues;
- a measure of total assets and/or total liabilities for a particular reportable segment if:
  - the related amounts are regularly provided to the CODM; and
  - there has been a material change in the total assets or total liabilities for that segment from the related amounts disclosed in the last annual financial statements;
- any change in the basis of segmentation or the basis of measuring segment profit or loss; and
- a reconciliation of the total of the reportable segments’ measures of profit or loss in respect of continuing operations and the profit or loss in the financial statements. [IAS 34.16A(g)]

Like IFRS, any new Codification requirement is applied to all interim periods within the annual period in which it is first adopted, unless the transitional requirements of the Codification topic/subtopic permit or require a different transition. [270-10-45-13]

Like IFRS, changes in accounting policies are reported through retrospective application to the financial statements for prior interim periods of the current annual reporting period as well as the comparative interim periods presented, unless specific guidance requires or permits adoption as of the beginning of an interim period other than the first interim period of the annual reporting period. [270-10-45-17]

Operating segments
The following segment information is disclosed in interim periods by an entity that is required to disclose segment information in its annual financial statements (see chapter 5.2):
- a measure of segment profit or loss, like IFRS;
- revenues from external customers, like IFRS except that the information need not be reported regularly to the chief operating decision maker (CODM);
- inter-segment revenues, like IFRS except that the information need not be reported regularly to the CODM;
- total assets for which there has been a material change from the amounts disclosed in the last annual financial statements, like IFRS except that the information need not be reported regularly to the CODM;
- any change in the basis of segmentation or the basis of measuring segment profit or loss, like IFRS; and
- a reconciliation of the total of the reportable segments’ measures of profit or loss in respect of continuing operations and the profit or loss reported in the financial statements, like IFRS. [280-10-50-32]

Although the disclosure requirements for revenues from external customers and inter-segment revenues do not refer to the information being provided to the CODM, we would not generally expect differences from IFRS in practice.

Unlike IFRS, there is no requirement to disclose total liabilities for each reportable segment, even if the information is reported to the CODM.

Financial instruments
An entity includes in the notes to its interim financial statements certain disclosures about the fair value of financial instruments that are required by other standards. [IAS 34.16A(j), IFRS 7.25–26, 28–30, 13.91–93(h), 94–96, 98–99]

Financial instruments
An entity includes in the notes to its interim financial statements certain disclosures about the fair value of financial instruments that are required by other Codification topics; however, these disclosure requirements differ in certain respects from IFRS. [820-10-50-2]
Forthcoming requirements
Revenue disclosures
Amendments to the interim reporting standard resulting from the new revenue standard are effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

All entities are required to disclose the information about disaggregated revenue in the interim financial reporting. Other annual disclosures about revenue are typically not required for interim financial reporting. [IAS 34.16A(iii)]

Forthcoming requirements
Revenue disclosures
The new revenue Codification Topic is effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted but not before annual periods beginning after 15 December 2016.

Like IFRS, all entities are required to disclose the information about disaggregated revenue in the interim financial reporting. Unlike IFRS, certain entities, including public business entities, have no relief for other revenue disclosures in the interim financial reporting. [606-10-50-3, 50-23]
5.10 Disclosure of interests in other entities

Overview

- A single standard deals with the disclosure of information about an entity’s interests in other entities.

- An entity discloses information that helps users of its financial statements to understand the composition of the group and the interests of NCI in the group’s activities and cash flows.

- An entity discloses information that helps users of its financial statements to evaluate the nature, extent and financial effects of its interests in joint arrangements and associates and the risks associated with them.

- Disclosures are required about an entity’s involvement with both consolidated and unconsolidated ‘structured entities’.

- An investment entity discloses information about the nature of its involvement with investees.

Objective of disclosures

A single standard deals with the disclosure of information about an entity’s interests in other entities. (IFRS 12)
An entity discloses the significant judgements and assumptions that it has made in determining the nature of its interest in another entity or arrangement. The standard also requires extensive disclosures for interests in other entities. For the purpose of these disclosures, an ‘interest in another entity’ refers to contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. However, an interest in another entity does not exist solely as a result of a typical customer-supplier relationship. [IFRS 12.A, 2]

**Significant judgements and assumptions**

An entity discloses information about the significant judgements and assumptions that management has made in determining whether it has control, joint control or significant influence over another entity/arrangement, and in determining whether a joint arrangement structured through a separate vehicle is a joint venture or joint operation (see chapter 3.6). An investment entity discloses information about the significant judgements and assumptions that it has made in determining that it is an investment entity (see chapter 5.6). [IFRS 12.7–9A]

Unlike IFRS, there is no overall concept of ‘interests in other entities’ that is applied consistently. Rather, disclosure requirements apply by type of investee. Like IFRS, US GAAP requires disclosure of the significant judgements and assumptions that an entity has made in determining whether to consolidate a variable interest entity (VIE). Unlike IFRS, there are no similar disclosures for equity-method investees and investments in joint ventures (see chapter 3.6). Unlike IFRS, because the scope of investment companies defines which entities are required to apply the guidance in that Codification Topic, US GAAP does not specifically require an entity to disclose information about significant judgements and assumptions made in determining that it is an investment company (see chapter 5.6). [810-10-50-1A(d), 50-1B]

**Aggregation**

The disclosures may be aggregated for interests in similar entities, with the method of aggregation being disclosed. A quantitative and qualitative analysis, taking into account the different risk and return characteristics of each entity, is made in order to determine the aggregation level. [IFRS 12.B2–B6]

However, in respect of the disclosure of summarised financial information for interests in material joint ventures and associates (see below), the disclosures need to be provided for each investee – i.e. they cannot be aggregated. [IU 01-15]

**Interests in consolidated subsidiaries**

An entity discloses information that helps users of its financial statements to understand the composition of the group and the interests of NCI in the group’s activities and cash flows. This includes:

- the nature and extent of significant restrictions on its ability to access or use assets, or to settle liabilities of the group;
- the consequences of changes in its ownership interests in a subsidiary while retaining control;
- the consequences of losing control of a subsidiary; and
- the nature of, and changes in, the risks associated with the interests in consolidated structured entities. [IFRS 12.10]

Unlike IFRS, there is no overall concept of ‘interests in other entities’ that is applied consistently. Rather, disclosure requirements apply by type of investee. Like IFRS, US GAAP requires disclosure of the significant judgements and assumptions that an entity has made in determining whether to consolidate a variable interest entity (VIE). Unlike IFRS, there are no similar disclosures for equity-method investees and investments in joint ventures (see chapter 3.6). Unlike IFRS, because the scope of investment companies defines which entities are required to apply the guidance in that Codification Topic, US GAAP does not specifically require an entity to disclose information about significant judgements and assumptions made in determining that it is an investment company (see chapter 5.6). [810-10-50-1A(d), 50-1B]

**Aggregation**

Except in relation to interests in equity-method investees and investments in joint ventures (see below), there is no specific guidance on the level of aggregation required in respect of investees, unlike IFRS. Instead, an entity follows the general materiality guidelines (see chapter 1.2).

**Interests in consolidated subsidiaries**

Like IFRS, an entity discloses information about the consequences of changes in its ownership interests in a subsidiary while retaining control, and the consequences of losing control of a subsidiary. However, in general the disclosure requirements are not as extensive as under IFRS. [810-10-50-1A(d), 50-1B]
An entity’s disclosures for each of its subsidiaries that has material NCI include summarised financial information about the subsidiary. [IFRS 12.12, B10–B11]

**Interests in joint arrangements and associates**

An entity discloses information that helps users of its financial statements to evaluate the nature and effects of its interests in joint arrangements and associates. This includes:
- the nature, extent and financial effects of its interests in such investees, including the nature and effects of contractual relationships with the other investors with joint control or significant influence; and
- the nature of, and changes in, the risks associated with its interests in such investees. [IFRS 12.20]

An entity’s disclosures for each material joint venture and associate include summarised financial information about the investee. [IFRS 12.21(b), B12–B13]

**Structured entities**

A ‘structured entity’ is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity (see chapter 2.5). [IFRS 12.A, B21]

In respect of consolidated structured entities, an entity discloses the terms of any contractual arrangements with consolidated structured entities that could require the parent or its subsidiaries to provide financial support. This includes events or circumstances that could expose the entity to loss. [IFRS 12.14]

Unlike IFRS, US GAAP does not explicitly require disclosure of summarised financial information about its subsidiaries with material NCI.

**Interests in equity-method investees and investments in joint ventures**

An entity may be required to make specific disclosures about its interests in entities that would be classified as joint arrangements and associates under IFRS. However, unlike IFRS, there is no single Codification Topic and the disclosures vary by investee.

An entity discloses summarised financial information about corporate joint ventures and other equity-method investees that are material in aggregate. For equity-method investees, an entity considers the extent of disclosures required based on the significance of the investee to the investor. This difference in approach may result in differences from IFRS in practice. [320-10-50-2, 50-3(c)]

**Structured entities**

US GAAP has no concept of structured entities. Instead, a VIE (see chapter 2.6) is an entity that has any of the following characteristics:
- the amount of equity investment at risk is insufficient for the entity to finance its own operations without additional subordinated financial support;
- the equity investment at risk lacks one of the following characteristics of a controlling financial interest:
  - the power, through voting or similar rights, to direct the activities that most significantly impact the entity’s economic performance;
  - the obligation to absorb the entity’s economic risks; or
  - the right to receive the entity’s economic rewards; or
- substantially all of the entity’s activities either involve or are conducted on behalf of an equity investor (and its related parties) that has disproportionately few voting rights in relation to its economic interests. [810-10-05-8, 15-14]

Like IFRS, US GAAP contains extensive disclosure requirements for VIEs that an entity is involved with or consolidates. These disclosures include the terms of any contractual arrangements with consolidated VIEs that could require the parent or its subsidiaries to provide financial support. In general, we would expect the disclosures under US GAAP for involvement with a VIE to be similar to those provided under IFRS for involvement with a structured entity. [810-10-50-3 – 50-6]
An entity discloses general information about its involvement with unconsolidated structured entities including, but not limited to, the nature, purpose, size and activities of the structured entity and how the structured entity is financed. More specific disclosures are required if an entity has an interest in an unconsolidated structured entity at the reporting date – e.g. a contract to provide management services [IFRS 12.24–31]

**Investment entities**

An investment entity (see chapter 5.6) discloses the following in respect of unconsolidated subsidiaries:
- the nature and extent of any significant restrictions on the ability of such investees to pay cash dividends to the investment entity or to repay loans or advances made by the investment entity;
- any commitment or intention to provide financial or other support to such investees; and
- the type and amount of financial or other support provided during the reporting period without a contractual obligation to do so, including the reasons for providing support. [IFRS 12.19D–19E]

For an unconsolidated subsidiary that is a structured entity, an investment entity discloses:
- contractual arrangements that could require the investment entity or its unconsolidated subsidiaries to provide financial support, including events or circumstances that could expose the investment entity to loss; and
- information about financial or other support provided during the reporting period without a contractual obligation to do so, including the relevant factors in deciding to provide support. [IFRS 12.19F–19G]

An entity that holds a significant variable interest in a VIE that it does not consolidate is required to disclose the nature of its involvement with the VIE and when the involvement began, the nature, purpose, size and activities of the VIE, and the entity’s maximum exposure to loss as a result of its involvement with the VIE. [810-10-50-3]

**Investment companies**

The disclosures required by investment companies (see chapter 5.6) in respect of investee are more extensive than IFRS and focus on the investment structure of the investment company and its investments. [946-235-50]
5.11 Extractive activities

(IFRS 6, IFRIC 20)

Overview

- IFRS provides specialised extractive industry guidance only in respect of expenditure incurred on exploration for and evaluation of (E&E) mineral resources after obtaining a legal right to explore and before being able to demonstrate technical feasibility and commercial viability.

- There is no industry-specific guidance on the recognition or measurement of pre-exploration expenditure or development expenditure. Pre-E&E expenditure is generally expensed as it is incurred.

- Entities identify and account for pre-exploration expenditure, E&E expenditure and development expenditure separately.

- Each type of E&E cost may be expensed as it is incurred or capitalised, in accordance with the entity’s selected accounting policy.

- Capitalised E&E costs are classified as either tangible or intangible assets, according to their nature.

US

(IFRS 6, IFRIC 20)

Overview

- Unlike IFRS, US GAAP provides detailed guidance on the accounting and reporting by oil- and gas-producing entities for expenditure incurred before, during and after exploration and evaluation (E&E) activities. US GAAP does not contain extensive authoritative guidance for other extractive industries.

- Unlike IFRS, there is industry-specific guidance on the recognition and measurement of pre-exploration expenditure and development expenditure for oil- and gas-producing entities. For other extractive industries, pre-E&E expenditure is generally expensed as it is incurred, like IFRS.

- Unlike IFRS, the accounting for oil- and gas-producing activities covers pre-exploration expenditure, E&E expenditure and development expenditure. Other extractive industries account for pre-exploration and E&E separately from development expenditure.

- Unlike IFRS, all costs related to oil- and gas-producing activities are accounted for under either the successful efforts method or the full cost method, and the type of E&E costs capitalised under each method differs. For other extractive industries, E&E costs are generally expensed as they are incurred unless an identifiable asset is created by the activity.

- Like IFRS, in extractive industries (other than oil- and gas-producing industries), capitalised costs are classified as either tangible or intangible assets, according to their nature. Unlike IFRS, oil- and gas-producing entities do not segregate capitalised E&E costs into tangible and intangible components; all capitalised costs are classified as tangible assets.
Overview (continued)

– The test for recoverability of E&E assets can combine several cash-generating units, as long as the combination is not larger than an operating segment.

– Stripping costs incurred during the production phase of surface mining are included in the cost of inventory extracted during the period, if appropriate, or are capitalised as a non-current asset if they improve access to the ore body.

Scope

IFRS provides specific extractive industry guidance only for the recognition, measurement and disclosure of expenditure incurred on the E&E of mineral resources. There is limited relief from the requirement to select accounting policies in accordance with the hierarchy for their selection (see chapter 2.8), and from the general requirements for impairment testing. However, no such relief is provided for either pre-exploration activities or development activities; therefore, in our view these activities should comply fully with IFRS, including the hierarchy for the selection of accounting policies (see chapter 2.8). [IFRS 6.3–4, 7, 18]

IFRS provides no specific guidance or exemptions for pre-exploration or development activities, which are excluded from the scope of the mineral resources standard. [IFRS 6.5]

The mineral resources standard cannot be applied to other research-type activities by analogy.

Overview (continued)

– Unlike IFRS, the test for recoverability is usually conducted at the oil and gas field level under the successful efforts method, or by geographic region under the full cost method. For other extractive industries, the test for recoverability is generally at the mine or group of mines level, unlike IFRS.

– Unlike IFRS, the guidance on production stripping applies to all extractive activities other than oil and gas. Unlike IFRS, stripping costs incurred during the production phase of a mine are included in the cost of inventory extracted during the period.

Scope

Unlike IFRS, US GAAP provides detailed guidance on the accounting and reporting by oil- and gas-producing entities for expenditure that occurs before, during and after E&E activities. US GAAP does not contain a significant amount of guidance for other extractive industries (e.g. mining entities). However, for SEC registrants the definition of oil and gas activities includes bitumen extracted from oil sands, as well as oil and gas extracted from coal and shales. [930, 932, 932-10-S99-1]

Unlike IFRS, US GAAP includes specific guidance on both pre-exploration and development activities by oil- and gas-producing entities. For other extractive industries, US GAAP does not contain specific guidance for pre-exploration activities. Costs incurred during development activities are capitalised and amortised or depleted, which may differ from IFRS.

Like IFRS, the industry-specific guidance for oil- and gas-producing entities cannot be applied to other research-type activities by analogy. However, because US GAAP contains little authoritative guidance for extractive industries other than the oil and gas industry, those in other extractive industries generally look to industry practice and may, in some circumstances, look to the guidance for the oil and gas industry when authoritative guidance does not exist. [932-10-05-3]
Recognition and measurement

For each type of E&E expenditure, an entity chooses an accounting policy, to be applied consistently, of either immediate expense or capitalisation as an E&E asset. The policy of expense or capitalisation reflects the extent to which the type of E&E expenditure can be associated with finding specific mineral resources. [IFRS 6.9]

An entity chooses an accounting policy, to be applied consistently, of either expensing administrative and other general overhead costs, or capitalising those costs associated with finding specific mineral resources in the initial recognition and measurement of an E&E asset. [IFRS 6.BC28]

Capitalised E&E assets are classified as tangible or intangible assets depending on their nature. The subsequent accounting for these assets is consistent with their classification. [IFRS 6.15]

E&E expenditure that is not recognised as an E&E asset is expensed as it is incurred. [IFRS 6.9]

Recognition and measurement

Unlike IFRS, an oil and gas entity has a choice of applying either the successful efforts or the full cost method to all oil and gas expenditure, which includes E&E expenditure.

- Under the successful efforts method, geological and geophysical activities, costs of carrying and retaining undeveloped properties and costs associated with exploratory dry holes are recognised as an expense as they are incurred. The costs of drilling exploratory and exploratory-type stratigraphic test wells are capitalised, pending determination of whether the well can produce proved reserves. If it is determined that the well will not produce proved reserves, then the capitalised costs, net of any salvage value, are expensed.

- Under the full cost method, all costs associated with the exploration of properties are capitalised within an appropriate cost centre at the geographic level (full cost pool), which generally covers an entire country. For SEC registrants, the geographic cost centres are required to be by country.

Under the full cost method, all costs (internal and external) that are directly identified with the acquisition of property, E&E costs and development activities undertaken by the entity generally qualify for capitalisation, which may differ from the policy adopted under IFRS. However, entities using the successful efforts method are limited to capitalising only those costs that are directly related to activities whose direct costs are capitalisable, which generally excludes most internal costs, unlike IFRS. Unlike IFRS, costs related to general corporate overhead or similar activities are expensed as they are incurred under both the successful efforts and the full cost methods. Costs related to production are capitalised to inventory. For other extractive industries, E&E costs are generally expensed as they are incurred, unless an identifiable asset is created by the activity. [932-10-599-1, 932-360-25-3 – 25-4, 25-7 – 25-10, 932-720-25-1]

Unlike IFRS, an oil and gas entity does not segregate capitalised E&E costs into tangible and intangible components. All capitalised costs are classified as tangible assets. For extractive activities other than oil and gas, capitalised costs are classified as tangible or intangible assets depending on their nature, like IFRS. [932-350-50-1]

Unlike IFRS, an entity using the full cost method capitalises pre-E&E (pre-licence) expenditure. An entity using the successful efforts method expenses pre-E&E (pre-licence) expenditure, like IFRS. Like IFRS, extractive industries other than oil and gas expense E&E expenditure as it is incurred unless an E&E asset is recognised, although the circumstances under which an E&E asset is recognised could differ from practice under IFRS. [932-10-599-1, 932-360-25-3]
Subsequent measurement

After recognition, an entity applies either the cost model or the revaluation model, as appropriate, to each of tangible and intangible E&E assets. The criteria for the revaluation of intangible assets are particularly strict (see chapter 3.3), and in effect rule out the revaluation of intangible E&E assets. In our experience, tangible E&E assets are rarely revalued. [IFRS 6.12]

Cost model

Tangible assets that are used for E&E (and intangible assets with a finite life that are used for E&E) are depreciated (amortised) over their useful lives. The depreciable amount of a tangible asset (or an intangible asset with a finite useful life) is its cost less its residual value. The residual value of a tangible asset (property, plant and equipment) is based on today’s values (see chapter 3.2). The residual value of an intangible asset with a finite useful life is assumed to be zero unless certain criteria are met (see chapter 3.3). [IAS 16.6, 53, 38.100]

Both tangible and intangible E&E assets are tested for impairment in some circumstances (see below). [IAS 36.2]

Revaluation model

If an entity elects to apply the revaluation model, then the model applied is consistent with the classification of the assets as tangible or intangible. Tangible E&E assets are revalued using the property, plant and equipment model (see chapter 3.2) and intangible E&E assets using the intangible asset model (see chapter 3.3). [IAS 16.31]

Both revaluation models apply the guidance in the fair value standard in measuring fair value (see chapter 2.4).

Depletion, depreciation and amortisation (DD&A)

The depletion of assets is calculated separately for each significant component of an asset. [IAS 16.43]

Subsequent measurement

Unlike IFRS, an entity applies the cost model to its tangible and intangible E&E assets; a revaluation model is not permitted.

Cost model

Like IFRS, tangible assets that are used for E&E (and intangible assets with a finite life that are used for E&E) are depreciated (amortised) over their useful lives. These assets normally are depreciated using a units-of-production method, which may result in differences from IFRS in practice. Like IFRS, the depreciable amount of a tangible asset (or an intangible asset with a finite useful life) is cost less residual value. Unlike IFRS, the residual value of a tangible asset (property, plant and equipment) is not required to be based on today’s values (see chapter 3.2). The residual value of an intangible asset with a finite useful life is assumed to be zero unless certain criteria are met, like IFRS. [350-30-35-8, 932-360-35-3 – 35-5]

Like IFRS, tangible and intangible E&E assets are tested for impairment in some circumstances (see below). [932-360-35-8 – 35-9]

Revaluation model

Unlike IFRS, entities are not permitted to use the revaluation model under US GAAP.

Depletion, depreciation and amortisation (DD&A)

Unlike IFRS, under the full cost method capitalised costs in a cost pool are depleted on a group basis. Unlike IFRS, under the successful efforts method all capitalised costs at the oil and gas field level are depleted based on proved reserves for that field. Unlike IFRS, for other extractive industries US GAAP does not require depletion to be calculated separately for each significant component of an asset. [932-360-35-3 – 35-5, 932-10-599-1]
Decommissioning and environmental obligations

IFRS does not distinguish between decommissioning and environmental obligations, and the same accounting requirements apply.

Decommissioning and environmental provisions are discussed in chapter 3.12.

Impairment

The general impairment standard is applied to measure, present and disclose the impairment of E&E assets (see chapter 3.10). [IFRS 6.18]

Asset retirement (decommissioning) and environmental obligations

Unlike IFRS, asset retirement (decommissioning) obligations are distinguished from environmental obligations. Under US GAAP, asset retirement obligations arise due to the 'normal' operation of an asset, whereas environmental obligations arise from the 'improper' operation of an asset. [410-20-15-2 – 15-3]

Decommissioning and environmental provisions are discussed in chapter 3.12.

Impairment

Like IFRS, entities using the successful efforts method for oil and gas properties and for extractive activities other than oil and gas apply the general impairment guidance in measuring the impairment of E&E assets whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset may not be recoverable. However, the methodology applied in calculating an impairment loss differs from IFRS (see chapter 3.10). [360-10-35-21]

Unlike IFRS, entities using the full cost method perform a limitation calculation on capitalised costs each reporting period ('ceiling test'). An impairment loss is recognised when the carrying amount of a cost centre is not recoverable and exceeds the limitation on capitalised costs (the 'ceiling'). The limitation on capitalised costs is the sum of:

- the present value of estimated future net revenues computed by applying the current prices of oil and gas reserves (with consideration of price changes only to the extent provided by contractual arrangements) to estimated future production of proved oil and gas reserves as at the date of the latest statement of financial position presented, less estimated future expenditures (based on current costs) to be incurred in developing and producing the proved reserves computed using a discount factor of 10 percent and assuming continuation of existing economic conditions; plus
- the cost of properties not being amortised; plus
- the lower of cost and the estimated fair value of unproven properties included in the costs being amortised; less
- income tax effects related to differences between the carrying amount and tax basis of the properties referred to in the previous two bullets. [932-10-S99-1]
The mineral resources standard provides industry-specific examples of facts and circumstances that, if one or more are present, indicate that an entity should test an E&E asset for impairment. These indications include:

- the entity’s right to explore in the specific area has expired or will expire in the near future, and is not expected to be renewed;
- substantive expenditure on further E&E activities in the specific area is neither budgeted nor planned;
- the entity has not discovered commercially viable quantities of mineral resources as a result of E&E activities in the area to date, and the entity has decided to discontinue such activities in the specified area; and
- even if the development is likely to proceed, the entity has sufficient data indicating that the carrying amount of the asset is unlikely to be recovered in full from successful development or by sale. [IFRS 6.19–20]

Unlike IFRS, there are no indications of impairment written specifically for extractive industries under US GAAP.

E&E assets are assessed for impairment only when the facts and circumstances suggest that the carrying amount of an E&E asset may exceed its recoverable amount, and on the transfer of E&E assets to development assets. Unlike other assets, there is no requirement to assess whether an indication of impairment exists at each reporting date until an entity has sufficient information to reach a conclusion about commercial viability and the feasibility of extraction. [IFRS 6.17–18, BC39]

An entity is permitted to aggregate cash-generating units (CGUs) to form a group of units for the purposes of impairment testing of E&E assets, but the grouping cannot be at a level of aggregation that is larger than that of the operating segment to which the CGU belongs (see chapter 5.2). [IFRS 6.21]

Partial or full reversals of impairments of assets, other than impairments of goodwill, are recognised if there is an indication that a previously recognised impairment loss has reversed and the recoverable amount of the impaired asset has subsequently increased (see chapter 3.10). [IAS 36.110]

Unlike IFRS, entities following the successful efforts method of accounting for oil and gas exploration activities are required to measure the impairment of all oil and gas assets, including E&E assets, whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset may not be recoverable. Additionally, as described above, under the full cost method an entity is required to assess capitalised oil and gas assets for impairment each reporting period. For other extractive activities, there are no requirements to assess impairment beyond the general impairment requirements. [360-10-35-21, 932-10-S99-1, 932-360-35-8 – 35-14]

Under US GAAP, the test for recoverability under the successful efforts method is generally at the field level, which is usually the lowest level of separate cash flows; under the full cost method, the test for recoverability is at the ‘geographic’ level (usually country), which may result in differences from IFRS in practice. For other extractive industries, the test for recoverability is generally at the mine or group of mines level, which may differ from IFRS in practice. [932-10-S99-1, 932-360-35-8]

Unlike IFRS, impairment losses are not reversed under US GAAP (see chapter 3.10). [360-10-35-20]
Change in accounting policy
An entity may change its existing IFRS accounting policy for E&E expenditure only if the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs, judged by the criteria for voluntary changes in accounting policies (see chapter 2.8). [IFRS 6.13]

Stripping costs
There is no specific guidance on accounting for stripping costs in surface mining activities in the pre-production phase. In our experience, costs are generally capitalised and amortised using a units-of-production method.

There is specific guidance on the accounting for stripping costs for surface mining activities in the production phase. Such costs that give rise to benefits in the form of inventory produced are accounted for in accordance with the inventory standard. However, production stripping costs that improve access to ore to be mined in the future are recognised as a non-current asset if, and only if, all of the following criteria are met.

- It is probable that the future economic benefit will flow to the entity.
- The entity can identify the component of the ore body to which access has been improved.
- The costs related to the stripping activity associated with that component can be measured reliably. [IFRIC 20.6, 8–9]

If the costs of the stripping activity asset vs inventory produced are not separately identifiable, then costs are allocated based on a relevant production method. [IFRIC 20.13]

Any stripping activity (non-current) asset recognised is accounted for as part of an existing asset, and measured at cost or revalued amount less depreciation, amortisation and impairment losses, in line with the accounting for the asset of which it is a part. Depreciation or amortisation is calculated based on the life of the identified component of the ore body that becomes more accessible as a result of the stripping activity using a units-of-production method unless another method is more appropriate. [IFRIC 20.14–19]

Change in accounting principle
Unlike IFRS, US GAAP establishes the successful efforts method as the preferred method, and therefore an entity is allowed to change from full cost to successful efforts with reference to the Codification Topic to support its preferability (see chapter 2.8). However, a change from the successful efforts to the full cost method would require demonstration that the change is preferable in the entity’s circumstances (see chapter 2.8). [932-10-59-3]

Stripping costs
Like IFRS, there is no specific guidance on accounting for stripping costs in surface mining and other extractive activities in the pre-production phase. Generally, practice is to capitalise and amortise the costs using a units-of-production method, like practice under IFRS.

Unlike IFRS, US GAAP guidance on stripping costs applies to all extractive activities other than oil and gas. Unlike IFRS, stripping costs incurred during the production phase of a mine are accounted for as variable production costs included in the costs of inventory extracted during the period. [930-330-25-1]
Other
There is no specific guidance on the accounting for farm-ins, and the general principles of other standards apply in determining whether the arrangement constitutes a business combination, investment in an associate, joint venture or asset acquisition.

There is no specific guidance on the accounting for farm-outs. Depending on the nature of the entity’s interest in the venture (e.g. a joint venture or an interest in a licence), the general principles of other standards apply in determining whether the entity has disposed of an interest and a gain or loss should be recognised.

There are no specific requirements in IFRS on the disclosure of information about reserves.

There is no specific guidance on the accounting for overlifts and underlifts. Therefore, an entity applies general principles in determining when it is entitled to receive future economic benefits (through entitlements to receive equivalent future production) in respect of an underlift, or is obliged to transfer future economic benefits (by foregoing the right to receive equivalent future production) in respect of an overlift. See forthcoming requirements.

There is no specific guidance on the taxes and other fiscal features that are prevalent in the oil and gas industry. Therefore, differences in the classification as income taxes or operating expenses of a number of petroleum taxes arise in practice.

Forthcoming requirements
The new revenue standard is effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

There is no specific guidance on the accounting for overlifts and underlifts. The general principles of the new revenue standard will apply (see chapter 4.2A).

Other
Unlike IFRS, US GAAP contains specific guidance on the accounting for farm-ins. The costs incurred to perform the functions required by the farm-in agreement generally become part of the cost basis of the performing party’s interest obtained in the farm-in agreement. [932-360-55-5]

Unlike IFRS, US GAAP contains specific guidance on the accounting for farm-outs. The assignor’s cost in the original interest generally becomes the cost of the interest retained. No gain or loss is typically recognised as a result of the assignment of the interest to the counterparty to the agreement. [932-360-55-3]

Unlike IFRS, US GAAP requires oil and gas entities that are issuers to follow SEC guidelines for the measurement of reserves. SEC guidelines allow oil and gas entities to report proved, probable and possible reserves in the forepart of their filings with the SEC. However, US GAAP only allows the disclosure of proved reserves for financial reporting purposes and requires supplemental disclosures of standardised measurements of oil and gas reserves, unlike IFRS. [932-235-50-29-50-36]

Unlike IFRS, there is specific guidance under US GAAP on the accounting for overlifts and underlifts. Entities may choose between two methods (see forthcoming requirements).
- The ‘entitlement method’ requires entities to recognise revenues based on their entitled share of production.
- The ‘sales method’ requires entities to recognise revenues equal to the proceeds received for their sales, whether or not they are entitled to all of those proceeds. [932-10-599-5]

Like IFRS, there is no specific guidance on the taxes and other fiscal features that are prevalent in the oil and gas industry. The recognition and presentation of taxes are governed by other applicable US GAAP, which may result in differences from IFRS in practice.

Forthcoming requirements
The new revenue Codification Topic is effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted but not before annual periods beginning after 15 December 2016.

The specific guidance in US GAAP on overlifts and underlifts no longer applies on adoption of the new revenue Codification Topic. Instead, the general principles of that standard apply (see chapter 4.2A).
5.12 Service concession arrangements

(IFRIC 12, SIC-29)

Overview

- The interpretation on service concession arrangements provides guidance on the accounting by private sector entities (operators) for public-to-private service concession arrangements. The guidance applies only to service concession arrangements in which the public sector (the grantor) controls or regulates:
  - the services provided with the infrastructure;
  - to whom the operator should provide the services;
  - the prices charged to end users; and
  - any significant residual interest in the infrastructure.

- For service concession arrangements in the scope of the guidance, the operator does not recognise public service infrastructure as its property, plant and equipment if the infrastructure is existing infrastructure of the grantor, or if the infrastructure is built or acquired by the operator as part of the service concession arrangement.

- If the grantor provides other items to the operator that the operator may retain or sell at its discretion, then the operator recognises those items as its assets, with a liability for unfulfilled obligations.

- The operator recognises and measures revenue for providing construction or upgrade services, and revenue for other services, in accordance with applicable revenue recognition standards.

US GAAP provides limited guidance on the accounting by operators for service concession arrangements. Unlike IFRS, the guidance applies only to service concession arrangements that are not regulated operations. Like IFRS, the guidance applies only to service concession arrangements in which the public sector (the grantor) controls:

- the services provided with the infrastructure;
- to whom the operator must provide those services;
- the price charged for the services; and
- any residual interest in the infrastructure at the end of the term of the arrangement.

- Like IFRS, for service concession arrangements in the scope of the guidance, the operator does not recognise public service infrastructure as its property, plant and equipment.

- Although no specific guidance exists, like IFRS, the operator would generally recognise as a separate asset items provided by the grantor that the operator may retain or sell at its discretion.

- Unlike IFRS, the operator evaluates construction and upgrade services as separate deliverables to determine whether they constitute separate units of accounting. The operator accounts for revenue and costs relating to construction, upgrade or operation services in accordance with the revenue Codification Topic and relevant cost Codification Topics, which differ in some respects from IFRS.
Overview (continued)

– The operator recognises consideration receivable from the grantor for construction or upgrade services, including upgrades of existing infrastructure, as a financial asset and/or an intangible asset.

– The operator recognises a financial asset to the extent that it has an unconditional right to receive cash (or another financial asset), irrespective of the use of the infrastructure.

– The operator recognises an intangible asset to the extent that it has a right to charge for use of the infrastructure.

– Any financial asset recognised is accounted for in accordance with the relevant financial instruments standards, and any intangible asset in accordance with the intangible assets standard. There are no exemptions from these standards for operators.

– The operator recognises and measures obligations to maintain or restore infrastructure, except for any construction or upgrade element, in accordance with the provisions standard.

– The operator generally capitalises attributable borrowing costs incurred during construction or upgrade periods to the extent that it has a right to receive an intangible asset. Otherwise, the operator expenses borrowing costs as they are incurred.

Overview (continued)

– Unlike IFRS, the operator evaluates the arrangement to determine whether it comprises a single or multiple units of accounting. US GAAP does not provide specific guidance on the classification of a resulting asset, unlike IFRS.

– Like IFRS, the operator recognises a receivable to the extent that it has an unconditional right to receive cash (or another financial asset), irrespective of the use of the infrastructure. However, differences from IFRS may arise.

– Unlike IFRS, an intangible asset generally would not be recognised. Instead, an ‘other’ asset might be recognised, but only if its realisation is not contingent on providing future service under the service concession arrangement.

– Any financial asset recognised is accounted for in accordance with the relevant financial instruments Codification Topics, which differ in certain respects from IFRS. Unlike IFRS, an intangible asset generally would not be recognised.

– Unlike IFRS, the operator would apply the general guidance applicable to separate deliverables (performance obligations) to determine whether a deliverable (obligation) to maintain or restore infrastructure, including any construction or upgrade element, is a separate unit of accounting and whether the related deliverable (obligation) should be recognised and measured.

– Like IFRS, the operator capitalises interest costs when it concludes that the construction service gives rise to a qualifying asset and it has net accumulated expenditure on the qualifying asset. However, differences from IFRS may arise in practice. Otherwise, the operator expenses interest costs as they are incurred.
Scope
The interpretation on service concession arrangements provides guidance to private sector entities on certain recognition and measurement issues that arise in accounting for public-to-private service concession arrangements; it does not address the accounting by the public sector. [IFRIC 12.4–9]

‘Public-to-private service concession arrangements’ are arrangements in which the public sector (the grantor) controls or regulates:
- what services the operator should provide with the infrastructure (control of services);
- to whom it should provide them (control of services);
- the price at which services are charged (control of pricing); and
- through ownership, beneficial entitlement or otherwise, any significant residual interest in the infrastructure at the end of the term of the arrangement (control of the residual interest). [IFRIC 12.5]

Typically, a public-to-private service concession arrangement will involve most of the following:
- infrastructure used to deliver public services;
- a contractual agreement between the grantor and the operator;
- supply of services by the operator;
- payments to the operator over the term of the arrangement; and
- return of the infrastructure to the grantor at the end of the arrangement. [IFRIC 12.3]

Service concession arrangements in the scope of this interpretation are scoped out of the leasing standard (see chapter 5.1). [IFRIC 4.4(b)]

The operator’s rights over the infrastructure
The operator does not recognise public service infrastructure as its property, plant and equipment, because the operator is considered to have a right of access rather than a right of use. This requirement applies to existing infrastructure of the grantor and to infrastructure that the operator constructs or acquires for the purposes of the concession. [IFRIC 12.11]

Scope
Like IFRS, US GAAP provides guidance on the accounting by operators for service concession arrangements; it does not address the accounting by the public sector, like IFRS.

Unlike IFRS, the guidance is limited to excluding service concession arrangements from the scope of the leasing Codification Topic and prohibiting the recognition of the infrastructure as property, plant and equipment of the operator. Other accounting aspects of a service concession arrangement are dealt with under other existing US GAAP requirements. [853-10-25]

Like IFRS, an arrangement is in the scope of the service concession arrangements Codification Topic when the grantor controls or has the ability to modify or approve:
- the services that the operator must provide with the infrastructure;
- to whom it must provide them;
- at what price the services are provided; and
- through ownership, beneficial entitlement or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement. [853-10-15-3]

Unlike IFRS, service concession arrangements that are regulated operations are excluded from the scope of the service concession arrangements Codification Topic and accounted for under the specific Codification Topic for regulated operations. [853-10-15-4]

Like IFRS, service concession arrangements that would otherwise fall in the scope of the leasing guidance are scoped out of the leasing Codification Topic (see chapter 5.1). [853-10-25-2]
Recognition of construction/upgrade revenue
The operator recognises revenue and costs related to construction and upgrade services in accordance with the accounting treatment for construction contracts (see chapter 4.2), which is based on the stage of completion of the services and is measured with reference to the fair value of the consideration receivable. See forthcoming requirements. [IFRIC 12.13–15]

If the operator provides more than one service, then the consideration received is allocated between services with reference to the relative fair values of the services delivered when the amounts are separately identifiable. See forthcoming requirements. [IAS 18.IE11, IFRIC 12.13]

Consideration receivable for construction/upgrade revenue
The operator recognises consideration received or receivable for providing construction or upgrade services as:
- a financial asset to the extent that it has an unconditional right to receive cash irrespective of use of the infrastructure; and/or
- an intangible asset to the extent that its consideration is dependent on use of the infrastructure. [IFRIC 12.15–17]

The operator recognises consideration receivable as it performs the construction or upgrade services. See forthcoming requirements. [IFRIC 12.BC67–BC68]

Recognition of construction/upgrade revenue
Unlike IFRS, US GAAP requires the arrangement to be evaluated to determine whether the deliverables are separate units of accounting under the revenue Codification Topic, which may result in differences from IFRS in practice. If the construction deliverable constitutes a separate unit of accounting (which may be more likely for ‘financial asset model’ arrangements), then revenue recognition would generally be based on the stage of completion of the services provided, and would be based on the amount of arrangement consideration allocated to that separate unit of accounting; this may result in differences from IFRS in practice. In arrangements to which the intangible asset model applies under IFRS, the ‘contingent revenue’ provisions of US GAAP would generally result in little, if any, arrangement consideration being allocated to the construction deliverable, even if it constitutes a separate unit of accounting, unlike IFRS (see chapter 4.2). See forthcoming requirements.

If there are multiple units of accounting, then the arrangement consideration is allocated between the units of accounting with reference to the relative selling prices of the services delivered. However, unlike IFRS, the arrangement consideration allocated to the delivered units of accounting is limited to the amount of the total consideration that is not contingent on the delivery of additional items or meeting other specified performance conditions (see chapter 4.2). In service concession arrangements that use the intangible asset model under IFRS, we would generally expect either the arrangement to be a single unit of accounting or the arrangement consideration allocated to the delivered element (construction services) to be limited by the contingent revenue provisions of US GAAP, unlike IFRS. See forthcoming requirements. [605-25-30-2, 30-6]

Although no specific guidance exists, unlike IFRS, the arrangement would be evaluated as a multiple-element arrangement (see above), with consideration receivable recognised based on the delivery or performance of the separate units of accounting.
**Borrowing costs**
If the operator receives a right to charge for use of the public service infrastructure, then the operator is generally required to capitalise attributable borrowing costs for qualifying assets incurred during the construction or upgrade phase (see chapter 4.6). Otherwise, the operator expenses borrowing costs as they are incurred. [IAS 23.8, 10, IFRIC 12.22, BC58]

**Items provided by the grantor**
If the grantor provides items to the operator that the operator may retain or sell at its discretion — namely ‘keep or deal’ items — and those items form part of the consideration for the services provided, then the operator recognises those items as assets. The operator measures the items at fair value on initial recognition and recognises a corresponding liability representing the unfulfilled obligation to provide services in the future. [IFRIC 12.27]

**Operation revenue**
The operator recognises and measures revenue related to operation services at the fair value of consideration received or receivable for services provided. See forthcoming requirements. [IAS 18.9, IFRIC 12.20]

**Maintenance obligations**
The operator recognises and measures contractual obligations to maintain or restore infrastructure in accordance with the provisions standard (see chapter 3.12), except for any upgrade element for which the operator recognises revenue and costs in accordance with the construction contracts standard (see chapter 4.2). [IFRIC 12.21]

**Subsequent accounting for financial and intangible assets**
The operator classifies a financial asset as a loan or receivable, available-for-sale, or at fair value through profit or loss if so designated and the designation criteria are met (see chapter 7.4). [IFRIC 12.23–24]

**Interest costs**
Like IFRS, the operator capitalises interest costs (borrowing costs) when it concludes that the construction service gives rise to a qualifying asset and it has net expenditure on the qualifying asset (see chapter 4.6). However, differences from IFRS may arise in practice. Otherwise, the operator expenses interest costs as they are incurred. [835-20-15-5]

**Items provided by the grantor**
Although no specific guidance exists, the operator would generally recognise as a separate asset items provided by the grantor that the operator may retain or sell at its discretion; such items may or may not form part of the consideration for the services provided by the operator, and differences from IFRS may arise in practice.

**Operation revenue**
Like IFRS, the operator recognises revenue related to operation services for services provided. However, unlike IFRS, the operation services would need to be evaluated to determine whether they are a separate unit of accounting. If so, then the amount of revenue allocated to that unit of accounting may differ from IFRS. Additionally, because of the ‘contingent revenue’ provisions of US GAAP, little or no revenue may be allocated to the initial deliverable (i.e. the construction of infrastructure) — see chapter 4.2.

**Maintenance obligations**
Unlike IFRS, the operator would apply the general guidance applicable to separate deliverables (performance obligations) to determine whether a deliverable (obligation) to maintain or restore infrastructure, including any construction or upgrade element, is a separate unit of accounting and whether the related deliverable (obligation) should be recognised and measured.

**Subsequent accounting for financial and intangible assets**
Unlike IFRS, the operator classifies a financial asset arising from the service concession arrangement as a receivable. [310-10-15-2]
The operator amortises an intangible asset over its useful life, using the straight-line method or another method consistent with how the benefits from the intangible asset are expected to be consumed. The use of the revenue-based method is allowed only when revenue and the consumption of economic benefits of the intangible asset are ‘highly correlated’ or the intangible right is expressed as a measure of revenue (see chapter 3.3). In our view, amortisation should begin when the asset is available for use – i.e. when the operator is able to charge the public for use of the infrastructure. [IFRIC 12.26, IAS 38.97–98C]

Unlike IFRS, an intangible asset generally is not recognised for service concession arrangements under US GAAP.

Forthcoming requirements

Revenue recognition
The new revenue standard is effective for annual periods beginning on or after 1 January 2018; early adoption is permitted.

The new revenue standard introduces consequential amendments to the interpretation on service concession arrangements to specify that the operator recognises and measures revenue in accordance with the new revenue standard (see chapter 4.2A). In particular, ‘keep-or-deal’ items that form part of the consideration payable by the grantor for services are accounted for as part of the transaction price, as defined in the new revenue standard.

Identity of the customer
There are no forthcoming requirements under IFRS.

The identity of the customer in a service concession arrangement is determined based on the terms of the arrangement. The nature of the consideration determines whether the operator recognises an intangible and/or a financial asset.

Unlike IFRS, US GAAP specifies that the grantor, rather than third party users, is the customer in the service concession arrangement. This conclusion then determines the following.

– The pattern of revenue recognition by the operator under the new revenue standard, which may be substantially the same as under IFRS (see chapter 4.2A).
– The accounting for payments made by the operator to the grantor for its rights under the arrangement. There are no defined accounting models within the service concession arrangements Codification Topic; however, because the grantor is the customer and this is therefore a payment to a customer, differences from IFRS may arise.

Forthcoming requirements

Revenue recognition
The new revenue Codification Topic is effective for annual periods beginning after 15 December 2017 (public business entities) or after 15 December 2018 (other entities); early adoption is permitted but not before annual periods beginning after 15 December 2016.

The operator recognises and measures revenue in accordance with the new revenue Codification Topic, which may be substantially the same as under IFRS (see chapter 4.2A).
5.13 Common control transactions and Newco formations

Overview

- In our view, the acquirer in a common control transaction has a choice of applying either book value accounting or acquisition accounting in its consolidated financial statements.

- In our view, the transferor in a common control transaction that is a demerger has a choice of applying either book value accounting or fair value accounting in its consolidated financial statements. In other disposals accounted for in accordance with the consolidation standard, judgement is required in determining the appropriate consideration received in calculating the gain or loss on disposal.

- Newco formations generally fall into one of two categories: to effect a business combination involving a third party, or to effect a restructuring among entities under common control.

- In a Newco formation to effect a business combination involving a third party, acquisition accounting generally applies.

- In a Newco formation to effect a restructuring among entities under common control, in our view it is first necessary to determine whether there has been a business combination. If there has been, then the same accounting choices are available as for common control transactions in consolidated financial statements.
This chapter deals with business combinations among entities under common control. It does not deal with the wider issue of common control transactions in general – e.g. the transfer of a single item of property, plant and equipment between fellow subsidiaries.

The accounting issues dealt with in this chapter are not explicitly covered in any of the standards.

**Common control transactions**

A business combination involving entities or businesses under common control is exempt from the scope of the business combinations standard (see chapter 2.6).

A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are controlled by the same party or parties both before and after the combination and that control is not transitory. The concept of control is discussed in chapter 2.5.

A group of individuals is regarded as controlling an entity if, as a result of contractual arrangements, they exercise control. In our view, the requirement for there to be a contractual arrangement should be applied strictly and is not overcome by an established pattern of voting together.

It is not necessary that an individual, or a group of individuals acting together under a contractual arrangement to control an entity, be subject to the financial reporting requirements of IFRS. Also, the entities are not required to be part of the same consolidated financial statements.

Unlike IFRS, there is specific guidance in US GAAP on common control transactions and, to a limited extent, Newco formations.

**Common control transactions**

Like IFRS, a business combination involving entities or businesses under common control is exempt from the scope of the business combinations Codification Topic (see chapter 2.6).

Like IFRS, a business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are controlled by the same party or parties both before and after the combination. However, unlike IFRS, US GAAP does not discuss the impact of transitory control, so differences from IFRS may arise in practice. The concept of control, which differs in some respects from IFRS, is discussed in chapter 2.5.

Although US GAAP does not have an authoritative definition of common control, the SEC Staff has indicated that common control exists between (or among) separate entities only in the following situations.

- An individual or enterprise holds more than 50 percent of the voting ownership interest of each entity.
- Immediate family members hold more than 50 percent of the voting ownership interest of each entity (with no evidence that those family members will vote their shares in any way other than in concert).
- ‘Immediate family members’ include a married couple and their children, but not the married couple’s grandchildren.
- Entities might be owned in varying combinations among living siblings and their children. These situations would require careful consideration regarding the substance of the ownership and voting relationships.
- A group of shareholders holds more than 50 percent of the voting ownership interest of each entity, and contemporaneous written evidence of an agreement to vote a majority of the entities’ shares in concert exists.

Like IFRS, it is not necessary that an individual, or a group of individuals acting together under a contractual arrangement to control an entity, be subject to the financial reporting requirements of US GAAP. Also, the entities are not required to be part of the same consolidated financial statements, like IFRS.
The extent of NCI in each of the combining entities before and after the business combination is not relevant in determining whether the combination involves entities under common control. [IFRS 3.B4]

In our view, the common control exemption in accounting for business combinations also applies to the transfer of investments in equity-accounted investees between investors under common control.

Consolidated financial statements of the acquirer
In our view, the acquirer in a common control transaction should choose an accounting policy in respect of its consolidated financial statements, to be applied consistently to all similar common control transactions, to use:
- ‘book value (carry-over basis) accounting’ on the basis that the investment has simply been moved from one part of the group to another; or
- ‘acquisition accounting’ on the basis that the acquirer is a separate entity in its own right and should not be confused with the economic group as a whole.

Book value accounting
In our view, the acquirer in its consolidated financial statements has a choice, to be applied consistently, in respect of whose book values are used: the ultimate parent, any intermediate parent, the transferor or the entity transferred.

In our view, the acquirer is permitted, but not required, to re-present its comparatives and adjust its current year before the date of the transaction as if the combination had occurred before the start of the earliest period presented. However, this restatement should not, in our view, extend to periods during which the entities were not under common control.

In our view, to the extent that the common control transaction involves transactions with NCI, the changes in NCI should be accounted for as acquisitions and/or disposals of NCI on the date when the changes occur (see chapter 2.5).

Acquisition accounting
In our view, in applying acquisition accounting to a common control transaction, the acquisition accounting methodology in the business combinations standard should be applied in its entirety by analogy (see chapter 2.6).

However, to the extent that the acquisition accounting gives rise to an apparent gain on a bargain purchase, in our view such amount should be recognised in equity as a capital contribution from the shareholders of the acquirer.

Like IFRS, the extent of NCI in each of the combining entities before and after the business combination is not relevant in determining whether the combination involves entities under common control. [805-50-15-6]

Like IFRS, the common control exemption in accounting for business combinations also applies to the transfer of investments in equity-method investees between investors under common control.

Consolidated financial statements of the acquirer
Unlike IFRS, the acquirer in a common control transaction applies book value accounting in all cases. [805-50-30-5]

Book value accounting
Unlike IFRS, the acquirer in its consolidated financial statements uses the book values of the ultimate parent. [805-50-30-6]

Unlike IFRS, the acquirer is required to restate its comparatives and adjust its current year before the date of the transaction as if the combination had occurred before the start of the earliest period presented. However, this restatement does not extend to periods during which the entities were not under common control, like IFRS. [805-50-45-2, 45-5]

To the extent that the common control transaction involves transactions with NCI, the changes in NCI are accounted for as acquisitions and/or disposals of NCI on the date when the changes occur (see chapter 2.5), like IFRS.

Acquisition accounting
Unlike IFRS, acquisition accounting is not permitted. [805-50-30-6]
Consolidated financial statements of the transferor

The requirements of the held-for-sale standard apply to the transferor in a common control transaction, regardless of whether the disposal occurs through non-reciprocal distribution of the shares in a subsidiary (a demerger or spin-off) or a sale (see chapter 5.4).

In our view, a demerger that is a common control transaction may be accounted for on either a fair value basis, in which case a gain or loss is recognised in profit or loss, or a book value basis, in which case no gain or loss is recognised.

Other disposals are accounted for in accordance with the consolidation standard and the loss of control guidance (see chapter 2.5). However, judgement is required in determining the appropriate consideration received in calculating the gain or loss on disposal. In some cases, it may be appropriate to conclude that two transactions have in effect occurred: a disposal and a contribution/distribution from/to the shareholder. [IFRS 10.B98]

Transactions involving a Newco

Although it is not a term that is defined in any of the standards, in practice a ‘Newco’ is a new entity. However, a Newco can also be an existing entity that is itself not a business under the business combination standard.

A ‘Newco formation’ is a transaction that involves the formation of a new entity for the purpose of effecting a business combination or a transaction that purports to be a business combination.

Newco formations generally fall into two categories. They are either used to effect a business combination involving a third party, or in a restructuring among entities under common control.

If a Newco is used to effect a business combination involving a third party, then acquisition accounting generally applies.

Consolidated financial statements of the transferor

Unlike IFRS, the requirements of the held-for-sale guidance apply to the transferor in a common control transaction only if the disposal occurs through a sale (see chapter 5.4).

Unlike IFRS, a demerger that is a common control transaction is accounted for on a book value basis in all cases; accordingly, no gain or loss is recognised.

Unlike IFRS, other disposals are accounted for in the same manner – i.e. using book values.

Transactions involving a Newco

Although it is not a term that is defined in US GAAP, in practice a ‘Newco’ is a new entity, like IFRS. However, a Newco can also be an existing entity that is itself not a business under the business combination Codification Topic (sometimes referred to as an ‘old and cold’ entity).

Like IFRS, a ‘Newco formation’ is a transaction that involves the formation of a new entity for the purpose of effecting a business combination or a transaction that purports to be a business combination.

Like IFRS, Newco formations generally fall into two categories. They are either used to effect a business combination involving a third party, or in a restructuring amongst entities under common control.

Like IFRS, if a Newco formation is used to effect a business combination involving a third party, then acquisition accounting generally applies. However, because there is more informal guidance under US GAAP, differences in practice from IFRS may arise.
In a Newco formation used in a restructuring among entities under common control, in our view it is necessary to determine whether there has been a business combination – i.e. whether it is possible to identify an acquirer and an acquiree. If there has been a business combination, then the guidance on accounting for common control transactions in the consolidated financial statements of the acquirer applies (see above). However, if only one business is put under Newco, then there is no business combination and book value accounting applies to the business transferred.

**Legal mergers and amalgamations following a Newco formation**

For the purposes of the discussion that follows, a ‘merger’ is a transaction that involves the combination of two or more entities in which one of the legal entities survives and the other ceases to exist, or in which both existing entities cease to exist and a new legal entity comes into existence.

In our view, when a legal merger or amalgamation follows a Newco formation to effect a business combination involving a third party, the surviving/emerging entity has a choice over which predecessor financial statements continue after the transaction:

- the consolidated financial statements of Newco, on the basis that Newco was the acquirer in the business combination and therefore the newly merged entity should be a continuation of Newco consolidated; or

- the consolidated financial statements of the acquiree in the business combination, on the basis that the acquiree continues to reflect the operations of the merged entity; from the acquiree’s point of view, there has simply been a change in shareholding.

A Newco formed in a restructuring among entities under common control is accounted for using book values, which may give rise to differences from IFRS in practice. In addition, unlike IFRS, there is specific guidance when common control did not exist for the entire period for which the Newco’s financial statements are being presented; in this case, the entity that was under common control the longest is generally considered to be the predecessor. [FRM 1170, Regulation C Rule 405]

**Legal mergers and amalgamations following a Newco formation**

For the purposes of the discussion that follows, a ‘merger’ is a transaction that involves the combination of two or more entities in which one of the legal entities survives and the other ceases to exist, or in which both existing entities cease to exist and a new legal entity comes into existence.

Unlike IFRS, when a legal merger or amalgamation follows a Newco formation to effect a business combination involving a third party, the surviving/emerging entity’s consolidated financial statements are generally those of Newco; this is on the basis that Newco was the acquirer in the business combination and therefore the newly merged entity should be a continuation of Newco consolidated.
7 Financial instruments

7.1 Scope and definitions

Overview

A ‘financial instrument’ is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial instruments include a broad range of financial assets and financial liabilities. They include both primary financial instruments (e.g. cash, receivables, debt and shares in another entity) and derivative financial instruments (e.g. options, forwards, futures, interest rate swaps and currency swaps).

The standards on financial instruments apply to all financial instruments, except for those specifically excluded from their scope.

This chapter includes only currently effective requirements (see About this publication).

Scope

The exemptions from the standard dealing with the recognition and measurement requirements for financial instruments, which are the subject of this chapter, are outlined below. [IAS 39.2–7]
Investments in subsidiaries, associates and joint ventures are excluded from the scope of the financial instruments standard, except for:
- investments in associates and joint ventures held by venture capital and similar organisations that do not qualify as investment entities and have elected to account for such investments at fair value through profit or loss (see chapter 3.5). Derivatives on such interests are in the scope of the standard unless they meet the definition of equity; and
- investments in subsidiaries, associates and joint ventures held by a qualifying investment entity. Such investments are measured at fair value through profit or loss in accordance with IAS 39. This exception does not apply to subsidiaries that are not themselves investment entities and whose main purpose is to provide services that relate to the investment entity’s investment activities. For a full discussion of the investment entity consolidation exception, see chapter 5.6. [IFRS 10.31–32, IAS 28.18–19, 39.2(a), 39.AG3]

Rights and obligations under leases, which are accounted for under the leasing standard (see chapter 5.1) are excluded from the scope of the financial instruments standard, except for the following:
- derecognition of lease receivables and payables;
- impairment of lease receivables; and
- derivatives embedded in leases. [IAS 39.2(b)]

Employers’ rights and obligations under employee benefit plans are accounted for under the employee benefits standard (see chapter 4.4). [IAS 39.2(c)]

Issued financial instruments classified as equity (see chapter 7.3). [IAS 39.2(d)]

Like IFRS, investments in subsidiaries and equity-method investees are excluded from the guidance discussed in chapters 7.1 to 7.8 except:
- unlike IFRS, investments that an investor irrevocably elects to account for at fair value under the fair value option, regardless of whether the investor is a venture capital or similar organisation; such investments would otherwise be accounted for under the equity method (see chapter 3.5); and
- investments in subsidiaries held by investment companies. Such investments are measured at fair value through profit or loss, like IFRS. However, this exception does not apply to subsidiaries that provide permitted investment-related services solely to the investment company. For a full discussion of the investment company consolidation exception, see chapter 5.6. [810-10-45-14, 825-10-15-4, 946-320-35-1, 946-810-45-2 – 45-3]

Like IFRS, rights and obligations under leases are accounted for under the leasing Codification Topic (see chapter 5.1). Like IFRS, derivatives embedded in leases are accounted for separately if they are not clearly and closely related to the lease agreement (host); however, because the bifurcation guidance differs from IFRS, differences may arise in practice. Unlike IFRS, guidance on the derecognition of lease receivables (except for sales-type and direct finance lease receivables) and payables, and the impairment of lease receivables, is provided in the leasing Codification Topic. [815-10-15-79 – 15-81, 840]

Like IFRS, employers’ rights and obligations under employee benefit plans are accounted for under the employee benefits Codification Topics (see chapter 4.4), although these topics differ in certain respects from IFRS. [825-10-15-5c]

Like IFRS, issued financial instruments classified as equity are excluded from the accounting described below (see chapter 7.3). However, the determination of which instruments are considered own equity differs in certain respects from IFRS. [815-10-15-74 – 15-78]
The following rights and obligations are excluded from the scope of the financial instruments standards.

- Those arising under an insurance contract as defined in the insurance standard (see chapter 8.1), other than:
  - an issuer’s rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract unless an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts. Then the issuer may elect on a contract-by-contract basis to apply either the financial instruments standard or the insurance standard to such contracts; and
  - a derivative that is embedded in a contract in the scope of the insurance standard if the derivative is not itself a contract in the scope of the insurance standard.

- Those arising under a contract that is in the scope of the insurance standard because it contains a discretionary participation feature. [IAS 39.2(e)]

A forward contract between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination at a future date is excluded from the scope of the financial instruments standard if certain conditions are met. The scope exclusion does not apply to option contracts, whether or not they are currently exercisable, that on exercise will result in obtaining control of an entity. The scope exemption also does not apply by analogy to contracts to acquire investments in associates and similar transactions such as investments in joint ventures. [IAS 39.2(g), BC24B–BC24D]

The following loan commitments are in the scope of the financial instruments standard:

- loan commitments designated as a financial liability at fair value through profit or loss;
- loan commitments that can be settled net in cash or by delivering or issuing another financial instrument;
- all loan commitments in a particular class if an entity has a past practice of selling the assets resulting from such loan commitments shortly after origination; and
- commitments to provide a loan at a below-market interest rate. [IAS 39.2(h), 4]

Other loan commitments are outside of the scope of the financial instruments standard and are within the scope of the standard on provisions (see chapter 3.12). The derecognition of all loan commitments is in the scope of the financial instruments standard. [IAS 39.2(h)]

Unlike IFRS, insurance contracts issued by an insurance company are excluded from the scope of the financial instruments Codification Topics if they are subject to the specialised insurance accounting topic (see chapter 8.1). Unlike IFRS, an insurance company may make an irrevocable election on a contract-by-contract basis to account for insurance contracts that it issued at fair value through profit or loss if the contract is a financial instrument or it permits the insurer to settle by paying a third party to provide goods or services. Unlike IFRS, financial guarantee contracts are excluded from the scope of the financial instruments Codification Topics. Also, there are differences between the IFRS and US GAAP definitions of a financial guarantee. Like IFRS, the requirements described below apply to a derivative that is embedded in an insurance contract issued by an insurance company. [815-10-15-52 – 15-58, 825-10-15-4]

Like IFRS, contracts between an acquirer and a seller to enter into a business combination at a future date are excluded from the financial instruments Codification Topics. [815-10-15-74(c)]

Unlike IFRS, only the loan commitments of issuers of mortgage loans to be held for sale are accounted for as derivatives. All other loan commitments are accounted for as contingent liabilities (see chapter 3.12), unless they are designated as at fair value through profit or loss. [815-10-15-69 – 15-71, 825-10-15-4]
Contracts and obligations under share-based payment transactions are generally accounted for under the share-based payment standard (see chapter 4.5). [IAS 39.2(i)]

Reimbursement rights in respect of recognised provisions are accounted for under the provisions standard (see chapter 3.12). [IAS 39.2(ii)]

Purchases and sales of non-financial items
A contract to buy or sell a non-financial item generally meets the definition of a derivative if it can be settled net in cash or another financial instrument (see below). Contracts that are entered into and continue to be held for the receipt or delivery of a non-financial item in accordance with the entity’s expected purchase, sale or usage requirements are exempt from being accounted for as derivatives (the ‘normal sales and purchases’ or ‘own use’ exemption). [IAS 39.5–6]

Like IFRS, a contract to buy or sell a non-financial item generally meets the definition of a derivative if the terms of the contract permit or require either party to settle it net in cash or another asset, or the non-financial item that is the subject of the contract is readily convertible into cash. Like IFRS, contracts for the delivery of a non-financial item for use or sale in the normal course of business are generally exempt from being accounted for as derivatives, but unlike IFRS certain additional conditions have to be met:
- it is at normal terms for normal quantities;
- the contract has a price based on an underlying that is clearly and closely related;
- it is probable at inception and throughout the contract that the contract will not settle net and will result in physical delivery; and

In our view, ‘past practice’ should be interpreted narrowly. Infrequent historical incidences of net settlement in response to events that could not have been foreseen at inception of a contract would not taint an entity’s ability to apply the own use exemption to other contracts.

In respect of the ‘own use exemption’, the entity should have no past practice of:
- settling similar contracts net in cash or other financial instruments; or
- taking delivery of the underlying and selling it within a short period after delivery for trading purposes. [IAS 39.6]

Also, contracts that permit either party to settle net in cash or contracts in respect of items that are readily convertible to cash have to be evaluated to determine if they are in the scope of the financial instruments standard.

Like IFRS, a past practice of settling similar contracts net in cash (or other financial instruments), or taking delivery of the underlying and selling it within a short period after delivery for trading purposes, may make the contract ineligible for the normal purchase/normal sale exemption and therefore the contract would be accounted for as a derivative. [815-10-15-29]

Like IFRS, infrequent historical incidences of net settlement in response to events that could not have been foreseen at inception of a contract would not taint an entity’s ability to apply the own use exemption to the other contracts. However, because US GAAP has more extensive guidance on past practice, differences from IFRS may arise in practice.
A written option, under which an entity might be required to purchase or sell a commodity or other non-financial asset that can be settled net in cash or another financial instrument, can never qualify for the own use exemption. Sometimes forward contracts, which may qualify for the own use exemption, are combined with written options in one contract. In our view, in such cases the contract may be split so that the forward element may qualify as own use even though the written option component will not. [IAS 39.7]

If a contract to buy or sell a non-financial item contains an embedded derivative, then an entity first determines whether the embedded derivative should be separated from the host contract and accounted for separately. If the embedded derivative is accounted for separately, then in our view the host contract might still qualify for the own use exemption. [IAS 39.11]

Unlike IFRS, the exemption cannot generally be applied to contracts with optionality features over quantity (which includes both purchased and written options). However, despite the above prohibitions, certain power purchase and sales agreements may still qualify for the exemption even if they are written options and/or even if the entity has a past practice of net settling such contracts, unlike IFRS. [815-10-15-40, 15-42 – 15-51]

Unlike IFRS, a contract to buy or sell a non-financial item cannot be separated into one or more components, such that one component qualifies for the normal purchase/normal sale scope exemption under the derivatives Codification Topic while one or more other components do not qualify for the scope exemption. [815-10-15-41 – 15-44]

### Definitions

A ‘financial asset’ is any asset that is:
- cash;
- a contractual right:
  - to receive cash or another financial asset; or
  - to exchange financial assets or financial liabilities under potentially favourable conditions;
- an equity instrument of another entity; or
- a contract that will or may be settled in the entity’s own equity instruments and is:
  - a non-derivative for which the entity is or may be obliged to receive a variable number of the entity’s own equity instruments; or
  - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. [IAS 32.11]

Unlike IFRS, the definition of a financial asset does not address contracts that will or may be settled in the entity’s own equity instruments.

A ‘financial liability’ is:
- a contractual obligation:
  - to deliver cash or another financial asset to another entity; or
  - to exchange financial instruments under potentially unfavourable conditions; or
- a contract that will or may be settled in the entity’s own equity instruments and is:
  - a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity’s own equity instruments; or
  - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. [IAS 32.11]

Unlike IFRS, the definition of a financial liability does not address contracts that will or may be settled in the entity’s own equity instruments. The guidance on such contracts is described in chapter 7.3.

Like IFRS, a ‘financial liability’ is a contractual obligation:
- to deliver cash or another financial asset to another entity; or
- to exchange financial instruments under potentially unfavourable conditions. [820-10-20]
An ‘equity instrument’ is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. [IAS 32.11]

There is no definition of a ‘security’ under IFRS because the financial instruments standards apply to all financial instruments in their scope, irrespective of whether the financial instrument is a security.

Like IFRS, an ‘equity instrument’ is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. However, US GAAP differs from IFRS in some respects over what is considered a residual interest (see chapter 7.3). [505-10-05-3]

Unlike IFRS, US GAAP defines a ‘security’ because certain accounting requirements apply only to instruments that meet the definition of a security. A ‘security’ is defined as a share, participation or other interest in property or in an entity of the issuer or an obligation of the issuer that:

- either is represented by an instrument issued in bearer or registered form or, if it is not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer;
- is of a type commonly dealt in on securities exchanges or markets or, if it is represented by an instrument, is commonly recognised in any area in which it is issued or dealt in as a medium for investment; and
- either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests or obligations. [320-10-20]
7.2 Derivatives and embedded derivatives

(IA 32, IA 39, IFRIC 9)

Overview

— A ‘derivative’ is a financial instrument or other contract in the scope of the financial instruments standards:
  - the value of which changes in response to some underlying variable;
  - that has an initial net investment smaller than would be required for other instruments that have a similar response to the variable; and
  - that will be settled at a future date.

— An ‘embedded derivative’ is a component of a hybrid contract that affects the cash flows of the hybrid contract in a manner similar to a stand-alone derivative instrument.

— A ‘host contract’ may be a financial or a non-financial contract.

— An embedded derivative is not accounted for separately from the host contract if it is closely related to the host contract, or if the entire contract is measured at fair value through profit or loss. In other cases, an embedded derivative is accounted for separately as a derivative.
Overview (continued)

– This chapter includes only currently effective requirements (see About this publication).

Derivatives

Definition
A ‘derivative’ is a financial instrument or other contract in the scope of the financial instruments standards that has all of the following features:
– its value changes in response to some underlying variable – e.g. an interest rate – provided that in the case of a non-financial variable it is not specific to a party to the contract;
– it has an initial net investment smaller than would be required for other instruments that would be expected to have a similar response to the variable; and
– it will be settled at a future date. [IAS 39.9]

A derivative usually has a notional amount. However, in our view contracts without notional amounts or with variable notional amounts also meet the definition of a derivative. A contract to pay or receive a fixed amount on the occurrence or non-occurrence of a future event meets the definition of a derivative, provided that this future event depends on a financial variable or a non-financial variable that is not specific to a party to the contract. [IAS 39.AG9]

Exemptions from derivative treatment

Regular-way contracts
‘Regular-way contracts’ are contracts to buy or sell financial assets that will be settled within the timeframe established by regulation or convention in the market concerned. Regular-way contracts are not treated as derivatives between the date from which the entity is committed (trade date) and the date on which the instrument is actually transferred (settlement date). [IAS 39.9, 38, AGS3–AGS6]

Derivatives on own equity
Derivatives on own equity are excluded from derivative treatment if they meet the definition of an equity instrument (see chapter 7.3). [IAS 39.2(d)]

Derivatives

Definition
A ‘derivative’ is a financial instrument or other contract in the scope of the financial instruments Codification Topics that has all of the following features:
– (1) one or more underlyings; and (2) one or more notional amounts or payment provisions or both, unlike IFRS;
– it has an initial net investment smaller than would be required for other instruments that would be expected to have a similar response to the variable, like IFRS; and
– it, unlike IFRS:
- requires or permits net settlement;
- is readily settleable through a market mechanism outside the contract; or
- provides for delivery of an asset that is readily convertible to cash. [815-10-15-83]

Unlike IFRS, a contract must have either a notional amount or a payment provision to meet the definition of a derivative. Like IFRS, a contract to pay or receive a fixed amount on the occurrence or non-occurrence of a future event meets the definition of a derivative if the other requirements – e.g. net settlement – are met. [815-10-15-88-h]

Exemptions from derivative treatment

Regular-way contracts
Like IFRS, ‘regular-way contracts’ are contracts to buy or sell securities that will be settled within the timeframe established by regulation or convention in the market concerned. Like IFRS, US GAAP exempts regular-way securities trades from being accounted for as derivatives between trade date and settlement date. [815-10-15–15-21]

Derivatives on own equity
Like IFRS, some derivatives on own equity are excluded from derivative treatment. However, the situations in which this exception from derivative accounting is applied differ in certain respects from IFRS (see chapter 7.3). [815-10-15-74 – 15-78]
Embedded derivatives

Definition

An 'embedded derivative' is a component of a hybrid (combined) contract that affects the cash flows of the hybrid contract in a manner similar to a stand-alone derivative instrument. [IAS 39.10]

A derivative embedded in a host contract, including leases and insurance contracts, is accounted for separately as a stand-alone derivative if the following conditions are met:

– the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract;
– a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
– the hybrid instrument is not measured at fair value with changes in fair value recognised in profit or loss. [IAS 39.11]

When to separate

Determining whether an embedded derivative is closely related to the host contract requires the nature – i.e. the economic risks and characteristics – of the host contract and the nature of the underlying of the derivative to be considered. If the natures of both the underlying and the host contract are similar, then they are generally closely related. [IAS 39.11, AG30–AG33]

An interest rate derivative embedded in a debt instrument or insurance contract would not generally be separated from its debt or insurance host contract unless the combined instrument can be settled in such a way that the holder would not recover substantially all of its recognised investment, or the embedded derivative could at least double the holder’s initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract. [IAS 39.AG33(a)]

Embedded derivatives

Definition

Like IFRS, an 'embedded derivative' is one or more implicit or explicit terms in a host contract that affect the cash flows of the contract in a manner similar to a stand-alone derivative instrument. [815-10-20]

Like IFRS, a derivative embedded in a host contract, including leases and insurance contracts issued by insurance companies, is accounted for separately as a stand-alone derivative if the following conditions are met:

– their economic characteristics and risks are not clearly and closely related to those of the host contract;
– a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
– the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in profit or loss. [815-15-25-1]

However, the determination of whether an embedded derivative is clearly and closely related to the host contract (see below), the definition of a derivative (see above) and the circumstances in which hybrid instruments are measured at fair value with changes in fair value recognised in profit or loss differ in certain respects from IFRS (see below).

When to separate

Like IFRS, determining whether an embedded derivative is clearly and closely related to the host contract requires the nature of the host contract and the nature of the underlying of the derivative to be considered. If the natures of both the underlying and the host contract are similar, then they are generally clearly and closely related. However, the US GAAP guidance on the term ‘clearly and closely related’ differs from IFRS in certain respects. [815-15-25-1, 25-16 – 25-51A]

Like IFRS, an interest rate derivative embedded in a hybrid instrument would not generally be separated from its host contract unless the combined instrument can be settled in such a way that the holder would not recover substantially all of its recognised investment or the embedded derivative could at least double the holder’s initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract. However, because US GAAP has more guidance, differences from IFRS may arise in practice. [815-15-25-26 – 25-39]
An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the contract is issued, and the cap or floor is not leveraged in relation to the host contract. [IAS 39.AG33(b)]

An insurance contract or a contract that is not a financial instrument, and which is denominated in a foreign currency, gives rise to an embedded derivative that is not considered to be closely related and therefore needs to be separated unless it is not leveraged and does not contain an option feature, and the payments required under the contract are denominated in one of the following currencies:
- the functional currency of one of the substantial parties to the contract;
- the currency in which the price of the related goods or services being delivered under the contract is routinely denominated in commercial transactions around the world; or
- the currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place. [IAS 39.AG33(d)]

Unlike IFRS, an embedded floor or cap on the interest rate on a hybrid instrument is clearly and closely related to the host contract unless the feature could at least double the holder’s initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract. [815-15-25-26, 25-32]

A contract that is not a financial instrument, and which is denominated in a foreign currency, gives rise to an embedded derivative that is not considered to be clearly and closely related and therefore is separated unless the payments required under the contract are denominated in one of the following currencies:
- the functional currency of one of the substantial parties to the contract, like IFRS;
- the currency in which the price of the related goods or services being delivered under the contract is routinely denominated in commercial transactions around the world, like IFRS;
- a currency that a substantial party to the contract uses as if it were its functional currency due to the primary economic environment of that substantial party being highly inflationary, unlike IFRS; or
- a currency that is the local currency of any substantial party to the contract, unlike IFRS. [815-15-15-10 – 15-19]

For an insurance contract issued by an insurance company in which losses are denominated in either (1) the functional currency of one of the parties to that contract (like IFRS) or (2) the local currency of the country in which the loss is incurred, during the period between the inception of the contract and the loss occurrence date (unlike IFRS), there is no embedded foreign currency derivative that requires separate accounting. [815-15-20, 15-21]

Unlike IFRS, a foreign currency option feature embedded in a contract that is not a financial instrument that is denominated in a foreign currency does not require bifurcation as long as the option feature does not contain leverage and does not represent a written option or net written option. [815-15-15]

Cash collateralised debt obligations

In a cash collateralised debt obligation (CDO) structure, the debt obligation is collateralised through a pool of mortgages or other loans (cash instruments). In a synthetic CDO structure, the debt obligation is collateralised through cash instruments (generally government bonds) together with a pool of credit derivatives, including credit default swaps and credit default options. In our view, the holder of an investment in a cash CDO is not required to separate an embedded credit feature if the exposure is structured such that the embedded credit feature meets the definition of a financial guarantee. In our view, the credit feature embedded in a synthetic CDO should be accounted for separately by the holder.

Unlike IFRS, regardless of whether a collateralised debt obligation (CDO) is a cash CDO or synthetic CDO, the holder of an investment in a CDO does not separate an embedded credit derivative as long as the feature transfers credit risk in the form of subordination of one financial instrument to another, such as the subordination of one beneficial interest to another tranche, thereby redistributing the credit risk. [815-15-15-9]
Reassessment of separation

The assessment of whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative is made at inception of the contract – i.e. when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is either (1) a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required under the contract; or (2) a reclassification of a financial asset out of the fair value through profit or loss category, in which case it is required. [IFRIC 9.7]

Accounting for separable embedded derivatives

Separable embedded derivatives are measured at fair value, with all changes in fair value recognised in profit or loss unless they form part of a qualifying cash flow or net investment hedging relationship (see chapter 7.7). [IAS 39.46–47, 55]

The initial bifurcation of a separable embedded derivative does not result in any gain or loss being recognised. [IAS 39.AG28, IGC.1–IGC.2]

The carrying amount of the host contract at initial recognition is generally the difference between the fair value of the hybrid instrument and the fair value of the embedded derivative. [IAS 32.31, 39.13, AG28]

If a single host contract has more than one embedded derivative with different underlying risk exposures, that are readily separable and are independent of each other, then they are accounted for separately. [IAS 39.AG29]

Reassessment of separation

Unlike IFRS, the evaluation of whether there is an embedded derivative that requires separation is made throughout the life of the contract, unless otherwise limited by the derivatives Codification Topic – e.g. the evaluation is required only at the inception of the contract for embedded foreign currency derivatives that meet one of the above exemptions from separation. [815-15-15-10]

Accounting for separable embedded derivatives

Like IFRS, separable embedded derivatives are required to be measured at fair value, with all changes in fair value recognised in profit or loss unless they form part of a qualifying cash flow or net investment hedging relationship (see chapter 7.7). [815-15-30-2]

Like IFRS, the initial bifurcation of a separable embedded derivative does not result in any gain or loss being recognised. [815-15-30-2]

The carrying amount of the host contract at initial recognition is the difference between the proceeds (which would generally be fair value) of the hybrid instrument and the fair value of the embedded derivative, like IFRS. However, the host contract is recorded at fair value for debt instruments with a conversion feature whose stated terms allow settlement in cash (or other assets) on conversion, including partial cash settlement, other than:

- those in which the embedded conversion option is required to be separately accounted for as a derivative, like IFRS; and
- debt instruments issued with a beneficial conversion feature, when the carrying amount of the host contract at initial recognition is the difference between the proceeds and the intrinsic value of the embedded beneficial conversion feature, unlike IFRS. [470-20-30-3, 815-15-25-51, 815-15-30-2]

Unlike IFRS, if a single host contract has more than one embedded derivative each of which would warrant separate accounting as a derivative, then those individual embedded derivatives are bundled together as a single, compound embedded derivative instrument and accounted for separately from the host contract. Therefore, an entity cannot embed a compound derivative in a hybrid instrument and separate that compound derivative into multiple derivatives based on the dissimilar components representing different risks, unlike IFRS. [815-15-25-7 – 25-8]
7.3 Equity and financial liabilities

Overview

An instrument, or its components, is classified on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.

A financial instrument is classified on initial recognition as a financial liability if it contains a contractual obligation to transfer cash or another financial asset.

A financial instrument is also classified as a financial liability if it will or may be settled in a variable number of the entity’s own equity instruments.

An obligation for an entity to acquire its own equity instruments gives rise to a financial liability, unless certain conditions are met.

As an exception to the general principle, certain puttable instruments and instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation are classified as equity instruments if certain conditions are met.

Unlike IFRS, the accounting for a puttable instrument depends on whether the entity is publicly or privately held and on whether it is conditionally or unconditionally puttable. Like IFRS, certain instruments that can be required to be redeemed only in the event of the liquidation of the issuer are equity; however, the conditions for such treatment differ from IFRS.
Overview (continued)

– The contractual terms of preference shares and similar instruments are evaluated to determine whether they have the characteristics of a financial liability.

– The components of compound financial instruments, which have both liability and equity characteristics, are accounted for separately.

– A non-derivative contract that will be settled by an entity delivering its own equity instruments is an equity instrument if, and only if, it will be settled by delivering a fixed number of its own equity instruments.

– A derivative contract that will be settled by the entity delivering a fixed number of its own equity instruments for a fixed amount of cash is an equity instrument. If such a derivative contains settlement options, then it is an equity instrument only if all settlement alternatives lead to equity classification.

– Incremental costs that are directly attributable to issuing or buying back own equity instruments are recognised directly in equity.

– Treasury shares are presented as a deduction from equity.

– Gains and losses on transactions in an entity’s own equity instruments are reported directly in equity.

Overview (continued)

– Like IFRS, an instrument issued in the legal form of a preferred share and similar instruments may be, in whole or in part, a liability based on an analysis of the contractual terms of the instrument. However, differences between IFRS and US GAAP exist in treating preferred shares as liability, equity or temporary equity.

– Unlike IFRS, instruments with characteristics of both liability and equity are not always split between their liability and equity components; and when they are, the basis of separation may differ from IFRS.

– Unlike IFRS, a non-derivative contract in the form of a share that the issuer must or may settle by issuing a variable number of its equity shares is recorded as equity, unless it is known at inception that the monetary value of the obligation is based solely or predominantly on a fixed monetary amount; will vary based on something other than the fair value of the issuer’s equity shares; or will vary inversely related to changes in the fair value of the issuer’s equity shares.

– Derivative instruments indexed to an entity’s own stock that will be settled by the entity delivering a fixed number of own equity instruments for a fixed amount of cash may meet the definition of equity; however, the criteria for determining whether they meet the definition of equity or liability differ from IFRS. Additionally, US GAAP contains more guidance on what constitutes ‘indexed to an entity’s own stock’. Also, derivative instruments indexed to an entity’s own stock may be treated as equity if they can be net share settled if certain criteria are met, unlike IFRS.

– Like IFRS, incremental costs that are directly attributable to issuing or buying back an entity’s own equity instruments are recognised directly in equity.

– Like IFRS, treasury shares are presented as a deduction from equity.

– Like IFRS, gains and losses on transactions in own equity instruments are reported directly in equity.
Overview (continued)

– Dividends and other distributions to the holders of equity instruments, in their capacity as owners, are recognised directly in equity.

– NCI are classified within equity, but separately from equity attributable to shareholders of the parent.

– This chapter includes only currently effective requirements (see About this publication).

Classification as a financial liability or equity

General principles
An instrument is a financial liability if it is:
– a contractual obligation:
  - to deliver cash or other financial assets; or
  - to exchange financial assets or financial liabilities with another entity under potentially unfavourable conditions (for the issuer of the instrument); or
– a contract that will or may be settled in the entity’s own equity instruments and is:
  - a non-derivative that comprises an obligation for the entity to deliver a variable number of its own equity instruments; or
  - a derivative that will or may be settled other than by the entity exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments. [IAS 32.11]

Any instrument that an issuer could be obliged to settle in cash, or by delivering other financial assets, is a financial liability regardless of the financial ability of the issuer to settle the contractual obligation or the probability of settlement. [IAS 32.19, IU 11-06]

Classification as a financial liability or equity

General principles
Although there are requirements for certain types of instruments that result in the same classifications as IFRS, there are many requirements under US GAAP that result in a different treatment from IFRS. Therefore, many instruments that are liabilities under IFRS could be classified as equity or ‘temporary equity’ (which is between total liabilities and equity) under US GAAP and certain instruments that are equity under IFRS could be classified outside equity under US GAAP (i.e. as temporary equity or as a liability).

Under US GAAP, financial liabilities include:
– mandatorily redeemable shares issued by a public entity that embody an unconditional obligation requiring the issuer to redeem it by transferring assets at a specified or determinable date (or dates) or on an event that is certain to occur, like IFRS;
– shares issued by a public or non-public entity that are mandatorily redeemable on fixed dates for amounts that are either fixed or determinable with reference to an interest rate, currency or other external index, like IFRS;
An equity instrument is an instrument that meets both of the following conditions.

- There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavourable conditions (for the issuer of the instrument).

- If the instrument will or may be settled in the issuer’s own equity instruments, then it is either:
  - a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or
  - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments. [IAS 32.11, 16]

In general, an ‘equity instrument’ is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. [IAS 32.11]

An obligation may arise from a requirement to repay principal or to pay interest or dividends. A perpetual instrument with an obligation to pay dividends or interest is a liability and the principal is assumed to be equal to the net present value of the dividend or interest obligation. [IAS 32.AG6]

Instruments or components of instruments are either a liability or equity; there is no midway classification between liabilities and equity. [IAS 32.15–16]

- an instrument that is not itself an outstanding share that, at inception, embodies an obligation for the issuer to repurchase its own equity shares, or is indexed to such an obligation, and requires or may require the issuer to settle the obligation by transferring assets (e.g. a forward purchase contract or written put option on the issuer’s equity shares that is to be physically settled or net cash-settled), like IFRS; and

- like IFRS, an instrument that embodies an unconditional obligation or, for an instrument that is not itself an outstanding share that embodies a conditional obligation, that the issuer must or may settle by issuing a variable number of its equity shares, if at inception the monetary value of the obligation is based solely or predominantly on:
  - a fixed monetary amount known at inception (e.g. a payable to be settled with a variable number of the issuer’s equity shares);
  - variations in something other than the fair value of the issuer’s equity shares (e.g. a financial instrument indexed to the S&P 500 and to be settled with a variable number of the issuer’s equity shares); or
  - variations inversely related to changes in the fair value of the issuer’s equity shares (e.g. a written put option that could be net share settled). [480-10-20, 480-10-25-8, 25-14]

Because IFRS does not have such prescriptive guidance, differences from IFRS may arise in practice.

Like IFRS, in general, an ‘equity instrument’ is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. However, application of the Codification topics/subtopics results in differences from IFRS for certain instruments.

Unlike IFRS, the liability classification is based on a requirement to repay the principal; a requirement to pay interest or dividends may not result in the entire instrument being classified as a liability because it is only one factor to consider in determining its classification.

Unlike IFRS, SEC registrants present redeemable preferred shares and redeemable NCI that would otherwise be equity (see above), and other redemption features that are bifurcated and accounted for separately, whose redemption is outside the control of the issuer, in temporary equity. [480-10-599]
The classification of an instrument as either financial liability or equity is made on initial recognition. However, a reclassification may be required if: an entity amends the contractual terms of an instrument; the effective terms of an instrument change without any amendment of the contractual terms; there is a relevant change in the composition of the reporting entity; or, in the case of puttable instruments and instruments that impose on the entity an obligation only on liquidation, if certain conditions are met. [IAS 32.15, 16E]

Contingent settlement provisions

An instrument that contains contingent settlement provisions is a financial liability because the issuer does not have the unconditional right to avoid making payments unless one of the following applies:

- the part of the contingent settlement provision that could require settlement in cash or another financial asset is not genuine; or
- the issuer can be required to settle in cash or another financial asset only in the event of its own liquidation. [IAS 32.25]

Puttable instruments

A ‘puttable instrument’ is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the holder. Puttable instruments are generally classified as financial liabilities of the issuer, unless certain conditions are met. [IAS 32.16A]

A puttable instrument is classified as equity if all of the following conditions are met:

- the instrument entitles the holder to a pro rata share of the entity’s net assets in the event of the entity’s liquidation;
- the instrument belongs to a class of instruments that is subordinated to all other classes of instruments issued by the entity. In determining whether an instrument is in the most subordinated class, an entity evaluates the instrument’s claim on liquidation as if it were to liquidate on the date when it classifies the instrument;
- all financial instruments in this most subordinated class of instruments have identical features (i.e. no instrument holder in that class can have preferential terms or conditions);

Like IFRS, the classification of an instrument as either financial liability or equity is made on initial recognition. However, unlike IFRS, the classification of a contract that is indexed to, and potentially settled in, an entity’s own stock, shall be reassessed at each balance sheet date. If the classification changes as a result of events during the period, the contract shall be reclassified as of the date of the event that caused the reclassification. Like IFRS, a reclassification may also be required if an entity amends the contractual terms of an instrument. [470-50-40-6, 815-40-35-8]

Contingent settlement provisions

Unlike IFRS, US GAAP has specific guidance on conditional (contingent) obligations to determine if the instruments should be presented as equity. Examples include the following.

- Conditionally redeemable shares are not liabilities unless and until they become mandatorily redeemable, unlike IFRS. Also, SEC registrants treat conditionally redeemable shares in temporary equity, unlike IFRS.
- Instruments are not liabilities if the settlement in cash or another financial asset can be required only in the event of the liquidation of the issuer, like IFRS. [480-10-25-4, 25-6]

Puttable instruments

Unlike IFRS, if the puttable instruments are in the form of shares (i.e. the put option is embedded in the share) but they do not meet the definition of mandatorily redeemable shares (see above), then:

- they are classified as temporary equity by SEC registrants; and
- they may be classified as equity by non-SEC registrants. [480]
– apart from the contractual obligation to repurchase or redeem the instrument, the instrument does not include any other contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; and
– the total expected cash flows attributable to the instrument over its life are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity. Profit or loss and the change in recognised net assets are measured in accordance with IFRS for this purpose. [IAS 32.16A, AG14A–AG14E]

In addition to the above conditions to be met by the instrument, the issuer must not have other financial instrument or contract that has:
– total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity; and
– the effect of substantially restricting or fixing the residual return to the puttable instrument holders. [IAS 32.16B]

Obligations arising on liquidation
Some financial instruments include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets only on liquidation. The obligation arises because liquidation either is certain to occur and is outside the control of the entity – e.g. a limited life entity – or is uncertain to occur but is at the option of the instrument holder. Such instruments are classified as equity if certain conditions are met (see below). [IAS 32.16C]

As an exception to the definition of a financial liability, an instrument (or a component of an instrument) that includes such an obligation is classified as equity if it has all of the following features:
– the instrument entitles the holder to a pro rata share of the entity’s net assets in the event of the entity’s liquidation;
– the instrument belongs to a class of instruments that is subordinated to all other classes of instruments issued by the entity. In determining whether an instrument is in the most subordinated class, an entity evaluates the instrument’s claim on liquidation as if it were to liquidate on the date when it classifies the instrument; and
– all financial instruments in this most subordinated class of instruments have an identical contractual obligation for the entity to deliver a pro rata share of its net assets on liquidation. [IAS 32.16C, AG14B]
In addition to the instrument having all the above features to be classified as an equity instrument, the issuer should have no other financial instrument or contract that has:
- total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity; and
- the effect of substantially restricting or fixing the residual return to the instrument holders. [IAS 32.16D]

**Impact of share settlement**

If a non-derivative contract will or may be settled in the issuer’s own equity instruments, then it is a liability if it includes a contractual obligation for the issuer to deliver a variable number of its own equity instruments. [IAS 32.11, 16(b)(i), 21, AG27(d)]

If a derivative contract will be settled only by the entity receiving or delivering a fixed number of own equity shares for a fixed amount of cash or another financial asset, then it is an equity instrument of the entity. [IAS 32.11, 16(b)(i)]

If a derivative financial instrument gives one party a choice over how it is settled – e.g., the issuer or the holder can choose settlement net in cash or by exchanging shares for cash – then it is a financial asset or financial liability unless all of the settlement alternatives result in it being an equity instrument. [IAS 32.26]

Contract that may be settled in a variable number of the entity’s own equity shares equivalent to a fixed value are financial liabilities or financial assets. [IAS 32.11, 16(b)(iii)]

Equity instruments include options and warrants on an entity’s own equity if they meet certain conditions. [IAS 32.11, 16(b)(iii)]

**Impact of share settlement**

Unlike IFRS, the classification of instruments that will or may require delivery of a variable number of shares depends on the predominant nature of the monetary value of the instrument, and other factors that are used to evaluate whether the entity has the ability to settle net in shares. [480-10-25-14]

Like IFRS, if a derivative contract will be settled by exchanging a fixed number of own equity shares for a fixed amount of cash or other financial assets is generally classified as equity. However, unlike IFRS, under US GAAP there are additional criteria to be considered before concluding whether equity classification is appropriate. For example, the derivative contract should be considered indexed to the reporting entity’s own stock (shares) and US GAAP provides detailed guidance on evaluating ‘indexed to its own stock’. Therefore, derivative instruments settled in own equity may be classified differently from IFRS. [815-40-15-7, 15-7C – 15-7H]

Like IFRS, derivative contracts that give the counterparty a choice of settlement by physical delivery, net-shares or net-cash delivery, are liabilities or assets. However, unlike IFRS, derivative contracts that can be settled net in shares are equity if they are indexed to the entity’s own equity instruments and the entity has the ability to settle net in shares. [815-40-25-4]

Like IFRS, contracts that may be settled in a variable number of the entity’s own equity shares equivalent to a fixed value are financial liabilities or financial assets. [480-10-25-14(a)]

Like IFRS, equity instruments include options and warrants on an entity’s own equity if they meet certain conditions. However, these conditions differ from IFRS. For example, a contract should be indexed to the reporting entity’s own shares to be equity-classified. US GAAP provides detailed guidance on evaluating ‘indexed to its own stock’ and ‘classified in stockholder’s equity’. [815-40-15-7 – 15-8A]
A contract that will be settled by the entity receiving or delivering a fixed or variable number of puttable instruments, or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation is a financial asset or a financial liability. [IAS 32.11]

Redemption options
An instrument may be redeemable at the option of the issuer but, through its terms and conditions, may establish an obligation indirectly for the issuer to transfer cash or other financial instruments to the holder. In such cases, the instrument is a liability. [IAS 32.20, IU 09-13]

Classification of rights issues
Rights (and similar derivatives) to acquire a fixed number of an entity’s own equity instruments for a fixed price stated in a currency other than the entity’s functional currency are equity instruments, provided that the entity offers the rights pro rata to all of its existing owners of the same class of its non-derivative equity instruments. [IAS 32.16(b)(ii)]

Compound instruments
An instrument that contains both liability and equity elements – e.g. a convertible bond or convertible preference shares – is a compound instrument. Compound instruments are allocated between their liability and equity components (split accounting). [IAS 32.28–29, AG31]

Unlike IFRS, a contract that will be settled by the entity receiving or delivering a fixed or variable number of puttable instruments or instruments that oblige the entity to deliver a pro rata share of the net assets of the entity only on liquidation, is evaluated using the above considerations and differences from IFRS may arise in practice.

Redemption options
An instrument that is redeemable at the option of the issuer may establish an obligation indirectly for the issuer to transfer cash or other financial instruments to the holder. However, the requirements under US GAAP for making this evaluation (see above) differ from IFRS, so differences may arise in practice.

Classification of rights issues
Unlike IFRS, rights (and similar derivatives) to acquire a fixed number of an entity’s own equity instruments for a fixed price stated in a currency other than the entity’s functional currency are a financial liability because these rights are not considered indexed to the entity’s own stock. [815-40-15-71]

Compound instruments
Unlike IFRS, instruments with characteristics of both liability and equity, such as convertible bonds, are not required to be split between their liability and equity components in all circumstances. The following are examples of circumstances in which split accounting of a compound instrument is required:
- a convertible debt that may be wholly or partly settled in cash (or other assets) on conversion, if the conversion option qualifies for equity treatment;
- a conversion option that is in-the-money – i.e. beneficial conversion feature – at the date of issue; and
- a conversion option that is not clearly and closely related to the host and, if it were a freestanding derivative instrument, would meet the definition of a derivative and not qualify for equity classification. [470-20-15, 470-20-25-4 – 25-7, 815-15-25-1]

Unlike IFRS, debt securities with non-detachable warrants are treated entirely as liabilities if the warrants are not required to be separated from the liability host under other Codification subtopics. [815-15]
The carrying amount of a compound instrument is allocated between its liability and equity components on initial recognition as follows.

- The amount allocated to the liability element is its fair value determined with reference to a similar stand-alone debt instrument including any embedded non-equity derivatives.
- The remaining issue proceeds are allocated to the equity element. [IAS 32.31–32]

Unlike IFRS, not all such compound instruments are separated. Unlike IFRS, beneficial conversion features contained within a compound instrument are separated at their intrinsic value. For other compound instruments that are required to be separated into liability and equity components – other than debt with detachable warrants – the allocation between their liability and equity components on initial recognition is as follows, like IFRS.

- The amount allocated to the liability element is the present value of the future interest and principal cash flows, discounted at a rate applicable to a similar liability without an equity component. The value of any embedded derivatives, other than the equity feature (i.e. the embedded call represented by the conversion feature) is included in the amount allocated to the liability.
- The remaining issue proceeds are allocated to the equity element. [470-20-25-2, 30-3, 30-27, 30-28]

On early redemption of a convertible instrument, the redemption payment is allocated to the liability and equity components using the method initially used to allocate the instrument between its liability and equity components. [IAS 32.AG33]

If US GAAP requires the initial proceeds on a convertible instrument to be allocated between a liability component and an equity component such that the liability component is initially recorded at its fair value and the equity component is recorded at the residual amount of the proceeds, then the redemption payment is allocated between its liability and equity components using this same method, like IFRS. However, unlike IFRS, in other circumstances the allocation is performed as follows.

- If the intrinsic value of the beneficial conversion feature was recognised previously, then a portion of the redemption price is allocated to the beneficial conversion feature as a reduction to paid-in capital based on its intrinsic value on the date of extinguishment. The remainder of the redemption price is allocated to the liability component to determine the gain or loss on extinguishment.
- If the compound instrument did not require separation of the conversion feature, then the redemption payment is treated in its entirety as the retirement of liability with the gain or loss recognised in profit or loss. [470-20-40-3, 40-20]

Accounting for conversion at maturity

On conversion of a compound instrument, the entity derecognises the liability component, which is extinguished when the conversion feature is exercised, and recognises that amount as equity. The original equity component remains as equity. No gain or loss is recognised in profit or loss. In our view, this accounting applies even if the conversion feature is exercised before the liability’s redemption date (i.e. in case of an American-style feature). [IAS 32.AG32]

Like IFRS, on conversion of a compound instrument for which the conversion option was previously separated from the liability host, the entity derecognises the liability component, which is extinguished when the conversion feature is exercised, and recognises the carrying amount of the liability as equity. Unlike IFRS, any remaining discount on the liability (e.g. an American-style feature that is exercised before the liability’s redemption date) is recognised as interest expense in profit or loss. Like IFRS, any original equity component remains in equity. [470-20-40-1, 40-20]
Recognition and measurement
The recognition and measurement of financial liabilities is discussed in chapters 7.5 and 7.6. The remainder of this chapter focuses on equity.

IFRS does not have any specific measurement requirements related to equity, other than in respect of splitting compound instruments, the cost of equity transactions, treasury shares, and equity instruments that are issued in share-based payment transactions (see chapter 4.5). [IAS 39.2(d)]

An entity may be owed an amount in respect of a contribution for new equity shares that have already been issued. In our view, the equity and a corresponding receivable are recognised if the receivable meets the definition of a financial asset. This requires the entity to have a contractual right to receive the amount at the reporting date. A ‘contractual right’ is more than an informal agreement or a non-contractual commitment.

As a general principle, the definitions of income and expenses exclude transactions with holders of equity instruments acting in that capacity. Therefore, gains or losses on transactions in the entity’s own equity are not recognised in profit or loss. The effects of transactions with owners are recognised in equity. However, derivatives on own equity that are classified as assets or liabilities (see above) result in gains and losses recognised in profit or loss.

Unlike IFRS, if the conversion option was not separated from the liability host, then the carrying amount of the debt is reclassified from liability to equity on conversion of the convertible instrument, with no gain or loss recognised in profit or loss. [470-20-40-4]

Recognition and measurement
The recognition and measurement of financial liabilities is discussed in chapters 7.5 and 7.6. The remainder of this chapter focuses on equity.

US GAAP contains more specific guidance on the measurement of equity than IFRS; these general requirements apply to all equity transactions other than share-based payments with employees (see chapter 4.5). Under US GAAP, equity instruments are generally recognised at fair value on initial recognition or, in certain circumstances, using an allocation based on relative fair value or intrinsic value, at the date of issue. Because US GAAP contains more specific guidance than IFRS, differences may arise in practice. [480-10-15-8]

Unlike IFRS, a note receivable that is received in exchange for the issue of an equity instrument is generally treated as a deduction from equity rather than as an asset. [605-10-45]

Like IFRS, the definitions of income and expenses exclude transactions with holders of equity instruments in their capacity as owners. Therefore, like IFRS, gains or losses on transactions in the entity’s own equity are not recognised in profit or loss; these amounts are recognised in equity. Like IFRS, derivatives on own equity that are classified as assets or liabilities (see above) result in gains and losses recognised in profit or loss. [815]
There is no specific guidance under IFRS on how to account for an issue of bonus shares to shareholders or distribution of shares in lieu of dividends (with or without a cash alternative). In our view:

– in the case of a simple split of shares or a bonus issue, there is no requirement to adjust total equity or an individual component of equity (however, the laws of the country of incorporation may require a reallocation of capital within equity);
– when shares with a value equal to the cash dividend amount are offered as an alternative to the cash dividend, it is acceptable to debit the liability and recognise a credit to equity as the proceeds of the issue; and
– when a share dividend is not an alternative to cash dividend, no accounting entries are required.

**Treasury shares**

Any amounts paid by an entity to acquire its own shares are debited directly to equity. This applies whether the shares are cancelled immediately or held for resale – i.e. treasury shares. Amounts received from the sale of treasury shares are credited directly to equity. No gains or losses are recognised in profit or loss on any transactions in own shares and changes in the value of treasury shares are not recognised, even if these shares are held for trading purposes. [IAS 32.33, A36]

Own shares held in connection with an equity compensation plan held by the entity are presented as treasury shares. [IAS 32.4(f), 33–34]

Treasury shares, including those held for trading purposes, are not recognised as assets or measured at fair value with gains and losses recognised in profit or loss. [IAS 32.33, AG36]

An associate may have an investment in its investor. IFRS does not provide specific guidance on whether the carrying amount of the associate under the equity method should include the investor’s share of the associate’s investment in the investor’s own shares. However, in our view the investor is not required to make any adjustments. [IAS 1.79, 32.33, IFRS 10.A]

Unlike IFRS, there is specific guidance under US GAAP to distinguish share dividends from share split.

– If a transaction meets the definition of a share split, then there is no requirement to adjust total equity or an individual component of equity, like IFRS.
– If a transaction meets the definition of a share dividend, then an entity transfers from retained earnings to capital stock and to additional paid-in capital an amount equal to the fair value of the additional shares issued, unlike IFRS. [505-20-25-3]

Because US GAAP has specific guidance, differences from IFRS may arise in practice.

**Treasury shares**

Like IFRS, treasury shares are accounted for directly in equity, with treasury shares held for reissue presented as a deduction from equity; any difference between the purchase price and reissue proceeds does not impact income. On reissue, the classification within equity of gains or losses on share transactions differs based on the comparison of proceeds received to original cost. If the proceeds from the sale of the treasury shares are greater than the cost of the shares sold, then the entity recognises the excess proceeds as additional paid-in capital. If the proceeds from the sale of the treasury shares are less than the original cost of the shares sold, then, generally, the excess cost first reduces any additional paid-in capital arising from previous sales of treasury shares for that class of share, and any remaining excess is recognised as a reduction of retained earnings. [505-30-30-6, 30-10]

Like IFRS, treasury share accounting also applies to own shares that will be used to satisfy obligations under employee share-based payment plans (see chapter 4.5) unless the plan constitutes an employee share ownership plan (ESOP), in which case specific provisions apply such that allocated shares cannot be treated as treasury shares, so differences from IFRS may arise in practice. [505-30-15-2, 71B-40-25-10]

Like IFRS, treasury shares, including those held for trading purposes, are not recognised as assets or measured at fair value with gains and losses recognised in profit or loss. [505-30]

Unlike IFRS, the carrying amount of an equity-method investee (associate) that has an investment in the investor is adjusted in the investor’s financial statements to show the amount related to the investee’s investment in the investor as treasury shares.
**Cost of an equity transaction**
Qualifying costs attributable to an equity transaction – e.g. issuing or buying back own equity instruments – are debited directly to equity. [IAS 32.35, 37]

A listing of existing shares, a secondary offering and share splits do not result in new equity instruments being issued; therefore, any costs associated with such transactions are expensed as they are incurred. [IAS 32.35, IU 09-08]

**Captions within equity**
IFRS does not include requirements for the presentation of separate captions within equity, except that the following are included in OCI:
- foreign currency translation reserve (see chapter 2.7);
- asset revaluation reserve for property, plant and equipment and intangible assets (see chapters 3.2 and 3.3);
- cash flow hedging reserve (see chapter 7.7);
- remeasurement of available-for-sale financial assets (see chapter 7.6); and
- immediate recognition of actuarial gains and losses on defined benefit plans (see chapter 4.4). [IAS 1.7]

NCI are presented within equity separately from equity of the parent’s shareholders. [IAS 1.54, 106, IFRS 10.22]

**Dividends**
Dividends and other distributions to holders of equity instruments are recognised directly in equity. [IAS 32.35]

A liability for dividends is not recognised until the entity has an obligation to pay dividends, which is generally not until they are declared or approved, if approval is required (see chapter 2.9). [IAS 10.12]

Dividends on shares that are liabilities are recognised in profit or loss as a financing cost, even if the legal form of the payment is a dividend unless the dividends are discretionary. Financing costs on shares that are liabilities are determined using the effective interest method (see chapter 7.6). [IAS 32.35]

**Cost of an equity transaction**
Like IFRS, qualifying costs attributable to an equity transaction – e.g. issuing or buying back own equity instruments – are debited directly to equity. [S05-10-25-2]

Like IFRS, a listing of existing shares, a secondary offering and share splits do not result in additional proceeds or new equity instruments being issued; therefore, any costs associated with such transactions are expensed as they are incurred, like IFRS.

**Captions within equity**
Like IFRS, US GAAP does not include extensive requirements for the presentation of separate captions within equity, and differences from IFRS may arise in practice. The following are included in accumulated OCI:
- foreign currency translation adjustments (see chapter 2.7), like IFRS;
- cash flow hedging reserve (see chapter 7.7), like IFRS;
- unrealised gains and losses on available-for-sale securities (see chapter 7.6), like IFRS; and
- actuarial gains and losses on defined benefit plans, like IFRS (see chapter 4.4) and, unlike IFRS, prior service costs on defined benefit plans.

Unlike IFRS, assets such as property, plant and equipment and intangible assets are not revalued (see chapters 3.2 and 3.3).

Like IFRS, NCI are classified as equity but are presented separately from the parent’s equity. [S10-10-45-16]

**Dividends**
Like IFRS, dividends and other distributions to holders of equity instruments are recognised directly in equity.

Like IFRS, a liability for dividends is not recognised until the entity has an obligation to pay dividends, which is generally not until they are declared or approved, if approval is required (see chapter 2.9).

Like IFRS, dividends on shares that are classified as liabilities are recognised in profit or loss as a financing cost, even if the legal form of payment is a dividend. Like IFRS, financing costs on shares that meet the definition of a liability are determined using the effective interest method (see chapter 7.6).
Distributions of non-cash assets to owners

There is specific guidance in respect of non-reciprocal distributions to shareholders in which all shareholders of the same class are treated equally; however, the guidance does not apply to common control transactions (see chapter 5.13) or to distributions of part of the ownership interests in a subsidiary when control is retained (see chapter 2.5). [IFRIC 17:3–7]

Distributions in the scope of the guidance, including spin-offs and demergers (see chapter 2.5), are accounted for on a fair value basis and any gain, representing the excess of the fair value of the assets distributed over their book value, is recognised in profit or loss on the date of settlement. [IFRIC 17:14]

Distributions of non-cash assets to owners

Like IFRS, there is specific guidance in respect of non-reciprocal distributions to shareholders in which all shareholders of the same class are treated equally. Unlike IFRS, the guidance also applies to common control transactions (see chapter 5.13). Like IFRS, the guidance does not apply to distributions of part of the ownership interests in a subsidiary when control is retained (see chapter 2.5). [845-10-30-10 – 30-14]

Unlike IFRS, under US GAAP spin-offs are accounted for on the basis of book values (with no gain or loss recognised) when there is a pro rata distribution to owners. [810-10-40-5, 845-10-30-10 – 30-14]
7.4 Classification of financial assets and financial liabilities

Overview

- Financial assets are classified into one of four categories: at fair value through profit or loss; loans and receivables; held-to-maturity; or available-for-sale. Financial liabilities are categorised as either at fair value through profit or loss, or other liabilities. The categorisation determines whether and where any remeasurement to fair value is recognised.

- Financial assets and financial liabilities classified at fair value through profit or loss are further subcategorised as held-for-trading (which includes derivatives) or designated as at fair value through profit or loss on initial recognition.

- Items may not be reclassified into the fair value through profit or loss category after initial recognition.

- An entity may reclassify a non-derivative financial asset out of the held-for-trading category in certain circumstances if it is no longer held for the purpose of being sold or repurchased in the near term.

- Unlike IFRS, US GAAP does not have categories for all financial instruments. However, like IFRS, it does have the following categories for debt and marketable equity securities: held-for-trading, available-for-sale and held-to-maturity. Unlike IFRS, these categories do not include equity securities not quoted in an active market, which are measured at cost unless the fair value option is elected. Unlike IFRS, loans are either measured at amortised cost or classified as held-for-sale, which are measured at the lower of cost and fair value, unlike IFRS. Unlike IFRS, classification categories for financial liabilities are not prescribed. Like IFRS, categorisation determines whether and where any remeasurement to fair value is recognised.

- Like IFRS, certain financial assets and financial liabilities can be classified as held-for-trading or designated as at fair value through profit or loss. However, the eligibility criteria and financial assets and financial liabilities to which the fair value option can be applied differ from IFRS in certain respects.

- Unlike IFRS, securities may be reclassified into the trading category in certain rare circumstances.

- Like IFRS, an entity may reclassify a security out of the held-for-trading category but, unlike IFRS, such reclassification is linked to rare circumstances.
Overview (continued)

– An entity may also reclassify a non-derivative financial asset from the available-for-sale category to loans and receivables if certain conditions are met.

– Other reclassifications of non-derivative financial assets may be permitted or required if certain criteria are met.

– Reclassifications or sales of held-to-maturity assets may require other held-to-maturity assets to be reclassified as available-for-sale.

– This chapter includes only currently effective requirements (see About this publication).

Classification

All financial instruments – i.e. not just securities – are classified into one of the following categories on initial recognition:

– Financial assets or financial liabilities measured at fair value through profit or loss (the ‘fair value through profit or loss’ category);
– Held-to-maturity investments;
– Loans and receivables;
– Available-for-sale financial assets; or
– Other liabilities. [IAS 39.9, 45, 47]

Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost.

Overview (continued)

– Also like IFRS, an entity may reclassify a security out the available-for-sale category on a change in intent. Additionally, an entity may reclassify a loan out of the loans held-for-sale category in certain circumstances.

– Like IFRS, other reclassifications of non-derivative financial assets may be permitted or required, but the criteria may differ from IFRS in certain respects.

– Like IFRS, reclassifications or sales of held-to-maturity securities may require other held-to-maturity securities to be reclassified as available-for-sale.

– This chapter includes only currently effective requirements (see About this publication).

Classification

Unlike IFRS, the classification of financial instruments is not generally prescribed other than for investments in debt and marketable equity securities, which are classified as:

– Trading;
– Held-to-maturity; or
– Available-for-sale. [320-10-25-1, 948-310-35-1]

Loans are either measured at amortised cost, like IFRS, or classified as held-for-sale, unlike IFRS. Also unlike IFRS, debt securities not quoted in an active market cannot be measured at amortised cost unless they are classified as held-to-maturity. Unlike IFRS, non-marketable equity securities are measured at cost unless the fair value option is elected on initial recognition (see below).

Unlike IFRS, classification categories for financial liabilities are not prescribed. [405-10, 470-10]

Like IFRS, financial instruments can be designated at fair value through profit or loss (see below). [825-10-15-4]
There are no special requirements for financial institutions and other entities that engage in transactions that involve mortgage activities or transactions.

Financial instruments at fair value through profit or loss

The fair value through profit or loss category of financial instruments includes:
- financial assets or financial liabilities held for trading – i.e. any financial asset or financial liability acquired or incurred to generate short-term profits, or that is part of a portfolio of financial instruments that are managed together for that purpose;
- all derivatives other than hedging instruments (see chapter 7.7);
- contingent consideration in a business combination classified as a financial liability;
- financial assets or financial liabilities that are designated by the entity on initial recognition as measured at fair value through profit or loss; and
- subsidiaries, associates and joint ventures of qualifying investment entities, except for subsidiaries that are not themselves investment entities and whose main purpose is to provide services that relate to the investment entity's investment activities. For a full discussion of the investment entity consolidation exception, see chapter 5.6. [IFRS 3.58, 10.31–32, IAS 39.9, IAS 28.18]

A financial asset or financial liability is classified as held-for-trading if it is:
- acquired or incurred principally for the purpose of selling or repurchasing it in the near term;
- on initial recognition, part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or
- a derivative, except for a derivative that is a designated and effective hedging instrument (see chapter 7.7). [IAS 39.9]

In addition to financial assets and financial liabilities held for trading, financial assets and financial liabilities in the scope of the financial instruments standard are classified in the fair value through profit or loss category if an entity chooses, on initial recognition, to designate such instruments as at fair value through profit or loss using the fair value option. An entity may use this designation only:

Unlike IFRS, entities have a free choice to designate any of the following items on an instrument-by-instrument basis at fair value through profit or loss, on initial recognition or on a remeasurement event. Unlike IFRS, this is a free election with no other criteria needing to be met for most instruments. Items eligible to be designated at fair value through profit or loss include:
- financial institutions (including banks, credit unions, finance companies, mortgage companies and savings institutions) that engage in transactions that involve lending to or financing the activities of others; and
- entities that engage in transactions that involve mortgage activities or transactions. [948-310-35-1 – 3A]

Financial instruments at fair value through profit or loss

The following financial instruments are measured at fair value through profit or loss:
- securities classified as trading, which differ in certain respects from IFRS (see below);
- all derivatives other than derivatives that qualify as cash flow or net investment hedging instruments, which differs in certain respects from IFRS (see chapter 7.7);
- financial assets or financial liabilities that are designated under the fair value option, which differs in certain respects from IFRS (see below); and
- subsidiaries of investment entities that are exempt from consolidation are measured at fair value through profit or loss, which excludes subsidiaries whose purpose is to provide services to the investment company. For a full discussion of the investment company consolidation exception and the differences from IFRS, see chapter 5.6. [320-10-35-1, 815-10-35-1, 825-10-15-4, 946-320-35-1, 946-810-45-3]

A security is classified as a trading security if it is:
- a debt or marketable equity security bought and held principally for the purpose of selling in the near term. Because US GAAP has more guidance on the concept of 'near term', differences from IFRS may arise in practice; or
- a mortgage-backed security that is held for sale in conjunction with mortgage banking activities, which is unlike IFRS because IFRS has no specific requirements for mortgage-backed securities. [320-10-25-1, 948-310-40-1]
- if doing so results in more relevant information because either:
  - it eliminates or significantly reduces a measurement or recognition inconsistency that would result from measuring assets or liabilities or recognising gains or losses on them on different bases (an ‘accounting mismatch’); or
  - a group of financial assets or financial liabilities (or both) is managed and its performance is evaluated on a fair value basis in accordance with the entity’s documented risk management or investment strategy, and information is provided to key management personnel on this basis; or
- in respect of an entire hybrid contract, if the contract contains one or more embedded derivatives, unless those embedded derivatives either:
  - do not significantly modify the cash flows that would otherwise be required by the contract; or
  - are ones for which it is clear with little or no analysis when first considering a similar hybrid instrument that separation is prohibited. [IAS 39.9, 11A]

This designation is not reversible and may be made only on initial recognition. An entity can choose which, if any, of its financial assets and financial liabilities are to be designated into this category. [IAS 39.9, 11A, 50b, AG4C]

**Held-to-maturity investments**

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and a fixed maturity that an entity has the positive intention and ability to hold to maturity, other than:

- those that the entity on initial recognition designates as at fair value through profit or loss;
- those that the entity designates as available-for-sale; and
- those that meet the definition of loans and receivables. [IAS 39.9]

The intent and ability to hold the securities until maturity are assessed at each reporting date. [IAS 39.AG25]

- recognised financial assets or financial liabilities, including hybrid financial instruments if a derivative embedded in a hybrid instrument would otherwise require separation, except for investments in subsidiaries or variable interest entities that the entity is required to consolidate, obligations for certain employee benefits, assets and liabilities recognised under leases, demand deposit liabilities and financial instruments classified by the issuer as equity;
- firm commitments that would not otherwise be recognised at inception and that involve only financial instruments – e.g. a forward purchase contract for a loan that is not readily convertible to cash and therefore is not a derivative;
- written loan commitments;
- rights and obligations under an insurance contract issued by an insurance company that is not a financial instrument – because it requires or permits the insurer to provide goods or services rather than cash settlement – but whose terms permit the insurer to settle by paying a third party to provide those goods or services;
- rights and obligations under a warranty that is not a financial instrument but whose terms permit the warrantor to settle by paying a third party to provide the goods or services under the arrangement; and
- host financial instruments resulting from the separation of an embedded non-financial derivative instrument from a non-financial hybrid instrument. [825-10-15-4, 15-5]

Although some of the above items might be capable of being designated at fair value through profit or loss under IFRS, this would depend on whether the specific criteria under IFRS are met.

Like IFRS, the designation is not reversible. However, the designation can be made at initial recognition or on the occurrence of a remeasurement event, which may result in differences from IFRS. [825-10]
An entity is prohibited from classifying any financial assets as held-to-maturity if the entity has sold or reclassified more than an insignificant amount of held-to-maturity assets in the current or previous two financial years, other than:
- when the asset was sufficiently close to maturity or the asset’s call date that changes in market interest rates no longer had a significant effect on the asset’s fair value;
- sales that occur after the entity has collected substantially all of the investment’s original principal through scheduled payments or prepayments; or
- sales attributable to an isolated non-recurring event that is beyond the entity’s control and that it could not reasonably have anticipated. [IAS 39.9]

More specifically, sales in the following circumstances do not taint an entity’s ability to classify instruments as held-to-maturity:
- a significant deterioration in the issuer’s creditworthiness;
- a change in tax law that eliminates or significantly reduces the tax-exempt status of interest on the investment;
- a major business combination or major disposition that necessitates the sale or transfer of held-to-maturity investments to maintain the entity’s existing interest rate risk position or credit risk policy;
- a change in statutory or regulatory requirements that significantly modifies what is a permissible investment or the maximum holdings of certain investments;
- a significant increase in the industry’s regulatory capital requirements that causes the entity to downsize by selling held-to-maturity investments; and
- a significant increase in the risk weights of held-to-maturity investments used for regulatory risk-based capital purposes. [IAS 39.AG22]

Sales for other reasons ‘taint’ the entity’s ability to classify any instruments as held-to-maturity. [IAS 39.9]

If a sale or reclassification of a held-to-maturity investment results in tainting, then all existing held-to-maturity investments are reclassified as available-for-sale for the current and next two complete financial years. [IAS 39.9]

The prohibition on classifying securities as held-to-maturity is like IFRS, except that US GAAP does not provide a specific time horizon over which the prohibition lasts. For listed entities, however, the SEC Staff has indicated that the time horizon should be at least two financial years. Sales of debt securities meeting either of the following conditions are considered maturities and do not ‘taint’ the entity’s ability to classify securities as held-to-maturity:
- when the security was sold sufficiently close to maturity or the security’s call date that changes in market interest rates no longer had a significant effect on the security’s fair value, like IFRS;
- sales that occur after collecting a substantial portion of the principal, which differs from IFRS in certain respects; or
- sales attributable to an isolated non-recurring event that is unusual for the entity and that it could not reasonably have anticipated, which differs in certain respects from IFRS. [320-10-25-9, 25-14]

Additionally, sales in the following circumstances do not taint an entity’s ability to classify securities as held-to-maturity:
- evidence of significant deterioration in the issuer’s creditworthiness, like IFRS;
- a change in tax law that eliminates or reduces the tax-exempt status of interest on the security, like IFRS;
- a major business combination or major disposition that necessitates the sale or transfer of held-to-maturity securities to maintain the entity’s existing interest rate risk position or credit risk policy, like IFRS;
- a change in statutory or regulatory requirements that significantly modifies what is a permissible investment or the maximum holdings of certain investments thereby causing an entity to dispose of a held-to-maturity security, like IFRS;
- a significant increase by the regulator in the industry’s capital requirements that causes the entity to downsize by selling held-to-maturity securities, like IFRS; and
- a significant increase in the risk weights of debt securities used for regulatory risk-based capital purposes, like IFRS. [320-10-25-6]

Like IFRS, sales for other reasons ‘taint’ the entity’s ability to classify any securities as held-to-maturity. [320-10-25-9]

Like IFRS, if a sale or reclassification of a held-to-maturity investment results in tainting, then all existing held-to-maturity investments are reclassified as available-for-sale until the entity is able to re-establish a positive intent and ability to hold securities to maturity. Unlike IFRS, US GAAP does not specify how long the tainting lasts. For listed entities, however, the SEC Staff has indicated that the period should be at least two financial years. [320-10-35-7]
Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those:
– that the entity intends to sell immediately or in the near term, which are classified as held-for-trading;
– that the entity on initial recognition designates as at fair value through profit or loss (see above);
– that the entity on initial recognition designates as available-for-sale; or
– for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which are classified as available-for-sale. [IAS 39.9]

This category includes purchased loans and receivables, and may include debt securities that are not quoted in an active market. [IAS 39.9, BC28]

The classification of financial instruments as loans and receivables is not appropriate if an entity intends to sell the instruments immediately or in the near term. [IAS 39.9]

Available-for-sale financial assets
Any financial asset that does not fall, or is not classified into, any of the previous three categories is classified as available-for-sale. [IAS 39.9]

A financial asset that the entity intends to hold to maturity, or a loan or receivable, may also be designated as available-for-sale on initial recognition. [IAS 39.9]

Other liabilities
Other liabilities constitute the residual category similar to the available-for-sale category of financial assets. All liabilities other than trading liabilities, liabilities designated as at fair value through profit or loss, and derivatives that are hedging instruments fall automatically into this category. [IAS 39.9]

Loans
There is no category of loans and receivables, unlike IFRS. Loans are accounted for either at amortised cost or classified as held-for-sale, in which case they are measured at the lower of cost and fair value. Unlike IFRS, loans cannot be classified as trading or available-for-sale because they do not meet the definition of a security (see chapter 7.1). However, entities can make an irrevocable election on initial recognition to measure loans at fair value through profit or loss (see below), like IFRS. [310-10-20]

Like IFRS, loans include purchased loans. [310-20-25]

Loans that the entity intends to sell immediately or in the near term are classified as loans held-for-sale, unlike IFRS. Loans held-for-sale are measured at the lower of cost and fair value, unlike IFRS. [310-20-15-4]

Available-for-sale securities
Unlike IFRS, the available-for-sale category is available only for investments in debt securities that are not classified as trading or held-to-maturity (see above), and equity securities that are marketable and that are not classified as trading. These restrictions permit fewer financial assets to be classified in the available-for-sale category than IFRS. [320-10-25-1]

Like IFRS, a debt security that the entity intends to hold to maturity may be designated as available-for-sale on initial recognition. Unlike IFRS, a loan or receivable cannot be classified as available-for-sale because it is not a security. Also unlike IFRS, non-marketable equity securities may not be classified as available-for-sale. [320-10-25-1, 310-10]

Other liabilities
Unlike IFRS, a classification category for financial liabilities is not prescribed, and differences from IFRS may arise. [405-10, 470-10]
Reclassifications of financial assets

The reclassification requirements related to financial assets are as follows.

- An entity may reclassify a financial asset that meets the definition of loans and receivables out of the held-for-trading category if it is no longer held for the purpose of being sold or repurchased in the near term and the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

- An entity may reclassify other non-derivative financial assets out of the held-for-trading category if they are no longer held for the purpose of being sold or repurchased in the near term in rare circumstances.

- An entity may not reclassify any financial asset into the held-for-trading category.

- An entity may not reclassify any financial asset into or from the designated as fair value through profit or loss category.

- An entity may reclassify a financial asset that meets the definition of loans and receivables out of the available-for-sale category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

- An entity may reclassify out of the available-for-sale category:
  - to the held-to-maturity category as a result of a change in intention or ability or because the two preceding financial years after a tainting event have elapsed; or
  - to financial instruments measured at cost in the rare circumstances that a reliable measure of fair value for certain unquoted equity instruments is no longer available. [IAS 39:50, 50B, 50D-50E, 54, BC104D]

Unlike IFRS, non-marketable equity securities may not be classified as available-for-sale. [320-10-25-1]
7.5 Recognition and derecognition

Overview

- Financial assets and financial liabilities, including derivative instruments, are recognised in the statement of financial position at trade date. However, ‘regular-way’ purchases and sales of financial assets are recognised either at trade date or at settlement date.

- A financial asset is derecognised only when the contractual rights to the cash flows from the financial asset expire or when the financial asset is transferred and the transfer meets certain conditions.

- A financial asset is ‘transferred’ if an entity transfers the contractual rights to receive the cash flows from the financial asset or enters into a qualifying ‘pass-through’ arrangement. If a financial asset is transferred, then an entity evaluates whether it has retained the risks and rewards of ownership of the transferred financial asset.

- An entity derecognises a transferred financial asset if it has: transferred substantially all of the risks and rewards of ownership, or neither retained nor transferred substantially all of the risks and rewards of ownership nor retained control of the financial asset.

- An entity continues to recognise a financial asset to the extent of its continuing involvement if it has neither retained nor transferred substantially all of the risks and rewards of ownership and it has retained control of the financial asset.

(IA S 39, IFRIC 19)

Overview

- Like IFRS, financial assets and financial liabilities, including derivative instruments, are recognised in the statement of financial position at trade date. However, unlike IFRS, certain industries are required to use trade date accounting for ‘regular-way’ transactions; otherwise, US GAAP is silent and practice varies.

- Unlike IFRS, the derecognition model for transfers of financial assets focuses on surrendering control over the transferred assets; the transferor has ‘surrendered’ control over transferred assets only if certain conditions are met.

- Unlike IFRS, a financial asset is ‘transferred’ when it has been conveyed by and to someone other than its issuer.

- Unlike IFRS, ‘risks and rewards’ is not an explicit consideration when testing a transfer for derecognition. Rather, an entity derecognises a transferred financial asset or a participating interest therein if it surrenders legal, actual and effective control of the financial asset or participating interest; otherwise, it continues to recognise the asset.

- After a transfer of a financial asset, or a participating interest therein, an entity continues to recognise the financial assets that it controls, which may be different from the treatment required by IFRS.

(Subtopic 405-20, Subtopic 470-50 and 60, Topic 860-10, 20, 30 and 50, Subtopic 940-320, Subtopic 942-325, Subtopic 946-320)
Overview (continued)

– A financial liability is derecognised when it is extinguished or when its terms are substantially modified.

– This chapter includes only currently effective requirements (see About this publication).

Initial recognition
Financial instruments are recognised when an entity becomes party to the contractual terms of the instrument. [IAS 39.14]

The purchase or sale of a non-derivative financial asset that will be delivered in a ‘regular-way’ transaction may be recognised either on trade date or settlement date. The method adopted is applied consistently to all purchases and all sales of financial assets in the same category. [IAS 39.38, AG53–AG56]

Derecognition of financial assets
Derecognition criteria
An entity first consolidates all subsidiaries as required under IFRS (see chapter 2.5) and then applies the derecognition principles to the resulting group. [IAS 39.15]

The derecognition analysis can be applied to:
– a financial asset or a group of similar financial assets; or
– part of a financial asset or a group of financial assets. [IAS 39.16]

The derecognition analysis is applied to a part of a financial asset or a group of similar financial assets only if that part comprises either:
– specifically identified cash flows arising from a financial asset (or a group of similar financial assets);
– a fully proportionate share of the cash flows, arising from a financial asset (or a group of similar financial assets); or
– a fully proportionate share of specifically identified cash flows, arising from a financial asset (or a group of similar financial assets). [IAS 39.16(a)]

Like IFRS, a financial liability is derecognised when it is extinguished or when its terms are substantially modified. However, unlike IFRS, there is specific guidance on the modification of terms in respect of convertible debt and troubled debt restructuring.

This chapter includes only currently effective requirements (see About this publication).

Initial recognition
Like IFRS, initial recognition of a financial instrument occurs when an entity becomes party to the contractual terms of that instrument.

Unlike IFRS, certain industries are required to use trade date accounting for ‘regular-way’ transactions. Otherwise, US GAAP is silent and practice varies. Like IFRS, the method selected is applied consistently to purchases and sales of financial assets in the same category. [940-320-25-1, 942-325-25-2, 946-320-25-1]

Derecognition of financial assets
Derecognition criteria
An entity first consolidates all subsidiaries as required (see chapter 2.5) and then applies the derecognition principles to the resulting group, like IFRS. However, there are differences in the consolidation requirements between IFRS and US GAAP (see chapter 2.5). [860-10-40-4]

The derecognition analysis can be applied to:
– a financial asset or a group of similar financial assets, like IFRS; or
– participating interests, unlike IFRS. [860-10-40-4D]

Unlike IFRS, transferring a part of a financial asset that does not meet the definition of a participating interest does not qualify for derecognition. A ‘participating interest’ generally is a portion of a financial asset that (1) conveys proportionate ownership rights with equal priority (including in the event of bankruptcy) to each participating interest holder; (2) involves no recourse (other than standard representations and warranties) to the transferor or any participating interest holder; (3) does not entitle any participating interest holder to receive cash before any other participating interest holder; and (4) prohibits any party from pledging or exchanging the entire financial asset without the approval of all participating interest holders. [860-10-40-6A]
In all other cases, the derecognition assessment applies to a financial asset in its entirety, or to the group of similar financial assets in its entirety. [IAS 39.16(b)]

An entity derecognises a financial asset when the contractual rights to the cash flows from that asset expire or when the entity transfers a financial asset and the transfer qualifies for derecognition. [IAS 39.17]

**Evaluating whether there is a transfer**

An entity is considered to have transferred a financial asset, or a part thereof, if the entity:
- transfers its contractual rights to receive the cash flows from the asset; or
- retains the contractual rights to receive the cash flows, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets certain criteria. [IAS 39.18]

**Pass-through arrangements**

If an entity retains the contractual right to the cash flows of a financial asset, but also assumes a contractual obligation to pay the cash flows to the transferee (sometimes called a ‘pass-through arrangement’), then the transaction is considered a transfer if and only if:
- there is no obligation to pay amounts to the transferee unless the entity collects equivalent amounts from the original asset;
- the entity is prohibited from selling or pledging the original asset under the terms of the pass-through arrangement; and
- the entity is obliged to remit all of the cash flows that it collects without material delay. [IAS 39.19]

**Risks and rewards evaluation**

For all transactions that meet the transfer requirements, the entity next evaluates the extent to which it has transferred or retained the risks and rewards of ownership of the financial asset.
- If the entity retains substantially all of the risks and rewards of ownership of the financial asset, then it continues to recognise the financial asset.
- If the entity transfers substantially all of the risks and rewards of ownership, then it derecognises the financial asset.
- If the entity neither transfers nor retains substantially all of the risks and rewards of ownership, then it determines whether it has retained control of the financial asset (see below). [IAS 39.20]

In all cases that do not constitute a participating interest, the derecognition assessment applies to a financial asset in its entirety, or to the group of similar financial assets in its entirety, like IFRS. [860-10-40-4E]

Unlike IFRS, a ‘transfer’ of financial assets, or a participating interest, in which the transferor surrenders control over the assets (‘financial components approach’) is accounted for as a sale (i.e. derecognition). [860-20-40-1A – 40-1B]

**Evaluating whether there is a transfer**

Unlike IFRS, a ‘transfer’ is the conveyance of a non-cash financial asset by and to someone other than the issuer of that financial asset. Therefore, a transfer includes selling a receivable, putting a receivable into a securitisation trust or posting it as collateral, but excludes the origination of a receivable, the settlement of a receivable or the restructuring of a receivable into a security in a troubled debt restructuring. [860-10-20]

**Pass-through arrangements**

Unlike IFRS, there is no pass-through derecognition test. Items would not qualify for derecognition under US GAAP unless they met the criteria described below for derecognising a transferred financial asset.

**Risks and rewards evaluation**

Unlike IFRS, ‘risks and rewards’ is not an explicit consideration when testing a transfer for derecognition. Unlike IFRS, transferred financial assets or participating interests are derecognised when the transferor surrenders control over those assets. The transferor has ‘surrendered’ control over transferred assets only if all of the following conditions are met.
- **Legal control:** The transferred asset is isolated from the transferor – i.e. put legally beyond the reach of the transferor, including its consolidated affiliates and its creditors, even in the event of the transferor’s bankruptcy or receivership.
Control evaluation

If an entity neither transfers nor retains substantially all of the risks and rewards of ownership of a financial asset, then it evaluates whether it has retained control of the financial asset. If the entity does not retain control, then it derecognises the financial asset. [IAS 39.20(c)]

An entity is considered to have lost control if the transferee has the practical ability unilaterally to sell the transferred financial asset in its entirety to an unrelated party without needing to impose additional restrictions on the sale. [IAS 39.23]

Continuing involvement

If an entity retains control of a financial asset for which some but not substantially all of the risks and rewards have been transferred, then the entity continues to recognise the financial asset to the extent of its continuing involvement in the financial asset. [IAS 39.20(c)(iii)]

Actual control: (1) The transferee (or, if the transferee is an entity whose sole purpose is to engage in securitisation or asset-backed financing activities and that entity is constrained from pledging or exchanging the assets that it receives, each third party holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interests) that it received, and (2) no condition both (i) constrains the transferee (or each third party holder of its beneficial interests) from taking advantage of its right to pledge or exchange and (ii) provides more than a trivial benefit to the transferor.

Effective control: Neither the transferor nor its consolidated affiliates included in the financial statements being presented or its agents maintains effective control over the transferred financial assets or third party beneficial interests related to those transferred assets. Examples include, but are not limited to: (1) an agreement that both entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity; (2) an agreement that provides the transferor with both the unilateral ability to cause the holder to return specific financial assets and a more-than-trivial benefit attributable to that ability, other than through a clean-up call; or (3) an agreement that permits the transferee to require the transferor to repurchase the transferred financial assets at a price that is so favourable to the transferee that it is probable that the transferee will require the transferor to repurchase them. [860-10-40-4D – 40-5]

Control evaluation

Unlike IFRS, control is always the focus of derecognition tests, rather than being considered only if an entity neither transfers nor retains substantially all of the risks and rewards of ownership. Derecogntion is based on whether legal, actual and effective control as described above has been surrendered. [860-10-40-5]

Unlike IFRS, derecognition is based on whether legal, actual and effective control as described above have been surrendered. [860-10-40-5]

Continuing involvement

As described above, unlike IFRS, continuing involvement is not an explicit consideration when testing a transfer for derecognition, but rather derecognition is based on whether legal, actual and effective control have been surrendered. However, after a transfer of financial assets or participating interests, an entity continues to recognise the financial and servicing assets that it controls and derecognises the financial assets or participating interest for which control has been surrendered. [860-20-40-1A – 40-1B]
Accounting for a sale

Transfers that qualify for derecognition

If only part of a financial asset qualifies to be derecognised, then the carrying amount of the entire financial asset before the transfer is allocated between the sold and retained portions based on their relative fair values on the date of transfer. [IAS 39.27]

Sometimes new financial assets, financial liabilities or servicing liabilities are created in the transfer – e.g. a credit guarantee. New financial assets or financial liabilities created as a result of the transfer are recognised separately and measured at fair value. Servicing assets and servicing liabilities are not considered financial instruments. [IAS 39.24–25]

If an entity transfers a financial asset that qualifies for derecognition in its entirety and retains the right to service the financial asset for a fee, then it recognises either:
– a servicing liability, at fair value, if the fee does not adequately compensate the entity for performing the servicing; or
– a servicing asset, calculated as an allocation of the carrying amount of the entire financial asset before the transfer between the sold and retained portions based on their relative fair values on the date of transfer, if the fee more than adequately compensates the entity for performing the servicing. [IAS 39.24]

In a transfer of a financial asset or a part thereof that qualifies for derecognition, a gain or loss is recognised based on the difference between (1) the carrying amount of the financial asset or the carrying amount allocated to the part derecognised; and (2) the sum of the proceeds received for the asset or the part derecognised, including the fair value of any new asset obtained less any new liability assumed, and the cumulative amount previously recognised in OCI in respect of the derecognised financial asset or part thereof. [IAS 39.25–27]

There is no specific guidance on the subsequent measurement of servicing assets and servicing liabilities and they are subsequently measured in accordance with other applicable IFRSs.

Transfers that do not qualify for derecognition

If a transfer does not qualify for derecognition, then the financial asset or the retained portion of the financial asset remains in the statement of financial position and a corresponding financial liability is recognised for any consideration received. [IAS 39.29, A447]

Accounting for a sale

Transfers that qualify for derecognition

Like IFRS, if a transfer of a participating interest qualifies as a sale, then the carrying amount of the transferred asset before the transfer is allocated between the sold and retained participating interests based on their relative fair values on the date of transfer. [860-20-40-1a(a)]

In general, if new financial assets, financial liabilities or servicing liabilities are created in the transfer, then they are recognised separately and measured at fair value, like IFRS. Like IFRS, servicing assets and servicing liabilities are not considered financial instruments. [860-20-40-1ac]

If an entity transfers a financial asset that qualifies for derecognition in its entirety and retains the right to service the financial asset for a fee, then the entity should recognise either:
– a servicing liability, at fair value, if the fee does not adequately compensate the entity for performing the servicing, like IFRS; or
– a servicing asset, if the fee more than adequately compensates the entity for performing the servicing, like IFRS; however, the servicing asset is recognised at fair value, unlike IFRS. [860-50-25-1, 860-50-30-1, 30-2]

Like IFRS, in a transfer of an entire financial asset or a participating interest, a gain or loss is recognised based on the difference between (1) the carrying amount of the financial asset or the carrying amount allocated to the part derecognised; and (2) the sum of the proceeds received for the asset or the participating interest derecognised, including the fair value of any new asset obtained less any new liability assumed, and the cumulative amount previously recognised in OCI in respect of the derecognised financial asset or part thereof. [860-20-40-18, 860-20-55-43 – 55-59]

Unlike IFRS, an entity has an accounting policy election to measure servicing assets and liabilities subsequently either at fair value through profit or loss or by amortising the servicing asset or liability in proportion to and over the period of estimated net servicing income or loss. [860-50-35-1]

Transfers that do not qualify for derecognition

Like IFRS, if a transfer does not qualify for derecognition, then the asset or the participating interest retained remains in the statement of financial position and a corresponding financial liability is recognised for any consideration received. [860-30-25]
If a transfer of a financial asset does not qualify for derecognition, then the transferee does not recognise the transferred asset as its asset in its statement of financial position. Instead, the transferee derecognises the cash or other consideration paid and recognises a receivable from the transferor. [IAS 39.AG50]

**Securitisations**

In a securitisation, the transferring entity securitises financial assets in return for cash proceeds. If financial instruments are securitised using a structured entity (see chapter 2.5) that is consolidated, then the transaction to evaluate for derecognition at the group level is the transfer of financial assets by the group, including the structured entity, to the investors in the securities issued by the structured entity. If the structured entity is not consolidated, then the transaction to evaluate for derecognition at the group level is the transfer of financial assets by the group, excluding the structured entity, to the structured entity. [IAS 39.15]

**Repurchase agreements and securities lending**

If a sale of a financial asset is subject to a repurchase agreement at a fixed price, or at the initial selling price plus interest, or if the asset is lent to a third party who agrees to return it, then the seller does not derecognise the asset, although it may reclassify it in the statement of financial position. [IAS 39.37(a), AG51(a)]

**Derecognition of financial liabilities**

A financial liability is derecognised when it is extinguished – i.e. it is discharged or cancelled or expires. This may happen when:
- payment is made to the lender;
- the borrower is legally released from primary responsibility for the financial liability; or
- there is an exchange of debt instruments with substantially different terms or a substantial modification of the terms of an existing financial liability.

[IAS 39.39–40, AG57, AG62]

If a financial liability is restructured or refinanced and the terms have been substantially modified, then the transaction is accounted for as an extinguishment of the old debt, with a gain or loss recognised in profit or loss. Any costs or fees incurred are recognised immediately in profit or loss on extinguishment. The gain or loss includes unamortised debt issue costs associated with the extinguished debt as well as fees paid to or received from the creditor and third parties. The new debt is recognised at fair value. [IAS 39.40–41, AG62]

Like IFRS, if a transfer of a financial asset does not qualify for derecognition, then the transferee does not recognise the transferred asset as its asset in its statement of financial position. Instead, the transferee derecognises the cash or other consideration paid and recognises a receivable from the transferor. [860-30]

**Securitisations**

In a securitisation, the transferring entity transfers financial assets to a structure in return for cash proceeds. Like IFRS, an entity first evaluates all securitisation structures for consolidation under the consolidation Codification Topic, which differs from IFRS in certain respects (see chapter 2.5). Like IFRS, if the structure is consolidated, then the transaction to evaluate for derecognition at the group level is the transfer of financial assets by the group, including the structure, to the structure's beneficial interest holders. Like IFRS, if a structure is not consolidated, then the transaction to evaluate for derecognition at the group level is the transfer of the financial assets by the group, excluding the structure, to the structure. [860-10-40-4 – 40-5]

**Repurchase agreements and securities lending**

Like IFRS, if a sale of a financial asset is subject to a repurchase agreement at a fixed price, or at the initial selling price plus interest, or if the asset is lent to a third party who agrees to return it, then the seller does not generally derecognise the asset, although it might reclassify it in the statement of financial position. Unlike IFRS, specific guidance is applied to repurchase-to-maturity transactions and repurchase financings. [860-10-40-12, 40-4C, 40-24, 40-24A]

**Derecognition of financial liabilities**

Like IFRS, a financial liability is derecognised when it is extinguished. This may happen when:
- the debtor pays the creditor and is relieved of its obligation for the liability; or
- the debtor is legally released from being the primary obligor under the liability either judicially or by the creditor; or
- there is an exchange or modification that results in debt instruments with substantially different terms. [405-20-40-1, 470-50-40-6]

Like IFRS, if a liability is restructured or refinanced and the terms have been substantially modified, then the transaction is accounted for as an extinguishment of the old debt, with a gain or loss recognised in profit or loss. The gain or loss includes unamortised debt issue costs associated with the extinguished debt as well as fees paid to or received from the creditor, like IFRS. Like IFRS, the new debt is recognised at fair value but, unlike IFRS, fees paid to third parties are capitalised as debt issue costs. [470-50-40-6, 40-13, 40-17, 40-18]
If a liability is restructured or refinanced and the terms have not been substantially modified – i.e. not accounted for as an extinguishment – then any fees and costs incurred, and existing unamortised debt issue costs, are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified instruments by recomputing the effective interest rate. [IAS 39.AG62]

Terms are considered to have been ‘substantially modified’ if the net present value of the cash flows under the new terms, including any fees paid, net of any fees received, discounted using the original effective interest rate of the original liability differs by at least 10 percent from the present value of the remaining payments under the original terms. [IAS 39.AG62]

If the 10 percent limit is not breached – i.e. the difference in the present values of the cash flows is less than 10 percent – then in our view the entity should perform a qualitative assessment to determine whether the terms of the two instruments are substantially different.

When an intermediary (e.g. a bank) is involved in restructuring or refinancing existing debt securities of an entity, the entity needs to identify the role of an intermediary – i.e. whether it is acting as a principal or as an agent of the entity. This assessment depends on the terms of the arrangements and whether the intermediary is exposed to any risks which in our experience, includes consideration of whether an intermediary:

- independently initiates an exchange or modification of debt securities;
- commits its own funds for acquiring and placing debt securities and is subject to the risk of loss of those funds;
- is responsible for placing the modified debt securities of the issuer with new investors on a firmly committed basis (i.e. the intermediary is required to hold any debt securities that it is unable to sell to others) or on a best-efforts basis (i.e. the intermediary agrees to buy only those securities that it is able to sell to others);
- exposes itself to the risk of loss from acquiring, exchanging and selling debt securities; and
- receives only a pre-established fee or may derive variable gains based on the value of the securities issued by the issuer. [IAS 39.40, AG62]

There are no special requirements for the modification of convertible debt.

Like IFRS, if a liability is restructured or refinanced and the terms have not been substantially modified, then fees paid to or received from the creditor are capitalised and, along with existing unamortised debt issue costs, are amortised over the remaining term of the modified instrument by recomputing the effective interest rate. Fees paid to third parties are expensed as they are incurred, unlike IFRS. [470-50-40-17 – 40-18]

Like IFRS, terms are considered to have been ‘substantially modified’ if the net present value of the cash flows under the new terms, including any fees paid, net of any fees received, discounted using the original effective interest rate of the original liability differs by at least 10 percent from the present value of the remaining payments under the original terms. [470-50-40-10]

Unlike IFRS, the 10 percent quantitative test is applied as a bright line, except that when there is a change in the debt’s currency we believe that an accounting policy choice can be made to either apply the 10 percent test or conclude that the terms of the debt have been substantially modified. [470-50-40-12]

Like IFRS, when an intermediary (e.g. a bank) is involved in restructuring or refinancing existing debt securities of an entity, the entity needs to identify the role of an intermediary – i.e. whether it is acting as a principal or as an agent of the entity. Like IFRS, an evaluation of the facts and circumstances surrounding the involvement of a third-party intermediary should be performed. The following indicators should be considered in that evaluation:

- whether the intermediary’s role is restricted to placing or reacquiring debt for the debtor without placing its own funds at risk;
- in an arrangement where an intermediary places notes issued by the debtor, whether the placement is done on a firmly committed basis, which requires the intermediary to hold any debt that it is unable to sell to others, or whether the placement is done under a best-efforts agreement;
- whether the debtor directs the intermediary and the intermediary cannot independently initiate an exchange or modification of the debt instrument; and
- whether the only compensation derived by an intermediary from its arrangement with the debtor is limited to a pre-established fee, or the intermediary derives gains based on the value of the security issued by the debtor. [470-50-55-7]

Unlike IFRS, for convertible debt there are specific additional tests that require consideration of the addition or removal of a conversion option or the change in the value of the conversion option, which can also result in a conclusion that the terms have been substantially modified. [470-50-40-10 – 40-12]
There are no special requirements for troubled debt restructurings.

Unlike IFRS, there are specific requirements for troubled debt restructurings. A debtor recognises a gain on the restructuring of troubled debt if it has transferred assets or equity interests in full settlement of the obligation.

Unlike IFRS, if the debt has been restructured by modification of its terms, or by transferring assets or equity interests in partial settlement and modifying the remaining terms, then no gain is recognised unless the total undiscounted modified cash flows are less than the carrying amount of the debt. The effective interest rate is recalculated as the discount rate that equates the present value of the new future contractual cash flows (excluding contingent amounts) with the carrying amount of the debt.

Derecognition of derivatives

Derivatives that might change from being an asset to a liability or vice versa are derecognised only when they meet both the derecognition criteria for financial assets and the derecognition criteria for financial liabilities.

Unlike IFRS, derivatives are derecognised only when they are sold or expire.

Unlike IFRS, if the terms of a financial liability are amended such that the financial liability extinguished is recognised in profit or loss. [IFRIC 19.5-9]

If the terms of a financial liability are amended such that the financial liability extinguished is recognised in profit or loss. [IFRIC 19.5-9]

If the terms of a financial liability are amended such that the financial liability extinguished is recognised in profit or loss. [IFRIC 19.5-9]

The debtor in a debt-for-equity swap transaction that arises as a result of a renegotiation of the terms of a financial liability measures equity instruments issued to a creditor to extinguish all or part of a financial liability at the fair value of those equity instruments, unless that fair value cannot be reliably measured. In such case the equity instruments are measured with reference to the fair value of the financial liability extinguished. The difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued is recognised in profit or loss. 

Like IFRS, the debtor in a debt-for-equity swap transaction that arises as a result of a renegotiation of the terms of a financial liability measures equity instruments issued to a creditor to extinguish all or part of a financial liability at the fair value of those equity instruments, unless that fair value cannot be reliably measured. In such case the equity instruments are measured with reference to the fair value of the financial liability extinguished. The difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued is recognised in profit or loss.

Like IFRS, if the terms of a financial liability are amended such that the financial liability extinguished is measured with reference to the fair value of the equity instruments issued, the difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued is recognised in profit or loss.

If the terms of a financial liability are amended such that the financial liability extinguished is measured with reference to the fair value of the equity instruments issued, the difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued is recognised in profit or loss.

Like IFRS, if the terms of a financial liability are amended such that the financial liability extinguished is measured with reference to the fair value of the equity instruments issued, the difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued is recognised in profit or loss.

Derecognition of derivatives

Derivatives that might change from being an asset to a liability or vice versa are derecognised only when they meet both the derecognition criteria for financial assets and the derecognition criteria for financial liabilities.
Overview

All financial assets and financial liabilities are initially measured at fair value plus directly attributable transaction costs, except for financial instruments classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are subsequently measured at fair value, except for loans and receivables and held-to-maturity investments (which are measured at amortised cost) and investments in unlisted equity instruments (which are measured at cost in the rare event that fair value cannot be measured reliably).

Changes in the fair value of available-for-sale financial assets are recognised in OCI, except for foreign exchange gains and losses on available-for-sale monetary items and impairment losses, which are recognised in profit or loss. On derecognition, any gains or losses accumulated in OCI are reclassified to profit or loss.

Financial liabilities, other than those held for trading or designated at fair value through profit or loss, are generally measured at amortised cost subsequent to initial recognition.

Overview

Like IFRS, derivatives, securities classified as trading and instruments for which the fair value through profit or loss option has been elected are initially measured at fair value. Unlike IFRS, available-for-sale securities are initially measured at fair value with no inclusion of transaction costs. Unlike IFRS, other financial instruments are initially measured at cost.

Financial assets held for trading, financial assets for which the fair value option is elected and available-for-sale securities are subsequently measured at fair value, like IFRS. Unlike IFRS, loans held for sale are measured at the lower of cost and fair value. Investments in non-marketable equity instruments are recorded at cost, unlike IFRS.

Like IFRS, changes in the fair value of available-for-sale securities are recognised in OCI, except for impairment losses, which are recognised in profit or loss if, unlike IFRS, they are deemed to be ‘other than temporary’. However, unlike IFRS, the amount recognised in OCI includes foreign exchange gains and losses on all available-for-sale securities. Like IFRS, on derecognition any gains or losses accumulated in OCI are reclassified to profit or loss.

Like IFRS, financial liabilities that are not measured at fair value are generally measured at amortised cost subsequent to initial recognition.
Overview (continued)

– Changes in the fair value of financial assets and financial liabilities at fair value through profit or loss are recognised in profit or loss.

– All derivatives (including separated embedded derivatives) are measured at fair value.

– Interest income and interest expense are calculated under the effective interest method, based on estimated cash flows that consider all contractual terms of the financial instrument at the date on which the instrument is initially recognised or at the date of any modification.

– An entity assesses whether there is objective evidence of impairment of financial assets not measured at fair value through profit or loss. When there is objective evidence of impairment, any impairment loss is recognised in profit or loss.

– This chapter includes only currently effective requirements (see About this publication).

Measurement at initial recognition

All financial instruments are initially measured at fair value plus directly attributable transaction costs, except for instruments classified as at fair value through profit or loss. [IAS 39.43, AG64]

– Like IFRS, changes in the fair value of financial assets and financial liabilities at fair value through profit or loss are recognised in profit or loss.

– Like IFRS, all derivatives (including separated embedded derivatives) are measured at fair value.

– Like IFRS, interest income and interest expense are calculated under the effective interest method. However, the effective interest method is generally based on the contractual cash flows of the financial instrument, unlike IFRS, except for instruments that are credit-impaired when they are acquired, for which, like IFRS, interest income is based on estimated cash flows.

– Unlike IFRS, there is not a single overarching requirement for objective evidence of impairment in assessing the impairment of financial assets. Instead, different impairment models are applied to different categories of financial instruments. Unlike IFRS, an impairment loss on a security is recognised only if it is other than temporary, even if there is objective evidence that the security may be impaired. If the impairment is other than temporary, then any impairment loss is recognised in profit or loss, except in certain situations involving debt securities, in which case the impairment loss is split between profit or loss and OCI.

– This chapter includes only currently effective requirements (see About this publication).

Measurement at initial recognition

Derivatives, securities classified as trading and instruments for which the fair value through profit or loss option has been elected are initially measured at fair value, like IFRS. Unlike IFRS, available-for-sale securities are initially measured at fair value with generally no inclusion of transaction costs. Also unlike IFRS, most other financial instruments are initially measured at cost, which includes transaction costs. Investment companies include directly related transaction costs for financial instruments at fair value through profit or loss in the determination of cost on initial recognition, unlike IFRS. For financial liabilities the transaction costs are deducted from the carrying amount of that liability, like IFRS. [B15-10-30-1, 820-10-35-9 – 35-9C, 835-30-45-1A, 946-320-30-1, 320-10-25, 325-20-30-1]
Generally, gains and losses are not recognised on the initial recognition of a financial instrument. The exception is when a gain or loss on initial recognition is supported by comparison with a quoted price in an active market for the same instrument, or with a valuation technique whose variables include only data from observable markets. [IAS 39.43A, AG76–AG76A]

‘Transaction costs’ are incremental costs that would not have been incurred if the instrument had not been acquired or issued. In practice, few internal costs are likely to meet this requirement. The requirement is applied on an instrument-by-instrument basis. Transaction costs do not include the internal costs associated with developing a new investment product. [IAS 39.9, 43, AG13]

If part of the consideration given or received on initial recognition is for something in addition to the financial instrument, then the entity separately measures the fair value of the financial instrument. Any additional element is accounted for separately. For example, in the case of a long-term loan that carries no interest, the fair value of the loan can be measured as the present value of all cash receipts discounted using the current market interest rate for a similar financial instrument. [IAS 39.AG64]

For short-term receivables and payables with no stated interest rate, no interest is imputed when the impact of discounting would be immaterial. [IFRS 13.BC138A]

Eligible transaction costs
Transaction costs on financial instruments at fair value through profit or loss are charged immediately to profit or loss. [IAS 39.43, IG.E.1.1]

For other financial instruments, eligible transaction costs are included in the initial measurement of the instrument. Such transaction costs are therefore included in the measurement of interest income or expense. [IAS 39.9, 43]

Like IFRS, gains and losses are not generally recognised on the initial recognition of a financial instrument. However, unlike IFRS, an entity could demonstrate that fair value differs from the transaction price on initial recognition because either the entity is able to operate at a different point in the bid-ask spread for the instrument, the entity has access to and frequently transacts in a different reference market for the instrument or, like IFRS, there are observable market prices or valuation techniques that use only observable market inputs. Unlike IFRS, recognition of the difference between the transaction price and the entity’s estimate of fair value is not dependent on where in the fair value hierarchy the entity’s fair value measurement falls – i.e. Level 1, 2, or 3 (see chapter 2.4). [820-10-30]

Unlike IFRS, certain internal costs of originating loans that are related directly to specified activities performed by the lender are included in capitalised initial direct costs. [310-20-25-2 – 25-7, 470-20-30-31]

Unlike IFRS, there is no general requirement for transactions where part of the consideration given or received on initial recognition is for something in addition to the financial instrument. Like IFRS, the initial measurement of a low-interest or interest-free loan is based on the present value of the expected future cash flows, discounted using a market interest rate. However, unlike IFRS, the initial measurement guidance for a low-interest or interest-free loan does not apply to the customary lending activities of financial institutions. [310-10-30-2, 30-6]

Unlike IFRS, trade receivables and payables maturing in less than one year are not required to be discounted, regardless of materiality. [835-30-15-3al]

Eligible transaction costs
Like IFRS, transaction costs on financial instruments at fair value through profit or loss are charged immediately to profit or loss. [820-10-35-9 – 35-9C]

For available-for-sale assets, transaction costs are generally recognised in profit or loss, unlike IFRS. Like IFRS, for other financial instruments – i.e. those not measured at fair value through profit or loss and not classified as available-for-sale – transaction costs are included in the initial measurement of the instrument. Debt issue costs are deducted from the carrying amount, like IFRS. The amortisation of debt issuance costs is reported as interest expense, like IFRS. [820-10-35-9 – 35-9C, 470-20-30-31, 835-10-45-1A, 45-3]
The inclusion in the initial measurement of a financial instrument of internal transaction costs is not specifically addressed by IFRS. In our experience, few internal costs are likely to be eligible transaction costs. [IAS 39.AG13]

Any transaction costs that do not qualify for inclusion in the initial measurement of an instrument are expensed as they are incurred. [IAS 39.43]

Subsequent measurement
The following measurement requirements apply to all financial assets and financial liabilities. However, financial assets and financial liabilities that are designated as hedged items may require further adjustment in accordance with the hedge accounting requirements (see chapter 7.7). [IAS 39.46-47]

Fair value through profit or loss
Subsequent to initial recognition, financial instruments at fair value through profit or loss are measured at fair value and all changes in fair value, both realised and unrealised, are recognised immediately in profit or loss. [IAS 39.46, 47(a)]

Held-to-maturity investments
Subsequent to initial recognition, held-to-maturity investments are measured at amortised cost using the effective interest method (see below). [IAS 39.46(b)]

Loans and receivables
Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method (see below). [IAS 39.46(a)]

Unlike IFRS, certain internal costs directly attributable to the origination of a loan are capitalised as part of the cost of the loan. Such costs are costs directly related to specific activities performed by the lender for that loan, such as evaluating the prospective borrower’s financial condition; evaluating and recording guarantees, collateral and other security arrangements; negotiating loan terms; preparing and processing loan documents; and closing the transaction. Amounts capitalised include only that portion of the employer’s total compensation related to time spent performing these activities for that loan. Other costs – e.g. advertising, servicing of existing loans and supervision and administration – are not capitalised. [310-20-20, 310-20-25-1 – 25-7]

Like IFRS, any transaction costs that do not qualify for inclusion in the initial measurement of an instrument are expensed as they are incurred. [820-10-35-9 – 9C, 310-20-20, 310-20-25-1 – 25-7]

Subsequent measurement
The following measurement requirements apply to all financial assets and financial liabilities. However, like IFRS, financial assets and financial liabilities that are designated as hedged items may require further adjustment in accordance with the hedge accounting requirements (see chapter 7.7). As discussed in chapter 7.4, there are differences between IFRS and US GAAP regarding the items that may be included in the categories that follow.

Fair value through profit or loss
Like IFRS, subsequent to initial recognition, financial instruments at fair value through profit or loss are measured at fair value and all changes in fair value, both realised and unrealised, are recognised immediately in profit or loss. [320-10-35-1, 815-10-35-1, 825-10-35-4, 946-320-35-1]

Held-to-maturity securities
Like IFRS, subsequent to initial recognition, held-to-maturity securities are measured at amortised cost using the effective interest method. Although there are differences in the calculation of amortised cost between US GAAP and IFRS, in general we would not expect those differences to be significant for financial instruments typically classified into this category. [320-10-35-1, 835-30-35-2 – 35-3]

Loans
Like IFRS, subsequent to initial recognition, loans not held for sale and receivables are measured at amortised cost using the effective interest method (see below). However, there are differences from IFRS in the determination of amortised cost – e.g. in respect of transaction costs. Additionally, unlike IFRS, loans held for sale are measured at the lower of cost and fair value. [310-10-35-47 – 35-48, 948-310-35-1]
Available-for-sale financial assets
Subsequent to initial recognition, available-for-sale financial assets are measured at fair value. Gains and losses on remeasurement, except for impairment and foreign exchange gains and losses on monetary items, are recognised in OCI.

[IAS 39.46, 55(b), 67]

For available-for-sale debt instruments, interest is calculated using the effective interest method and is recognised in profit or loss (see below). [IAS 39.55(b)]

Amounts recognised in OCI are reclassified to profit or loss when the related asset is derecognised or impaired. For a partial disposal, a share of the fair value gains and losses recognised previously in OCI is reclassified from equity to profit or loss. [IAS 39.26–27, 55(b), 67]

Other financial liabilities
Subsequent to initial recognition, other financial liabilities are measured at amortised cost using the effective interest method (see below). However, there are specific measurement requirements for the following financial liabilities:

– financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition;
– financial guarantee contracts; and
– commitments to provide loans at below market rate. [IAS 39.47]

Available-for-sale securities
Like IFRS, subsequent to initial recognition, available-for-sale securities are measured at fair value. Also like IFRS, gains and losses on fair value remeasurement are recorded in OCI. However, unlike IFRS, foreign currency remeasurement gains and losses on all available-for-sale securities are recorded in OCI. [320-10-35-1, 35-38]

Like IFRS, for available-for-sale debt securities, interest is calculated using the effective interest method and is recognised in profit or loss. [320-10-35-38 – 35-43]

Like IFRS, amounts recognised in accumulated OCI are reclassified to profit or loss when the related asset is derecognised. However, unlike IFRS, an impairment does not always result in a reclassification of the related amounts in accumulated OCI. [320-40-35-34, 35-34D]

Other financial liabilities
Unlike IFRS, there is no ‘other financial liabilities’ category. However, like IFRS, subsequent to initial recognition, financial liabilities that are not measured at fair value through profit or loss are measured at amortised cost using the effective interest method (see below). However, there are specific measurement requirements for the following financial liabilities:

– mandatorily redeemable instruments, unlike IFRS;
– financial guarantee contracts, like IFRS;
– obligations to repurchase an issuer’s own equity shares, although the requirements differ from IFRS (see below); and
– certain obligations to issue a variable number of shares, unlike IFRS.


Unlike IFRS, there is no specific guidance for commitments to provide loans at below-market rates.

Additionally, there are differences from IFRS in the determination of cost for the purpose of applying amortised cost – e.g. in respect of transaction costs.

Fair value
Fair value is measured in accordance with the fair value measurement Codification Topic (see chapter 2.4).
Fair value exemption
Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, and derivatives that are linked to and must be settled by delivery of such quoted equity instruments, are not measured at fair value subsequent to initial recognition. Such instruments are measured at cost. [IAS 39.46]

Financial instruments denominated in a foreign currency
For monetary items denominated in a foreign currency and measured at amortised cost – e.g. held-to-maturity debt securities – interest is accrued using the effective interest method in the foreign currency, and translated using the average exchange rate. Gains and losses on remeasuring the investment into the functional currency are recognised in profit or loss (see chapter 2.7). [IAS 21.23(a), 28, 39.AG83, IG.E.3.4]

For the purpose of recognising foreign exchange differences, available-for-sale monetary items are treated as if they were measured at amortised cost in the foreign currency. Accordingly, the foreign exchange differences arising from changes in amortised cost are recognised in profit or loss and not in OCI. [IAS 21.23(a), 28, 39.AG83, IG.E.3.2, IG.E.3.4]

The functional currency (see chapter 2.7) fair value of a financial instrument is determined by multiplying the fair value in the foreign currency by the spot exchange rate at the reporting date. [IAS 21.23(a)]

Effective interest rate calculation
The ‘effective interest rate’ is the rate that exactly discounts the estimated stream of future cash payments or receipts, without consideration of future credit losses, over the expected life of the financial instrument or through to the next market-based repricing date, to the net carrying amount of the financial asset or financial liability on initial recognition. [IAS 18.30(a), 39.9, AG5–AG8]

The calculation of the effective interest rate takes into account the estimated cash flows, which consider all contractual terms of the financial instrument – e.g. prepayment, call and similar options – but without inclusion of future credit losses. In those rare cases when it is not possible to make a reliable estimate of the cash flows or the expected life of the financial instrument, or a group of financial instruments, the contractual cash flows over the full contractual term are used. [IAS 39.9]

Fair value exemption
Unlike IFRS, non-marketable equity securities are measured at cost subsequent to initial measurement, unless the fair value through profit or loss option is elected or the securities are required to be measured at fair value by specialised industry guidance – e.g. for investment companies and broker-dealers. [325-20-35, 320-946, 325-940]

Financial instruments denominated in a foreign currency
Like IFRS, for monetary items denominated in a foreign currency and measured at amortised cost – e.g. held-to-maturity debt securities – interest is accrued using the effective interest method in the foreign currency, and translated using the average exchange rate. Gains and losses on remeasuring the investment into the functional currency are recognised in profit or loss (see chapter 2.7), like IFRS. [830-20-35-1]

Unlike IFRS, the foreign exchange gains and losses on both available-for-sale debt and equity securities are recognised in OCI as part of the change in fair value of those instruments and not in profit or loss. [320-10-35-36]

Like IFRS, the functional currency (see chapter 2.7) fair value of a financial instrument is determined by multiplying the fair value in the foreign currency by the spot exchange rate at the reporting date. [830-20-30-1, 946-830-45-9]

Effective interest rate calculation
Like IFRS, the ‘effective interest rate’ is the rate that exactly discounts the estimated stream of future cash payments or receipts, without consideration of future credit losses, through to maturity or to the next market-based repricing date, to the net carrying amount of the financial asset or financial liability on initial recognition. [835-30-35-2 – 35-3]

Unlike IFRS, the calculation of the effective interest rate is generally based on contractual cash flows. However, for certain financial instruments (e.g. portfolio of loans receivable where prepayment is probable and reasonably estimated), if estimated cash flows differ from contractual cash flows (e.g. because of anticipated prepayments and such payments are probable and can be reasonably estimated, or loans that are credit-impaired at the time of acquisition), then the effective interest rate is based on expected rather than contractual cash flows, like IFRS. [310-20-35-17 – 35-33]
The calculation of the effective interest rate considers all contractual terms of an instrument, including any embedded derivatives (e.g. prepayment options) that are not separated (see chapter 72), all fees and points paid or received that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. Future credit losses are not taken into account. [IAS 39.9]

There are no general exemptions from the requirement to calculate the effective interest rate. However, interest is not required to be imputed when the impact of discounting would be immaterial. [IFRS 13.BC138A]

Changes in timing or amount of estimated cash flows (other than impairment)
If there is a change in the timing or amount of estimated future cash flows, then the carrying amount of the instrument (or group of instruments) is adjusted in the period of change to reflect the actual and/or revised estimated cash flows, with a corresponding gain or loss recognised in profit or loss. The revised carrying amount is generally recalculated by discounting the revised estimated future cash flows at the instrument’s original effective interest rate. [IAS 39.AGB]

Like IFRS, the effective interest rate of an instrument includes the principal amount adjusted by fees or costs and any purchase premium or discount. Like IFRS, the effective interest rate incorporates any embedded derivatives that are not separated. Also like IFRS, future credit losses are not taken into account. [310-20-35-17 – 35-33, 835-30-35-2 – 35-5]

Unlike IFRS, the effective interest rate calculation is not applicable in certain situations – e.g. receivables (payables) arising from transactions with customers (suppliers) in the normal course of business due within one year on normal trade terms; amounts that do not require repayment in the future, but instead will be applied to the purchase price of property, goods or services, such as deposit progress payments on construction contracts; and troubled debt that has been restructured. [470-60-35-5 – 35-10, 835-30-15-3]

Changes in timing or amount of estimated cash flows (other than impairment)
The accounting for changes in the estimated future cash flows of financial assets differs from IFRS because it does not generally result in the revised carrying amount being recalculated using the original effective interest rate. However, when an entity holds a large number of similar loans for which prepayments are probable and reasonably estimable, the entity may consider an estimate of future principal repayments in the calculation of the effective yield necessary to apply the effective interest method, like IFRS. Changes in estimated prepayments are accounted for by recalculating the effective yield to reflect actual payments to date and anticipated future payments, and adjusting the carrying amount through profit or loss to an amount that would have existed had the new effective yield been applied since the acquisition of the loans. For other financial assets, changes in estimated cash flows that do not result in impairment are generally accounted for prospectively using a revised effective interest rate, unlike IFRS. [310-20-35-17 – 35-33]
Modification of financial liabilities

If a modification of a financial liability results in its derecognition and recognition of a new financial liability (see chapter 7.5), then the effective interest rate of the new financial liability is calculated based on the revised terms at the date of modification. In this case, any costs or fees incurred are recognised as part of the gain or loss on extinguishment and do not adjust the carrying amount of the new liability. Accordingly, in our view no transaction costs are included in the initial measurement of the new liability unless it can be demonstrated incontrovertibly that they relate solely to the new liability instrument and in no way to the modification of the old liability. This would not usually be possible but might apply to taxes and registration fees payable on execution of the new liability instrument. If the exchange or modification is not accounted for as an extinguishment, then any costs and fees incurred, including existing unamortised debt issue costs, are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified instrument by recomputing the effective interest rate on the instrument. [IAS 39.41, AG62]

There are no special requirements in respect of troubled debt restructurings, and the above general principles apply.

Instruments acquired in a business combination

At the date of acquisition, the fair value of the instrument and the total cash flows expected over the remaining term of the instrument are used by the acquirer to calculate a new original effective interest rate for the instrument. The new original effective interest rate is used to determine interest income or expense in the consolidated financial statements of the acquirer but has no impact on the acquiree’s financial statements. [IAS 39.9, IFRS 3.18]

Modification of financial liabilities

If a modification of a financial liability results in its derecognition and recognition of a new financial liability (see chapter 7.5), then the effective interest rate of the new financial liability is generally calculated based on the revised terms at the date of the modification, like IFRS. In this case, unamortised debt issue costs and fees paid to or received from the creditor are included as part of the gain or loss on extinguishment and do not adjust the carrying amount of the new liability, like IFRS. However, fees paid to third parties are capitalised as debt issue costs associated with the new financial liability, unlike IFRS. Like IFRS, if the exchange or modification is not accounted for as an extinguishment, then fees paid to or received from the creditor are capitalised and, along with existing unamortised debt issue costs, are amortised based on the recomputed effective interest rate on the instrument. Fees paid to third parties are recognised in profit or loss, unlike IFRS. [470-50-40-17, 40-18]

As an exception to the above, and unlike IFRS, for a modification of a financial liability in a troubled debt restructuring, interest expense recognised by the debtor is based on the interest rate that would equate the present value of the remaining contractual cash flows to the carrying amount of the debt. This results in the use of a below-market rate. [470-60-35-1 – 35-12]

Instruments acquired in a business combination

Like IFRS, effective interest calculations on instruments acquired in a business combination reflect current market interest rates and are used to recognise interest income or expense in the consolidated financial statements of the acquirer. [805-20-25]

Hedged item in a fair value hedge

When hedge accounting is discontinued, or at any earlier date, the carrying amount of the instrument and the total payments to be made over the remaining term of the instrument are used to calculate a revised effective interest rate for the instrument. [IAS 39.92]

Hedged item in a fair value hedge

Like IFRS, when hedge accounting is discontinued, or at any earlier date, the carrying amount of the instrument and the total payments to be made over the remaining term of the instrument are used to calculate a revised effective interest rate for the instrument. [815-25-35-8, 35-9]
**Discounts, premiums and pre-acquisition interest**

Discounts and premiums are generally recognised over the expected life of the related instrument using the effective interest rate. The straight-line amortisation of discounts or premiums is not permitted. Interest that has accrued on an interest-bearing investment before it is acquired is not recognised as income. 

[IAS 18.32, 39.9, AG6]

**Impairment**

After an impairment loss has been recognised in profit or loss, interest income is recognised based on the rate used to discount the future cash flows when measuring the amount of the impairment loss. 

[IAS 39.AG93]

**Impairment of financial assets**

Recognising the impairment of financial assets is a two-step process. First, the entity assesses whether there is objective evidence that impairment exists for a financial asset or a group of financial assets. This assessment is done at least at each reporting date. If there is no objective evidence of impairment, then no further action is generally required. However, if there is objective evidence of impairment, then the entity calculates the amount of any impairment loss and recognises it in profit or loss in that reporting period.

[IAS 39.58]

A financial instrument is considered to be impaired and impairment losses are incurred only if objective evidence indicates that one or more events ('loss events') occurring after its initial recognition have an impact on the estimated future cash flows of that asset. 

[IAS 39.59–60]

**Discounts, premiums and pre-acquisition interest**

Like IFRS, discounts and premiums are recognised using the effective interest rate. However, unlike IFRS, the term over which discounts and premiums are recognised is generally the contractual term of the instrument. Like IFRS, the straight-line amortisation of discounts or premiums is not permitted. Interest that has accrued on an interest-bearing investment before it is acquired is not recognised as income, like IFRS.

[310-10.35-17 – 35-33, 835-30-35-2, 35-4]

**Impairment**

Like IFRS, after an impairment loss has been recognised in profit or loss, interest income is recognised based on the rate used to discount the future cash flows when measuring the amount of the impairment loss. However, unlike IFRS, entities are also permitted to recognise interest income on impaired loans using either the cost-recovery or the cash-basis method.

[310-10-35-39 – 35-43]

**Impairment of financial assets**

Unlike IFRS, there is not a single overarching requirement that there be objective evidence of impairment for assessing the impairment of financial assets. Rather, different impairment models are applied to different categories of financial instruments.

For loans not held for sale, an impairment exists when, based on current information and events, it is probable (likely) that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement, like IFRS. Unlike IFRS, debt securities classified as available-for-sale or held-to-maturity and equity securities classified as available-for-sale are impaired when the fair value of the investment is less than its amortised cost in the case of debt securities and cost in the case of equity securities. However, an impairment loss on these securities is recognised only when the impairment is considered other-than-temporary, unlike IFRS.

[310-10-35-2, 320-10.35-18 – 35-30]

An impairment loss on a debt security classified as available-for-sale or held-to-maturity is considered ‘other than temporary’ if the entity has an intention to sell the security, the entity determines that it is more likely than not that it will be required to sell the security before the recovery of the security’s amortised cost, or the security has a credit loss. A ‘credit loss’ is the difference between the amortised cost of the security and the present value of cash flows expected to be collected; the expected cash flows are discounted at the effective rate implicit in the security at the date of acquisition.

[320-10.35-33A – 35-33]
In addition to the general impairment considerations above, an equity instrument is impaired if there has been a significant or prolonged decline in the fair value of the equity instrument below its cost. There are no specific thresholds or bright lines in IFRS for making the assessment of what is ‘significant’ or ‘prolonged’. In our view, for equity securities that are quoted in an active market, the general concepts of significance and materiality should apply. We believe that:

- a decline in excess of 20 percent should generally be regarded as significant; and
- a decline in a quoted market price that persists for nine months should generally be considered to be ‘prolonged’; however, it may be appropriate to consider a shorter period. [IAS 39.61, IG.E.4.10, IU-07-09]

In our view, if a decline in the fair value of an equity instrument is significant or prolonged, then there is objective evidence of impairment and an impairment loss should be recognised, regardless of how long management intends to hold the investment.

A decline in the fair value of an investment in a debt instrument below its cost that results from an increase in market interest rates is not itself an indication of impairment. [IAS 39.59-60]

Impairment loss calculations

**Loans and receivables and held-to-maturity investments**

An ‘impairment loss’ for financial assets measured at amortised cost is the difference between the asset’s carrying amount and the present value of the estimated future cash flows discounted at the asset’s original effective interest rate, and is recognised in profit or loss in that reporting period. The ‘estimated future cash flows’ include only those credit losses that have been incurred at the time of the impairment loss calculation – i.e. an ‘incurred loss model’. Losses expected as a result of future events, no matter how likely, are not taken into account. [IAS 39.59, 63]

Unlike IFRS, a significant and prolonged decline in the fair value of an equity security below its cost may, but would not automatically, result in recognising an other-than-temporary impairment loss. Unlike IFRS, the decline in fair value has to be both significant and prolonged and, unlike IFRS, an entity also considers whether the decline is expected to recover and whether the entity has the intent and ability to hold the equity security to recovery (other-than-temporary assessment). The more severe the decline in value and the longer the security has been impaired, the more likely it is that the impairment is other than temporary. Like IFRS, there are no specific thresholds or bright lines in making the assessment of whether impairment is significant and prolonged. However, because this is a judgemental area, differences from IFRS may arise in practice. [320-10-599-1(a)]

Unlike IFRS, a decline in the fair value of an investment in a debt instrument below its cost that results from an increase in interest rates does result in an impairment loss if the decline is assessed to be other than temporary. [320-10-35-33f, 35-37]

**Impairment loss calculations**

**Loans and held-to-maturity securities**

Like IFRS, for loans individually assessed for impairment, an ‘impairment loss’ is the difference between the asset’s carrying amount and the present value of the estimated future cash flows discounted at the loan’s original effective interest rate. Unlike IFRS, an ‘other-than-temporary impairment loss’ on a held-to-maturity security is the difference between the asset’s carrying amount and its fair value. Also unlike IFRS, an other-than-temporary impairment loss on a debt security is recognised in profit or loss if the entity has an intention to sell the security or it is determined to be more likely than not that the entity will be required to sell the security before recovery of its amortised cost less any current-period credit loss. For other-than-temporarily impaired debt securities for which a credit loss exists and for which the entity has no intention to sell and has determined that it is not more likely than not that it will be required to sell the security before recovery, the impairment loss is presented partly in profit or loss (the credit loss portion) and partly in OCI (the non-credit loss portion), unlike IFRS. [310-10-35-20 – 35-30, 320-10-35-33A – 35-33I, 35-34A – 35-34D]


Available-for-sale financial assets
An impairment loss for an available-for-sale financial asset is measured as the difference between its cost/amortised cost and fair value. The cumulative loss that had been recognised in OCI is reclassified from equity to profit or loss. Furthermore, once an investment in equity instruments has been impaired, all subsequent losses are recognised in profit or loss until the asset is derecognised. [IAS 39.58, 67-69, IG E.4.9]

Hedged assets
The principles for hedge accounting do not override the recognition of impairment losses on the hedged item, under either the standard on the impairment of non-financial assets (see chapter 3.10) or the financial instruments standards. Therefore, if a hedged item is impaired, this impairment is recognised even if the risk that causes the impairment is being hedged and hedge accounting is being applied. However, the hedge accounting principles may require a gain on a hedging instrument used to hedge the risk that gave rise to the impairment to be recognised simultaneously in profit or loss and offset (partly) against the recognised impairment. [IAS 39.58]

In our view, for assessing whether a decline in fair value of an available-for-sale equity investment that is or was a hedged item in a fair value hedge is significant or prolonged, its cost should be adjusted for the effects of the hedge accounting.

Unlike IFRS, loans held for sale are recognised at the lower of cost and fair value on an asset-by-asset basis. Therefore, there is no need for a separate impairment loss to be recognised. [310-10-35-49, 948-310-35-1]

Available-for-sale securities
Like IFRS, an impairment loss for an available-for-sale security is measured as the difference between its cost/amortised cost and fair value. Unlike IFRS, the other-than-temporary impairment losses on debt securities are recognised in profit or loss if the entity has an intention to sell the security or it is determined to be ‘more likely than not’ that the entity will be required to sell the security before recovery of its amortised cost less any current-period credit loss. For other-than-temporarily impaired debt securities for which a credit loss exists and that the entity has no intention of selling and has determined that it is not more likely than not that it will be required to sell the security before recovery, the impairment loss is presented partly in profit or loss (the credit loss portion) and partly in OCI (the non-credit loss portion), unlike IFRS. The other-than-temporary impairment losses on equity securities are recognised in profit or loss for the difference between its cost and its fair value, like IFRS. Subsequently, additional losses are recognised in profit or loss only when an additional impairment is deemed to be other than temporary as described above, unlike IFRS. [320-10-35-33A – 35-33I]

Hedged assets
Like IFRS, a financial asset that has been designated as the hedged item in a fair value hedge remains subject to the impairment Codification Topics applicable to that item. Like IFRS, the assessment of impairment is performed based on the carrying amount of the asset after any adjustment as a result of applying fair value hedge accounting. When assessing impairment, the fair value or cash flows of the hedging derivative instrument do not affect the determination of whether the hedged item is impaired, like IFRS. However, the hedge accounting principles may require a gain on a hedging instrument used to hedge the risk that gave rise to the impairment to be recognised simultaneously in profit or loss and offset (partly) against the recognised impairment, like IFRS. [815-25-35-10]

Like IFRS, for assessing whether a decline in fair value of an available-for-sale equity investment that is or was a hedged item in a fair value hedge is significant or prolonged, its cost should be adjusted for the effects of the hedge accounting. [815-25-35-10]
Reversals of impairment losses

**Loans and receivables and held-to-maturity investments**

If, after an impairment loss has been recognised in respect of loans and receivables or held-to-maturity investments, the amount of any previous impairment loss decreases due to an event occurring subsequent to the loss recognition, then the previously recognised impairment loss is reversed through profit or loss. The reversal is limited to an amount that does not state the asset at more than what its amortised cost would have been in the absence of impairment. [IAS 39.65]

**Available-for-sale financial assets**

An impairment loss on an available-for-sale equity instrument may not be reversed through profit or loss. Any increase in the fair value of such an instrument after an impairment loss has been recognised is treated as a revaluation and is recognised in OCI. [IAS 39.69]

If, in a subsequent period, the fair value of an available-for-sale debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, then the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. [IAS 39.70]

**Collective impairment assessment**

For financial assets measured at amortised cost, an entity starts the impairment assessment by considering whether objective evidence of impairment exists individually for financial assets that are individually significant and individually or collectively for financial assets that are not individually significant. If an individually assessed financial asset has been reviewed and found not to be impaired, then it is included in a group of financial assets with similar credit characteristics and assessed collectively for impairment. If an asset is assessed individually for impairment and found to be impaired, then it is not included in a collective assessment for impairment. If an entity does not have a group of assets with similar credit characteristics, then the additional collective assessment is not performed. [IAS 39.64, AG87–AG88, IG. E.4.7]

Impairment is recognised in respect of losses that have been ‘incurred but not reported’ that are not yet identified on an individual basis. [IAS 39.AG87, AG89–AG90]

Reversals of impairment losses

**Loans not held for sale and held-to-maturity securities**

Like IFRS, if an impairment loss has been recognised through a valuation allowance in respect of loans, then any decrease in a previous impairment loss due to an event occurring subsequent to the loss recognition is reversed through profit or loss to the extent of the previously recognised impairment loss unless, unlike IFRS, an impairment loss has been recognised through a charge-off of the loan or receivable – because the charge-off establishes a new cost basis. Also unlike IFRS, once impairment is recognised through profit or loss on a held-to-maturity security, it may not be reversed subsequently because the impairment establishes a new cost basis. [310-10-35-37, 320-10-35-34E]

**Available-for-sale securities**

Like IFRS, an impairment loss on an available-for-sale equity instrument may not be reversed through profit or loss. Any increase in the fair value of such an instrument after an impairment loss has been recognised is treated as a revaluation and is recognised in OCI. [320-10-35-34]

Unlike IFRS, once an other-than-temporary impairment is recognised on an available-for-sale debt security, it is not subsequently reversed through profit or loss. Instead, unlike IFRS, increases in expected cash flows result in a prospective adjustment to the effective interest rate. Other changes in fair value are recognised in OCI. [320-10-35-35 – 35-43]

**Collective impairment assessment**

Like IFRS, similar groups of loans measured at amortised cost that are not individually significant may be assessed for impairment as part of a portfolio. Like IFRS, if an individually assessed financial asset has been reviewed and found not to be impaired, then it is included in a group of financial assets with similar credit characteristics and assessed collectively for impairment. Like IFRS, if an asset is assessed individually for impairment and found to be impaired, then it is not included in a collective assessment for impairment. Unlike IFRS, securities are not assessed for impairment collectively. [310-10-35-13, 35-15, 320-10-35-18]

Like IFRS, characteristics or risk factors are identified specifically to support an accrual for losses that have been incurred but that have not yet reached the point at which it is probable that amounts will not be collected on a specific individual loan. [310-10-35, 450-20]
Any impairment model used for measuring the impairment of financial assets accounted for at amortised cost incorporates the effect of the time value of money. The estimated future cash flows determined for assets assessed for impairment on a collective basis are discounted at a rate that approximates the original effective interest rate of the group of assets. A portfolio of similar assets will have a range of interest rates and therefore judgement is necessary to determine a discounting methodology appropriate to that portfolio, which may result in using the average effective yield if it is a homogeneous portfolio. [IAS 39.63, AG92]

In our view, a collective evaluation of impairment for available-for-sale financial assets is not required. In addition, in our view a portfolio approach to impairment is not appropriate for individual equity instruments, because the equity instruments of different issuers do not have similar risk characteristics, and therefore their equity price risk differs.

Interest income and expense
Interest income and expense are recognised using the effective interest method. [IAS 18.29, 30(a), 32, 39.9, AG5–AG8]

Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability should be recognised in profit or loss. Therefore, dividends on shares wholly classified as liabilities are reported in the statement of profit or loss and OCI using the effective interest method, as are any gains or losses arising on their early redemption or refinancing. Dividends paid on redemptions or refinancings of instruments wholly classified as equity are recognised directly in equity. [IAS 32.35]

For instruments classified as available-for-sale, interest is also recognised using the effective interest method and the gains and losses recognised in OCI are the difference between the amortised cost and fair value of an instrument. [IAS 39.55(b)]

Dividend income
Dividend income is recognised when the shareholder’s right to receive payment is established. In our view, the shareholder’s right to receive payment of dividends on quoted investments is normally established on the date when the security trades ex-dividend. In our view, for dividends on unquoted investments, the shareholder’s right to receive payment is normally established when the shareholders have approved the dividends. If shareholder approval is not required for a dividend distribution, then a right to receive payment is established when the payment of dividends is binding. [IAS 18.30]

Unlike IFRS, there is no specific guidance for determining the amount of the impairment for assets assessed on a collective basis. Therefore, although entities may use a methodology similar to IFRS, differences may arise in practice.

Securities are not assessed for impairment collectively, such as securities classified as available-for-sale. Like IFRS, a portfolio approach to impairment is not appropriate for individual equity securities, because equity securities of different issuers do not have similar risk characteristics, and therefore their equity price risk differs. [320-10-35]

Interest income and expense
Interest income and expense are generally recognised using the effective interest method, like IFRS. [835-30-35-2 – 35-3]

Like IFRS, interest, dividends, losses and gains are reported in a manner that is consistent with the classification of an item as a liability or as equity, although some items are classified differently (see chapter 73). Therefore, like IFRS, dividends on financial instruments classified as liabilities are reported in the statement of comprehensive income using the effective interest method, as are any gains or losses arising on early redemption or refinancing of an instrument classified as a liability. Like IFRS, dividends and gains or losses on items classified as equity are recognised directly in equity.

Like IFRS, for instruments classified as available-for-sale, interest is recognised using the effective interest method and the gains and losses recognised in OCI are the difference between the amortised cost and fair value of an instrument. [320-10-35-1, 35-4]

Dividend income
Like IFRS, dividend income is recognised when the shareholder’s right to receive payment is established. The shareholder’s right to receive dividends is generally established on the date the entity has an obligation to pay dividends, which is not normally until they are declared or approved.
Share dividends

In some cases, shareholders may receive or choose to receive dividends in the form of additional shares rather than cash. There is no specific guidance on the treatment of such dividends. In our view, dividend income should be recognised for the amount of the cash dividend alternative, because the substance of share dividends with a cash alternative is the payment of a cash dividend, with reinvestment of the cash in additional shares.

In other cases, an entity may receive bonus shares or other equity instruments on a pro rata basis with other ordinary shareholders, with no cash alternative. If all ordinary shareholders receive bonus shares or other equity instruments in proportion to their shareholdings, then the fair value of each shareholder’s interest should be unaffected by the bonus issue. In our view, in such circumstances dividends should not be recognised as revenue because it is not probable that there is an economic benefit associated with the transaction that will flow to the investor. [IU 01-10]

Fee income

The accounting treatment of fee income related to interest-bearing instruments depends on whether the fees are an integral part of the effective yield of the instrument. Financial services fees are classified as origination fees, commitment fees and syndication fees. [IAS 18.IE14, 39.AG64–AG65]

Fees that are an integral part of the effective yield of an instrument – e.g. origination or commitment fees, compensation from the borrower for transaction costs incurred by the lender or appraisal fees for evaluating collateral – are recognised as an adjustment to the effective interest rate of the instrument. However, if the financial instrument is measured at fair value through profit or loss, then the fees are recognised as revenue on initial recognition of the instrument. [IAS 18.IE14]

A syndication fee that meets specific conditions is recognised as revenue when the syndication has been completed. There are also specific requirements relating to commitment fees.

Financial services fees that are not an integral part of the effective yield of an instrument are generally recognised as services are provided or on the execution of a significant act (see chapter 4.2).

Share dividends

In some cases, shareholders may receive or choose to receive dividends in the form of additional shares rather than cash. Like IFRS, if the substance of share dividends with a cash alternative is the receipt of a cash dividend, then it is accounted for as such.

Unlike US GAAP, IFRS contains guidance on determining when bonus shares should be accounted for at fair value or in a manner consistent with a stock (share) split.

Like IFRS, loan origination fees and commitment fees and costs are recognised as an adjustment to the effective interest rate of the instrument over the life of the loan; however, the items included in this determination differ in some respects from IFRS. Like IFRS, such fees are recognised when the syndication is complete, unless a portion of the loan is retained and the yield on the retained portion is less than the average yield to other syndication participants; in which case a portion of the fee is deferred to produce a yield on the portion of the loan retained that is not less than the average yield held by syndication participants. [310-20-35-1 – 35-12]

Like IFRS, there are specific requirements relating to syndication and commitment fees. Like IFRS, such fees are recognised when the syndication is complete, unless a portion of the loan is retained and the yield on the retained portion is less than the average yield to other syndication participants; in which case a portion of the fee is deferred to produce a yield on the portion of the loan retained that is not less than the average yield held by syndication participants. [310-20-26-19 – 25-20]

Like IFRS, financial services fees that are not an integral part of the effective yield of an instrument are generally recognised as the services are provided or on the execution of a significant act (see chapter 4.2).
7.7 Hedge accounting (IAS 39, IFRIC 16)

Overview

- Hedge accounting allows an entity to selectively measure assets, liabilities and firm commitments on a basis different from that otherwise stipulated in IFRS, or to defer the recognition in profit or loss of gains or losses on derivatives.

- Hedge accounting is voluntary; however, it is permitted only if strict documentation and effectiveness requirements are met.

- There are three hedge accounting models: fair value hedges of fair value exposures; cash flow hedges of cash flow exposures; and net investment hedges of foreign currency exposures on net investments in foreign operations.

- Qualifying hedged items can be recognised assets or liabilities, unrecognised firm commitments, highly probable forecast transactions or net investments in foreign operations.

- In general, only derivative instruments entered into with an external party qualify as hedging instruments. However, for hedges of foreign exchange risk only, non-derivative financial instruments may qualify as hedging instruments.

7.7 Hedge accounting (Topic 815)

Overview

- Like IFRS, hedge accounting allows an entity to selectively measure assets, liabilities and firm commitments on a basis different from that otherwise stipulated, or to defer the recognition in profit or loss of gains or losses on derivatives.

- Like IFRS, hedge accounting is voluntary; however, it is permitted only if strict documentation and effectiveness requirements are met.

- Like IFRS, there are three hedge accounting models: fair value hedges of fair value exposures; cash flow hedges of cash flow exposures; and net investment hedges of foreign currency exposures on net investments in foreign operations. However, the requirements differ from IFRS in certain respects.

- Like IFRS, qualifying hedged items can be recognised assets or liabilities, unrecognised firm commitments, highly probable forecast transactions or net investments in foreign operations. Unlike IFRS, for a portfolio hedge of interest rate risk, designating a portion of a portfolio of financial assets or financial liabilities that share the risk being hedged is not allowed. In addition, the details differ in certain respects from IFRS. Also unlike IFRS, the hedged risk is restricted to the entire risk of changes in cash flows or fair value, benchmark interest rate risk, currency risk or counterparty credit risk for a financial hedged item and to the entire risk of changes in cash flows or fair value or currency risk for a non-financial hedged item.

- Like IFRS, in general only derivative instruments qualify as hedging instruments. Non-derivative financial instruments may qualify as hedging instruments of foreign exchange risk exposure in, but, unlike IFRS, only: hedges of a net investment in a foreign operation and hedges of unrecognised firm commitments. Unlike IFRS, intra-group derivatives can be used as hedging instruments in certain circumstances.
Overview (continued)

– The hedged risk should be one that could affect profit or loss.

– Effectiveness testing is conducted on both a prospective and a retrospective basis. For a hedge to be ‘effective’, changes in the fair value or cash flows of the hedged item attributable to the hedged risk should be offset by changes in the fair value or cash flows of the hedging instrument within a range of 80–125 percent.

– Hedge accounting is discontinued prospectively if: the hedged transaction is no longer highly probable; the hedging instrument expires or is sold, terminated or exercised; the hedged item is sold, settled or otherwise disposed of; the hedge is no longer highly effective; or the entity revokes the designation.

– This chapter includes only currently effective requirements (see About this publication).

Hedge accounting models

There are three hedge accounting models, and the type of model applied depends primarily on whether the hedged exposure is a fair value exposure, a cash flow exposure or a foreign currency exposure on a net investment in a foreign operation. [IAS 39.86]

Fair value hedges

A ‘fair value hedge’ is a hedge of changes in the fair value of a recognised asset or liability, an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. [IAS 39.86(a)]

A hedge of the foreign currency risk of a firm commitment may be accounted for as either a fair value hedge or a cash flow hedge. [IAS 39.87]

Overview (continued)

– Like IFRS, the hedged risk should be one that could affect profit or loss.

– Like IFRS, effectiveness testing is conducted on both a prospective and a retrospective basis. Unlike IFRS, the 80–125 percent range is not specified. However, this range is very commonly used in practice and the SEC Staff has indicated that this is an acceptable range. Unlike IFRS, hedging instruments meeting very restrictive criteria are accounted for as if they are perfectly effective without testing effectiveness.

– Like IFRS, hedge accounting is discontinued prospectively if: the hedged transaction is no longer probable; the hedging instrument expires or is sold, terminated or exercised; the hedged item is sold, settled or otherwise disposed of; the hedge is no longer highly effective; or the entity revokes the designation. However, the requirements differ in certain respects from IFRS.

– This chapter includes only currently effective requirements (see About this publication).

Hedge accounting models

Like IFRS, there are three hedge accounting models, and the type of hedge accounting model applied depends on whether the hedged exposure is a fair value exposure, a cash flow exposure or a foreign currency exposure on a net investment in a foreign operation. However, the requirements differ in certain respects from IFRS. [815-20-05-1 – 05-2]

Fair value hedges

Like IFRS, a ‘fair value hedge’ is a hedge of changes in the fair value of a recognised asset or liability, an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. However, because US GAAP has more guidance, particularly on the concept of a firm commitment, differences from IFRS may arise in practice. [815-20-20]

Like IFRS, a hedge of the foreign currency risk on a firm commitment may be accounted for as either a fair value hedge or a cash flow hedge. [815-20-25-12(f)(3), 25-150(i)]
If the hedging instrument is a derivative, then it is measured at fair value with changes in fair value recognised in profit or loss. The hedged item is remeasured to fair value in respect of the hedged risk, even if it is normally measured at amortised cost. Any resulting adjustment to the carrying amount of the hedged item related to the hedged risk is recognised in profit or loss, even if such a change would normally be recognised in OCI. [IAS 39.89]

For a hedge of a firm commitment, fair value hedge accounting results in the change in fair value of the firm commitment attributable to the hedged risk during the period of the hedging relationship being recognised as an asset or a liability in the statement of financial position. When the hedged transaction is recognised, the amount previously recognised in the statement of financial position adjusts the initial measurement of the underlying transaction (basis adjustment). [IAS 39.93–94]

**Cash flow hedges**

A ‘cash flow hedge’ is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecast transaction, and that could affect profit or loss. [IAS 39.86(b)]

If the hedging instrument is a derivative, then it is measured at fair value with the effective portion of changes in its fair value recognised in OCI and presented as a separate component of equity. Ineffectiveness due to the derivative’s change in fair value being greater than the change in the hedge item’s value is recognised immediately in profit or loss. [IAS 39.95–96]

If the hedging instrument is a non-derivative monetary item, which is permitted only for hedges of foreign currency risk, then the effective portion of the foreign currency gains and losses on the hedging instrument is recognised in OCI. [IAS 39.72]

The change in the fair value of the hedging instrument that is recognised in OCI is reclassified to profit or loss when the hedged item affects profit or loss, as follows.

Like IFRS, the derivative hedging instrument is measured at fair value with changes in fair value recognised in profit or loss. The hedged item is remeasured to fair value in respect of the hedged risk, even if it is normally measured at cost, like IFRS. Also like IFRS, any resulting adjustment to the carrying amount of the hedged item related to the hedged risk is recognised in profit or loss, even if such a change would normally be recognised in OCI. [815-20-35-1(b)]

Like IFRS, for a hedge of a firm commitment, fair value hedge accounting results in the change in fair value of the firm commitment attributable to the hedged risk during the period of the hedging relationship being recognised as an asset or a liability in the statement of financial position. Like IFRS, when the hedged transaction is recognised the amount previously recognised in the statement of financial position adjusts the initial measurement of the underlying transaction (basis adjustment). [815-25-35-1, 35-13]

**Cash flow hedges**

Like IFRS, a ‘cash flow hedge’ is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability, or a probable forecast transaction that could affect profit or loss. However, the details differ in certain respects from IFRS. [815-20-20]

Like IFRS, a derivative hedging instrument is measured at fair value with the effective portion of changes in its fair value recognised in OCI, and becomes a component of accumulated OCI. Ineffectiveness due to the derivative’s change in fair value being greater than the change in the hedge item’s value is recognised immediately in profit or loss, like IFRS. [815-20-35-1(c)]

Unlike IFRS, a non-derivative cannot be designated as a hedging instrument in a cash flow hedge. [815-20-25-71]

Like IFRS, the change in the fair value of the hedging instrument that is recognised in accumulated OCI is reclassified to profit or loss when the hedged item affects profit or loss, as follows.
Net investment hedges

A ‘net investment hedge’ is a hedge of the foreign currency exposure arising from a net investment in a foreign operation using a derivative, and/or a non-derivative financial item, as the hedging instrument. [IAS 39.86(c)]

The hedged risk is the foreign currency exposure arising from a net investment in a foreign operation when the net assets of the foreign operation are included in the financial statements. The hedged risk cannot be designated as the fair value of the underlying shares, or the currency exposure on the fair value of the shares. [IAS 39.AG99]

The hedged item may be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation at the beginning of any given period in respect of a foreign currency exposure. [IFRIC 16.2, 11]

A derivative, a non-derivative instrument or a combination of both may be used as the hedging instrument. The hedging instrument can be held by any entity within the group. [IFRIC 16.14]
The effective portion of the gain or loss on the hedging instrument is recognised in OCI as an offset to the foreign currency translation reserve in respect of that foreign operation. Any ineffectiveness is recognised in profit or loss immediately. [IAS 39.102, IFRIC 16.3]

**Hedge accounting criteria**

The following conditions apply to all three types of hedges. Hedge accounting is permitted only if all of the following conditions are met.

- There is formal designation and written documentation at inception of the hedge that identifies:
  - the hedging instrument, the hedged item and the risk being hedged;
  - the risk management objective and strategy for undertaking the hedge; and
  - how effectiveness will be assessed, both prospectively and retrospectively.

- The hedge is expected to be highly effective in achieving fair value or cash flow offsets in accordance with the original documented risk management strategy.

- The effectiveness of the hedge can be measured reliably. This requires the fair value of the hedging instrument, and the fair value (or cash flow) of the hedged item with respect to the risk being hedged, to be reliably measurable.

- The hedge is assessed and determined to be highly effective on an ongoing basis throughout the hedge relationship. A hedge is ‘highly effective’ if changes in the fair value of the hedging instrument, and changes in the fair value or expected cash flows of the hedged item attributable to the hedged risk, offset within the range of 80–125 percent.

- For a cash flow hedge of a forecast transaction, the transaction is highly probable and creates an exposure to variability in cash flows that ultimately could affect profit or loss. IFRS does not define what is meant by a forecast transaction that is ‘highly probable’ of occurring. [IAS 39.88]

Risk exposure is assessed on a transaction basis, and entity-wide risk is not a condition for hedge accounting. [IAS 39.IGF.2.6]

Like IFRS, the effective portion of the gain or loss on the hedging instrument is recognised in OCI as an offset to the foreign currency translation of that foreign operation. Any ineffectiveness is recognised in profit or loss immediately, like IFRS. [815-20-35-1(d)]

**Hedge accounting criteria**

The general conditions for hedge accounting for all three types of hedges are as follows.

- Like IFRS, at inception of the hedge there is formal designation and written documentation of the hedging relationship and the entity’s risk management objective and strategy for undertaking the hedge, including identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the hedging instrument’s effectiveness in offsetting the exposure to changes in the hedged item’s fair value or cash flows attributable to the hedged risk will be assessed and, unlike IFRS, there is an explicit requirement to state how ineffectiveness will be measured.

- Both at inception of the hedge and on an ongoing basis, the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated, like IFRS. However, the effectiveness testing requirements differ in certain respects from IFRS (see below).

- There is no explicit requirement that the effectiveness of the hedge can be measured reliably, unlike IFRS. However, we do not expect differences to arise in practice.

- Like IFRS, for a cash flow hedge of a forecast transaction, the transaction is probable and creates an exposure to variability in cash flows that ultimately could affect profit or loss. A forecast transaction needs to be probable of occurring, whereas under IFRS it needs to be ‘highly probable’. However, in our experience the application of ‘probable’ under US GAAP and ‘highly probable’ under IFRS is often the same in this regard. Like IFRS, there is no specific guidance on what percentage probability constitutes probable of occurring. [815-20-25-3, 25-5, 25-75, 25-132]

There are additional criteria that need to be met for fair value, cash flow and net investment hedges, which differ from IFRS. [815-20-25-4 – 25-72, 25-87-132]

Like IFRS, risk exposure is assessed on a transaction basis, and entity-wide risk is not a condition for hedge accounting. [815-20-25-4 – 25-44]
**Qualifying hedged items**

The hedged item is an item that exposes the entity to risk of changes in fair value or future cash flows that an entity has chosen to designate as a hedged item. The hedged item can be:

- a single recognised asset or liability, unrecognised firm commitment, highly probable forecast transaction or net investment in a foreign operation;
- a group of recognised assets or liabilities, unrecognised firm commitments, highly probable forecast transactions or net investments in foreign operations, if they share the same hedged risk; or
- in a portfolio hedge of interest rate risk, a portion – i.e. an amount of currency – of a portfolio of financial assets or financial liabilities that share the risk being hedged. [IAS 39.78]

A firm commitment to acquire a business in a business combination can be a hedged item only for foreign exchange risk because other risks cannot be specifically identified and measured. In our view, an entity may also hedge the foreign exchange risk of a highly probable forecast business combination. In our view, in the consolidated financial statements, a cash flow hedge of the foreign exchange risk of a firm commitment to acquire a business or a forecast business combination relates to the foreign currency equivalent of the consideration paid. [IAS 39.AG98]

There are no restrictions on the timing of designation or redesignation of a hedged item and an item may be hedged after its initial recognition. [IAS 39.IG.F.2.17]

**Hedging a portion**

It is possible to designate only a portion of the cash flows, fair value or net investment as a hedged item. If a portion of the cash flows of a financial asset or financial liability is designated as the hedged item, then the designated portion needs to be less than the total cash flows of the asset or liability. The designated risks and portions need to be separately identifiable components of the financial instrument, and changes in cash flows or the fair value of the entire financial instrument arising from the changes in the designated risks and portions need to be reliably measurable. [IAS 39.81, AG99E–AG99F]

For example, for a fixed-rate financial instrument hedged for changes in fair value attributable to changes in a risk-free or benchmark interest rate, the risk-free or benchmark rate is normally regarded as both a separately identifiable component of the financial instrument and reliably measurable. [IAS 39.AG99F(a)]

**Unlike IFRS, a business combination is not a qualifying hedged item.** [815-20-25-15(g)]

**Hedging a portion**

Like IFRS, there are no restrictions on the timing of designation or redesignation of a hedged item and an item may be hedged after its initial recognition. [815-20-25-4 – 25-44]

Unlike IFRS, a portion of the coupon on a fixed-rate instrument cannot be designated as a hedged component. [815-20-25-11 – 25-12]
An item may be hedged for only a portion of its period to maturity (partial-term hedging). [IAS 39.AG.F.2.17]

Hedging a proportion
The term ‘portion’ is distinct from the term ‘proportion’, the latter being used to indicate a certain percentage only. It is possible to designate a proportion of the cash flows, fair value or net investment as a hedged item. Once a partial designation is made, hedge effectiveness is measured on the basis of the hedged exposure. [IAS 39.A.81, AG107A]

If a proportion of the cash flows or fair value of a financial asset or financial liability is designated as the hedged item, then that designated proportion should be less than the total cash flows of the asset or liability. However, an entity may designate all of the cash flows of the entire financial asset or financial liability as the hedged item and hedge them for only one particular risk as long as it is one of the eligible specified risks. [IAS 39.AG99C]

Portfolio fair value hedges of interest rate risk
An entity is permitted to designate the interest rate exposure of a portfolio of financial assets or financial liabilities as the hedged item based on expected rather than contractual cash flows under the portfolio fair value hedge model. Although the hedged item may include both assets and liabilities, the amount designated is an amount of assets or an amount of liabilities; designation of a net amount comprising both assets and liabilities is not permitted. The entity may also hedge a portion of the interest rate risk associated with the designated amount. The portfolio fair value hedge model can be applied only for hedges of interest rate risk. [IAS 39.78, 81A, AG114(b)–AG114(c), AG116, AG118]

Net positions
A net position cannot be a hedged item, although a portion of the assets or liabilities making up the net position may be designated as the hedged item. [IAS 39.AG101]

Even though partial-term hedging is not prohibited, it is difficult to achieve effectiveness for a fair value hedge of only selected contractual cash flows because, unlike IFRS, excluding a hedged item’s cash flows for only a portion of its time period when assessing effectiveness and measuring ineffectiveness is prohibited. [815-20-55-5 – 55-6]

Hedging a proportion
Like IFRS, it is possible to designate a proportion of the cash flows, fair value or net investment as a hedged item. Like IFRS, once a partial designation is made, hedge effectiveness is measured on the basis of the hedged exposure. [815-20-25-11 – 25-12]

Like IFRS, if a proportion of the cash flows or fair value of a financial asset or financial liability is designated as the hedged item, then that designated proportion needs to be less than the total cash flows of the asset or liability. Also like IFRS, an entity may designate all of the cash flows of the entire financial asset or financial liability as the hedged item and hedge them for only one particular risk, as long as the hedged risk is one of the eligible specified risks. As discussed above, the eligible risks may differ from IFRS. [815-20-25-6 – 25-44]

Portfolio fair value hedges of interest rate risk
The portfolio hedging model is not allowed. Unlike IFRS, an entity is not permitted to designate a hedged item in a fair value hedge based on expected cash flows. Also unlike IFRS, a hedged item cannot be designated in terms of an amount of currency rather than as individual assets or liabilities. [815-20-25-11 – 25-12]

Net positions
Like IFRS, a net position cannot be a hedged item, although a portion of the assets or liabilities making up the net position may be designated as the hedged item. [815-20 25-12]
Hedging groups of similar items

The hedged item can be a portfolio of similar assets, liabilities, unrecognised firm commitments, highly probable forecast transactions or net investments in foreign operations. Only similar items can be grouped together in a portfolio. Items are considered to be ‘similar’ if:
- they share the hedged risk; and
- the change in fair value attributable to the hedged risk for each individual item is expected to be approximately proportional to the overall change in the fair value of the portfolio attributable to the hedged risk. [IAS 39.83, BC176]

Qualifying hedging instruments

All derivatives, including separable embedded derivatives, can qualify as hedging instruments, with the following limitations.
- Written options may be designated as hedging instruments only of purchased options.
- A derivative cannot be designated as a hedging instrument for only a portion of its remaining period to maturity.
- Derivatives in their entirety or a proportion thereof need to be designated as hedging instruments. Designation of only certain components of derivatives is not permitted, except as noted below. [IAS 39.72, 74–75, AG94]

There are two exceptions from the requirement not to split the components of derivative hedging instruments: separating the intrinsic value and time value of an option; and separating the interest element and the spot price element in a forward. [IAS 39.74]

A written option cannot be designated as a hedging instrument unless the hedged item is a purchased option, including one that is embedded in, but not separated from, another contract. [IAS 39.AG94]

Hedging groups of similar items

Like IFRS, similar assets, liabilities, unrecognised firm commitments, probable forecast transactions or net investments in foreign operations may be aggregated and hedged as a group only if the individual items in the group share the risk exposure that is designated as being hedged. Also like IFRS, the change in fair value attributable to the hedged risk for each individual item in the group should be expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group of items. However, the details differ in certain respects from IFRS. [AS 20-25-12(b)]

Qualifying hedging instruments

All derivatives, including separable embedded derivatives, can qualify as hedging instruments, with the following limitations.
- Unlike IFRS, the use of written options as hedging instruments is not restricted to hedges of purchased options; however, additional hedge criteria apply (see below).
- Like IFRS, a derivative cannot be designated as a hedging instrument for only a portion of its remaining period to maturity.
- Like IFRS, derivatives in their entirety or a proportion thereof need to be designated as hedging instruments. Designation of only certain components of derivatives is not permitted. [AS 20-25-45 – 25-71]

Unlike IFRS, the intrinsic value component or the spot price element of a hedging instrument cannot be designated as a hedging instrument. However, the entire hedging instrument may be designated and hedge effectiveness may be based on only the intrinsic value of an option or on the spot price element of a forward contract. [AS 20-25-82]

Unlike IFRS, a written option may be designated as a hedge of a recognised asset or liability or unrecognised firm commitment, or related variability in cash flows, but only if the combination of the hedged item and the written option provides at least as much potential for gains as a result of a favourable change in the fair value of the combined instruments as exposure to losses from an unfavourable change in their combined fair value (or, for cash flow hedges, at least as much potential for favourable cash flows as exposure to unfavourable cash flows). That test is met if all possible favourable percentage changes in the underlying (from zero percent to 100 percent) would provide at least as much gain (or favourable cash flow) as the loss (or unfavourable cash flow) that would be incurred from an unfavourable change in the underlying of the same percentage. [AS 20-25-94 – 25-97]
Non-derivatives may be used as hedging instruments only for hedges of foreign currency risk. [IAS 39.72]

A combination of derivatives and non-derivatives, or proportions thereof, may be used as the hedging instrument. [IAS 39.77]

**Dynamic hedging strategies**

IFRS allows an entity to apply dynamic hedging strategies such as ‘delta-neutral’ hedging strategies and other dynamic strategies under which the quantity of the hedging instrument is constantly adjusted to maintain a desired hedge ratio. [IAS 39.74–76, 91(a), 101(a), IG.F.1.9]

**Qualifying hedged risks**

The hedged risk should be one that could affect profit or loss. [IAS 39.86, AG110]

A financial asset or financial liability can be hedged against exposure to any one or more of its individual risk types that are identifiable and reliably measurable, including market prices, interest rates or a component of interest rates, foreign currency rates or credit risk. [IAS 39.81, IG.F.3.8]

A non-financial item may be hedged with respect to either all of its risks or foreign currency risk only. [IAS 39.82, AG100]

The risks associated with treasury share transactions (see chapter 7.3), forecast transactions in own equity and distributions to shareholders do not qualify for hedge accounting. [IAS 39.86, AG110]

To qualify for hedge accounting, the hedged risk should be specific and identifiable. A hedge against general business risks does not qualify for hedge accounting. [IAS 39.98, AG110, IG.F.2.8]

**Lease payments and receipts**

IFRS does not contain guidance on whether cash flows under lease agreements are financial or non-financial items. In our view, whether cash flows payable or receivable under a lease arrangement are financial or non-financial items with respect to their designation as a hedged item depends on whether the lease is classified as a finance lease or an operating lease.

Unlike IFRS, non-derivatives may be used as hedging instruments only for hedges of foreign currency exposure of a net investment in a foreign operation and foreign currency fair value hedges of unrecognised firm commitments. [815-20-25-66, 25-37(d)]

Unlike IFRS, a combination of derivatives and non-derivatives, or proportions thereof, to be used as the hedging instrument is prohibited. [815-20-25-66]

**Dynamic hedging strategies**

Like IFRS, an entity may apply dynamic hedging strategies such as ‘delta-neutral’ hedging strategies and other dynamic strategies under which the quantity of the hedging instrument is constantly adjusted to maintain a desired hedge ratio. However, the details of the application of hedge accounting to these strategies differ from IFRS in certain respects. [815-20-25-101]

**Qualifying hedged risks**

Like IFRS, the hedged risk should be one that could affect profit or loss. [815-20-25-12(c), 25-15(c)(2)]

Unlike IFRS, for a financial asset or financial liability an entity is limited to hedging benchmark interest rate risk, foreign currency risk, credit risk, overall changes in cash flows or fair value, or a combination of one or more of these risks. [815-20-25-6 – 25-44]

Like IFRS, a non-financial item other than servicing rights may be hedged in respect of either all of its risks or foreign currency risk only. [815-20-25-12el]

Like IFRS, the risks associated with treasury share transactions (see chapter 7.3), forecast transactions in own equity and distributions to shareholders do not qualify for hedge accounting. [815-20-25-43(b)(3)]

Like IFRS, the hedged risk should be specifically identifiable, and general business risk does not qualify for hedge accounting. [815-20-25-6 – 25-44]

**Lease payments and receipts**

Operating leases are not required to be considered as non-financial items. For example, a non-cancellable operating lease may be treated as a firm commitment, and therefore may be designated as the hedged item in a fair value hedge. Furthermore, such a firm commitment may be hedged for total changes in fair value as well as the following segregated risks: interest rate risk, credit risk or foreign currency risk. [815-20-25-12el]
Effectiveness testing
If a hedge is not perfect, then the gain or loss on the hedging instrument will differ from the gain or loss on the hedged item. The difference may give rise to hedge ineffectiveness.

To qualify for hedge accounting, a hedge should ‘expected to be’ (prospectively) and ‘actually have been’ (retrospectively) highly effective at inception and subsequently, which requires the following conditions to be met:

- the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated or for the period until the amount of the hedging instrument is next adjusted (prospective effectiveness); and
- the actual results of the hedge are within the range of 80–125 percent (retrospective effectiveness). [IAS 39.88(b), AG106]

Any actual ineffectiveness is recognised in profit or loss immediately, even if the hedge has been ‘highly effective’. [IAS 39.95(b), 102(b)]

IFRS does not specify how often effectiveness should be measured, beyond noting that it should be done at a minimum at each reporting date, including interim reporting dates. [IAS 39.AG106]
IFRS does not prescribe the methods that should be used in measuring effectiveness. The method that will be used in measuring hedge effectiveness is specified in the hedge documentation. Different methods may be used to measure prospective effectiveness and retrospective effectiveness for a single hedge relationship, as well as for different hedging relationships. [IAS 39.88(a), AG107]

The approach that will be used to measure effectiveness is determined on a hedge-by-hedge basis. There is no requirement to adopt a consistent method for all hedge relationships. However, in our view an entity should adopt a method for assessing hedge effectiveness that is applied consistently for similar types of hedges unless different methods are explicitly justified. [IAS 39.88(a)]

Effectiveness calculations may be done on a pre-tax or post-tax basis. Whichever method is used, the basis of calculating the change in fair value or cash flows of the hedged item and the change in fair value of the hedging instrument should be consistent. [IAS 39:IG.F.4.1]

**Prospective and retrospective effectiveness**

Prospective effectiveness may be demonstrated using statistical or offset methods or by comparing all critical terms. ‘Comparing all critical terms’ does not mean applying the ‘short-cut method’ as allowed under US GAAP. [IAS AG105, IG.F.4.4]

Retrospective effectiveness is demonstrated using statistical or offset methods and is measured on a cumulative or period-by-period basis. However, the actual ineffectiveness recognised in profit or loss is calculated using the offset method. IFRS does not permit the ‘critical terms match’ approach to test retrospective effectiveness. [IAS AG105, IG.F.5.5]

For hedging relationships that use a purchased option as the hedging instrument, the time value of an option may be excluded from the effectiveness tests and effectiveness may be tested based solely on the intrinsic value of the option. [IAS 39.74, AG105, IG.F.4.2, IG.F.4.4, IG.F.5.5]

Like IFRS, no particular method to be used in assessing effectiveness is prescribed. Like IFRS, the method that will be used in assessing hedge effectiveness is specified in the hedge documentation. Also like IFRS, different methods may be used to assess prospective effectiveness and retrospective effectiveness for a single hedge relationship. [815-20-25-3]

Like IFRS, the approach that will be used to measure effectiveness is determined on a hedge-by-hedge basis, although an entity will ordinarily use a similar approach for similar hedges. [815-20-25-81]

Like IFRS, effectiveness calculations may be done on a pre- or post-tax basis. Whichever method is used, the basis of calculating the change in fair value or cash flows of the hedged item and the change in fair value of the hedging instrument should be consistent, like IFRS. [815-20-25-31(b) vii]

**Prospective and retrospective effectiveness**

Like IFRS, prospective effectiveness may be demonstrated using statistical or offset methods or by comparing the critical terms. [815-20-25-84]

Also like IFRS, retrospective effectiveness may be demonstrated using statistical or offset methods and it may be assessed on a cumulative or period-by-period basis. Unlike IFRS, there are several methods that can be used that allow the assumption of perfect effectiveness:

- the short-cut method, whereby the hedge of a recognised interest-bearing asset or liability for the changes in the benchmark interest rate with interest rate swaps is considered perfectly effective, assuming that strict criteria are met;

- the critical terms match, whereby the hedge of a forecast transaction with forwards or futures is considered perfectly effective, assuming that the critical terms match and other conditions are met; and

- the terminal value approach, whereby the hedge of a one-sided risk in a cash flow hedge using purchased options is considered perfectly effective, assuming that the critical terms and other conditions are met. [815-20-25-126 – 25-129]

Like IFRS, a purchased option’s time value may be excluded from the assessment of hedge effectiveness. However, unlike IFRS, if certain conditions are met for a hedge of a one-sided risk in a cash flow hedge using a purchased option, then effectiveness may be assessed by comparing the changes in a purchased option’s total fair value to a hypothetical derivative that would be considered perfectly effective under the terminal value approach noted above. [815-20-25-82, 25-79, 25-98, 25-126 – 25-129, 820-20-25-102 – 25-118]
**Actual ineffectiveness**

In a cash flow hedge, regardless of the methods that are used to assess prospective and retrospective effectiveness, the actual ineffectiveness recognised in profit or loss is calculated using the offset method on a cumulative basis to ensure that all ineffectiveness is recognised in profit or loss immediately. If the cumulative gain or loss on the hedging instrument is more than the cumulative change in fair value of the expected future cash flows on the hedged item, then the excess is recognised in profit or loss as ineffectiveness. However, if the reverse applies, then no ineffectiveness is recognised in profit or loss. [IAS 39.96, IG.F.5.5]

In a fair value hedge, ineffectiveness is recognised automatically in profit or loss as a result of separately remeasuring the hedging instrument and the hedged item. No separate calculation is required of the amount of ineffectiveness to be recognised in profit or loss. [IAS 39.89]

For hedging relationships that use a purchased option as the hedging instrument, the time value of an option may be excluded from the effectiveness tests and effectiveness may be tested based solely on the intrinsic value of the option. However, in this case, changes in the option’s time value are recognised directly in profit or loss, regardless of the hedging model used. [IAS 39.74, 96(c)]

**Effect of credit risk on effectiveness testing**

For all hedges, changes in both counterparty credit risk and own credit risk impact the measurement of changes in the fair value of a derivative hedging instrument. These changes would probably have no offsetting effect on the measurement of the changes in the value of the hedged item attributable to the hedged risk and may lead to a conclusion that the hedging relationship has not been and/or is not expected to be highly effective. For all hedges, an entity considers the risk that the counterparty to the hedging instrument will default by failing to make any contractual payments to the entity. For cash flow hedges, if it becomes probable that a counterparty will default by failing to make any contractual payments to the entity, then the entity would be unable to conclude that the hedging relationship will be highly effective. [IAS 39.AG.107, IG.F.4.3, IG.F.5.2]
**Discontinuing hedge accounting**

Hedge accounting is discontinued prospectively if:
- the hedged transaction is no longer highly probable;
- the hedging instrument expires or is sold, terminated or exercised;
- the hedged item is sold, settled or otherwise disposed of;
- the hedge is no longer highly effective;
- the entity revokes the designation. [IAS 39.91, 101, AG113, IG.F.6.2(ii)]

At the date on which hedge accounting is discontinued, it is necessary to determine hedge effectiveness and to recognise any ineffectiveness in profit or loss. [IAS 39.AG113]

The hedging instrument and the hedged item are subsequently accounted for according to the normal requirements of IFRS. [IAS 39.92]

The treatment of the cumulative gain or loss previously recognised in OCI in respect of a cash flow hedge depends on whether the hedged transaction is still expected to occur.
- If the transaction is no longer expected to occur, then the amount previously recognised in OCI is reclassified to profit or loss immediately.
- If the hedged transaction is still expected to occur, then the amount deferred in OCI remains there until the forecast transaction impacts profit or loss. [IAS 39.101]

For a hedge of a net investment in a foreign operation, the cumulative amount previously recognised in OCI remains in OCI until the investment is disposed of. [IAS 39.102]

**Clearing derivatives with central counterparties**

IFRS provides relief from discontinuing hedge accounting if the following criteria are met:
- as a consequence of laws or regulations or the introduction of laws and regulations, a clearing counterparty becomes a new counterparty to each of the original parties; and
- any changes to a derivative’s terms are limited to those necessary to replace the counterparty – e.g. changes to collateral terms. [IAS 39.91(a)]

**Discontinuing hedge accounting**

Like IFRS, hedge accounting is discontinued prospectively if:
- the hedged transaction is no longer probable;
- the hedging instrument expires or is sold, terminated or exercised;
- the hedged item is sold, settled or otherwise disposed of;
- the hedge is no longer highly effective;
- the entity revokes the designation. [815-25-40-1 – 40-6, 815-30-40-1 – 40-7]

Like IFRS, at the date on which hedge accounting is discontinued, it is necessary to determine hedge effectiveness and to recognise any ineffectiveness in profit or loss. [815-25-40-3, 815-30-40-2]

The hedging instrument and the hedged item are subsequently accounted for according to the normal requirements of US GAAP, which may differ from the requirements of IFRS.

The treatment of the cumulative gain or loss previously recognised in OCI in respect of a cash flow hedge depends on whether the hedged transaction is probable of not occurring at the originally forecast date or within two months thereafter.
- Gains and losses remain in accumulated OCI unless it is probable that the forecast transaction will not occur by the end of the originally specified time period or within a two-month period thereafter, unlike IFRS.
- If a forecast transaction is expected to occur in the period noted above, then the amount deferred in accumulated OCI remains there until the forecast transaction impacts profit or loss. However, there still exists the potential difference between ‘expected to occur’ for IFRS and ‘expected to occur on the originally forecasted date or within two months thereafter’ for US GAAP. [815-30-35-38 – 35-41, 40-4]

Like IFRS, for a hedge of a net investment in a foreign operation, the cumulative amount recognised in accumulated OCI remains in accumulated OCI until the investment is disposed of or an impairment loss is recognised. [830-40]

**Clearing derivatives with central counterparties**

For public business entities, for the purposes of applying hedge accounting, a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument, provided that all other hedge accounting criteria continue to be met. [815-25-40-1A, 815-30-40-1A, 815-20-55-56A]
Unlike IFRS, the reason for change in counterparty is not limited to requirements of laws and regulations, but it may also include other circumstances, for example, financial institution mergers, intercompany transactions, an entity exiting a particular derivatives business or relationship, or an entity managing against internal credit limits. [ASU 2016-05.BC2]

There may be cases where the legal characterisation of variation margin is changed from collateralised-to-market to settled-to-market without any other changes to the contractual terms. Like IFRS, such a change on its own would not require clearing members or end users to discontinue the existing hedging relationship.

Hedging on a group basis
Internal derivatives
An entity may use internal derivatives to transfer risk from individual operations within the group to a centralised treasury. Derivatives between entities within the same reporting group can also be used to control and monitor risks through the central treasury function in order to benefit from pricing advantages and to offset equal and opposite exposures arising from different parts of the group. However, all such internal derivatives eliminate on consolidation and therefore are not eligible for hedge accounting in the consolidated financial statements, even if at a group level the overall net position is hedged externally. Therefore, only derivatives involving external third parties can be designated as hedging instruments in consolidated financial statements. However, it is possible for the centralised treasury to enter into one or more derivatives with external counterparties to offset the internal derivatives. Such external derivatives may qualify as hedging instruments in the consolidated financial statements provided that they are legally separate contracts and serve a valid business purpose – e.g. laying off risk exposures on a gross basis. In our view, a relationship should exist between the internal transactions and one or multiple related external transactions and this relationship should be documented at inception of the hedging relationship. [IAS 39.73, IG.F.1.4]
Intra-group balances or transactions as the hedged item

The foreign currency risk on recognised intra-group monetary items qualifies for hedge accounting in the consolidated financial statements if it results in an exposure that is not fully eliminated on consolidation. [IAS 39.80]

The foreign currency risk of a highly probable forecast intra-group transaction may qualify as the hedged item in the consolidated financial statements provided that the transaction is denominated in a currency other than the currency of the entity entering into the transaction and the foreign currency risk will affect consolidated profit or loss. [IAS 39.80, AG99A]

Intra-group balances or transactions as the hedged item

Unlike IFRS, a hedge of the currency risk on a forecast intra-group transaction qualifies for hedge accounting provided that:

– either (1) the operating unit that has the foreign currency exposure is a party to the hedging instrument; or (2) another member of the consolidated group that has the same functional currency as that operating unit is a party to the hedging instrument and there is no intervening subsidiary with a different functional currency;
– the hedge transaction is denominated in a currency other than the hedging unit’s functional currency; and
– the other cash flow hedge criteria are met, including that the transaction will affect consolidated profit or loss. [815-20-25-30]
Overview

- A financial asset and a financial liability are offset only if there are both a current legally enforceable right to offset and an intention to settle net or to settle both amounts simultaneously.

- Disclosure is required in respect of the significance of financial instruments for the entity’s financial position and performance, and the nature and extent of risk arising from financial instruments and how the entity manages those risks.

- For disclosure of the significance of financial instruments, the overriding principle is to disclose sufficient information to enable users of financial statements to evaluate the significance of financial instruments for an entity’s financial position and performance.

- Risk disclosures require both qualitative and quantitative information.

Overview

- Like IFRS, a financial asset and a financial liability may be offset only if there are both a legally enforceable right to offset and an intention to settle net or to settle both amounts simultaneously. However, unlike IFRS, derivatives with the same counterparty, and related collateral, may be offset, provided that they are subject to a master netting arrangement and certain criteria are met. Also, unlike IFRS, repurchase agreements and reverse repurchase agreements that clear through a qualified clearing house may be offset, provided that they are subject to a master netting arrangement and certain criteria are met. Once the applicable criteria are met, offsetting is a policy choice, unlike IFRS.

- Like IFRS, disclosures are required to enable users to evaluate the significance of financial instruments for the entity’s financial position and performance, and the extent of risk arising from financial instruments.

- Like IFRS, the overriding principle is to disclose sufficient information to enable users of financial statements to evaluate the significance of financial instruments for an entity’s financial position and performance. However, the specific requirements differ from IFRS.

- Risk disclosure requirements differ for public and non-public entities under US GAAP. Public entities are required to disclose qualitative and quantitative information; however, the specific disclosure requirements differ from IFRS. The disclosure requirements for non-public entities are primarily qualitative and much less detailed than for public entities under US GAAP or under IFRS.
Overview (continued)

- Qualitative disclosures describe management’s objectives, policies and processes for managing risks arising from financial instruments.

- Quantitative data about the exposure to risks arising from financial instruments is based on information provided internally to key management. However, certain disclosures about the entity’s exposures to credit risk, liquidity risk and market risk arising from financial instruments are required, irrespective of whether this information is provided to management.

- This chapter includes only currently effective requirements (see About this publication).

The presentation and disclosure requirements discussed in this chapter are not exhaustive, and are intended to provide an overview only.

Presentation

Statement of financial position

Financial assets are presented in the statement of financial position, with separate presentation of cash and cash equivalents, trade and other receivables, and investments accounted for under the equity method. [IAS 1.54]

Financial liabilities are presented in the statement of financial position, with separate presentation of trade and other payables. [IAS 1.54]

Additional line items may also be presented. [IAS 1.55]
Transaction costs of a liability that is not measured at fair value through profit or loss are deducted from the carrying amount of the financial liability and are not recognised as separate assets. [IAS 39.43]

Refinancing or debt covenant waivers completed after the reporting date would not result in non-current classification of debt, even if they are executed before the financial statements are authorised for issue. [IAS 1.74]

IFRS does not provide specific guidance on the statement of financial position presentation of non-derivative or derivative hedging instruments, and practice varies over whether they are presented together with the item to which they relate, or separately. Derivatives not held primarily for trading purposes are classified as current or non-current based on their outstanding maturities. However, entities are required to comply with the requirements for offsetting (see below).

Statement of profit or loss and OCI
There is no specific guidance on presentation of gains or losses on financial instruments in the statement of profit or loss and OCI. In our view, gains and losses on financial instruments should be reported in the most appropriate line item according to their nature. If an entity designates derivatives as hedging instruments for accounting purposes, or applies the fair value option to an economically hedged non-derivative as an alternative to hedge accounting (see chapter 7.4), then in our view gains or losses on both the non-derivative, being the item that is economically hedged or subject to hedge accounting, and the derivative may be split for presentation purposes in order to best reflect the impact on profit or loss of the economics of the relationship. However, in our view gains and losses arising on derivatives other than those resulting from qualifying hedging instruments, or derivatives economically hedging a financial instrument designated using the fair value option, should be presented in their entirety in a single line in the statement of profit or loss and OCI.

Offsetting
Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only if both of the following conditions are met:
- the entity currently has a legally enforceable right to set off the recognised amounts; and
- the entity has the intention to settle on a net basis or to realise the asset and settle the liability simultaneously. [IAS 32.42, 45]

Unlike IFRS, transaction costs of a liability that is not measured at fair value through profit or loss are recognised as a separate deferred asset. [835-30-45-3]

Unlike IFRS, entities may classify debt due within 12 months as non-current at the reporting date as a result of refinancing or debt covenant waivers achieved after the reporting date, provided that they are completed before the financial statements are issued or available to be issued. [470-10-45]

Like IFRS, US GAAP does not provide specific guidance on the statement of financial position presentation of non-derivative or derivative hedging instruments, and practice varies over whether they are presented together with the item to which they relate or separately. Derivatives are classified as current or non-current based on their outstanding maturities and management’s intended holding of the derivative, like IFRS. Like IFRS, entities are required to comply with the requirements for offsetting (see below).

Statement of comprehensive income
Unlike IFRS, some guidance is provided on the statement of comprehensive income presentation of gains and losses on financial instruments, but these requirements apply only to SEC registrants. Unlike IFRS, for hedging instruments the effective portion of the gain or loss is required to be presented in the same statement of comprehensive income line item as the hedged item. For derivatives that are not designated as hedging instruments, split presentation of the unrealised and realised portions is prohibited for SEC registrants and they have to be presented on the same line item. Otherwise, like IFRS, there is no other specific guidance on presentation of gains or losses on financial instruments in the statement of comprehensive income, and practice varies.

Offsetting
Under US GAAP, a financial asset and a financial liability may be offset only if a right of setoff exists. US GAAP contains detail on the criteria for offsetting, and therefore differences from IFRS are likely. 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 right of setoff exists if all of the following conditions are met:
- each of two parties owes the other determinable amounts, unlike IFRS;
- the reporting entity has the right to offset the amount owed with the amount owed by the other party, unlike IFRS;
An entity currently has a legally enforceable right to set off if the right is:
- not contingent on a future event; and
- enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all of the counterparties. [IAS 32.AG38B]

Once these criteria are met, offsetting is required. [IAS 32.42]

Individual instruments that, when viewed together, form a synthetic instrument are not usually offset unless the offsetting conditions above are met. [IAS 32.49(a)]

If a transfer of financial assets does not qualify for derecognition (see chapter 7.5), then the associated liability and the corresponding assets are not offset. [IAS 32.42]

Derivative assets and liabilities are usually presented on a gross basis as separate line items in the statement of financial position (see above) because they do not generally meet the offsetting criteria. This is because they are usually entered into with different counterparties and there is no right to set off the recognised amounts. If they are entered into with the same counterparty, then the entity may not have a current legally enforceable right to set off or the intent to settle on a net basis or to realise the asset and the liability simultaneously. [IAS 32.42, 50]

A lessor is prohibited from presenting its lease receivable along with its related financing on a net basis. [IAS 32.42]

Repurchase agreements and reverse repurchase agreements are generally presented on a gross basis in the statement of financial position because they do not usually meet the offsetting criteria – i.e. there is no current legally enforceable right to set off or they are not intended to be settled on a net basis or simultaneously. [IAS 32.42, 50]

Minimum quantitative and qualitative disclosures are required for financial assets and financial liabilities that are:
1. offset in the statement of financial position; or
2. subject to an enforceable master netting agreement or similar arrangement that covers similar financial instruments and transactions, irrespective of whether they are offset in the statement of financial position. [IFRS 7.13A–13C, B40]

- the reporting entity intends to offset, like IFRS; and
- the right to offset is enforceable at law and there is reasonable assurance that the right would be upheld in bankruptcy, like IFRS. [210-20-20, 210-20-45]

Once these criteria are met, offsetting is a policy decision, unlike IFRS. [210-20-45]

Like IFRS, the disclosures include minimum quantitative and qualitative information about financial assets and financial liabilities that are:
1. offset in the statement of financial position; or
2. subject to enforceable master netting agreements or similar arrangements, irrespective of whether they are offset in the statement of financial position. [210-20-50]
‘Similar financial instruments and transactions’ include derivatives, sales and repurchase agreements, and securities borrowing and lending agreements. Financial instruments that are outside of the scope of the disclosure requirements (in (2) above) include loans and customer deposits at the same institution, and instruments subject only to a collateral agreement. [IFRS 7B41]

The significance of financial instruments
Financial assets or financial liabilities at fair value through profit or loss
Disclosures required for loans and receivables and financial liabilities that an entity has elected to measure at fair value through profit or loss include the nature of instruments and how the entity has satisfied the conditions for such election. For loans and receivables designated at fair value through profit or loss, an entity discloses the maximum exposure to credit risk and the amount by which this risk is mitigated by credit derivatives or similar instruments, the change in the fair value of the loan or receivable attributable to credit risk (cumulatively and for the period), and from the date of designation the change in the fair value of any related credit derivatives or similar instruments (cumulatively and for the period). [IFRS 7B, B5]

For financial liabilities designated at fair value through profit or loss, an entity discloses the change in the fair value of the financial liability that is attributable to changes in credit risk (cumulatively and for the period) and the difference between the carrying amount of the financial liability and the amount that the entity is contractually required to pay at maturity. [IFRS 710]

Hedge accounting
Separate qualitative and quantitative information is disclosed for fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation, including:
– a description of each type of hedge;
– a description of the financial instruments designated as hedging instruments for the hedge and their fair values at the reporting date; and
– the nature of the risks being hedged. [IFRS 722]

Unlike IFRS, US GAAP specifically identifies financial instruments that are subject to the offsetting disclosures, as follows: derivatives, sales and repurchase agreements and securities borrowing and lending agreements. [210-20-50-1]

The significance of financial instruments
Financial assets or financial liabilities at fair value through profit or loss
Disclosures required for financial assets and financial liabilities that an entity has elected to measure at fair value through profit or loss include the reasons for making such election, and the reasons why such an election was made for only some eligible items within a group but not others, which is more specific than IFRS. US GAAP has disclosure requirements on credit risk exposure for loans and other receivables, which are similar to but not exactly the same as IFRS. [825-10-50-28(a), 50-28(b)]

Like IFRS, US GAAP requires that for financial liabilities designated at fair value through profit or loss, an entity discloses the change in the fair value of the financial liability attributable to changes in credit risk (cumulatively and for the period). Unlike IFRS, US GAAP requires an entity to disclose the difference between the carrying amount and the amount that the entity is contractually required to pay at maturity only in respect of a long-term debt. Moreover, unlike IFRS, this disclosure also pertains to long-term debt that is measured at amortised cost. [825-10-50-28(d), 50-30(d)]

Hedge accounting
Like IFRS, the required quantitative and qualitative disclosures in respect of hedging distinguish between fair value hedging instruments, cash flow hedging instruments and hedging instruments for a net investment in a foreign operation. However, unlike IFRS, some of the disclosure requirements also apply to derivatives not designated as hedging instruments. The disclosures for derivatives designated as hedging instruments include the objectives for holding the derivative, the context needed to understand those objectives, the risk management strategies for achieving those objectives and a description of the items or transactions that are being hedged. The requirements are similar to IFRS, although the precise language under US GAAP differs from IFRS. [815-10-50-1A, 50-2]
Additional disclosures are required in respect of cash flow hedges. [IFRS 7.23]

**Fair values**

For each class of financial asset and financial liability, an entity discloses the fair value in a manner that allows for it to be compared with its carrying amount. This disclosure is not required:
- if the carrying amount is a reasonable approximation of the fair value;
- for an investment in equity instruments that do not have a quoted market price in an active market and for derivatives linked to such equity instruments that are measured at cost because their fair value cannot be determined reliably; and
- for a contract containing a discretionary participation feature if the fair value of the feature cannot be measured reliably. [IFRS 7.25, 29]

The fair value measurement standard provides guidance on fair value measurement and the related disclosure requirements (see chapter 2.4).

**Nature and extent of risks arising from financial instruments**

**Qualitative risk disclosures**

Qualitative disclosures are required in respect of each type of risk arising from financial instruments:
- exposure to the risk and how it arises;
- the entity’s objectives, policies and process for managing the risk; and
- the methods used to measure the risk. [IFRS 7.33]

**Quantitative risk disclosures**

Quantitative disclosures are required for each type of risk arising from financial instruments, as follows:
- summary quantitative data based on the information provided internally to key management personnel;
- additional information specifically required by the standard; and
- information on concentration of risk, if this is not apparent from the above disclosures. [IFRS 7.34]

**Additional disclosures required in respect of cash flow hedges, although they are not identical to those under IFRS.** [US 15-30-50]

Unlike IFRS, US GAAP requires further detailed qualitative and quantitative disclosures to provide an understanding of how and why an entity uses derivatives, how derivatives and related hedged items are accounted for, and how derivatives and related hedged items affect an entity’s financial position, financial performance and cash flows. [US 15-10-50-1]

**Fair values**

Like IFRS, for each class of financial asset and liability, an entity discloses the fair value in a manner that allows for it to be compared with its carrying amount. However, US GAAP provides detailed guidance on defining major categories of debt and equity securities, and therefore differences from IFRS may arise in practice. Fair value disclosures are not required for a non-public entity that meets certain size limitations and has no derivatives. [US 320-10-50-18, US 825-10-50-3, 50-10 - 50-11]

The fair value measurement Codification Topic provides guidance on fair value measurement and the related disclosure requirements (see chapter 2.4).

**Nature and extent of risks arising from financial instruments**

**Qualitative risk disclosures**

Unlike IFRS, US GAAP does not require specific qualitative disclosures in respect of financial instruments other than related to significant concentrations of credit risk. However, qualitative disclosures about market risk (interest rate risk, foreign currency risk, commodity price risk and other relevant price risk – e.g. equity price risk) are required to be disclosed by SEC registrants outside the financial statements (e.g. in the management discussion and analysis (MD&A)). [US 235-10-S99, 825-10-50-20 – 50-22]

**Quantitative risk disclosures**

Unlike IFRS, non-SEC registrants are not required to make specific quantitative risk-related disclosures in respect of financial instruments, other than related to concentrations of credit risk and maximum credit exposure. Like IFRS, SEC registrants are required to make certain quantitative disclosures; however, unlike IFRS, those disclosures are limited to market risk disclosures and are provided outside the financial statements (e.g. in the MD&A). [US 235-10-S99, 825-10-50-20 – 50-22]
Concentrations of risk should be disclosed. Concentrations of risk arise from financial instruments that have similar characteristics and are affected in a similar manner when there are changes in economic or other conditions. Identifying concentrations of risk is a matter of judgement and therefore an entity discloses:

- a description of how management determines concentrations;
- a description of the shared characteristics that identify each concentration – e.g. counterparty, geographic area, currency or market; and
- the amount of the risk exposure associated with financial instruments sharing that characteristic. [IFRS 7.34(c), B8]

Credit risk
In respect of credit risk, an entity discloses quantitative data, including information about:

- the amount that best represents its maximum exposure to credit risk, unless the carrying amount already reflects such exposure;
- a description of collateral held as security and other credit enhancements and their financial effect in respect of the amount that best represents the maximum exposure to credit risk;
- the credit quality of financial assets that are neither past due nor impaired;
- financial assets that are either past due or impaired; and
- collateral and other credit enhancements obtained during the period that meet the recognition criteria in IFRS. [IFRS 7.36-38, B9]

Liquidity risk
In respect of liquidity risk, an entity discloses quantitative data, including:

- a maturity analysis for non-derivative financial liabilities, including issued financial guarantee contracts, showing their remaining contractual maturities;
- a maturity analysis for derivative financial liabilities, including the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows; and
- information about how liquidity risk is managed.
An entity discloses a maturity analysis of financial assets held to manage liquidity risk if such information is necessary to evaluate the extent and nature of liquidity risk. [IFRS 7.39, B11-B11F]

Unlike IFRS, concentration disclosures in US GAAP are required only in the context of credit risk. In addition, US GAAP and IFRS differ in the level of detail of the disclosure requirements for concentration of credit risk. For US GAAP, for each significant credit concentration an entity’s disclosures should include:

- the nature and characteristic of the credit concentration;
- the maximum credit exposure;
- collateral information, including the entity’s policy on requiring collateral; and
- information about the entity’s master netting arrangements, including the entity’s policy on entering into master netting arrangements. [220-10-50-21]

Credit risk
Like IFRS, US GAAP requires disclosure regarding maximum credit exposure, collateral held, assets that are past due and impaired. However, the exact situations requiring such disclosure and the exact disclosures themselves differ from IFRS. In addition, US GAAP has concentration disclosures that are specific to the type of financial asset. For example, US GAAP requires disclosure of information that enables financial statement users to understand the types of available-for-sale and held-to-maturity debt and equity securities held, including information about investments in an unrealised loss position for which an other-than-temporary impairment has or has not been recognised. Also, US GAAP requires disclosure of information that enables financial statement users to understand why a portion of an other-than-temporary impairment of a debt security was not recognised in profit or loss and the methodology and significant inputs used to calculate the portion of the total other-than-temporary impairment that was recognised in profit or loss, unlike IFRS. [220-10-50-2, 50-5 – 50-6, 225-10-50-21]

Liquidity risk
Unlike IFRS, maturity disclosures in the financial statements are not required for financial liabilities, other than the current and non-current distinction (see chapter 3.1) and the requirement to disclose amounts to be paid in each of the next five years and in the aggregate thereafter. If the tabular format is used by SEC registrants in their MD&A market risk disclosures (see below), then a maturity analysis is required to be included. Like IFRS, an entity discloses a maturity analysis of financial assets if such information is necessary to evaluate the extent and nature of liquidity risk. However, US GAAP contains specific guidance requiring maturity disclosures of debt securities based on appropriate groupings of each of held-to-maturity and available-for-sale securities. Furthermore, SEC registrant banks are required to provide a maturity analysis of their loan portfolio in the MD&A. [220-10-50-3, 50-5, 470-10-50-1, 825-10-50-23[c]1]
Market risk

IFRS does not mandate the form of the disclosures about market risk. However, an entity presents a sensitivity analysis for each type of market risk: currency risk, interest rate risk and other price risk that it is exposed to as at the reporting date. [IFRS 7.40–41, B18–B20]

Transfers of financial assets

An entity discloses information on:
– transferred financial assets that are not derecognised in their entirety; and
– transferred financial assets that are derecognised in their entirety and in which the entity retains continuing involvement. [IFRS 7.42A]

Examples of disclosures that are required for each class of transferred financial assets that are not derecognised in their entirety include:
– the nature of the transferred assets;
– the nature of the risk and rewards associated with those assets to which the entity is exposed; and
– the nature of the relationship between the transferred assets and the associated liabilities and the restrictions on the entity’s use of those assets. [IFRS 7.42D]

Examples of disclosures that are required for each type of continuing involvement in transferred financial assets that are derecognised in their entirety include:
– the carrying amounts and fair values of the assets and liabilities representing the entity’s continuing involvement;
– the entity’s maximum exposure to loss from its continuing involvement;
– a maturity analysis of the undiscounted cash flows that may be payable to the transferee in respect of those assets; and
– the gain or loss on transfer and income and expense arising from the entity’s continuing involvement. [IFRS 7.42E, 42G]

Market risk

Like IFRS, US GAAP does not mandate the form of disclosures. However, market risk disclosures provided in the MD&A by SEC registrants are required to be in one of three forms: tabular, sensitivity analysis or value-at-risk. An entity is not required to use the same format for each risk. In all cases, the inherent limitations of the disclosure are explained. Like IFRS, separate quantitative information is presented for each market risk exposure category – i.e. interest rate risk, foreign currency risk, commodity price risk and other relevant market risks, such as equity price risk.

Transfers of financial assets

The principal objectives of the disclosure requirements in US GAAP are to provide an understanding of:
– a transferor’s ongoing involvement, if any, with transferred financial assets;
– the nature of any restrictions on assets reported by an entity in its statement of financial position that relate to a transferred financial asset, including carrying amounts of those assets;
– how servicing assets and liabilities are reported; and
– how the transfer affects the transferor’s financial position, financial performance and cash flows when transfers are either accounted for as secured borrowings or as sales when the transferor has some form of ongoing involvement. [860-10-50-3]
8 Insurance contracts

8.1 Insurance contracts

Overview

- The insurance contracts standard applies to all insurance contracts that an entity issues and reinsurance contracts that it holds, regardless of the type of entity that issued the contract. An ‘insurance contract’ is a contract that transfers significant insurance risk.

- Generally, entities that issue insurance contracts are required to continue their existing accounting policies with respect to insurance contracts except when the standard requires or permits changes in accounting policies.

- A financial instrument that does not meet the definition of an insurance contract (including investments held to back insurance liabilities) is accounted for under the general recognition and measurement requirements for financial instruments.

- Changes in existing accounting policies for insurance contracts are permitted only if the new policy, or combination of new policies, results in information that is more relevant or reliable, or both, without reducing either relevance or reliability.

- Financial instruments that include ‘discretionary participation features’ may be accounted for as insurance contracts.

Overview

- Unlike IFRS, the insurance literature applies to all insurance contracts that are issued by an insurance company; there are no specific requirements for other entities that accept significant insurance risk. An ‘insurance contract’ is a contract that provides economic protection from identified risks occurring or discovered within a specific period, which differs from IFRS in certain respects.

- Unlike IFRS, insurance companies comply with the accounting policies specified in the insurance literature.

- Contracts that are not insurance contracts are accounted for under other applicable Codification topics/subtopics, which may differ from IFRS.

- Like IFRS, an entity may change an accounting policy if it is justified on the basis that it is ‘preferable’.

- Unlike IFRS, US GAAP does not use the term ‘discretionary participation feature’ and instead addresses the accounting for dividends to policyholders. Further, US GAAP does not address discretionary participation features in contracts that are not insurance contracts.
Overview (continued)

- In some cases, a deposit element is ‘unbundled’ (separated) from an insurance contract and accounted for as a financial instrument.

- Some derivatives that are embedded in insurance contracts should be separated from their host insurance contract and accounted for as if they were stand-alone derivatives.

- The recognition of catastrophe and equalisation provisions is prohibited for contracts not in existence at the reporting date.

- A liability adequacy test is required to ensure that the measurement of an entity’s insurance liabilities considers all contractual cash flows, using current estimates.

- The application of ‘shadow accounting’ for insurance liabilities is permitted for consistency with the treatment of unrealised gains or losses on assets.

- An expanded presentation of the fair value of insurance contracts acquired in a business combination or portfolio transfer is permitted.

- This chapter includes only currently effective requirements (see About this publication).

Scope

The insurance contracts standard applies to insurance contracts (including reinsurance contracts) that an entity issues and reinsurance contracts that it holds – i.e. to the contractual rights and obligations arising from these contracts. The insurance contracts standard focuses on types of contracts rather than types of entities. [IFRS 4.2–4, 6, B18–B19]

Overview (continued)

- Unlike IFRS, US GAAP does not have a broad unbundling concept for insurance contracts.

- Like IFRS, derivatives that are embedded in insurance contracts and meet certain criteria should be separated from the host insurance contract and accounted for as if they were stand-alone derivatives.

- Like IFRS, the recognition of catastrophe and equalisation provisions is prohibited for contracts not in existence at the reporting date.

- Unlike IFRS, the term ‘liability adequacy test’ is not used, and instead a form of premium deficiency testing is required, which generally meets the minimum requirements of IFRS for a liability adequacy test.

- Unlike IFRS, the use of ‘shadow accounting’ is required.

- Unlike IFRS, US GAAP requires an expanded presentation of the fair value of insurance contracts acquired in a business combination.

- This chapter includes only currently effective requirements (see About this publication).

Scope

Unlike IFRS, US GAAP establishes industry-specific accounting and reporting guidance for insurance companies, as opposed to insurance contracts. In the US, an insurance company is a company that has registered as such under the relevant state regulations. For entities other than insurance companies, any contract issued that would meet the definition of an insurance contract under IFRS is accounted for in accordance with other applicable US GAAP literature, most notably the Codification Topics on financial instruments (see section 7) and provisions (see chapter 3.12). [944-10-15]
This chapter discusses only those sections of US GAAP that apply to insurance companies and that are directly comparable to the requirements of IFRS for insurance contracts, and does not provide an overview of the requirements of US GAAP for insurance companies. Therefore, it does not deal with insurance industry-specific guidance for assets or liabilities other than insurance contracts. Additionally, this chapter does not provide information about the accounting when an entity other than an insurance company issues a contract that would meet the definition of an insurance contract under IFRS.

Definition

An ‘insurance contract’ is a contract under which the insurer accepts significant insurance risk from the policyholder by agreeing to compensate the policyholder if a specified uncertain future event adversely affects the policyholder. [IFRS 4A]

The uncertain future event that is covered by an insurance contract creates insurance risk. ‘Insurance risk’ is any risk, other than financial risk, transferred from the holder to the issuer of the contract. ‘Financial risk’ is the risk of a possible future change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided, in the case of a non-financial variable, that it is not specific to a party of a contract. [IFRS 4.A]

A contract that exposes the issuer to financial risk without significant insurance risk is not an insurance contract and therefore the contract is accounted for as a financial instrument (see chapter 7.1). Insurance risk is ‘significant’ if there is at least one scenario that has commercial substance (i.e. has a discernible effect on the economics of the transaction), so that the insurer would be required to pay additional significant benefits to the policyholder beyond those that would be paid if the insured event does not occur. [IFRS 4.B22-B23]

Definition

An ‘insurance contract’ is a contract that provides economic protection from identified risks occurring or discovered within a specified period of time. The accounting for an insurance contract issued by an insurance company depends on whether it is classified as short- or long-duration and whether the contract transfers insurance risk, and differences from IFRS may arise in practice. [944]

‘Long-duration contracts’ include contracts such as whole-life, universal life, guaranteed renewable term life, endowment, annuity and participating life that are expected to remain in force for an extended period. Long-duration contracts with terms that are not fixed and guaranteed are referred to as ‘non-traditional’ contracts. Most other insurance contracts are considered ‘short-duration contracts’ and include most property and liability insurance contracts. There is specific guidance for financial guarantee contracts. [944-20-05-3A, 05-12 – 05-13, 05-20, 05-37, 15-05 – 15-19]

Under US GAAP, ‘insurance risk’ is the risk arising from uncertainties about underwriting and timing risk. ‘Underwriting risk’ is the risk arising from uncertainties about the ultimate amount of net cash flows under a contract. ‘Timing risk’ is the risk arising from uncertainties about the timing of the receipt or payments of the net cash flows under a contract.

Under US GAAP, elements such as timing and underwriting risk are central to determining whether significant insurance risk exists, rather than focusing on the type of risk – i.e. financial vs insurance.
Deposit components and embedded derivatives

Some insurance contracts contain a deposit component, which is a component that would, if it were a stand-alone instrument, be a financial instrument (see chapter 7.1). The deposit component is required to be ‘unbundled’ and accounted for as a financial instrument if the rights or obligations under that component would not otherwise be recognised under the insurer’s accounting policies and the component can be measured separately. [IFRS 4.10, 12]

Components of insurance contracts that meet the definition of a derivative are in the scope of the financial instruments standards and therefore are subject to the general requirements for embedded derivatives (see chapter 7.2), unless the embedded derivative is itself an insurance contract or a surrender option with fixed terms. [IFRS 4.7–9, IG4]

Recognition and measurement

Accounting policies for insurance contracts

The insurance contracts standard exempts an insurer from applying certain portions of the hierarchy for the selection of accounting policies (see chapter 2.8) to insurance contracts. The standard also permits an insurer to continue some existing practices for insurance contracts, but prohibits their introduction as changes in accounting policy. [IFRS 4.13]

For example, an entity is not required to eliminate excessive prudence in accounting for insurance contracts; nor is it required, on consolidation, to apply consistent accounting policies to insurance contracts held by each entity within a group. There is also no requirement to use discounting in the measurement of insurance liabilities. However, these policies may not be adopted if they were not used before the insurer adopted the insurance contracts standard. [IFRS 4.25–26]

The impact of the exemption from portions of the hierarchy is limited by five specific requirements.

Deposit components and embedded derivatives

Unlike IFRS, US GAAP does not have a broad unbundling concept for insurance contracts issued by an insurance company; however, contract holder contributions for certain types of contracts, such as universal life contracts and deferred annuities, are accounted for as deposits similar to financial instruments. Deposit accounting is used for contracts that do not transfer significant insurance risk. [944-20]

Like IFRS, derivatives that are embedded in insurance contracts issued by an insurance company and meet certain criteria are separated from the host insurance contract and accounted for as if they were stand-alone derivatives (see chapter 7.2). [815-15]

Recognition and measurement

Accounting policies for insurance contracts

Unlike IFRS, because there are explicit accounting requirements for insurance contracts under US GAAP, there is no need for an exemption from applying the authoritative literature (see chapter 1.1). The accounting for insurance contracts depends on the classification of the policy as either a short-duration, long-duration or a financial guarantee. Additionally, US GAAP requires that only costs that are directly related to the successful acquisition of new or renewal insurance contracts can be capitalised as deferred acquisition costs, which may result in differences from IFRS in practice. [944]

In contrast to the IFRS example, US GAAP does not permit excessive prudence in accounting for insurance contracts, and permits discounting only if the payment pattern is fixed or reliably determinable. [944-20-S99-1]

Under US GAAP, the accounting for an insurance contract that is issued by an insurance company varies and depends on whether it is classified as short-duration, long-duration or a financial guarantee and whether it is a whole-life, universal life, guaranteed renewable term life, endowment, annuity or participating life.
An insurer does not:

– recognise as a liability any provisions for possible future claims under insurance contracts if those contracts are not in existence at the reporting date, such as catastrophe and equalisation provisions; or
– offset reinsurance assets against the related insurance liabilities or offset reinsurance income and expenses against expenses or income from the related insurance contracts. [IFRS 4.14]

An insurer:

– derecognises an insurance liability only when the obligation specified in the contract is discharged, cancelled or expires;
– considers whether its reinsurance assets are impaired; and
– carries out a liability adequacy test. [IFRS 4.14, 15, 20, B30]

Liability adequacy test
An insurer assesses at each reporting date whether its recognised insurance liabilities (less deferred acquisition costs and related intangible assets) are adequate, using current estimates of future cash flows under the insurance contracts. Any shortfall is recognised in profit or loss. [IFRS 4.15]

At a minimum, the assessment of the adequacy of the liability considers current estimates of all contractual cash flows and of related cash flows such as claim handling costs, as well as cash flows resulting from embedded options and guarantees. If an insurer’s existing accounting policies include an assessment that meets this requirement, then no further test is required. If they do not, then the provisions standard (see chapter 3.12) is applied to determine whether the recognised liabilities are adequate. [IFRS 4.16–18]

Reinsurance
Reinsurance contracts that an insurer holds are an exception to the general scope of the insurance contracts standard, which otherwise excludes accounting by policyholders. Therefore, there are separate requirements for the cedant’s reinsurance assets. [IFRS 4.2, 4(f)]

An entity is prohibited from offsetting reinsurance assets against the related insurance liabilities. [IFRS 4.14(d), BC106]

As a consequence, the accounting depends on the type of the insurance arrangement as well as other factors, and as a result differences from IFRS may arise in practice. [944]

Liability adequacy test
US GAAP has a similar concept to the liability adequacy test under IFRS; however, it does not use the term ‘liability adequacy test’ and instead requires insurance companies to carry out a form of premium deficiency testing, which generally meets the minimum requirements of IFRS for a liability adequacy test. However, other tests that satisfy the IFRS liability adequacy test might not satisfy the US GAAP requirement for premium deficiency testing. [944-60]

Reinsurance
Like IFRS, US GAAP specifies the accounting by policyholders for reinsurance contracts. [944]

Like IFRS, US GAAP requires reinsurance receivables, including amounts related to claims incurred but not reported and liabilities for future policy benefits, and prepaid reinsurance premiums to be reported separately from the related liabilities. [944-310-25-2]
An entity is prohibited from offsetting income or expenses from reinsurance contracts against expenses or income from the related insurance contracts. [IFRS 4.14(d), BC106]

The cedant considers at each reporting date whether its reinsurance assets are impaired. A reinsurance asset is considered impaired if:
- there is objective evidence that the cedant may not receive all of the amounts that are due to it under the terms of the contract, as a result of an event that occurred after initial recognition of the reinsurance asset; and
- the impact of that event on the amounts that the cedant will receive from the reinsurer is reliably measurable. [IFRS 4.14(e), 20]

**Changes in accounting policies**

An entity is permitted to make changes in its accounting policies for insurance contracts as long as the change improves either the relevance or the reliability of its financial statements without reducing either. [IFRS 4.22]

The assessment of relevance and reliability is judged by the criteria in the hierarchy for the selection of accounting policies (see chapter 2.8) without the need to achieve full compliance with those criteria. [IFRS 4.23]

An insurer is permitted, for example, to change a policy in order to:
- remeasure some insurance liabilities (but not necessarily all of them) to reflect changes in current market interest rates;
- switch to a comprehensive, widely used, investor-oriented model for insurance policy liabilities, even if this means a move towards recognising future investment margins; or
- apply ‘shadow accounting’ to remeasure insurance liabilities (see below). [IFRS 4.24, 27, 30]

**Shadow accounting**

The use of shadow accounting is permitted. Under shadow accounting, the effect of unrealised losses and gains on an insurance liability is recognised in OCI, consistent with the recognition of those unrealised gains and losses on the related financial assets classified as available-for-sale (see chapter 7.4). [IFRS 4.30]

Unlike IFRS, US GAAP permits the amounts of earned premiums ceded and recoveries recognised under reinsurance contracts to be presented net in the income statement, with disclosure of the gross amounts in the notes to the financial statements. [944-605-50-1]

US GAAP requires the recognition of an impairment of a reinsurance asset. A reinsurance asset is considered impaired if it is probable that all amounts that are due under the terms of the contract will not be recovered. Because the precise language under US GAAP differs from IFRS, it is possible that differences may arise in practice. [944-310-35-4]

**Changes in accounting policies**

Unlike IFRS, there is a presumption that an entity should not change an accounting policy for events and transactions. This presumption can be overcome if the entity justifies the use of an alternative acceptable accounting policy on the basis that it is preferable (see chapter 2.8). [250-10-45-12]

**Shadow accounting**

Unlike IFRS, the use of shadow accounting is required under US GAAP by insurance companies. Like IFRS, under shadow accounting the effect of unrealised losses and gains on an insurance liability is recognised in OCI, consistent with the recognition of those unrealised gains and losses on the related financial assets classified as available-for-sale (see chapter 7.4). [320-10-599-2]
Insurance contracts acquired in a business combination

At the date of acquisition, an insurer measures at fair value the assets and liabilities arising under insurance contracts acquired in a business combination. An insurer is permitted, but not required, to use an expanded presentation that splits the fair value of acquired insurance contracts into two components:

- a liability measured in accordance with the insurer’s existing accounting policies, which is generally greater than the fair value of the acquired contracts; and
- an intangible asset, representing the difference between the fair value of the acquired insurance contracts and the larger reported amount under the first component. [IFRS 4.31]

An insurer acquiring a portfolio of insurance contracts (portfolio transfer), outside a business combination, may also use the expanded presentation described above. [IFRS 4.32]

The impairment and intangible assets standards apply to other intangible assets in a business combination, such as customer lists and customer relationships that are not part of the insurance rights and obligations that existed at the date of the business combination or portfolio transfer. [IFRS 4.33]

Contracts with discretionary participation features

A ‘discretionary participation feature’ (DPF) is a contractual right of the investor or policyholder to receive additional benefits, as a supplement to guaranteed benefits. To fall under the definition of a DPF, the additional benefits should be a significant portion of the total contractual benefits. These additional benefits are generally based on the performance of a specified pool of contracts, on the realised and/or unrealised investment returns on a designated pool of assets or on the profit or loss of the entity. The amount or timing of the additional benefits received by the policyholder contractually is at the discretion of the issuer. [IFRS 4.A]

Such contracts may be insurance contracts or investment contracts, and are often described as ‘participating’ or ‘with-profits’ contracts. [IFRS 4.A]

Insurance contracts acquired in a business combination

Like IFRS, under US GAAP an insurance company recognises and measures at fair value the assets and liabilities arising from insurance contracts acquired in a business combination. Unlike IFRS, an entity is required to split the fair value of the acquired insurance contracts into the two components that are permitted by IFRS. [944-805-30-1]

Unlike IFRS, US GAAP has no specific guidance on the presentation for insurance contracts acquired in a portfolio transfer.

Contracts with discretionary participation features

US GAAP does not use the term ‘discretionary participation feature’ and instead addresses the accounting for dividends to policyholders, defined as amounts that are distributable to policyholders of participating insurance contracts when the amounts distributed are determined by the insurer. [944-50]

These participating insurance contracts are accounted for as insurance contracts under US GAAP. Those participating contracts with terms that are, in substance, universal life-type contracts follow the accounting for long-duration insurance contracts, unlike IFRS. [944-50-15-2]
Any guaranteed amount, to which the policyholder has an unconditional right, is classified as a liability by the entity issuing the policy. The amount that is payable under the DPF, if it is measured separately from the guaranteed amount, may be classified as a liability or as a separate component of equity. It may not be classified in an intermediate (mezzanine) category that is neither liability nor equity. [IFRS 4.34]

If a contract that is classified as a financial instrument contains a DPF, then the contract falls into the scope of the insurance contracts standard and the guidance of the insurance contracts standard for insurance contracts also applies. If the entire DPF within the investment contract is classified as a liability, then the liability adequacy test is applied to the whole contract. If some or all of the DPF is classified as equity, then the liability amount includes, as a minimum, the amount that would be recognised for the guaranteed element under the financial instruments standards. [IFRS 4.2, 35]

Premiums received may be recognised as revenue for both insurance contracts and investment contracts containing a DPF. However, the portion of profit or loss that is attributable to the equity component is presented as an allocation of profit or loss in a manner similar to the presentation of NCI (see chapter 2.5), and not as expense or income. [IFRS 4.34(c)]

Financial instrument issues
With the exception of insurance assets (e.g. salvage and subrogation, and premium receivables), deferred acquisition costs related to insurance contracts, present value of future profits and reinsurance assets, an insurer’s accounting for its assets follows other applicable IFRSs. [IAS 18.IE14]

To avoid artificial accounting mismatches when an insurer changes its accounting policies for insurance liabilities, such as remeasuring the insurance liabilities to reflect current market interest rates and recognising the changes in insurance liabilities in profit or loss, an insurer is permitted to reclassify some or all of its financial assets as at fair value through profit or loss. This reclassification is treated as a change in accounting policy (see chapter 2.8). [IFRS 4.45]

Financial guarantee contracts
Although financial guarantee contracts meet the definition of an insurance contract, they are generally outside the scope of the insurance contracts standard and are accounted for under the financial instruments standards. However, if an entity issuing such contracts has previously asserted explicitly that it regards financial guarantee contracts as insurance contracts and has accounted for them as such, then it may apply the insurance contracts standards to such contracts. [IFRS 4.4]

Unlike IFRS, annual policyholder dividends are reported separately as an expense in profit or loss and as a liability in the statement of financial position, based on estimates of amounts incurred for the policies in effect during the period. Terminal dividends, which are calculated and paid to policyholders on termination of the contract, are accrued as part of the liability for future policy benefits. [944-40-25-30, 944-50-30-4, 45-1]

US GAAP does not address investment contracts with discretionary participation features and differences in practice from IFRS may arise. [944-50-25-2]

Unlike IFRS, premiums from participating insurance contracts, other than contributions for deposit components, are recognised entirely as revenue when they are due for long-duration contracts and when they are earned for short-duration contracts. [944-605-25-3]

Financial instrument issues
Unlike IFRS, US GAAP specific to insurance companies deals with, in part, financial instruments that under IFRS are subject to the general recognition and measurement requirements for financial instruments. Therefore, differences from IFRS may arise in practice. [944-325]

Unlike IFRS, for traditional long-duration insurance products, the liability for future policy benefits is based on assumptions that are applicable when the insurance contract is entered into. These original assumptions continue to be used unless indications of a premium deficiency emerge. In contrast, non-traditional long-duration products, such as universal life policies, are subject to periodic remeasurement using current assumptions. [944-40-30-7, 30-25]

Financial guarantee contracts
Unlike IFRS, there is specific accounting guidance that applies only to financial guarantee contracts. [944]
Forthcoming requirements

Amendments to IFRS 4 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts introduce two optional approaches for certain entities applying IFRS 9 and IFRS 4:

- the temporary exemption from IFRS 9; and
- the overlay approach.

The temporary exemption from IFRS 9 permits an entity to apply IAS 39 rather than IFRS 9 for annual periods beginning on or after 1 January 2018 but not after 1 January 2021. An entity is permitted to apply the temporary exemption from IFRS 9 if it has not previously applied IFRS 9 and its activities are predominantly connected with insurance. [IFRS 4.20A-B, 35A]

The overlay approach applies when an entity first applies IFRS 9. An entity is permitted, for designated financial assets, to adjust its profit or loss for the difference between the amounts reported in profit or loss under IFRS 9 and the amount that would have been reported in profit or loss for those assets if the entity had applied IAS 39. [IFRS 4.35A–35C]

Forthcoming requirements

There are no forthcoming requirements under US GAAP.
Effective dates: US GAAP

The following table shows the effective dates of Accounting Standards Updates (ASUs) that are not yet effective for all entities. The titles have been condensed and are not necessarily the exact titles of the ASUs. For completeness, this table also includes the interim periods in which ASUs are effective. Not-for-profit entities and employee benefit plans are not in the scope of this publication and are therefore excluded.

A public business entity is a business entity (which excludes not-for-profit entities and employee benefit plans) that meets any of the following criteria:

- it is required by the SEC to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing);
- it is required by the Securities Exchange Act of 1934 (the Act), or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC;
- it is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer;
- it has issued, or is a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market; or
- it has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract or regulation to prepare US GAAP financial statements (including notes) and make them publicly available on a periodic basis (e.g. interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity’s filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

Unless otherwise stated, the effective date should be read as periods in fiscal years beginning after the stated date.

In this table:

A = annual periods
I = interim periods

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Notes:
1. This edition of our GAAP Comparison focuses only on currently effective requirements under both IFRS and US GAAP related to financial instruments (see About this publication).
2. The effective dates for ASU 2017-10 for entities that have not adopted ASU 2014-09 are presented. The effective dates for entities that have not adopted ASU 2014-09 are the same as ASU 2014-09.
3. ASU 2017-04 is effective for annual or interim goodwill impairment tests performed for fiscal years beginning after the presented dates. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates on or after 1 January 2017.
4. Early adoption is permitted but no earlier than fiscal years beginning after 15 December 2018.
5. Early adoption is permitted for non-public business entities no earlier than fiscal years beginning after 15 December 2017.

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