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# IFRS and US GAAP: similarities and differences

Partially updated June 2023

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# ***About the IFRS and US GAAP: Similarities and differences guide***

PwC is pleased to offer our updated *IFRS and US GAAP: similarities and differences* guide. This publication is designed to alert companies, investors, and other capital market participants to the major differences between IFRS and US GAAP.

It would appear that the use of IFRS in the United States by public companies is off the table, at least for now. However, as discussed in Chapter 1, being financially bilingual continues to be important for US capital market participants due to IFRS reporting needs of multinational companies and cross-border mergers and acquisitions.

Each topical chapter consists of the following:

- A conceptual discussion of the current IFRS and US GAAP similarities and differences
- A detailed analysis of current differences between the frameworks, including an assessment of the impact of the differences
- In addition, this publication includes an overview of IFRS for small and medium-sized entities.

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

## ***References to other PwC US GAAP guidance***

This guide provides general and specific references to chapters in other PwC US GAAP guides to assist users in finding other relevant information. References to other guides are indicated by the applicable guide abbreviation followed by the specific section number. The other PwC guides referred to in this guide, including their abbreviations, are:

- *Business combinations and noncontrolling interests (BCG)*
- *Consolidation (CG)*
- *Equity method investments and joint ventures (EM)*
- *Fair value measurements (FV)*
- *Financing transactions (FG)*
- *Property, plant, equipment and other assets (PPE)*

### *Summary of significant changes*

Following is a summary of recent noteworthy revisions to the guide. Additional updates may be made to keep pace with significant developments.

#### ***Revisions made in June 2023***

##### **Chapter 12, Consolidation**

- **SD 12.10** was updated to reflect the guidance on tax credit structures in ASU 2023-02, *Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*.

#### ***Revisions made in March 2023***

##### **Chapter 7, Assets—financial assets**

- **SD 7.1** and **SD 7.13** were updated to reflect the guidance on expected credit losses in ASC 326, *Financial Instruments – Credit Losses*.
- The content in **SD 7.3** on equity investments was moved to **SD 7.7**, and other sections were renumbered accordingly.

##### **Chapter 8, Liabilities—taxes**

- **SD 8** was updated to remove guidance that was superseded by ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*.
- **SD 8.4** was updated to include the IAS 12 amendments, *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*.
- **SD 8.11** was updated to include discussion about a difference in the accounting for the impact of a change in tax status.

#### ***Revisions made in November 2022***

##### **Chapter 4, Expense recognition—share-based payments**

- **SD 4.7** was updated to address accounting for awards that vest upon a liquidity event.

##### **Chapter 5, Expense recognition—employee benefits**

- **SD 5.5** was added to address the attribution of service cost.

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***Chapter 1:***  
***Importance of being***  
***financially bilingual—***  
***updated November 2020***

## 1.1 Overview

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

The remaining major capital markets without an IFRS mandate are:

- The US, with no current plans to change for domestic registrants (full IFRS allowed for non-US filers);
- Japan, where voluntary adoption is allowed, but no mandatory transition date has been established;
- China, whose accounting standards are converged with IFRS to some extent.

IFRS requirements elsewhere in the world impact US companies through statutory reporting requirements of US multinationals, cross-border merger and acquisition (M&A) activity, and the IFRS reporting demands of non-US stakeholders. It is clear from a preparer perspective that being financially bilingual in the US is important.

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

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

## 1.2 IFRS affects US businesses in multiple ways

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

### 1.2.1 Mergers and acquisitions and capital-raising

Global economic slowdown caused by the Covid-19 pandemic led to a decline in the volume of global M&A transactions in 2020. However, we expect that as world economies recover, M&A activity will recover. For companies that look outside their borders for potential buyers, targets, and capital, knowledge and understanding of IFRS become increasingly important. Significant differences in both bottom-line impact and disclosure requirements exist between IFRS and US GAAP. Understanding these differences and their impact on key deal metrics, as well as on both short- and long-term

financial reporting requirements, will lead to a more informed decision-making process and help minimize late surprises that could significantly impact deal value or timing.

### **1.2.2 *Non-US stakeholders***

Many US companies have non-US stakeholders. These stakeholders may require IFRS financial information, audited IFRS financial statements, and budgets and management information prepared under IFRS.

### **1.2.3 *Non-US subsidiaries***

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

## **1.3 *Our point of view***

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

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***Chapter 2:  
IFRS first-time  
adoption—updated November  
2020***

## 2.1 *IFRS first-time adoption*

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

### 2.1.1 *What does IFRS 1 require?*

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

IFRS 1 requires companies to:

- Identify the first IFRS financial statements
- Prepare an opening balance sheet at the date of transition to IFRS (see SD 2.1.3)
- Select accounting policies that comply with IFRS effective at the end of the first IFRS reporting period and apply those policies retrospectively to all periods presented in the first IFRS financial statements
- Apply mandatory exceptions to retrospective application
- Consider whether to apply any of the optional exemptions from retrospective application
- Make extensive disclosures to explain the transition to IFRS, including reconciliations from previous GAAP to IFRS for equity and total comprehensive income (see SD 2.1.4)

IFRS 1 identifies certain areas in which retrospective application is prohibited. Examples of these mandatory exceptions to retrospective application include the use of estimates (hindsight is not permitted), the classification and measurement of financial assets, impairments of financial assets, accounting for non-controlling interests (i.e., certain requirements of IFRS 10 are applied prospectively), and accounting for embedded derivatives, among others. When IFRS 17 becomes effective, the accounting for insurance contracts will also be precluded from retrospective application.

In addition to the mandatory exceptions, IFRS 1 includes a variety of optional exemptions that provide limited relief for first-time adopters, mainly in areas where the information needed to apply IFRS retrospectively might be particularly challenging to obtain.

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

IFRS 1 is regularly updated to address first-time adoption issues arising from new standards and amendments as they become effective. Accordingly, consideration should be given to the impact on



IFRS 1, if any, when a company adopts new standards or amendments to understand, for example, if that new standard or amendment should be applied on a full retrospective basis or if there is an exception or exemption to allow alternative accounting considerations.

### **2.1.2 *When to apply IFRS 1***

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

### **2.1.3 *The opening IFRS balance sheet***

The opening IFRS balance sheet is the starting point for all subsequent accounting under IFRS and is prepared at the date of transition, which is the beginning of the earliest period for which full comparative information is presented and disclosed in accordance with IFRS. For example, preparing IFRS financial statements for the two years ending December 31, 20X1 would have a transition date of January 1, 20X0. This would also be the date of the opening IFRS balance sheet. Therefore, as the opening balance sheet is required to be prepared and presented as a primary financial statement in accordance with IFRS 1, the entity would present a balance sheet as of January 1, 20X0, December 31, 20X0, and December 31, 20X1.

IFRS 1 requires that the opening IFRS balance sheet:

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

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

### **2.1.4 *Reconciliations of equity and total comprehensive income***

Under IFRS 1, reconciliations between previous GAAP and IFRS are required for equity and total comprehensive income. The reconciliation of a company's equity is required for both the date of transition to IFRS and the end of the last period presented under previous GAAP. For total comprehensive income/loss (or profit/loss if a company did not report total comprehensive income/loss), the reconciliation is only required for the latest annual period under previous GAAP. The reconciliations should provide sufficient detail to enable users to understand the material adjustments to the balance sheet, statement of comprehensive income/loss, and if presented under previous GAAP, statement of cash flows.

For example, a company that is preparing its first IFRS financial statements for the year ended December 31 20X1, with one year of comparative information as well as presenting its opening balance

sheet, would disclose reconciliations for equity at January 1, 20X0 and December 31, 20X0, and comprehensive income/loss for the year ended December 31, 20X0.

### 2.1.5 *IFRS first-time adoption - important takeaways*

The transition to IFRS can be a long and complicated process with many technical and accounting challenges to consider. Experience with companies adopting IFRS for the first time indicates there are some challenges that are consistently underestimated, including:

**Consideration of data gaps**—Preparation of the opening IFRS balance sheet and all of the related footnote disclosures may require the calculation or collection of information that was not previously required under US GAAP. Companies should plan their transition and identify the differences between IFRS and US GAAP early so that all of the information required can be collected and verified in a timely manner.

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

**Consideration of accounting policy choices**—A number of IFRS standards allow companies to choose between alternative policies. Companies should select carefully the accounting policies to be applied to the opening balance sheet and have a full understanding of the implications to current and future periods. Companies should take this opportunity to evaluate their IFRS accounting policies with a “clean sheet of paper” mind-set. That is, the guidance in IAS 8, *Accounting Policies, Changes in Estimates and Errors*, does not apply to changes in accounting policies until after a company presents its first set of financial statements under IFRS. Although many accounting requirements are similar between US GAAP and IFRS, companies should not overlook the opportunity to explore alternative IFRS accounting policies that might better reflect the economic substance of their transactions and enhance their communications with investors.

**Regulatory considerations**—In addition to differences that arise between accounting standards, there may also be local regulatory requirements to consider. For example, certain information required by the SEC but not by IFRS (e.g., a summary of historical data) can still be presented, in part under US GAAP; however, such comparative information must be clearly labeled as not being prepared in accordance with IFRS, and the nature of the main adjustments to comply with IFRS must be discussed (although such adjustments do not need to be quantified). Further, other incremental information required by a regulator might need to be presented in accordance with IFRS. For example, the SEC in certain instances requires two years of comparative IFRS financial statements, whereas IFRS would require only one year.

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***Chapter 3:***  
***Revenue recognition—***  
***updated November 2020***

### 3.1 Revenue recognition

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

#### Technical references

##### US GAAP

ASC 340-40, ASC 606, CON 5

##### IFRS

IFRS 15

#### Note

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

### 3.2 Collectibility threshold

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

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

### 3.3 *Noncash consideration*

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

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

### 3.4 *Licenses of intellectual property*

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

US GAAP	IFRS
ASC 606 specifies that an entity should consider the nature of its promise in granting a license (i.e., whether the license is a right to access or right to use intellectual property) when applying the general revenue recognition model to a combined performance obligation that includes a license and other goods or services.	IFRS 15 does not contain the same specific guidance. However, we expect entities to reach similar conclusions under both standards.
ASC 606 defines two categories of intellectual property – functional and symbolic – for purposes of assessing whether a license is a right to access or a right to use intellectual property.	Under IFRS 15, the nature of a license is determined based on whether the entity's activities significantly change the intellectual property to which the customer has rights. We expect that the outcome of applying the two standards will be similar; however, there will be fact patterns for which outcomes could differ.
ASC 606 was amended to use different words to explain that a contract could contain multiple licenses that represent separate performance obligations, and that contractual restrictions of time, geography, or use within a single license are attributes of the license. ASC 606 also includes additional examples to illustrate these concepts.	IFRS 15 was not amended and does not include the same additional examples; however, the IASB included discussion in the basis for conclusions regarding how to account for restrictions within a license.

US GAAP	IFRS
ASC 606 specifies that an entity cannot recognize revenue from the renewal of a license of intellectual property until the beginning of the renewal period.	IFRS 15 does not contain this specific guidance; therefore, entities applying IFRS might reach a different conclusion regarding when to recognize license renewals.

### 3.5 *Practical expedients at transition*

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

US GAAP	IFRS
ASC 606 provides a “use of hindsight” practical expedient intended to simplify the transition for contracts modified multiple times prior to the initial application of the standard. An entity applying the expedient will determine the transaction price of a contract at the date of initial application and perform a single, standalone selling price allocation (with the benefit of hindsight) to all of the satisfied and unsatisfied performance obligations in the contract from inception.	IFRS 15 provides a similar “use of hindsight” practical expedient; however, entities can choose to apply the expedient either at the beginning of the earliest period presented or at the date of initial application.
ASC 606 permits entities using the modified retrospective transition approach to apply the new standard to either all contracts or only contracts that are not yet complete as of the date of initial application. The US GAAP standard defines a completed contract as a contract for which all (or substantially all) of the revenue was recognized in accordance with legacy revenue guidance before the date of initial application.	IFRS 15 permits entities to apply the new standard either to all contracts or only contracts that are not yet complete as of the date of initial application under the modified retrospective transition approach. The IFRS standard defines a completed contract as a contract for which the entity has transferred all of the goods or services identified in accordance with legacy revenue guidance.  IFRS 15 also permits entities using the full retrospective transition approach to not restate contracts that are completed contracts as of the beginning of the earliest period presented.

### 3.6 *Shipping and handling*

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

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

### 3.7 *Presentation of taxes collected from customers*

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

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

### 3.8 *Interim disclosure requirements*

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

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

### 3.9 *Effective date*

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

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

**US GAAP****IFRS**


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most nonpublic entities for periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.

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### 3.10 *Impairment loss reversal*

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

**US GAAP****IFRS**


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Consistent with other US GAAP impairment guidance, ASC 340-40, *Other Assets and Deferred Costs—Contracts with Customers*, does not permit entities to reverse impairment losses recognized on contract costs.

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Consistent with other IFRS impairment guidance, IFRS 15 requires impairment losses to be reversed in certain circumstances similar to the existing standard on impairment of assets.

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### 3.11 *Relief for nonpublic entities*

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

**US GAAP****IFRS**


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ASC 606 gives nonpublic entities relief relating to certain disclosures, transition, and the effective date.

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IFRS 15 applies to all IFRS reporters, public and nonpublic, except entities that apply IFRS for SMEs.

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***Chapter 4:***  
***Expense recognition—***  
***share-based payments—***  
***updated November 2022***

## 4.1 *Expense recognition—share-based payments*

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

Differences within the two frameworks may result in different classifications of an award as a component of equity or as a liability. This may result in different total compensation cost and it may impact earnings volatility and balance sheet metrics. Classification under IFRS is based solely on whether awards are ultimately settled in equity or cash. However, US GAAP has guidance for certain types of awards that are equity settled but may result in liability classification (e.g., awards with vesting conditions outside of service, performance, or market conditions), as well as guidance for some awards that may be cash settled but result in equity classification (e.g., puttable awards).

In addition, companies that issue awards with graded vesting (e.g., awards that vest ratably over time, such as 25 percent per year over a four-year period) may require faster expense recognition under IFRS than under US GAAP.

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

### ***Technical references***

#### *US GAAP*

ASC 480, ASC 718, SAB Topic 14

#### *IFRS*

IFRS 2

### ***Note***

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

## 4.2 *Scope—share-based payments*

While both US GAAP and IFRS apply a single standard to all share-based payment arrangements, regardless of whether the counterparty is a nonemployee, each framework has certain guidance specific to the measurement of nonemployee awards.

Some awards categorized as nonemployee instruments under US GAAP will be treated as employee awards under IFRS.

US GAAP	IFRS
<p>ASC 718, <i>Compensation—Stock Compensation</i>, applies to employee and nonemployee share-based transactions. The guidance is the same except for specific guidance related to the attribution of compensation cost and certain inputs used in the valuation of nonemployee awards.</p> <p>The guidance focuses on the legal definition of an employee with certain specific exceptions.</p>	<p>IFRS 2, <i>Share-based payments</i>, includes accounting for all employee and nonemployee arrangements. Furthermore, under IFRS, the definition of an employee is broader than the US GAAP definition.</p> <p>IFRS focuses on the nature of the services provided and treats awards to employees and others providing employee-type services similarly. Awards for goods from vendors or nonemployee-type services are treated differently.</p>

### 4.3 *Measurement of awards granted by non-public companies*

IFRS does not permit alternatives in choosing a measurement method.

US GAAP	IFRS
<p><b>Equity-classified</b></p> <p>The guidance allows nonpublic companies to measure stock-based compensation awards by using the fair value method, or the calculated-value method if it is not practicable to estimate expected stock price volatility.</p> <p><b>Liability-classified</b></p> <p>The guidance allows nonpublic companies to make an accounting policy decision on how to measure stock-based compensation awards that are classified as liabilities. Such companies may use the fair value method (or calculated-value method, if applicable) or the intrinsic-value method.</p>	<p>IFRS does not include such alternatives for nonpublic companies and requires the use of the fair-value method in all circumstances.</p>

### 4.4 *Measurement of awards granted to nonemployees*

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

US GAAP	IFRS
<p>Nonemployee awards are measured in the same manner as employee awards under ASC 718, at the fair value of the equity instrument on the grant date, with the exception of certain inputs used in the calculation of expected term.</p>	<p>Transactions with parties other than employees (or those providing employee-type services) should be measured at the date(s) on which the goods are received or the date(s) on which the services are rendered.</p>

US GAAP	IFRS
	<p>Nonemployee transactions are generally measured at the fair value of the goods or services received, since it is presumed that it will be possible to reliably measure the fair value of the consideration received. If an entity is not able to reliably measure the fair value of the goods or services received (i.e., if the presumption is overcome), the fair value of the award should be measured indirectly by reference to the fair value of the equity instrument granted as consideration.</p> <p>When the presumption is not overcome, an entity is also required to account for any unidentifiable goods or services received or to be received. This would be the case if the fair value of the equity instruments granted exceeds the fair value of the identifiable goods or services received and to be received.</p>

## 4.5 *Classification of instruments as liabilities or equity*

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

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

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

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

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

## 4.7 *Awards with performance targets*

Under IFRS, a performance target met after the service period is a non-vesting condition that is reflected in the measurement of the grant date fair value. Awards that vest upon a liquidity event, such as an IPO or change in control of the company, are recognized when probable of occurring. Probability, however, may be interpreted differently under IFRS and US GAAP.

US GAAP	IFRS
A performance target that may be met after the requisite service period is complete is a performance vesting condition. The fair value of the award should not incorporate the probability of a performance condition vesting, but rather should be recognized only if the performance condition is probable of being achieved.	A performance target that may be met after the requisite service period is a non-vesting condition and is reflected in the measurement of the grant date fair value of an award.
A company typically cannot conclude it is probable that a liquidity event, such as an IPO or change in control of the company, will occur until the consummation date of the liquidity event because such an event is (1) fundamental to the company's organizational structure, (2) outside the company's control, and (3) subject to significant external contingencies with a high degree of uncertainty.	Under IFRS, a company should begin to recognize expense for an award that vests only on an exit event, such as an IPO, when it is determined to be probable of occurring. It may be appropriate to conclude that an exit event is probable of occurring before consummation.

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

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

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

## 4.9 *Attribution—awards with graded-vesting features*

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

US GAAP	IFRS
<p>Companies are permitted to make an accounting policy election regarding the attribution method for awards with service-only conditions and graded-vesting features. The valuation method that the company uses (single award or multiple tranches of individual awards) is not required to align with the choice in attribution method used (straight-line or accelerated tranche by tranche). For awards with graded vesting and performance or market conditions, the accelerated graded-vesting attribution approach is required.</p>	<p>Companies are not permitted to choose how the valuation or attribution method is applied to awards with graded-vesting features. Companies should treat each installment of the award as a separate grant. This means that each installment would be separately measured and attributed to expense over the related vesting period, which would accelerate the expense recognition.</p>

## 4.10 *Attribution—awards to nonemployees*

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

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

## 4.11 *Certain aspects of share-based award modification accounting*

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

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

## 4.12 *Accounting for forfeitures of share-based awards*

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

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

## 4.13 *Derived service period of share-based awards*

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

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

US GAAP	IFRS
derived service period must be determined by reference to a valuation technique.	
The expense for the award would be recognized over the derived service period and reversed if the employee does not complete the requisite service period.	

## 4.14 *Tax withholding arrangements—impact to classification*

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

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

## 4.15 *Accounting for income tax effects of share-based awards*

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

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

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



US GAAP	IFRS
between the recorded deferred tax asset and the tax benefit of the actual tax deduction) are recognized within income tax expense.	recorded in the income statement; the excess is recorded in equity.  When the expected tax benefit is less than the tax effect of the cumulative amount of recognized expense, the entire tax benefit is recorded in the income statement.

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

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

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

## 4.17 *Valuation—Guidance on expected volatility and expected term*

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

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

## 4.18 *Employee stock purchase plans (ESPP)*

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

US GAAP	IFRS
<p>ESPPs are compensatory if terms of the plan:</p> <ul style="list-style-type: none"> <li>□ Either (1) are more favorable than those available to all shareholders, or (2) include a discount from the market price that exceeds the percentage of stock issuance costs avoided (discount of 5 percent or less is a safe harbor);</li> <li>□ Do not allow all eligible employees to participate on an equitable basis; or</li> <li>□ Include any option features (e.g., look-backs).</li> </ul> <p>In practice, most ESPPs are compensatory; however, plans that do not meet any of the above criteria are non-compensatory.</p>	<p>ESPPs are always compensatory and treated like any other equity-settled share-based payment arrangement. IFRS does not allow any safe-harbor discount for ESPPs.</p>

## 4.19 Group share-based payment transactions

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

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

US GAAP	IFRS
	for as an equity-settled share-based payment. Conversely, if the parent is obligated to issue the shares directly to employees of the subsidiary, then the arrangement should be accounted for as equity-settled in both the consolidated financial statements and the separate standalone financial statements of the subsidiary.

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***Chapter 5:***  
***Expense recognition—***  
***employee benefits—updated***  
***November 2022***

## 5.1 *Expense recognition—employee benefits*

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

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

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

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

Under IFRS, companies have flexibility to present components of net benefit cost within different line items on the income statement. Components recognized in determining net income (i.e., service and finance costs, but not actuarial gains and losses) may be presented as (1) a single net amount or (2) separately displayed. US GAAP prescribes presentation of service cost in the same line item or items as other current employee compensation costs and presentation of the remaining components of net benefit cost separately in one or more line items and outside of income from operations (if that subtotal is presented).

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

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

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

### **Technical references**

#### *US GAAP*

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

#### *IFRS*

IAS 19, IAS 37, IFRS 13, IFRIC 14

#### **Note**

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

## **5.2 Expense recognition—gains/losses**

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

Note: Gains and losses as referenced under US GAAP include (1) the differences between actual and expected return on assets and (2) changes in the measurement of the benefit obligation.

Remeasurements under IFRS, as referenced, include (1) actuarial gains and losses, (2) the difference between actual return on assets and the amount included in the calculation of net interest cost (see SD 5.4), and (3) changes in the effect of the asset ceiling (see SD 5.12).

<b>US GAAP</b>	<b>IFRS</b>
The guidance permits companies to either (1) record gains/losses in the period incurred within the statement of operations or (2) defer gains/losses through the use of the corridor approach (or any systematic method that results in faster recognition than the corridor approach).	Remeasurements are recognized immediately in OCI. There is no option to recognize gains/losses in profit or loss. In addition, the “corridor and spreading” option—which allows delayed recognition of gains and losses—is prohibited.
Whether gains/losses are recognized immediately or amortized in a systematic fashion, they are ultimately recorded within the statement of operations as components of net periodic benefit cost.	Once recognized in OCI, gains/losses are not subsequently recorded within profit or loss. The standard does not require that the amounts recognized in OCI be immediately taken to retained earnings; they may remain in a specific reserve or ‘other’ reserves within equity.

## 5.3 *Expense recognition—prior service costs and credits*

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

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

US GAAP	IFRS
<p>Prior service cost (whether for vested or unvested benefits) should be recognized in other comprehensive income at the date of the adoption of the plan amendment and then amortized into income over one of the following:</p> <ul style="list-style-type: none"> <li>□ The participants' remaining years of service (for pension plans, except where all or almost all plan participants are inactive)</li> <li>□ The participants' remaining years of service to full eligibility date (for other postretirement benefit plans, except where all or almost all plan participants are inactive)</li> <li>□ The participants' life expectancy (for plans that have all or almost all inactive participants)</li> </ul> <p>Negative prior service cost should be recognized as a prior service credit in other comprehensive income and used first to reduce any remaining positive prior service cost included in accumulated other comprehensive income. Any remaining prior service credits should then be amortized over the same periods as described above.</p>	<p>Recognition of all past service costs is required at the earlier of when a plan amendment occurs or when the entity recognizes related restructuring costs (in the event of a curtailment). Unvested past service cost may not be spread over a future service period. Curtailments that reduce benefits are not disclosed separately, but are considered as part of the past service costs.</p>

## 5.4 *Expense recognition—expected return on plan assets*

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

US GAAP	IFRS
Expected return is based on an expected rate of return on plan assets.	Net interest cost or income is calculated by applying the discount rate (as described below) to the defined benefit liability or asset of the plan. The defined benefit asset or liability is the surplus or deficit (i.e., the net amount of the defined benefit obligation less plan assets) which is recognized on the balance sheet after considering the asset ceiling test (see SD 5.13).
Plan assets should be measured at fair value for balance sheet recognition and for disclosure purposes. However, for purposes of determining the expected return on plan assets and the related accounting for gains and losses, plan assets can be measured by using either fair value or a calculated value that recognizes changes in fair value over a period of not more than five years.	Plan assets should always be measured at fair value.

## 5.5 *Expense recognition – attribution of service cost*

Attribution of service cost may differ under the two frameworks as IFRS has specific guidance on the topic that US GAAP does not.

US GAAP	IFRS
Under US GAAP, benefits are attributed to service using the projected benefit approach (which typically means ratably over the service period). The guidance does not specifically address attribution when benefits are impacted only for service after a certain age.	The IFRS IC issued an agenda decision regarding the period over which an entity should attribute the benefit for a particular defined benefit arrangement (a lump sum payment when a minimum number of years of consecutive service is provided and a specific retirement age is reached). In that specific fact pattern, benefits should only be attributed to service after the age when service starts impacting either the timing or the amount of the retirement benefits. If consecutive service is not required, then benefits can be attributed from the date of hire.

## 5.6 *Income statement classification*

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

US GAAP	IFRS
Service cost is presented in the same line item or items as other current employee compensation costs (and included within income from operations, if that subtotal is presented). The remaining components of net benefit cost must be presented separately in one or more line items and outside of income from operations (if that subtotal is presented).	Employers have flexibility to either (1) present all components recognized in determining net income (i.e., service and net interest cost but not gains and losses) as a single net amount (similar to US GAAP) or (2) present those components separately within the income statement.



## 5.7 Capitalization of employee benefit costs

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

US GAAP	IFRS
Only service cost is eligible to be capitalized.	IFRS does not specify which components of net benefit costs are eligible for capitalization. Therefore, there could be a difference in the components of costs capitalized.

## 5.8 Measurement date and frequency

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

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

## 5.9 Substantive commitment to increase retirement benefits

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

**US GAAP**

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

**IFRS**

In certain circumstances, a history of regular increases may indicate a present commitment to make future plan amendments. In such cases, a constructive obligation (to increase benefits) is the basis for determining the obligation.

## 5.10 *Defined benefit versus defined contribution classification*

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

**US GAAP**

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

Multiemployer plans are treated similar to defined contribution plans. A pension plan to which two or more unrelated employers contribute is generally considered to be a multiemployer plan.

A common characteristic of a multiemployer plan is that there is commingling of assets contributed by the participating employers.

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

**IFRS**

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

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

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

## 5.11 Curtailments

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

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

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

US GAAP	IFRS
<p>A curtailment is defined as an event that significantly reduces the expected years of future service of present employees or eliminates for a significant number of employees the accrual of defined benefits for some or all of their future service.</p> <p>Curtailments resulting from employee terminations are recognized when the curtailment is probable and reasonably estimable for losses, but when the termination occurs for gains.</p> <p>Curtailments resulting from plan terminations or amendments are recognized when realized (i.e., once the plan amendment is adopted).</p> <p>The guidance requires certain offsets of unamortized gains/losses in a curtailment but does not permit pro rata recognition of the remaining unamortized gains/losses.</p>	<p>The definition of a curtailment is limited to “a significant reduction by the entity in the number of employees covered by a plan.”</p> <p>Curtailment gains and losses should be recorded when the curtailment occurs.</p> <p>IFRS requires the gain or loss related to plan amendments, curtailments, and termination benefits that occur in connection with a restructuring to be recognized when the related restructuring cost is recognized, if that is earlier than the normal IAS 19 recognition date.</p>

## 5.12 Settlements

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

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

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

US GAAP	IFRS
A partial settlement of any one participant's obligation is generally not allowed. If a portion of the obligation for vested benefits to plan participants is satisfied and the employer remains liable for the balance of those participants' vested benefits, it may not eliminate significant risks related to the pension benefit obligation for the participants and therefore, the amount that is satisfied is not considered settled.	A partial settlement occurs if a transaction eliminates all further legal or constructive obligations for part of the benefits provided under a defined benefit plan.

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

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

## 5.13 Asset ceiling

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

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

## 5.14 *Obligation measurement when employers and employees contribute*

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

US GAAP	IFRS
<p>The measurement of plan obligations generally does not reflect a reduction when the employer's exposure is limited or when the employer can increase contributions from employees from current levels to help meet a deficit.</p> <p>Under US GAAP, employee contributions typically reduce service cost in the period of contribution.</p>	<p>The measurement of plan obligations where risks associated with the benefit are shared between employers and employees should reflect the substance of the arrangements where the employer's exposure is limited or where the employer can increase contributions from employees to help meet a deficit.</p> <p>IFRS allows contributions that are linked to service, and do not vary with the length of employee service, to be deducted from the cost of benefits earned in the period that the service is provided rather than spreading them over the employees' working lives.</p> <p>Contributions that are linked to service, and vary according to the length of employee service, must be spread over the service period using the same attribution method that is applied to the benefits; either in accordance with the formula in the pension plan, or, where the plan provides a materially higher level of benefit for service in later years, on a straight line basis</p>

## 5.15 *Plan asset valuation*

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

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

US GAAP	IFRS
Under US GAAP, contracts with insurance companies (other than purchases of annuity contracts) should be accounted for as investments and measured at fair value. In some cases, the contract value may be the best available evidence of fair value unless the contract has a determinable cash surrender value or conversion value, which would provide better evidence of the fair value.	Under IFRS, the fair value of insurance policies should be estimated using, for example, a discounted cash flow model with a discount rate that reflects the associated risk and the expected maturity date or expected disposal date of the assets. Qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan are measured at the present value of the related obligations. Under IFRS, the use of the cash surrender value is generally inappropriate.

## 5.16 *Discount rates*

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

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

## 5.17 *Accounting for termination indemnities*

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

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

## 5.18 *Deferred compensation arrangements—employment benefits*

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

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

## 5.19 *Accounting for benefit plan related taxes*

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

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



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***Chapter 6:***  
***Assets—nonfinancial assets—***  
***updated November 2020***

## 6.1 *Assets—nonfinancial assets*

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

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

### ***Technical references***

#### *US GAAP*

ASC 205, ASC 250, ASC 330, ASC 360-10, ASC 360-20, ASC 410-20, ASC 410-20-25, ASC 835-20, ASC 842, ASC 845, ASC 853

#### *IFRS*

IAS 2, IAS 16, IAS 23, IAS 36, IAS 37, IAS 40, IAS 41, IFRS 5, IFRS 13, IFRS 16

### ***Note***

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

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

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

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

Differences relating to goodwill impairment are discussed in SD 13, *Business Combinations*.

**US GAAP**

Long-lived assets that are held and used are tested for impairment at the asset group level. US GAAP requires a two-step impairment test and measurement model as follows:

**Step 1**—The carrying amount is first compared with the undiscounted cash flows. If the carrying amount is lower than the undiscounted cash flows, no impairment loss is recognized, although it might be necessary to review depreciation (or amortization) estimates and methods for the related asset.

**Step 2**—If the carrying amount is higher than the undiscounted cash flows, an impairment loss is measured as the difference between the carrying amount and fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). Fair value should consider the impact of the related current and deferred tax balances and should be based on the assumptions of market participants and not those of the reporting entity.

An asset group should be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount of the asset group may not be recoverable. ASC 360-10-35-21 provides examples of such impairment indicators. Changes in market interest rates are not considered impairment indicators.

**IFRS**

IFRS uses a one-step impairment test. The carrying amount of an asset is compared with the recoverable amount. The recoverable amount is the higher of (1) the asset's fair value less costs of disposal or (2) the asset's value in use.

A cash-generating unit (CGU) is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. It can be a single asset. In practice, individual assets do not usually meet the definition of a CGU. As a result, assets are rarely tested for impairment individually but are tested within a group of assets. See SD 6.2.1 for additional information on asset groupings under US GAAP and IFRS.

Fair value less costs of disposal represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date less costs of disposal. Current and deferred tax balances, with the exception of unused tax losses, and their associated cash flows, are taken into account when calculating fair value less costs of disposal, if a market participant would also include them.

Value in use represents entity-specific or CGU-specific future pretax cash flows discounted to present value by using a pretax, market-determined rate that reflects the current assessment of the time value of money and the risks specific to the asset or CGU for which the cash flow estimates have not been adjusted.

A CGU is impaired when its carrying amount exceeds its recoverable amount. IAS 36.12 to IAS 36.14 provide examples of such impairment indicators, which are generally consistent with the impairment indicators in US GAAP. However, changes in market interest rates can potentially trigger impairment and, hence, are impairment indicators (e.g., an increase in market interest rates that affect the discount rate used in calculating the nonfinancial asset's value in use).

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

### 6.2.1 *Impairment of long-lived assets—asset groupings*

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

Indefinite-lived intangible assets, including goodwill, are governed by ASC 350 under US GAAP. See SD 6.8 for additional information on the accounting for such indefinite-lived intangible assets under US GAAP and IFRS.

US GAAP	IFRS
<p>For purposes of recognition and measurement of an impairment loss, a long-lived asset or asset group should represent the lowest level for which an entity can separately identify cash flows that are largely independent of the cash flows of other assets and liabilities. In limited circumstances, a long-lived asset (e.g., a corporate asset) might not have identifiable cash flows that are largely independent of the cash flows of other assets and liabilities and of other asset groups. In those circumstances, the asset group for that long-lived asset should include all assets and liabilities of the entity.</p> <p>Generally, debt instruments should not be included in an asset group as they do not represent the lowest level of identifiable cash flows (i.e., debt payments are generally funded at the corporate level and are not attributable to an asset group). If debt is tied to specific assets within the asset group, or the asset group is a business or reporting unit, there may be circumstances when it is appropriate to include the cash flows associated with debt.</p>	<p>A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. It can be a single asset. If an active market (as defined by IFRS 13) exists for the output produced by an asset or group of assets, that asset or group should be identified as a CGU, even if some or all of the output is used internally.</p> <p>Liabilities are generally excluded from the carrying amount of the CGU. However, there may be circumstances when it is not possible to determine the recoverable amount without considering a recognized liability (e.g., asset retirement obligations, restoration obligations). In such cases, the liability should be included in the CGU.</p>

US GAAP	IFRS
A lease liability for a finance lease is generally viewed as “debt like” and therefore is excluded from an asset group. For operating lease liabilities, an entity may elect to either (1) include the carrying amount of the operating lease liabilities in the asset group and include the associated operating lease payments in the cash flows or (2) exclude the carrying amount of the operating lease liabilities from the asset group and exclude the associated operating lease payments from the cash flows.	While lease right-of-use assets are included in a CGU, when testing value in use, the related lease liabilities should be excluded because they are a form of financing and all financing cash flows are explicitly excluded from value in use (IAS 36 para 50(a)). While this position is clear for value in use, it is less so for fair value less cost of disposal (FVLCD) models, since IAS 36 has little specific guidance on determining FVLCD. Generally, if the buyer of a CGU is required to assume the lease liability, the FVLCD would also include the liability.

### 6.2.2 *Impairment of long-lived assets—cash flow estimates*

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

US GAAP	IFRS
<p>Future cash flow estimates used in an impairment analysis should include:</p> <ul style="list-style-type: none"> <li>□ All cash inflows expected from the use of the long-lived asset (asset group) over its remaining useful life, based on its existing service potential</li> <li>□ Any cash outflows necessary to obtain those cash inflows, including future expenditures to maintain (but not improve) the long-lived asset (asset group)</li> <li>□ Cash flows associated with the eventual disposition, including selling costs, of the long-lived asset (asset group)</li> </ul> <p>US GAAP specifies that the remaining useful life of a group of assets over which cash flows may be considered should be based on the remaining useful life of the “primary” asset of the group.</p> <p>Cash flows are from the perspective of the entity itself. Expected future cash flows should represent management’s best estimate and should be based on reasonable and supportable assumptions consistent with other assumptions made in the preparation of the financial statements and other information used by the entity for comparable periods.</p>	<p>IAS 36 provides little specific guidance when measuring the recoverable amount using fair value less costs of disposal. Therefore, when the recoverable amount is determined using fair value less costs of disposal, the measurement guidance in IFRS 13 applies.</p> <p>However, cash flow estimates used to calculate value in use under IFRS should include:</p> <ul style="list-style-type: none"> <li>□ Cash inflows from the continuing use of the asset or the activities of the CGU</li> <li>□ Cash outflows necessarily incurred to generate the cash inflows from continuing use of the asset or CGU (including cash outflows to prepare the asset for use) and that are directly attributable to the asset or CGU</li> <li>□ Cash outflows that are indirectly attributable (such as those relating to central overheads) but that can be allocated on a reasonable and consistent basis to the asset or CGU</li> <li>□ Cash flows expected to be received (or paid) for the disposal of assets or CGUs at the end of their useful lives</li> <li>□ Cash outflows to maintain the operating capacity of existing assets, including, for example, cash flows for day-to-day servicing</li> </ul>

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

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

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

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

### 6.4 *Disposal of non-financial assets*

ASC 610-20, *Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets*, provides a model for the derecognition of nonfinancial assets that do not meet the definition of a business and is effective at the same time an entity adopts the revenue guidance in ASC 606. IFRS does not contain similar guidance and often follows the form of the disposal. As such, differences could exist in certain circumstances.

**US GAAP**

ASC 610-20 applies to transfers of all nonfinancial assets and in substance nonfinancial assets to parties that are not customers. The process for evaluating whether the transfer of assets to a counterparty is within the scope of ASC 610-20 is determined based on the ordering guidance addressing derecognition in ASC 610-20-15-10. The guidance does not change the derecognition model for financial assets under the scope of ASC 860, *Transfers and Servicing*, or businesses under the scope of ASC 810, *Consolidation*. For example, if the transferred set of activities and assets meets the definition of a business, the transaction is within the scope of the derecognition guidance in ASC 810. On the other hand, the sale of a subsidiary that does not meet the definition of a business is scoped out of ASC 810-10-40-3A when the underlying assets of the subsidiary are determined to be nonfinancial assets (or in substance nonfinancial assets) under ASC 610-20.

If a transaction is within the scope of ASC 610-20, in order for an entity to derecognize nonfinancial assets and recognize a gain or loss, the entity must lose control of the assets while also satisfying the criteria for transfer of control to another party under the new revenue recognition guidance. If these criteria are not met, an entity would continue to recognize the asset and record a liability for the consideration received. Situations may arise when a loss of control has occurred, but the transaction does not meet the transfer of control criteria in the revenue standard. For example, if the seller retains a call option to repurchase the assets, the transfer of control test will likely not be satisfied. In these situations, alternate guidance will need to be followed.

Under ASC 610-20, when an entity transfers its controlling financial interest in a nonfinancial asset (or in substance nonfinancial asset) but retains a noncontrolling ownership interest, the entity would measure such interest (including interests in joint ventures) at fair value, similar to the current guidance on the sale of businesses. This would result in full gain or loss recognition upon the sale of the nonfinancial asset (or in substance nonfinancial asset).

**IFRS**

IFRS does not include the concept of in substance nonfinancial assets in its guidance. Accounting for a disposal under IFRS will usually depend on the nature of what is disposed. If a subsidiary is disposed of, an entity would generally follow the deconsolidation guidance in IFRS 10, *Consolidated Financial Statements*. If other assets are disposed of and not in the scope of the revenue standard, an entity would follow the related guidance (e.g., IAS 16 for property, plant, and equipment).

IAS 28, *Investments in Associates and Joint Ventures*, requires entities to recognize a partial gain or loss on contribution of nonfinancial assets that do not constitute a business (as defined in IFRS 3) to equity method investees and joint ventures for an interest in that associate unless the transaction lacks commercial substance.

## 6.5 Carrying basis

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

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

## 6.6 Internally developed intangibles

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

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

US GAAP	IFRS
<p>In general, both research costs and development costs are expensed as incurred, making the recognition of internally generated intangible assets rare.</p> <p>However, separate, specific rules apply in certain areas. For example, there is distinct guidance governing the treatment of costs associated with the development of software for sale to third parties. Separate guidance governs the treatment of costs associated with the development of software for internal use, including fees paid in a cloud computing arrangement.</p> <p>The guidance for the two types of software varies in a number of significant ways. There are, for example, different thresholds for when capitalization commences, and there are also different parameters for what types of costs are permitted to be capitalized.</p>	<p>Costs associated with the creation of intangible assets are classified into research phase costs and development phase costs. Costs in the research phase are always expensed. Costs in the development phase are capitalized, if all of the following six criteria are demonstrated:</p> <ul style="list-style-type: none"> <li>□ The technical feasibility of completing the intangible asset</li> <li>□ The intention to complete the intangible asset</li> <li>□ The ability to use or sell the intangible asset</li> <li>□ How the intangible asset will generate probable future economic benefits (the entity should demonstrate the existence of a market or, if for internal use, the usefulness of the intangible asset)</li> </ul>



US GAAP	IFRS
ASU 2018-15 was issued to provide specific US guidance on when implementation costs incurred in a cloud computing service contract should be capitalized under US GAAP. This guidance is effective for calendar year-end public business entities on January 1, 2020. It can be early adopted.	<ul style="list-style-type: none"> <li>□ The availability of adequate resources to complete the development and to use or sell it</li> <li>□ The ability to measure reliably the expenditure attributable to the intangible asset during its development</li> </ul> <p>Expenditures on internally generated brands, mastheads, publishing titles, customer lists, and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognized as intangible assets.</p> <p>Development costs initially recognized as expenses cannot be capitalized in a subsequent period.</p> <p>IFRS does not contain specific guidance relating to cloud computing arrangements. Although non-authoritative, the IFRS Interpretations Committee issued an agenda decision that if a customer receives a software asset at contract commencement (either in the form of a software lease or software intangible asset), the customer would recognize an asset at the date it obtains control of the software. If the customer only obtains access to the software over the contract term, the arrangement is a service contract. Assessing these arrangements will require judgment.</p>

## 6.7 *Acquired research and development assets*

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

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

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

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not needed at the acquisition date to use the asset.

Research and development intangible assets acquired in a business combination are recognized and measured at fair value and classified as indefinite-lived intangible assets until completion or abandonment. Research and development activities acquired in a business combination are not required to have an alternative future use in order to be recognized.

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## 6.8 *Impairment of indefinite-lived intangible assets*

Impairment testing and measurement of indefinite-lived intangible assets are different under US GAAP and IFRS.

### 6.8.1 *Indefinite-lived intangible assets—assessment level*

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

US GAAP	IFRS
<p>Separately recorded indefinite-lived intangible assets, whether acquired or internally developed, shall be combined into a single unit of accounting for purposes of testing impairment if they are operated as a single asset and, as such, are essentially inseparable from one another.</p> <p>Indefinite-lived intangible assets may be combined only with other indefinite-lived intangible assets; they may not be tested in combination with goodwill or with a finite-lived asset.</p> <p>US GAAP provides a number of indicators that an entity should consider to determine if indefinite lived intangible assets should be combined for impairment testing purposes. See ASC 350-30-35-21 through ASC 350-30-35-28.</p>	<p>As most indefinite-lived intangible assets (e.g., brand name) do not generate cash flows independently of other assets, it might not be possible to calculate the value in use for such an asset on a standalone basis. Therefore, it is necessary to determine the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets, (i.e., the CGU), in order to perform the test.</p>

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### 6.8.2 *Indefinite-lived intangible assets—impairment testing*

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

**US GAAP**

ASC 350-30-35-18 requires an indefinite-lived intangible asset to be tested for impairment annually, or more frequently if events or changes in circumstances indicate that it is more likely than not that the asset is impaired. Similar to goodwill impairment testing, current practice is to perform the annual impairment test for indefinite-lived intangible assets at the same time each year (although not specifically required by ASC 350).

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

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

**IFRS**

IAS 36, *Impairment of Assets*, requires an entity to test an indefinite-lived intangible asset for impairment annually. The impairment test may be performed at any time during the annual period, but it must be performed at the same time every year. It also requires an impairment test in between annual tests at the end each reporting period whenever there is an indication of impairment.

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

### 6.8.3 *Indefinite-lived intangible assets—impairment measurement*

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

**US GAAP**

The quantitative impairment test for indefinite-lived intangible assets compares the fair value of the asset to its carrying amount. If the carrying amount exceeds the fair value of the asset, an impairment loss is recognized for the difference.

**IFRS**

Indefinite-lived intangible asset impairments are calculated by comparing the recoverable amount to the carrying amount (see above for determination of level of assessment). The recoverable amount is the higher of fair value less costs of disposal or value in use. If the carrying amount exceeds the recoverable amount of the asset, an impairment loss is recognized for the difference.

## 6.9 Software costs to be sold, leased, or marketed—impairment

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

US GAAP	IFRS
<p>When assessing potential impairment, at least at each balance sheet date, the unamortized capitalized costs for each product must be compared with the net realizable value of the software product. The amount by which the unamortized capitalized costs of a software product exceed the net realizable value of that asset shall be written off. The net realizable value is the estimated future gross revenue from that product reduced by the estimated future costs of completing and disposing of that product.</p> <p>The net realizable value calculation does not utilize discounted cash flows.</p>	<p>Under IFRS, intangible assets not yet available for use are tested annually for impairment because they are not being amortized.</p> <p>Once such assets are brought into use, amortization commences and the assets are tested for impairment when there is an impairment indicator.</p> <p>The impairment is calculated by comparing the recoverable amount (the higher of either (1) fair value less costs of disposal or (2) value in use) to the carrying amount. If the carrying amount exceeds the recoverable amount of the asset, an impairment loss is recognized and is measured as the difference.</p>

## 6.10 Advertising costs

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

US GAAP	IFRS
<p>The costs of other than direct response advertising should be either expensed as incurred or deferred and then expensed the first time the advertising takes place. This is an accounting policy election and should be applied consistently to similar types of advertising activities.</p> <p>Certain direct response advertising costs are eligible for capitalization if, among other requirements, probable future economic benefits exist. Direct response advertising costs that have been capitalized are then amortized over the period of future benefits (subject to impairment considerations).</p> <p>Aside from direct response advertising-related costs, sales materials such as brochures and catalogs may be accounted for as prepaid supplies until they no longer are owned or expected to be used, in which case their cost would be a cost of advertising.</p>	<p>Costs of advertising are expensed as incurred. The guidance does not provide for deferrals until the first time the advertising takes place, nor is there an exception related to the capitalization of direct response advertising costs or programs.</p> <p>Prepayment for advertising may be recorded as an asset only when payment for the goods or services is made in advance of the entity's having the right to access the goods or receive the services.</p> <p>The cost of materials, such as sales brochures and catalogues, is recognized as an expense when the entity has the right to access those goods.</p>

## 6.11 Property, plant, and equipment—depreciation

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

US GAAP	IFRS
<p>US GAAP generally does not require the component approach for depreciation.</p> <p>While it would generally be expected that the appropriateness of significant assumptions within the financial statements would be reassessed each reporting period, there is no explicit requirement for an annual review of residual values.</p> <p>In accordance with ASC 350-30-35-9, an entity should evaluate the remaining useful life of an intangible asset each reporting period to determine whether events or circumstances may indicate that a revision to the useful life (presumably shorter) is warranted to reflect the remaining expected use of the asset. Unlike the guidance that exists for long-lived intangible assets, there is no explicit requirement to evaluate the useful lives of long-lived tangible assets each reporting period. However, we believe the useful lives of long-lived tangible assets should be reassessed whenever events or circumstances indicate that a revision to the useful life (presumably shorter) is warranted.</p>	<p>IFRS requires that separate significant components of property, plant, and equipment with different economic lives be recorded and depreciated separately.</p> <p>IAS 16, <i>Property, plant and equipment</i>, requires entities to review the residual value, useful life, and depreciation method applied to an asset, at a minimum at each balance sheet date.</p>

## 6.12 Property, plant, and equipment—overhaul costs

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

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

## 6.13 Property, plant, and equipment - AROs

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

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

## 6.14 *Property, plant, and equipment—borrowing costs*

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

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

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

US GAAP	IFRS
Capitalization of interest costs is required while a qualifying asset is being prepared for its intended use.	Borrowing costs directly attributable to the acquisition, construction, or production of a qualifying asset are required to be capitalized as part of the cost of that asset.
The guidance does not require that all borrowings be included in the determination of a weighted-average capitalization rate. Instead, the requirement is to capitalize a reasonable measure of cost for financing the asset's acquisition in terms of the interest cost incurred that otherwise could have been avoided.	The guidance acknowledges that determining the amount of borrowing costs directly attributable to a qualifying asset may require judgment. IAS 23, <i>Borrowing costs</i> , first requires the consideration of any specific borrowings and then requires consideration of all general borrowings outstanding during the period.
Eligible borrowing costs do not include exchange rate differences from foreign currency borrowings. Also, generally, interest earned on invested borrowed funds cannot offset interest costs incurred during the period.	In broad terms, a qualifying asset is one that necessarily takes a substantial period of time to get ready for its intended use or sale.
An investment accounted for by using the equity method meets the criteria for a qualifying asset while the investee has activities in progress necessary to commence its planned principal operations, provided that the investee's activities include the use of funds to acquire qualifying assets for its operations.	Investments accounted for under the equity method would not meet the criteria for a qualifying asset.
	Eligible borrowing costs may include exchange rate differences from foreign currency borrowings.

## 6.15 *Distributions of nonmonetary assets to owners*

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



US GAAP	IFRS
Accounting for the pro-rata distribution of assets that constitute a business to owners of an enterprise (a spin-off) should be based on the recorded amount (after reduction, if appropriate, for an indicated impairment of value) of the nonmonetary assets distributed. Upon distribution, those amounts are reflected as a reduction of owner's equity.	<p>Unless part of a common control transaction, accounting for the distribution of nonmonetary assets to owners of an entity should be based on the fair value of the nonmonetary assets to be distributed. A dividend payable is measured at the fair value of the nonmonetary assets to be distributed. Upon settlement of a dividend payable, the distributing entity will recognize any differences between the carrying amount of the assets to be distributed and the carrying amount of the dividend payable in profit or loss.</p> <p>The recognition of the distribution at fair value by the entity distributing nonmonetary assets does not affect the accounting by the spinee after the distribution.</p>

## 6.16 *Inventory costing*

As LIFO inventory costing is not permitted under IFRS, companies that utilize the LIFO costing methodology under US GAAP might experience significantly different operating results as well as cash flows.

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

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

## 6.17 *Biological assets—fair value versus historical cost*

Agricultural activity is the management of the biological transformation of living animals or plants into items for sale, agricultural produce, or additional biological assets. IFRS requires biological assets to be measured at fair value less costs to sell.



US GAAP	IFRS
Biological assets can be measured at historical cost or fair value less costs to sell, as a policy election. If historical cost is elected, these assets are tested for impairment in the same manner as other long-lived assets. If fair value is elected, all changes in fair value in subsequent periods are recognized in the income statement in the period in which they arise.	Under IAS 41, biological assets are measured at fair value less costs to sell for initial recognition and at each subsequent reporting date, except when the measurement of fair value is unreliable. All changes in fair value are recognized in the income statement in the period in which they arise.
	Bearer plants are accounted for under IAS 16, <i>Property, Plant and Equipment</i> . Whereas, the produce growing on bearer plants is within the scope of IAS 41 and measured at fair value. Once harvested, produce is in the scope of IAS 2, <i>Inventories</i> .

## 6.18 Investment property

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

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

## 6.19 *Leasehold improvements—useful life—added February 2022*

The determination of the useful life of leasehold improvements may be different under IFRS compared with US GAAP. In limited circumstances, the useful life of leasehold improvements may exceed the lease term under IFRS.

US GAAP	IFRS
In accordance with ASC 842-20-35-12, leasehold improvements are amortized over the shorter of the useful life of those leasehold improvements and the remaining lease term. However, if the lease transfers ownership of the underlying asset to the lessee or the lessee is reasonably certain to exercise an option to purchase the underlying asset, the lessee should amortize the leasehold improvements to the end of their useful life.	<p>IAS 16.56(d) states that the legal or similar limits on the use of the asset, such as the expiry dates of related leases, should be considered in determining the useful life of the asset. Therefore, it would generally be expected that the useful life (that is, the depreciation period) of the leasehold improvements is the same as the lease term under IFRS 16. However, there might be situations when the useful life of a leasehold improvement exceeds the assessed lease term.</p> <p>The IFRS Interpretations Committee issued an agenda decision in November 2019 that addressed the question of whether the useful life of any related non-removable leasehold improvements is limited to the lease term determined applying IFRS 16. The agenda decision confirmed that if the lease term of the related lease is shorter than the economic life of those leasehold improvements, reporting entities should apply IAS 16.56 and IAS 16.57 to consider whether they expect to use the leasehold improvements beyond that lease term. If not, the useful life of the non-removable leasehold improvements should not be longer than the lease term.</p>

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***Chapter 7:***  
***Assets—financial assets—***  
***updated March 2023***

## 7.1 Assets — financial assets

Under US GAAP, the guidance for the classification of financial assets is codified in different sections of the Accounting Standards Codification (ASC) depending on the type of instrument or entity. IFRS 9 contains all the classification and measurement guidance for financial assets and does not provide any industry-specific guidance. The specialized US guidance and the singular IFRS guidance in relation to classification can drive differences in measurement (because classification drives measurement under both IFRS and US GAAP).

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

Under IFRS 9, investments in debt instruments are either measured at: (1) amortized cost, (2) FVOCI (with subsequent reclassification to profit or loss) or (3) FVTPL, depending on the entity's business model for managing the assets and the cash flows characteristic of the instrument, regardless of legal form. Under US GAAP, the legal form of a debt instrument primarily drives classification. For example, available-for-sale (AFS) debt instruments that are securities in legal form are typically carried at fair value, even if there is no active market to trade the securities. At the same time, a debt instrument that is not in the form of a security (for example, a corporate loan) is accounted for at amortized cost even though both the security and the loan have similar economic characteristics. In addition to these classification differences, the interest income recognition models also differ between the frameworks. Further, although the credit impairment accounting guidance under both US GAAP and IFRS is an "expected" loss model, the guidance is not converged. The major difference is that under US GAAP, the entire lifetime expected credit loss on financial instruments measured at amortized cost is recognized at inception, whereas under IFRS 9, generally only a portion of the lifetime expected credit loss is initially recognized. Subsequently, if there is a significant increase in credit risk, the entire lifetime credit loss is recognized under IFRS. Under US GAAP, a separate incurred credit loss model applies to debt securities classified as available-for-sale. Under IFRS, the expected credit loss model applies equally to debt instruments measured at FVOCI.

The impairment guidance in ASC 326 was effective for public business entities that are SEC filers for annual reporting periods (including interim periods) beginning after December 15, 2019 and is effective for nonpublic entities for periods beginning after December 15, 2022. The guidance in ASU 2022-02, *Financial Instruments - Credit Losses (Topic 326), Troubled Debt Restructurings and Vintage Disclosures*, is effective for periods beginning after December 15, 2022. The IFRS 9 impairment guidance was effective as of January 1, 2018. The impairment guidance in this chapter compares the US GAAP guidance after adoption of ASC 326 and ASU 2022-02 with the impairment guidance under IFRS 9.

Finally, this section describes the fundamental differences in the ways that US GAAP and IFRS assess the derecognition of financial assets. These differences can have a significant impact on a variety of transactions, such as asset securitizations and factoring transactions. IFRS focuses on whether a qualifying transfer has taken place, whether risks and rewards have been transferred, and, in some cases, whether control over the asset in question has been transferred. US GAAP focuses on whether an entity has surrendered effective control over a transferred asset; this assessment also requires the transferor to evaluate whether the financial asset has been "legally isolated," even in the event of the

transferor's bankruptcy or receivership. While the same conclusion on derecognition may often be reached under IFRS and US GAAP, it is important to work through the different models as the results may differ.

This chapter focuses on financial assets – both debt and equity investments – which do not result in the investor having significant influence or control over the investee. The consolidation and equity method of accounting models are covered in Chapter 12. It captures several of the more significant GAAP differences but is not inclusive of all differences between the frameworks in this area.

### ***Technical references***

#### *US GAAP*

ASC 310, ASC 320, ASC 321, ASC 325-10, ASC 325-20, ASC 325-40, ASC 326, ASC 815, ASC 815-15, ASC 820, ASC 825, ASC 860

#### *IFRS*

IFRS 9, IFRS 13, IAS 32

## **7.2 Determining the overall appropriate classification model**

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

<b>US GAAP</b>	<b>IFRS</b>
<p>To determine the appropriate accounting treatment for a financial interest not consolidated or accounted for under the equity method, a reporting entity should first determine whether the interest meets the definition of a security, which, to a large extent, is a legal determination.</p> <p>If the entity determines that an interest meets the definition of a security, it should then determine whether that security is an equity or debt security based on the definitions in ASC 321 and ASC 320 and follow the measurement models described in those sections unless industry-specific guidance applies.</p> <p>If the entity determines that the interest does not meet the definition of an equity security, it may still have to follow the guidance in ASC 321 if the interest is in the form of an investment in a partnership, unincorporated joint venture, or LLC (See SD 7.7).</p>	<p>For financial assets that are not consolidated or accounted for using the equity method, an entity first considers whether the financial asset is an investment in an equity instrument by evaluating the classification of the instrument from the perspective of the issuer under IAS 32 (see SD 10 for a discussion of the issuer's classification model). If the financial asset is an investment in an equity instrument, the entity should follow the guidance for equity instruments. If the financial asset is not an investment in an equity instrument, the entity should follow the guidance for debt investments.</p> <p>There is one exception to this rule, which applies to instruments that are classified as equity under the "puttable instruments" provisions of IAS 32, such as investments in mutual funds (see SD 10.8). An entity should follow the guidance for debt investments for these instruments (even when they are presented as equity from the issuer's perspective).</p>

**US GAAP****IFRS**

If the entity determines that the interest is not a security, and does not represent a partnership or similar interest, other guidance would apply. For example, for trade account receivables, loans, and other similar assets, ASC 310 would generally be applicable, unless the entity follows industry-specific guidance (See SD 7.3).

## 7.3 *Loans and receivables—classification*

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

**US GAAP****IFRS**

The classification and accounting treatment of loans and receivables generally depends on whether the asset in question meets the definition of a debt security under ASC 320. To meet the definition of a security under ASC 320, the asset is required to be of a type commonly available on securities exchanges or in markets, or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment. Loans and receivables are also evaluated for embedded derivative features, which could require separate fair value accounting.

Loans and receivables that are not within the scope of ASC 320 fall within the scope of other guidance, such as ASC 310, *Receivables*. These loans are generally:

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

Classification under IFRS 9 of all debt investments – including debt securities, loans, and receivables – is based on a single model, which is driven by:

- The entity's business model for managing the assets, and
- The instrument's characteristics (i.e., the Solely Payment of Principal and Interest (SPPI) test).

The business model determination is not made at the individual asset level; rather, it is performed at a higher level of aggregation. An entity can have different business models for different portfolios. Business practices, such as factoring, might affect the business model (and hence, classification and measurement). Under the SPPI test, an entity needs to determine whether the contractual cash flows of the financial asset represent solely payments of principal and interest. Contractual features that introduce exposure to risks or volatility unrelated to a basic lending arrangement, such as exposure to changes in equity or commodity prices, do not give rise to contractual cash flows that are SPPI.

The financial asset should be subsequently measured at amortized cost if both of the following conditions are met:

- The financial asset is held within a “hold to collect” business model. Although the objective of an entity's business model might be to hold financial assets in order to collect contractual cash flows, the entity does not

US GAAP	IFRS
	necessarily need to hold all of those instruments until maturity; and
	<ul style="list-style-type: none"> <li>□ The contractual terms of the financial asset give rise, on specified dates, to cash flows that are SPPI.</li> </ul>
	A financial asset should be subsequently measured at FVOCI if both of the following conditions are met:
	<ul style="list-style-type: none"> <li>□ The financial asset is held within a business model whose objective is achieved by both holding financial assets in order to collect contractual cash flows and selling financial assets; and</li> <li>□ The contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.</li> </ul>
	If the financial asset is measured at FVOCI, movements in fair value are recorded through OCI. However, interest income computed using the effective interest method, foreign exchange gains and losses, impairment losses, and gains and losses arising on derecognition of the asset, are recognized in profit or loss.
	If the financial asset does not pass the business model assessment or SPPI test, it is measured at FVTPL. This is the residual measurement category under IFRS 9.

## 7.4 Debt securities—classification

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

US GAAP	IFRS
If the asset meets the definition of a security under ASC 320, it is generally classified as trading, available for sale, or held-to-maturity. If classified as trading or available for sale, the debt security is carried at fair value.	The same general model described in SD 7.3 applies to investments in debt securities.
Held-to-maturity securities are carried at amortized cost. Debt securities are also evaluated for embedded derivative features that could require separate fair value accounting.	

## 7.5 *Debt investments at FVOCI—foreign exchange gains/losses*

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

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

## 7.6 *Embedded derivatives in financial assets*

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

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

## 7.7 *Equity investments—measurement*

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



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

## 7.8 *Effective interest rate—expected vs contractual cash flows*

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

US GAAP	IFRS
<p>Under US GAAP, to determine the appropriate interest income recognition model, an entity must first consider the nature of the financial instrument, any industry-specific guidance, and the accounting model being applied to the instrument. US GAAP can be prescriptive in certain instances, such as interest income</p>	<p>Under IFRS 9, there is only one effective interest model. The calculation of the effective interest rate is based on the <i>estimated</i> cash flows (excluding expected credit losses) over the <i>expected</i> life of the asset.</p> <p>Contractual cash flows over the full contractual term of the financial asset are used in the rare</p>

US GAAP	IFRS
<p>recognition for beneficial interests or structured notes.</p> <p>However, generally, for loans, receivables, and debt securities, the interest method is applied over the contractual life of the asset for purposes of recognizing accretion and amortization associated with premiums, discounts, and deferred origination fees and costs. However, estimated cash flows can be used when certain criteria are met. For example, when a reporting entity holds a large number of similar loans, investments in debt securities, or other receivables for which prepayments are probable, and the timing and amount of prepayments can be reasonably estimated, an entity may elect to consider estimates of future principal prepayments in the calculation of the effective interest rate.</p> <p>Although not specifically prescribed in US GAAP, the accrual of interest income is generally suspended when the collection of interest is less than probable or the collection of any portion of the loan's principal is doubtful (i.e., a non-performing loan). These are referred to as "non-accrual loans."</p>	<p>case when it is not possible to reliably estimate the cash flows or the expected life of a financial asset.</p> <p>Under IFRS, the accrual of interest is not suspended.</p>

## 7.9 *Effective interest rate—changes in expectations*

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

US GAAP	IFRS
<p>Different models apply to the way revised estimates are treated depending on the nature of the asset. Changes may be reflected prospectively or retrospectively. However, none of the prescribed US GAAP models is the equivalent of the IFRS cumulative-catch-up-based approach.</p>	<p>If an entity revises its estimates of payments or receipts, the entity adjusts the carrying amount of the financial asset (or group of financial assets) to reflect revised estimated cash flows.</p> <p>Revisions of the expected life or the estimated future cash flows may occur, for example, in connection with debt instruments that contain a put or call option that does not cause the asset to fail the SPPI test described in SD 7.3.</p> <p>The carrying amount is recalculated by computing the present value of estimated future cash flows at the financial asset's original effective interest rate. The adjustment is recognized as income or expense in the income statement (i.e., by the cumulative-catch-up approach).</p>

US GAAP	IFRS
	Generally, floating rate instruments issued at par are not subject to the cumulative-catch-up approach; rather, the effective interest rate is revised as market rates change.

## 7.10 Restructuring of debt investments

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

US GAAP	IFRS
A creditor and debtor each must determine whether the modification or exchange of debt restructurings should be accounted for as (a) the creation of a new debt instrument and the extinguishment of the original debt instrument or (b) the modification of the original debt instrument.	When a change in cash flow arises in connection with a renegotiation or other modification, a careful analysis is required.  An entity first needs to determine whether the change in cash flows arises under the contractual terms. For example, in a fixed rate loan that is prepayable at par (or with only an insignificant amount of compensation), having the lender reset the interest rate to market may not be considered a change in contractual terms.  In this case, the entity would follow the guidance for changes in interest rates applicable to floating rate instruments.
A new or restructured debt instrument is considered an extinguishment of the existing instrument and origination of a new instrument by the lender/investor when both of the following conditions are met: <ul style="list-style-type: none"> <li>□ The terms of the new or restructured debt instrument are at least as favorable to the lender as the terms for comparable debt instruments to customers with similar creditworthiness.</li> <li>□ A modification is more than minor quantitatively or if facts and circumstances (and other relevant considerations) indicate that the modification is more than minor.</li> </ul>	Where an entity determines that the change is due to a renegotiation, the entity then needs to determine whether the modification is substantial. If the change in terms is considered substantial, it is accounted for as a derecognition of a financial asset and the recognition of a new financial asset (i.e., an extinguishment). If the renegotiation does not result in a substantial change in terms, it is accounted for as a modification.  Judgment is required to assess whether the change in terms is substantial enough to represent an extinguishment (i.e., derecognition of the asset). The assessment is based on all relevant factors, such as deferral of certain payments to cover a shortfall, insertion of substantial new terms, significant extension of the term, change in interest rate, insertion of collateral or other credit enhancement, changes to loan covenants, or change in the currency of the instrument.

US GAAP	IFRS
For a refinancing or restructuring that is considered a modification of the debt instrument, the amortized cost basis of the new loan should comprise the remaining amortized cost basis in the original loan, any additional amounts loaned, any fees received, and direct loan origination costs associated with the refinancing or restructuring. A new effective interest rate is calculated using the new contractual cash flows.	For a modification or renegotiation that does not result in derecognition, an entity is required to recognize a modification gain or loss immediately in profit or loss. The gain or loss is determined by recalculating the gross carrying amount of the financial asset by discounting the new contractual cash flows using the original effective interest rate.

## 7.11 *Eligibility for the fair value option*

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

US GAAP	IFRS
With some limited exceptions for certain financial assets addressed by other applicable guidance (e.g., an investment in a consolidated subsidiary, employer's rights under employee benefit plans), US GAAP permits entities to elect the fair value option for any recognized financial asset.  The fair value option may only be elected upon initial recognition of the financial asset or upon some other specified election dates identified in ASC 825-10-25-4.  See SD 12.8.5 for differences related to the fair value option for equity-method investments.	Under IFRS 9, the only instance when an entity can irrevocably designate financial assets as measured at FVTPL at initial recognition is when doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as “an accounting mismatch”) that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases.  See SD 12.8.5 for differences related to the fair value option for equity-method investments.

## 7.12 *Reclassifications of financial assets*

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

US GAAP	IFRS
Changes in classification between trading, available-for-sale, and held-to-maturity categories can occur only when justified by the facts and circumstances within the concepts of ASC 320. Given the nature of a trading security, transfers into or from the trading category should be rare.	Once the initial classification has been determined, reclassification of investments in debt instruments is only permitted when an entity changes its business model for managing the financial assets. Changes to the business model are expected to be infrequent; the change is determined by the entity's senior management as a result of external or internal changes. It

US GAAP	IFRS
For loans, reclassification between the held for sale and held for investment categories should generally occur at the point the intent changes.	must be significant to the entity's operations and should be evident to external parties. Changes in intention related to particular financial assets (even in circumstances of significant changes in market conditions) and transfers of financial assets between parts of the entity with different business models, are examples for circumstances that are not considered changes in business model.  For equity investments, the initial election to present fair value changes in OCI is irrevocable.

## 7.13 Impairment of financial assets

The impairment accounting approach under both US GAAP and IFRS is an expected loss model.

### 7.13.1 Impairment—scope

The scope of instruments subject to the IFRS 9 impairment requirements is similar to the scope of instruments subject to ASC 326. Both apply to financial assets measured at amortized cost, as well as to off-balance sheet exposures, such as loan commitments and guarantees. Neither apply to investments in equity instruments or to instruments measured at fair value through profit or loss. Explicit scope differences between the standards do exist; however, they are mostly limited to specific areas.

- Loans and receivables between entities under common control are not in the scope of ASC 326 but are subject to IFRS 9 in the separate financial statements of the lender.
- Reinsurance receivables are not in the scope of IFRS 9 but are in the scope of ASC 326 for purposes of measurement of expected losses related to credit risk (although expected losses due to contractual coverage disputes or other noncontractual issues are not in the scope of either standard).

US GAAP	IFRS
<p>The CECL model applies to financial assets measured at amortized cost and certain off-balance sheet credit exposures, including:</p> <ul style="list-style-type: none"> <li>□ Loans carried at amortized cost</li> <li>□ Held-to-maturity (HTM) debt securities (including corporate bonds, mortgage-backed securities, municipal bonds, and other fixed income instruments)</li> <li>□ Noncancellable loan commitments (including lines of credit) that are not accounted for at FVTPL</li> </ul>	<p>The IFRS 9 impairment model applies to:</p> <ul style="list-style-type: none"> <li>□ Investments in debt instruments measured at amortized cost</li> <li>□ Investments in debt instruments measured at FVOCI</li> <li>□ All loan commitments not measured at FVTPL</li> <li>□ Financial guarantee contracts that are not accounted for at FVTPL or under IFRS 17, <i>Insurance Contracts</i></li> <li>□ Lease receivables that are within the scope of IFRS 16, <i>Leases</i></li> </ul>

US GAAP	IFRS
<ul style="list-style-type: none"> <li>□ Financial guarantees accounted for under ASC 460, <i>Guarantees</i>, that are not accounted for at FVTPL</li> <li>□ Net investments in leases</li> <li>□ Trade and reinsurance receivables</li> <li>□ Credit losses on contract assets recognized under ASC 606, <i>Revenue from Contracts with Customers</i></li> <li>□ Purchased financial assets with credit deterioration measured at amortized cost (which have specific initial measurement provisions)</li> </ul> <p>A separate credit loss model applies to debt securities classified as available-for-sale.</p>	<ul style="list-style-type: none"> <li>□ Trade receivables and contract assets within the scope of IFRS 15, <i>Revenue from Contracts with Customers</i></li> </ul> <p>Specific measurement provisions apply to purchased or originated credit-impaired assets.</p>

### 7.13.2 Impairment principles

The credit impairment accounting approach under both US GAAP and IFRS follows an expected loss model. Thus, under both standards, a “day 1 credit loss” will be recognized for most financial assets measured at amortized cost. However, the amount of loss will typically differ between the two standards. Many significant differences exist between the CECL model in US GAAP and the expected credit loss (ECL) model in IFRS, such as the three-stage model for impairment in IFRS compared to a consistent measurement method throughout the life of the instrument under US GAAP.

US GAAP	IFRS
For instruments in the scope of the general CECL model, lifetime expected credit losses are recorded upon initial recognition of the instrument as an allowance for loan losses.	<p>An entity shall recognize a loss allowance for expected credit losses.</p> <p>The IFRS impairment model contains three stages for measuring impairment losses based on the changes in credit quality of the instrument since inception.</p> <p><b>Stage 1</b> includes financial instruments that have not had a significant increase in credit risk (SICR) since initial recognition or that have low credit risk at the reporting date. For these assets, an entity will typically record a 12-month ECL (i.e., the expected credit loss that result from default events that are possible within 12 months after the reporting date). It is not the expected cash shortfalls over the 12-month period, but the entire credit loss on an asset weighted by the probability that the loss will occur in the next 12 months.</p> <p><b>Stage 2</b> includes financial instruments that have had a SICR since initial recognition (unless they have low credit risk at the reporting date and elect the practical expedient described in SD 7.13.8). For these assets, lifetime ECL is recognized, but interest revenue is still</p>

US GAAP	IFRS
	<p>recognized on the gross carrying amount of the asset.</p> <p><b>Stage 3</b> includes financial assets that have objective evidence of impairment at the reporting date. For these assets, lifetime ECL is recognized, and interest revenue is calculated on the net carrying amount (i.e., net of the credit allowance).</p> <p>An entity is required to continually assess whether a SICR has occurred.</p> <p>The ECL measurement must reflect the time value of money. The entity should discount the cash flows that it expects to receive at the effective interest rate determined at initial recognition, or an approximation thereof, to calculate ECL.</p>
The allowance for loan losses is a valuation account deducted from the amortized cost of the financial assets to present the net amount expected to be collected.	"Credit losses" are defined as the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive, discounted at the original effective interest rate (EIR). Expected credit loss are recognized as a loss allowance.
Each reporting period, changes in the estimate of expected credit losses are generally recognized through earnings as a credit expense or a reversal of credit expense.	Each reporting period, the estimate of the loss allowance is adjusted, with changes recognized in profit or loss as an impairment gain or loss.

### 7.13.3 *Impairments—measurement of expected credit losses*

US GAAP and IFRS contain guidance regarding the factors and methods that should be considered when forecasting expected credit losses. The frameworks agree on requiring the measurement to reflect the probability of loss occurring, even if the probability is low. Neither framework requires the use of a specific methodology for the measurement of the allowance for expected credit losses.

US GAAP	IFRS
The guidance requires that the allowance for loan losses be determined based on the amortized cost of the financial asset, which includes all premiums, discounts, and other adjustments. The use of some approaches to estimating the expected credit losses, such as discounted cash flow (DCF), already requires consideration of premiums and discounts included in the amortized cost. When using the DCF method, expected cash flows are discounted at the EIR of the financial asset.	The ECL measurement must reflect the time value of money. The entity should discount the cash flows that it expects to receive at the EIR determined at initial recognition, or an approximation thereof, to calculate ECL.



US GAAP	IFRS
Loss rate approaches could also be used. When historic loss rates are not based on the amortized cost of the financial asset (but rather on the par value), an adjustment will need to be made to incorporate premiums and discounts..	If a loss rate approach is used, time value of money needs to be considered. Hence, the cash shortfalls must be discounted using the effective interest rate to determine the credit loss on a present value basis, which would also consider premiums and discounts.

#### 7.13.4 *Impairments—estimates*

The estimate of expected credit losses under both standards should consider historical information (past events), information about current conditions, and reasonable and supportable forecasts of future events and economic conditions, as well as estimates of prepayments. Both standards use the words “reasonable and supportable” to describe the forecasts and forward-looking information, but neither defines exactly what is meant by that term. Under both standards, credit losses for assets are generally limited to the contractual period (with certain exceptions). Prepayments and extension options held by the borrower, which the borrower can unilaterally exercise, are taken into account under both frameworks.

US GAAP	IFRS
Under US GAAP, there is no explicit requirement in the standard to consider multiple forward-looking scenarios when measuring expected credit losses. However, the scenario used should be selected to adequately represent the expected credit losses.	Under IFRS, a single forward-looking economic scenario would not fully meet the objective of IFRS 9 when there is a nonlinear relationship between the possible forward-looking economic scenarios and their associated credit losses. In such circumstances, more than one forward-looking scenario that is representative of the range of possible outcomes should be used.
<p>The CECL model requires an estimate of the credit losses expected over the life of an exposure (or pool of exposures). The measurement should include consideration of estimated prepayments but exclude expected extensions and renewals (unless the borrower is able to unilaterally exercise these options).</p> <p>For off-balance sheet credit exposures, expected credit losses are estimated over the contractual period in which the entity is exposed to credit risk via a present contractual obligation to extend credit, unless that obligation can be unconditionally cancelled by the issuer. If a loan commitment can be unconditionally (i.e., unilaterally, and irrevocably) cancelled by the issuer, no estimate of expected credit losses is required for the unused or undrawn portion of the commitment.</p>	<p>The maximum period to consider when measuring expected credit losses is the maximum contractual period (including extension options held by the borrower that the borrower can unilaterally exercise). Expected prepayments should also be considered in the measurement.</p> <p>However, specific guidance regarding the period to consider for measurement of ECL applies to certain financial instruments that include both a loan and an undrawn commitment component. If the entity’s contractual ability to demand repayment and cancel the undrawn commitment does not limit its exposure to credit losses to the contractual notice period, expected credit losses are measured over the period that the entity is exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions. This period might extend beyond the contractual notice period.</p>



### 7.13.5 *Impairments—collective versus individual assessment*

Under both frameworks, the grouping of instruments is performed based on shared or similar risk characteristics.

US GAAP	IFRS
When estimating CECL, reporting entities are required to calculate expected credit losses on a "pooled" basis when instruments have similar risk characteristics.	IFRS 9 requires calculating a probability-weighted amount in the measurement of ECL. Hence, entities need to consider the possibility that a credit loss occurs even if the possibility is very low.
If financial instruments do not share similar risk characteristics, expected credit losses would be calculated on an individual basis, but must incorporate risk of loss that may be based on internal or external expected loss assumptions from groups of similar assets.	When reasonable and supportable information to measure lifetime ECL on an individual basis is not available without undue cost or effort, ECL should be recognized on a collective basis. Instruments are grouped on the basis of shared credit risk characteristics.
An entity's estimate of expected credit losses should include a measure of the expected risk of credit loss, even if the risk is remote.	

### 7.13.6 *Impairments—loan modifications and restructurings*

Generally, the two frameworks have different models and consider different periods in accounting for modifications and restructuring of loans.

US GAAP	IFRS
A creditor should determine whether refinancing or restructuring of debt is a modification or a new loan.	A creditor should determine whether modifications of the contractual cash flows of a financial asset result in modification or derecognition of the existing instrument. Modified assets should be assessed to determine whether a significant increase in credit risk has occurred, in the same way as it is assessed for any other financial instrument. If not, the loss allowance should be measured at 12-month ECL.
The period over which credit losses are estimated should not include modifications or extensions (unless they are exercisable by the borrower and not unconditionally cancellable by the lender).	The period to consider when measuring expected credit losses is generally the maximum contractual period (except as noted in SD 7.13.4 with respect to certain loan commitments, such as credit cards). However, the cash flows expected from the entity's recovery activity upon default of a loan should generally be included in the measurement of ECL. The cash flows that an entity expects to receive on a default of a loan may be based on several different scenarios, such as taking no action; keeping the loan and restructuring it to maximize collections; selling the loan; or foreclosing on the loan and collecting the collateral. Those different

US GAAP	IFRS
	scenarios are factored into the measurement of ECL for a portfolio when restructurings are expected.

### 7.13.7 *Impairments—reversion to historical information*

The period over which it is necessary to estimate expected credit losses for a financial instrument may exceed the period for which a reporting entity can develop a reasonable and supportable forecast. Neither standard allows entities to assume zero expected credit losses due to an inability to develop a reasonable forecast.

US GAAP	IFRS
For periods beyond which an entity can develop a reasonable and supportable forecast, the guidance discusses reversion to historical loss information that reflects the contractual term of the financial instrument (or group of financial instruments) using a variety of reversion techniques, including reversion for specific inputs or for the entire estimate.	<p>Different methods for estimating ECL for periods beyond which an entity can develop a reasonable and supportable forecast could be acceptable depending on the facts and circumstances.</p> <p>One such method is to use historical data as a base from which to measure ECL. Such data should be adjusted to reflect current conditions and forecasts of future conditions not reflected in the historical data and to remove the effects of the conditions in the historical period that are not relevant to the future contractual cash flows. Or, the most reasonable and supportable information might be the unadjusted historical information, depending on the nature of the historical information and when it was calculated, compared to the circumstances at the reporting date.</p>

### 7.13.8 *Impairments—zero expected credit losses*

Under the US GAAP CECL model, certain assets (e.g., US Treasury securities), for which the expectation of non-repayment is zero, do not require an estimate of expected credit losses. Under IFRS, on the other hand, entities are always required to consider the possibility that a credit loss occurs. Although US GAAP and IFRS are different in principle, the practical effect may be small.

Under IFRS, there is a practical expedient for assets with low credit risk, which applies, for example, to investment grade assets. For such assets, entities can choose to measure the impairment loss at the 12-month ECL and assume that no significant increase in credit risk has occurred (i.e., they can assume that the financial assets are always in “stage 1” as long as they remain investment grade).

US GAAP	IFRS
The CECL model generally requires that the estimate of expected credit losses include a measure of the expected risk of credit loss even if that risk is remote. However, expected credit losses do not need to be estimated when the expectation of nonpayment of the amortized cost basis is zero. These situations are not expected to occur frequently.	<p>When measuring expected credit losses, an entity should consider the risk that a credit loss may occur even if the possibility of a credit loss occurring is very low.</p> <p>As an exception to the general model, if the credit risk of a financial instrument is low at the reporting date (e.g., the instrument is investment grade), the entity can measure impairment using 12-month ECL. It would not have to assess whether a significant increase in credit risk has occurred. This is an optional practical expedient. To qualify for this practical expedient, the instrument should meet the description of low credit risk in IFRS 9.</p>

### 7.13.9 *Impairments—credit enhancements/collateral*

Under both US GAAP and IFRS, the impact of collateral that is part of the same unit of account as the financial instrument is factored into the measurement of the expected credit loss. However, even if the asset is overcollateralized, there can still be an expected credit loss because the possibility of the collateral's value declining must be considered.

A difference in measurement could arise between US GAAP and IFRS in some circumstances.

US GAAP	IFRS
<p>If financial assets are secured by collateral that is part of the unit of account of the instrument, the expected credit losses should consider the impact the collateral will have in reducing credit losses. The estimate of expected credit losses should consider the current collateral value as well as the nature of the collateral, potential future changes in its value, and historical loss information for financial assets secured with similar collateral.</p> <p>ASC 326 provides a number of specific provisions relating to collateralized instruments, including:</p> <ul style="list-style-type: none"> <li>□ When an entity determines that foreclosure is probable, it should estimate the expected credit losses based on the fair value of the collateral at the balance sheet date.</li> <li>□ If the borrower is experiencing significant financial difficulty and repayment of the loan is expected to be provided substantively through the operation or sale of the collateral, then the asset is “collateral dependent.” An entity is then permitted to estimate the expected credit losses based on the fair value of the collateral (if operating</li> </ul>	<p>When measuring ECL, the estimate of expected cash shortfalls should reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognized separately by the entity.</p> <p>The estimate of expected cash shortfalls on a collateralized financial instrument reflects the amount and timing of cash flows that are expected from foreclosure on the collateral, less the costs of obtaining and selling the collateral. This is irrespective of whether foreclosure is probable (i.e., the estimate of expected cash flows considers the probability of a foreclosure and the cash flows that would result from it).</p>

US GAAP	IFRS
the collateral for repayment of the financial asset) or the fair value of the collateral less costs to sell (if selling the collateral for repayment of the financial asset).	
When assets have collateral maintenance requirements, the amount of collateral is continually adjusted as a result of changes in its fair value. In these arrangements, a reporting entity may estimate expected credit losses by comparing the fair value of the collateral to the asset's amortized cost basis. If the collateral maintenance provisions require the counterparty to continually replenish the collateral to an amount equal to or greater than amortized cost, a reporting entity may determine that the expected credit loss is zero.	IFRS does not have a practical expedient for assets with collateral maintenance provisions. The possibility that a credit loss will occur should be taken into account based on its weighted-average probability. This means that for a collateralized loan, the possibility that the borrower may default before the collateral is replenished should be considered. For loans that are significantly over collateralized, this may result in a small ECL.

### 7.13.10 *Impairments—guarantees*

For holders of guarantees, the standards have different criteria to assess whether the cash flows from the guarantees can be included in the measurement of the expected credit losses for the guaranteed asset. Guarantees issued that are not accounted for as insurance contracts or measured at FVTPL are in the scope of the impairment guidance and require an estimate of expected credit losses for the issuer.

US GAAP	IFRS
Credit enhancements, such as guarantees or insurance contracts, should be considered in the estimate of expected credit losses if they are part of the lending arrangement. A credit enhancement deemed to be a freestanding contract, however, should not be considered in the estimate of the expected credit losses - a guarantee entered into separate and apart from the guaranteed asset or entered into in conjunction with the asset that is legally detachable and separately exercisable should be accounted for separately.	The estimate of expected cash shortfalls should reflect the cash flows expected from collateral and other credit enhancements that are part of or integral to the contractual terms and are not recognized separately by the entity.  If a financial guarantee is obtained at the date of initial recognition of the guaranteed loan, the cash flows from the guarantee could be included in the measurement of the allowance for the financial asset if the entity views it as being integral.
The expected credit losses are measured and accounted for without regard to the initial fair value of the guarantee.	After initial recognition, an issuer of a financial guarantee contract subsequently measures it at the higher of (1) the amount of the loss allowance and (2) the amount initially recognized less, when appropriate, the cumulative amount of income recognized in accordance with the principles of IFRS 15 (unless the guarantee was designated at FVTPL or arises upon a failed derecognition of a financial asset).

**7.13.11 Impairments—fair value hedge adjustments**

Under both frameworks, the carrying amount of assets that qualify as the hedged item in a fair value hedge (e.g., fixed interest rate loan hedged against the exposure to interest rate risk) includes an adjustment for fair value changes attributable to movements in the hedged risk.

US GAAP	IFRS
The loss allowance is determined based on the amortized cost of the financial asset, which includes fair value hedge accounting adjustments (and all premiums and discounts).	Although IFRS does not have explicit guidance, we believe that the measurement of ECL on an asset that qualifies as a hedged item in a fair value hedge, which is based on the amortized cost of that asset, does not need to take into account fair value adjustments since inception of the hedge until those adjustments are amortized and adjust the EIR. This will be on the earlier of when (1) hedge accounting is terminated or (2) the holder of the loan chooses to start amortizing the fair value hedge adjustments.

**7.13.12 Impairments—write-off and default**

The guidance in US GAAP and IFRS describing when to write off an asset is similar in principle, but the words are different. IFRS is more prescriptive on how an entity should define “default” compared to US GAAP. As a result, practices may differ, particularly in industries like banking, where the timing of asset write-off may be heavily influenced by regulators’ interpretations of the guidance.

US GAAP	IFRS
Reporting entities are required to write off financial assets (or a portion thereof) in the period in which a determination is made that the financial asset (or portion of it) is uncollectible. This generally occurs when all commercially reasonable means of recovering the loan balance have been exhausted.	IFRS 9 requires an entity to reduce the gross carrying amount of a financial asset (in its entirety or a portion thereof) when the entity has no reasonable expectations of recovering it.
US GAAP does not have an explicit definition of default.	An entity would apply a definition of default consistent with the definition used for internal credit risk management purposes for the relevant financial instrument and can consider qualitative indicators (for example, financial covenants) when appropriate. However, there is a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due, unless an entity has reasonable and supportable information to demonstrate that a more lagging default criterion is appropriate.

**7.13.13    *Impairments—application to trade receivables and contract assets***

Trade receivables and contract assets are in the scope of the impairment guidance under both frameworks. Even entities that are not financial institutions need to apply the requirements of the guidance and recognize “day 1” impairment losses on receivables under both frameworks. Operational simplifications under IFRS for trade receivables and contract assets could eliminate the major difference between the frameworks related to the IFRS three stage model, as described in SD 7.13.2.

<b>US GAAP</b>	<b>IFRS</b>
Full day 1 credit loss recognition is required by the general model for assets in scope, such as trade receivables and contract assets.	Although in scope, the model includes some operational simplifications for trade receivables, contract assets, and lease receivables (see SD 7.13.15). These simplifications eliminate the need to calculate 12-month ECL and to assess when a significant increase in credit risk has occurred, as they allow (or in some cases require) measurement of the loss allowance at initial recognition and throughout the life of an instrument at an amount equal to lifetime ECL.

**7.13.14    *Impairments—patterns of interest recognition***

IFRS 9 specifies the amount to which the effective interest rate (EIR) is applied depending on the stage in the credit life of the asset. ASC 326 does not prescribe an EIR nor when an asset should be moved to non-accrual status, but it may permit existing non-accrual practices to continue.

<b>US GAAP</b>	<b>IFRS</b>
US GAAP does not preclude non-accrual status but does not prescribe when an entity should move an instrument to non-accrual status. Interest revenue is recognized based on the effective interest method. This is calculated by applying the effective interest rate to the gross carrying amount of a financial asset.	Under IFRS, there is no non-accrual status. Interest revenue is recognized based on the effective interest method. This is calculated by applying the effective interest rate to the gross carrying amount of a financial asset, except for stage 3 financial assets. For stage 3 financial assets, the entity would apply the effective interest rate to the amortized cost of the financial asset (i.e., net of the allowance) in subsequent reporting periods.

**7.13.15    *Impairments—lease receivables***

A lessor’s net investment in a lease, whether a sales type/direct financing lease under US GAAP or finance lease under IFRS, is within the scope of the impairment guidance under both frameworks while operating lease receivables are not in the scope of ASC 326 for impairment but are in scope for IFRS 9.

US GAAP	IFRS
<p>A lessor's net investment in a sales-type or direct financing lease is within the scope of the impairment guidance. When measuring the expected credit losses on the net investment in leases using a DCF method, the discount rate used in measuring the lease receivable under ASC 842, <i>Leases</i>, should be used.</p> <p>ASC 842 does not provide explicit guidance on how to assess unguaranteed residual value (URV) for impairment. For purposes of applying ASC 326, the net investment in the lease should be evaluated as one unit of account. When measuring expected credit losses on net investment in a lease, a lessor would use cash flows it expects to derive from the underlying asset during the remaining lease term and cash flows it expects to derive from the underlying asset following the end of the lease term.</p>	<p>A lessor's net investment in a lease is within the scope of the impairment guidance. The cash flows and discount rate used for determining the ECL for lease receivables under IFRS 9 should be consistent with the cash flows used in measuring the lease receivable under IFRS 16, <i>Leases</i>.</p> <p>An entity has an accounting policy choice when measuring ECL for finance lease receivables whether to apply the general model or measure the loss allowance at an amount equal to lifetime ECL at initial recognition and throughout the life of the lease receivable.</p> <p>IFRS 9 does not provide explicit guidance on how to assess URV for impairment. We believe that the URV should be excluded from the calculation of the ECL and assessed for impairment under IFRS 16.</p>

### 7.13.16 *Impairments—AFS debt securities measured at FVOCI*

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

US GAAP	IFRS
<p>An investment in certain debt securities classified as available for sale is assessed for impairment if the fair value is less than amortized cost. When fair value is less than amortized cost, an entity needs to determine whether the shortfall in fair value is temporary or other than temporary and how much is credit-related.</p> <p>In determining whether an impairment is other than temporary, the following factors are assessed for available-for-sale securities:</p> <p><b>Step 1</b>—Can management assert (1) it has the intent to sell and (2) it is more likely than not that it will have to sell before recovery of the amortized cost basis? If yes to either of these requirements, then impairment is triggered. If no, then move to Step 2.</p> <p><b>Step 2</b>—Determine how much of the decline in fair value below the amortized cost of the security is “credit-related.” An allowance for</p>	<p>As described in SD 7.13.2, IFRS 9 has a three-stage model for impairment based on the changes in credit quality of the instrument since inception. The same general impairment model applies to debt investments measured at FVOCI.</p> <p>Upon initial recognition of a financial asset, an entity will typically record a 12-months ECL. Subsequently, the entity is required to continually assess whether a SICR has occurred. If such an increase occurs, the allowance is increased to an amount equal to lifetime ECL.</p> <p>Movements in the ECL allowance are recognized in the income statement. However, the allowance itself is credited to a FVOCI reserve.</p> <p>A practical expedient is available for assets with low credit risk. This expedient applies, for example, to investment grade assets. For such assets, an entity can choose to measure the impairment loss at the 12-months ECL and assume that no significant increase in credit risk</p>



US GAAP	IFRS
loan losses is only required for “credit-related” losses, and is limited to the difference between the fair value and amortized cost.	has occurred, as long as the asset continues to be low credit risk.
A policy election exists to use either a single best estimate or a probability-weighted methodology to measure the present value of cash flows expected to be collected.	The measurement of ECL has to be a probability-weighted amount based on the expected cash flows under different scenarios.

### 7.13.17 ***Impairments—Equity investments***

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

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

### 7.13.18 ***Impairments—“purchased credit deteriorated” versus “purchased or originated credit impaired”***

Both frameworks contain specific guidance for instruments that have already suffered credit deterioration since their origination at the time of purchase. While the concepts in the two frameworks are similar, there are differences in the definitions and in the accounting treatment. Purchase credit deteriorated (PCD) assets under US GAAP are limited to financial assets that are acquired. Under IFRS, an originated financial asset could follow the credit-impaired or purchased or originated credit impaired (POCI) model, although it is expected to be rare.



Under US GAAP, the cost basis of the asset is increased for the initial amount of the allowance. Under IFRS, no allowance is recorded on initial recognition of the asset. Under both models, subsequent credit improvements are recognized in the income statement as a reversal of credit loss and not as interest income. However, on the balance sheet, US GAAP would record such favorable changes in cash flows through reversal of the allowance, whereas under IFRS, favorable changes compared to initial expectations are recognized as a direct adjustment to the gross carrying amount of the asset.

US GAAP	IFRS
The definition of a PCD asset is an asset that has "experienced a more than insignificant deterioration in credit quality" since origination.	The definition of a POCI asset is an asset for which, on initial recognition, "one or more events that have a detrimental impact on the estimated future cash flows of that financial asset," such as significant financial difficulty, default, and additional events, have occurred.
For PCD assets, an investor will need to recognize an allowance for loan losses on initial recognition by estimating the expected credit losses of the purchased assets.	For POCI financial assets, an entity only recognizes the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance. Impairment gains are recognized as a direct adjustment to the gross carrying amount, to the extent they exceed the loss allowance estimated at initial recognition and included in the estimated cash flows.
For financial assets that are considered PCD, an entity should not recognize the initial estimate of expected credit losses through current earnings. It would be recorded as an adjustment to the amortized cost basis of the related financial asset at acquisition (i.e., a balance-sheet gross-up). A similar gross-up should be recorded for AFS instruments that are deemed to be PCD assets. Specifically, both the recorded asset balance (i.e., the purchase price) and the allowance for loan losses should be increased by the amount of the expected credit losses at acquisition.	
Interest income for a PCD asset should be recognized by accreting the amortized cost basis of the instrument (which does not include the allowance) to its contractual cash flows. The accretable yield may be different for loan loss allowances estimated using a DCF model versus a non-discounted cash flow model.	For POCI assets, entities are to use the credit-adjusted EIR, which is the rate that discounts estimated (rather than contractual) future cash payments and receipts through the expected life of the asset to its amortized cost (net of the allowance).  In some unusual circumstances, there might be evidence that the modified financial asset is credit-impaired at initial recognition, and thus should be recognized as an originated credit-impaired financial asset.

## 7.14 *Financial asset derecognition*

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

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

US GAAP	IFRS
<p>ASC 860 does not apply to transfers in which the transferee is a consolidated affiliate of the transferor, as defined in the standard. If this is the case, regardless of whether the transfer criteria are met, derecognition is not possible as the assets are, in effect, transferred within the consolidated entity.</p> <p>The guidance focuses on an evaluation of the transfer of control. The evaluation is governed by three key considerations:</p> <ul style="list-style-type: none"> <li>□ Legal isolation of the transferred asset from the transferor</li> <li>□ The ability of the transferee (or, if the transferee is a securitization vehicle, each third-party beneficial interest holder) to pledge or exchange the asset (or the beneficial interest)</li> <li>□ The transferor has no right or obligation to repurchase the transferred assets</li> </ul> <p>As such, derecognition can be achieved even if the transferor has significant ongoing involvement with the transferred assets, such as significant exposure to credit risk.</p> <p>If a transfer of an entire financial asset qualifies for sale accounting, the transferred asset must be derecognized from the transferor's balance sheet. All assets received and obligations assumed in exchange are recognized at fair value.</p> <p>If the transferor continues to service the transferred assets, a related servicing asset or servicing liability should be recorded at its fair value. Any gain or loss on the transfer should be recognized, calculated as the difference between the net proceeds received and the carrying value of the assets sold.</p> <p>A transfer may comprise only a portion of an entire financial asset (e.g., a transfer involving a loan participation). To potentially qualify for sale accounting, the transferred portion must first meet the stringent accounting definition of a “participating interest.” If the transferred portion does not satisfy this definition, the exchange must be accounted for as a secured borrowing. If the definition is met, the transfer</p>	<p>The transferor first applies the consolidation guidance and consolidates any and all subsidiaries or special purpose entities it controls.</p> <p>The guidance focuses on evaluation of whether a qualifying transfer has taken place, whether risks and rewards have been transferred, and, in some cases, whether control over the asset in question has been transferred.</p> <p>The model can be applied to part of a financial asset (or part of a group of similar financial assets) or to the financial asset in its entirety (or a group of similar financial assets in their entirety).</p> <p>Under IFRS 9, full derecognition is appropriate once both of the following conditions have been met:</p> <ul style="list-style-type: none"> <li>□ The financial asset has been transferred outside the consolidated group.</li> <li>□ The entity has transferred substantially all of the risks and rewards of ownership of the financial asset.</li> </ul> <p>The first condition is achieved in one of two ways:</p> <ul style="list-style-type: none"> <li>□ When an entity transfers the contractual rights to receive the cash flows of the financial asset, or</li> <li>□ When an entity retains the contractual rights to the cash flows but assumes a contractual obligation to pass the cash flows on to one or more recipients (referred to as a pass-through arrangement)</li> </ul> <p>Many securitizations do not meet the strict pass-through criteria to recognize a transfer of the asset outside of the consolidated group and as a result fail the first condition for derecognition.</p> <p>If there is a qualifying transfer, an entity must determine the extent to which it retains the risks and rewards of ownership of the financial asset. IFRS 9 requires the entity to evaluate the extent of the transfer of risks and rewards by comparing its exposure to the variability in the amounts and timing of the transferred financial</p>

**US GAAP**

of the participating interest must then satisfy the three derecognition criteria cited above to qualify for sale accounting.

If a transfer of a participating interest qualifies for derecognition, the transferor must allocate the carrying value of the entire financial asset between the participating interest sold and the portion retained on a pro-rata basis. All assets received and obligations assumed in exchange are recognized at fair value, consistent with the measurement principles that govern derecognition of an entire financial asset.

**IFRS**

assets' net cash flows, both before and after the transfer.

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

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

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***Chapter 8:***  
***Liabilities—taxes—updated***  
***March 2023***

## 8.1 Liabilities – taxes

Both US GAAP and IFRS base their deferred tax accounting requirements on balance sheet temporary differences measured at the tax rates expected to apply when the differences reverse. Discounting of deferred taxes is prohibited under both frameworks. Although the two frameworks share many fundamental principles, they are at times applied in different manners and there are different exceptions to the principles under each framework. This may result in differences in income tax accounting between the two frameworks. Some of the more significant differences relate to the allocation of tax expense/benefit to financial statement components (“intraproduct allocation”), income tax accounting with respect to share-based payment arrangements, and some elements of accounting for uncertain tax positions.

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

### Technical references

US GAAP:ASC 740

IFRS :

IAS 12, IAS 34, IAS 37, IFRIC 23, Standard Interpretations Committee (SIC) Interpretation 25

### Note

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

## 8.2 Hybrid taxes

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

US GAAP	IFRS
Taxes based on a gross amount are not accounted for as income taxes and should be reported as pretax items.	Accounting for hybrid taxes is not specifically addressed within IFRS.
If a hybrid tax is based on the greater of an income-based calculation and a non-income-based calculation, the amount of tax that is based on income should be accounted for as an income-based tax (i.e., in the income tax line), with any incremental amount accounted for as a non-income-based tax (i.e., above the line) recognized entirely in the period incurred.	Applying the principles in IAS 12 to the accounting for hybrid taxes, entities can adopt either one of the following approaches and apply it consistently: <ul style="list-style-type: none"> <li>□ Designate the tax based on the gross amount not considered income as the minimum amount and recognize it as a pretax item. Any excess over that minimum amount would then be reported as income tax</li> </ul>

US GAAP	IFRS
Deferred taxes should be recognized and measured according to that classification.	<p>expense; or</p> <ul style="list-style-type: none"> <li>□ Designate the tax based on the net amount of income less expenses as the minimum amount and recognize it as income tax expense. Any excess over that minimum would then be reported as a pretax item.</li> <li>□ Deferred taxes should be recognized and measured according to the classification chosen.</li> </ul>

### 8.3 *Tax base of an asset or a liability*

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

US GAAP	IFRS
Tax base is based upon the relevant tax law. It is generally determined by the amount that is depreciable for tax purposes or deductible upon sale or liquidation of the asset or settlement of the liability.	<p>Tax base is based on the tax consequences that will occur based upon how an entity is expected to recover or settle the carrying amount of assets and liabilities.</p> <p>The carrying amount of assets or liabilities can be recovered or settled through use or through sale.</p> <p>Assets and liabilities may also be recovered or settled both through use and sale. In that case, the carrying amount of the asset or liability is bifurcated, resulting in more than a single temporary difference related to that item.</p> <p>Exceptions to these requirements include:</p> <ul style="list-style-type: none"> <li>□ A rebuttable presumption exists that investment property measured at fair value will be recovered through sale.</li> <li>□ Non-depreciable assets measured using the revaluation model in IAS 16 are presumed to be recovered through sale.</li> </ul>

### 8.4 *Taxes – initial recognition of an asset or a liability*

Certain situations that generate a deferred tax asset or liability under US GAAP may have no deferred tax accounting under IFRS.

In May 2021, the IASB issued *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*. The amendments to IAS 12 narrow the scope of an initial recognition exemption for deferred taxes and are effective for annual periods beginning on or after January 1, 2023. Early

adoption is permitted. Differences may still exist between US GAAP and IFRS after adoption of the amendments.

US GAAP	IFRS
A temporary difference may arise on initial recognition of an asset or liability. In asset purchases that are not business combinations, a deferred tax asset or liability is recorded with the offset generally recorded against the assigned value of the asset. The amount of the deferred tax asset or liability is determined by using a simultaneous equation method. If the simultaneous equation reduces the basis of the asset to less than zero, a deferred credit is recorded. The deferred credit is amortized to income tax expense in proportion to the realization of the tax benefits that gave rise to the deferred credit.	<p>Prior to adoption of the May 2021 amendments, an exemption exists that deferred taxes should not be recognized on the initial recognition of an asset or liability in a transaction that is not a business combination and affects neither accounting profit nor taxable profit/loss at the time of the transaction.</p> <p>After adoption of the May 2021 amendments, the exemption is changed such that deferred taxes should not be recognized on the initial recognition of an asset or liability in a transaction that:</p> <ul style="list-style-type: none"> <li><input type="checkbox"/> is not a business combination;</li> <li><input type="checkbox"/> affects neither accounting profit nor taxable profit/loss at the time of the transaction; and</li> <li><input type="checkbox"/> does not give rise to equal taxable and deductible temporary differences.</li> </ul>

## 8.5 Recognition of deferred tax assets

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

US GAAP	IFRS
Deferred tax assets are recognized in full, but then a valuation allowance is recorded if it is considered more likely than not (more than 50% probable) that some portion of the deferred tax assets will not be realized.	Deferred tax assets are recognized to the extent that it is probable (more than 50%) that sufficient taxable profits will be available to realize the deductible temporary difference or carryforward of unused tax losses or tax credits.

## 8.6 Deferred taxes for outside basis differences

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

US GAAP	IFRS
With respect to undistributed profits and other outside basis differences, different requirements exist depending on whether they involve investments in subsidiaries, joint ventures, or equity investees.	With respect to undistributed profits and other outside basis differences related to investments in foreign and domestic subsidiaries, branches and associates, and interests in joint arrangements, deferred tax liabilities are recognized except when a parent company,

**US GAAP***Investments in subsidiaries and corporate joint ventures*

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

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

As it relates to investments in foreign subsidiaries and corporate joint ventures, no deferred tax liabilities are recognized on undistributed profits and other outside basis differences if sufficient evidence shows that (1) the subsidiary has invested or will invest the undistributed earnings indefinitely or (2) the earnings will be remitted in a tax-free liquidation. A parent entity should have evidence of specific plans for reinvestment of undistributed earnings of a subsidiary which demonstrate that remittance of the earnings will be postponed indefinitely (this is known as the “indefinite reversal criteria”).

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

*Investments in equity investees*

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

**IFRS**

investor, joint venturer, or joint operator is able to control the timing of reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

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

## **8.7 Deferred taxes for exchange rate changes or tax indexing**

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



US GAAP	IFRS
No deferred taxes are recognized for differences related to nonmonetary assets and liabilities that are remeasured from local currency into their functional currency by using historical exchange rates (if those differences result from changes in exchange rates or indexing for tax purposes).	Deferred taxes should be recognized for the difference between the carrying amount determined by using the historical exchange rate and the relevant tax base, which may have been affected by exchange rate changes or tax indexing.

## 8.8 *Uncertain tax positions*

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

US GAAP	IFRS
Uncertain tax positions are recognized and measured using a two-step process: (1) determine whether a benefit may be recognized and (2) measure the amount of the benefit. Tax benefits from uncertain tax positions may be recognized only if it is more likely than not that the tax position is sustainable based on its technical merits.	Tax assets or liabilities arising from uncertain tax treatments should be assessed using a “probable” recognition threshold, i.e., the assets and liabilities are recognized if it is more likely than not that a tax authority would accept the tax treatment.
Uncertain tax positions are evaluated at the individual tax position level.	An entity is required to assess whether to consider individual uncertainties separately or collectively based on which method better predicts the resolution of the uncertainty.
The tax benefit is measured by using a cumulative probability model: the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement.	For those items that meet the probable recognition threshold, an entity is required to measure the tax position consistent with the amount that is, or will be, reported in the tax returns.  If it is not probable that a tax authority will accept the tax position, the entity is required to measure the impact of the uncertainty using the method that better predicts the resolution of the uncertainty: either the most likely amount method or the expected value method.
Relevant developments affecting uncertain tax positions after the balance sheet date but before issuance of the financial statements (including the discovery of information that was not available as of the balance sheet date) would be considered a non-adjusting subsequent event for which no effect would be recorded in the current-period financial statements.	Relevant developments affecting uncertain tax positions occurring after the balance sheet date but before issuance of the financial statements (including the discovery of information that was not available as of the balance sheet date) would be considered either an adjusting or non-adjusting event depending on whether the new information provides evidence of conditions that existed at the end of the reporting period.

US GAAP	IFRS
The income statement classification of interest and penalties related to uncertain tax positions (either in income tax expense or as a pretax item) represents an accounting policy decision that is to be consistently applied.	An entity needs to consider the specific nature of interest and penalties to determine whether they are income taxes or not. If a particular amount is an income tax, the entity should apply IAS 12 to that amount. Otherwise, the entity should apply the contingency guidance under IAS 37. This determination is not an accounting policy choice.

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

US GAAP has specific guidance related to special deductions and investment tax credits, generally grounded in US tax law. US GAAP also addresses tax holidays. IFRS does not specify accounting treatments for any specific national tax laws and entities instead are required to apply the principles of IAS 12 to local legislation. Even though US GAAP and IFRS have different references to special deductions and tax holidays, the ultimate impact could be the same under both frameworks in some scenarios.

US GAAP	IFRS
<b>Special deductions</b> Several specific deductions under US tax law have been identified under US GAAP as special deductions. Special deductions are recognized in the period in which they are claimed on the tax return. Entities subject to graduated tax rates should evaluate whether the ongoing availability of special deductions is likely to move the entity into a lower tax band which might cause deferred taxes to be recorded at a lower rate.	<b>Special deductions</b> Special deductions are not defined under IFRS but are generally treated in the same way as tax credits. Tax credits are generally recognized in the period in which they are claimed on the tax return, however certain credits may have the substantive effect of reducing the entity's effective tax rate for a period of time. The impact on the tax rate can affect how entities should record their deferred taxes. In other cases, the availability of credits might reduce an entity's profits in a way that moves it into a lower tax band, and again this may impact the rate at which deferred taxes are recorded.
<b>Investment tax credits</b> It is preferable to account for investment tax credits using the "deferral method" in which the entity spreads the benefit of the credit over the life of the asset. However, entities might alternatively elect to recognize the benefit in full in the year in which it is claimed (the "flow-through method").	<b>Investment tax credits</b> IAS 12 states that investment tax credits are outside the scope of the income taxes guidance. IFRS does not define investment tax credits, but we believe that it is typically a credit received for investment in a recognized asset. Depending on the nature of the credit it might be accounted for in one of three ways: <ol style="list-style-type: none"> <li>1. In the same way as other tax credits;</li> <li>2. As a government grant under IAS 20; or</li> <li>3. As an adjustment to the tax base of the asset to which the initial recognition exemption is likely to apply.</li> </ol>

US GAAP	IFRS
<b>Tax holidays</b> Deferred taxes are not recorded for any tax holiday but rather the benefit is recognized in the periods over which the applicable tax rate is reduced or that the entity is exempted from taxes. Entities should, however, consider the rate at which deferred taxes are recorded on temporary differences. Temporary differences expected to reverse during the period of the holiday should be recorded at the rate applicable during the holiday rather than the normal statutory income tax rate.	<b>Tax holidays</b> While IFRS does not define a tax holiday, the treatment is in line with US GAAP in that the holiday itself does not create deferred taxes, but it might impact the rate at which deferred tax balances are measured.

## 8.10 Taxes – intercompany transfers of inventory

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

US GAAP	IFRS
For purposes of the consolidated financial statements, any tax impacts to the seller as a result of an intercompany sale or transfer of inventory are deferred until the asset is sold to a third-party or otherwise recovered (e.g., written down).  In addition, the buyer is prohibited from recognizing a deferred tax asset resulting from the difference between the tax basis and consolidated carrying amount of the inventory.	There is no exception to the model for the income tax effects of transferring assets between the entities in the consolidated groups. Any tax impacts to the consolidated financial statements as a result of the intercompany transaction are recognized as incurred.  If the transfer results in a change in the tax base of the asset transferred, deferred taxes resulting from the intragroup sale are recognized at the buyer's tax rate.

## 8.11 Change in tax laws, rates, and status

The impact on deferred and current taxes as a result of changes in tax laws and tax rates may be recognized earlier under IFRS. Also, the impact of a change in tax status is typically reflected only in profit or loss under US GAAP, but could be reflected in different line items under IFRS.

US GAAP	IFRS
US GAAP requires the use of enacted tax laws and tax rates when calculating current and deferred taxes.  The tax effects of a change in tax status are recognized in income from continuing operations.	Current and deferred tax are calculated using enacted or substantively enacted tax laws and tax rates.  SIC 25 requires current and deferred tax consequences of a change in tax status to be included in net profit or loss for the period, unless those consequences relate to transactions and events that result in an entry to OCI or to equity in the same or different period.

## 8.12 Tax rate on undistributed earnings of a subsidiary

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

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

## 8.13 Taxes – presentation

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

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

US GAAP	IFRS
disallowance of the uncertain tax position. Netting would not apply, however, if the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the carryforward for such purpose.	guidance in IAS 12 on the presentation of income taxes applies.

## 8.14 Taxes – intraperiod allocation

Changes to deferred taxes could result in less volatility in the statement of operations under IFRS.

US GAAP	IFRS
<p>The tax expense or benefit is allocated between the financial statement components (such as continuing operations, discontinued operations, other comprehensive income, and equity) following a “with and without” approach:</p> <ul style="list-style-type: none"> <li>□ First, the total tax expense or benefit for the period is computed,</li> <li>□ Then the tax expense or benefit attributable to continuing operations is computed separately without considering the other components, and</li> <li>□ The difference between the total tax expense or benefit for the period and the amount attributable to continuing operations is allocated amongst the other components.</li> </ul> <p>Subsequent changes in deferred tax balances due to enacted tax rate and tax law changes are taken through profit or loss regardless of whether the deferred tax was initially created through profit or loss or other comprehensive income, through equity, or in acquisition accounting. The same principle applies to changes in assertion with respect to unremitted earnings of foreign subsidiaries; deferred taxes are recognized in continuing operations even if some of the temporary difference arose as a result of foreign exchange recognized in OCI (with the exception of current-year foreign exchange that is recognized in CTA).</p> <p>Changes in the amount of valuation allowance due to changes in assessment about realization in future periods are generally taken through the income statement, with limited exceptions for certain equity-related items.</p>	<p>Tax follows the pretax item. Current and deferred tax on items recognized in other comprehensive income or directly in equity should be similarly recognized in other comprehensive income or directly in equity. When an entity pays tax on all of its profits, including elements recognized outside of profit or loss, it can be difficult to determine the share attributable to individual components. Under such circumstances, tax should be allocated on a pro rata basis or other basis that is more appropriate in the circumstances.</p> <p>Subsequent changes in deferred tax are recognized in profit or loss, OCI, or equity depending on where the transaction(s) giving rise to the deferred tax were recorded. Entities must “backwards trace” based upon how the deferred tax balance arose to determine where the change in deferred tax is recorded.</p>

## 8.15 Taxes – disclosures

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

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

## 8.16 Taxes – interim reporting

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

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

## 8.17 Taxes – separate financial statements

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

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

**US GAAP****IFRS**

An entity issuing financial statements is not required to allocate income tax expense to a legal entity that is both not subject to tax and disregarded by the taxing authority (e.g., single member LLCs), but an entity may elect to do so. This accounting policy election may be applied on an entity-by-entity basis even if the separate entities are included in the same consolidated income tax return.

## **8.18 Taxes – share-based payment arrangements**

Significant differences in current and deferred taxes exist between US GAAP and IFRS with respect to share-based payment arrangements. The relevant differences are described in the *Expense recognition—share-based payments* chapter (see SD 4.15).

## **8.19 Accounting considerations of certain aspects of US tax law**

The Tax Cuts and Jobs Act of 2017 (the 2017 Act) significantly changed many provisions of US tax law. In response, the FASB staff issued several [FASB Staff Q&As](#) that address accounting for certain aspects of the 2017 Act under US GAAP. Since the FASB guidance is applied only to entities under US GAAP, the accounting impact of the provisions of the 2017 Act discussed in this section could be different between IFRS and US GAAP.

### **8.19.1 Base erosion anti-abuse tax (BEAT)**

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

**US GAAP****IFRS**

The FASB staff concluded that temporary differences should be measured at regular statutory tax rates versus considering the impact of BEAT in determining the rate expected to apply. Therefore, the effects of BEAT should be recognized as a period cost when incurred versus being considered in the measurement of deferred taxes.

No specific guidance related to BEAT exists under IFRS. It would be acceptable for an entity to measure deferred taxes at the regular statutory tax rate and account for the effects of BEAT in the year in which they are incurred.

The FASB staff also concluded that an entity does not need to evaluate the effect of potentially paying the BEAT tax in future years on the realization of deferred tax assets. While not required, we believe that companies may elect to do so.

There is no similar guidance under IFRS on the potential impact of BEAT on the realizability of deferred tax assets.



### 8.19.2 *Global intangible low-taxed income (GILTI)*

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

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

### 8.19.3 *Foreign derived intangible income (FDII)*

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

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



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***Chapter 9:***  
***Liabilities—other—updated***  
***November 2022***

## 9.1 *Liabilities—other*

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

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

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

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

### ***Technical references***

#### *US GAAP*

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

#### *IFRS*

IAS 19, IAS 20, IAS 37, IFRIC 21

### ***Note***

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

## 9.2 *Recognition of provisions*

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

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

US GAAP	IFRS
<p>A loss contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur.</p> <p>An accrual for a loss contingency is required if two criteria are met: (1) if it is probable that a liability has been incurred and (2) the amount of loss can be reasonably estimated.</p> <p>Implicit in the first condition above is that it is probable that one or more future events will occur confirming the fact of the loss.</p> <p>The guidance uses the term “probable” to describe a situation in which the outcome is likely to occur. While a numeric standard for probable does not exist, practice generally considers an event that has a 75% or greater likelihood of occurrence to be probable.</p>	<p>A contingent liability is defined as a possible obligation from a past event whose outcome will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the entity’s control.</p> <p>A contingent liability is not recognized. A contingent liability becomes a provision and is recorded when three criteria are met: (1) a present obligation from a past event exists, (2) it is probable that an outflow of resources will be required to settle the obligation, and (3) a reliable estimate can be made.</p> <p>The term “probable” is used for describing a situation in which the outcome is more likely than not to occur. Generally, the phrase “more likely than not” denotes any chance greater than 50%.</p>

### 9.3 *Measurement of provisions*

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

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

US GAAP	IFRS
<p>A single standard does not exist to determine the measurement of obligations. Instead, entities must refer to guidance established for specific obligations (e.g., environmental or restructuring) to determine the appropriate measurement methodology.</p> <p>Pronouncements related to provisions do not necessarily have settlement price or even fair value as an objective in the measurement of liabilities, and the guidance often describes an accumulation of the entity’s cost estimates.</p> <p>When no amount within a range is a better estimate than any other amount, the low end of the range is accrued.</p>	<p>The amount recognized should be the best estimate of the expenditure required (the amount an entity would rationally pay to settle or transfer to a third party the obligation at the balance sheet date).</p> <p>Where there is a continuous range of possible outcomes and each point in that range is as likely as any other, the midpoint of the range is used.</p>

## 9.4 *Discounting of provisions*

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

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

## 9.5 *Restructuring provisions (excluding business combinations)*

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

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

## 9.6 Onerous contracts

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

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

## 9.7 Accounting for government grants

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

US GAAP	IFRS
Government grants to business entities are scoped out of the US GAAP contribution accounting model. However, business entities may analogize to the US GAAP contribution accounting model or other appropriate US GAAP based on the facts and circumstances of the grant. Otherwise, business entities may use other accounting literature, such as IAS 20.	Government grants are recognized once there is reasonable assurance that both (1) the conditions for their receipt will be met and (2) the grant will be received. Income-based grants are deferred in the balance sheet and released to the income statement to match the related expenditure that they are intended to compensate. Asset-based grants are deferred and matched with the depreciation on the asset for which the grant arises.
If a business entity elects to use the US GAAP contribution accounting model for a grant that contains conditions, recognition of the grant is delayed until such conditions have been fulfilled.	Grants that involve recognized assets are presented in the balance sheet either as deferred income or by deducting the grant in arriving at the asset's carrying amount, in which case the grant is recognized as a reduction of depreciation.

## 9.8 Reimbursement and contingent assets

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

US GAAP	IFRS
<p><b>Recovery of recognized losses</b>—An asset relating to the recovery of a recognized loss shall be recognized when realization of the claim for recovery is deemed probable.</p> <p><b>Recoveries representing gain contingencies</b>—Gain contingencies should not be recognized prior to their realization. In certain situations a gain contingency may be considered realized or realizable prior to the receipt of cash.</p>	<p><b>Reimbursements</b>—Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The amount recognized for the reimbursement shall be treated as a separate asset and shall not exceed the amount of the provision.</p> <p>The virtually certain threshold may, in certain situations, be achieved in advance of the receipt of cash.</p>

US GAAP	IFRS
	<b>Contingent assets</b> —Contingent assets are not recognized in financial statements because this may result in the recognition of income that may never be realized. If the inflow of economic benefits is probable, the entity should disclose a description of the contingent asset. However, when the realization of income is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate.

## 9.9 *Levies*

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

US GAAP	IFRS
Specific guidance does not exist within US GAAP. Levies and their related fines and penalties follow the guidance in ASC 450 (see SD 9.2) unless other guidance established for the specific obligation exists (e.g., environmental).	<p>Levies are defined as a transfer of resources imposed by a government on entities in accordance with laws and/or regulations, other than those within the scope of other standards (such as IAS 12); and fines or other penalties imposed for breaches of laws and/or regulations.</p> <p>The obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. The fact that an entity is economically compelled to continue operating in a future period, or prepares its financial statements under the going concern principle, does not create an obligation to pay a levy that will arise from operating in the future. A liability to pay a levy is recognized when the obligating event occurs, at a point in time or progressively over time, and an obligation to pay a levy triggered by a minimum threshold is recognized when the threshold is reached.</p>

## 9.10 *Expenses or liabilities paid by a principal stockholder*

US GAAP may result in more expenses or liabilities being recorded than IFRS when another party pays it on the entity's behalf.

**US GAAP**

If a principal stockholder settles an obligation on behalf of the entity, it should be reflected as an expense in the company's financial statements with a corresponding credit to contributed (paid-in) capital, unless the stockholder's action is caused by a relationship or obligation completely unrelated to their position as a stockholder or such action clearly does not benefit the company.

**IFRS**

IFRS does not include the concept that the expense should be reflected on the company's financial statements if it was not paid by the company, except if it is within the scope of IFRS 2.



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## ***Chapter 10: Financial liabilities and equity— updated October 2019***

## 10.1 *Financial liabilities and equity*

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

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

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

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

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

Written options are another area where US GAAP and IFRS produce different accounting results. Freestanding written put options on an entity's own shares are classified as financial liabilities and recorded at fair value through earnings under US GAAP. Under IFRS, such instruments are recognized

and measured as a gross financial liability at the discounted value of the settlement amount and accreted to their settlement amount.

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

### ***Technical references***

#### *US GAAP*

ASC 470, ASC 480, ASC 815, ASC 820, ASC 825, ASC 850, ASC 860, ASR 268, CON 8

#### *IFRS*

IAS 32, IFRS 9, IFRS 13, IFRIC 2

### ***Note***

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

## **10.2 *Contingent settlement provisions***

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

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

<b>US GAAP</b>	<b>IFRS</b>
A contingently redeemable financial instrument (e.g., one redeemable only if there is a change in control) is outside the scope of ASC 480 because its redemption is not unconditional. Any conditional provisions must be assessed to ensure that the contingency is substantive.	IAS 32 notes that a financial instrument may require an entity to deliver cash or another financial asset in the event of the occurrence or nonoccurrence of uncertain future events beyond the control of both the issuer and the holder of the instrument. Contingencies may include linkages to such events as a change in control or to other matters such as a change in a stock market index, consumer price index, interest rates, or net income.

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

### 10.3 *Derivatives—fixed-for-fixed vs indexed to issuer's own shares*

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

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

US GAAP	IFRS
<p>Equity derivatives need to be indexed to the issuer's own shares to be classified as equity. The assessment follows a two-step approach under ASC 815-40-15.</p> <p><b>Step 1</b>—Considers whether there are any contingent exercise provisions, and if so, they cannot be based on an observable market or index other than those referenced to the issuer's own shares or operations.</p> <p><b>Step 2</b>—Considers the settlement amount. Only settlement amounts equal to the difference between the fair value of a fixed number of the entity's equity shares and a fixed monetary amount, or a fixed amount of a debt instrument issued by the entity, will qualify for equity classification.</p>	<p>For derivatives, only contracts that provide for gross physical settlement and meet the fixed-for-fixed criteria (i.e., a fixed number of shares for a fixed amount of cash) are classified as equity. Variability in the amount of cash or the number of shares to be delivered results in financial liability classification.</p> <p>For example, a warrant issued by Company X has a strike price adjustment based on the movements in Company X's stock price. This feature would fail the fixed-for-fixed criterion under IFRS, but the same adjustment would meet the criteria under US GAAP.</p>

US GAAP	IFRS
<p>If the instrument's strike price (or the number of shares used to calculate the settlement amount) is not fixed as outlined above, the instrument may still meet the equity classification criteria; this could occur where the variables that might affect settlement include inputs to the fair value of a fixed-for-fixed forward or option on equity shares and the instrument does not contain a leverage factor.</p> <p>Down round features (as defined) do not cause a freestanding equity-linked financial instrument (or an embedded conversion option) to fail equity accounting when assessing whether the instrument is indexed to an entity's own stock. Once the down round is triggered, the change in the fair value of the instrument as a result of the change in strike price is recognized as a reduction of income available to common shareholders in basic EPS.</p>	<p>IFRS does not provide an exception related to down round features. Freestanding warrants and embedded conversion options in debt instruments containing down round features require liability classification.</p>
<p>In case of rights issues, if the strike price is denominated in a currency other than the issuer's functional currency, it should not be considered as indexed to the entity's own stock as the issuer is exposed to changes in foreign currency exchange rates. Therefore, rights issues of this nature would be classified as liabilities at fair value through profit or loss.</p>	<p>There is a narrow exception to the fixed-for-fixed criterion in IAS 32 for rights issues. Under this exception, rights issues are classified as equity if they are issued for a fixed amount of cash regardless of the currency in which the exercise price is denominated, provided they are offered on a pro rata basis to all owners of the same class of equity.</p>

## 10.4 *Derivatives on own shares—settlement models*

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

US GAAP	IFRS
<p>Derivative contracts that are in the scope of ASC 815-40 and either (1) require physical settlement or net share settlement, or (2) give the issuer a choice of net cash settlement or settlement in its own shares are considered equity instruments, provided they meet the criteria set forth within the literature.</p>	<p>Contracts that are net settled (net cash or net shares) are classified as liabilities or assets. This is also the case even if the settlement method is at the issuer's discretion.</p> <p>Gross physical settlement is required to achieve equity classification.</p>

US GAAP	IFRS
<p>Analysis of a contract's terms is necessary to determine whether the contract meets the qualifying criteria, some of which can be difficult to meet in practice.</p> <p>Similar to IFRS, derivative contracts that require net cash settlement are assets or liabilities.</p> <p>Contracts that give the counterparty a choice of net cash settlement or settlement in shares (physical or net settlement) result in derivative classification. However, if the issuer has a choice of net cash settlement or share settlement, the contract can still be considered an equity instrument.</p>	<p>Unlike US GAAP, under IFRS, a derivative contract that gives one party (either the holder or the issuer) a choice over how it is settled (net in cash, net in shares, or by gross delivery) is a derivative asset/liability unless all of the settlement alternatives would result in the contract being an equity instrument.</p>

## 10.5 *Written put option on the issuer's own shares*

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

US GAAP	IFRS
<p>A financial instrument—other than an outstanding share—that at inception (1) embodies an obligation to repurchase the issuer's equity shares or is indexed to such an obligation, and (2) requires or may require the issuer to settle the obligation by transferring assets shall be classified as a financial liability (or an asset, in some circumstances). Examples include written put options on the issuer's equity shares that are to be physically settled or net cash settled.</p> <p>ASC 480 requires written put options to be measured at fair value, with changes in fair value recognized in current earnings.</p>	<p>If the contract meets the definition of an equity instrument (because it requires the entity to purchase a fixed amount of its own shares for a fixed amount of cash), any premium received must be recorded in equity. Therefore, the premium received on such a written put is classified as equity (whereas under US GAAP, the fair value of the written put is recorded as a financial liability).</p> <p>In addition, the issuer records a financial liability for the discounted value of the amount of cash that the entity may be required to pay. The financial liability is recorded against equity.</p>

## 10.6 *Compound instruments with no equity conversion features*

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

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

## 10.7 *Compound instruments with equity conversion features*

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

US GAAP	IFRS
Equity conversion features should be separated from the liability host and recorded separately as embedded derivatives only if they meet certain criteria (e.g., fail to meet the scope exception of ASC 815).	For convertible instruments with a liability component and a conversion feature that exchanges a fixed amount of cash for a fixed number of shares, IFRS requires split accounting between the liability and equity components of the instrument.
If the conversion feature is not recorded separately, then the entire convertible instrument may be considered one unit of account—interest expense would reflect cash interest if issued at par. However, there are a few exceptions:	Equity conversion features within liability host instruments that fail the fixed-for-fixed requirement are considered to be embedded derivatives. Such embedded derivatives are bifurcated from the host debt contract and measured at fair value, with changes in fair value recognized in the income statement.
<ul style="list-style-type: none"> <li>□ For certain convertible debt instruments with a cash conversion feature, the liability and equity components of the instrument should be separately accounted for by</li> </ul>	<p>When split accounting applies, the liability component is recognized at fair value calculated by discounting the cash flows associated with the liability component at a market rate for nonconvertible debt. The equity conversion feature is measured as the residual amount and recognized in equity with no subsequent remeasurement.</p> <p>IFRS does not have the concept of a BCF.</p>

US GAAP	IFRS
allocating the proceeds from the issuance of the instrument between the liability component and the embedded conversion option (i.e., the equity component). This allocation is done by first determining the carrying amount of the liability component based on the fair value of a similar liability excluding the embedded conversion option, and then allocating to the embedded conversion option the excess of the initial proceeds ascribed to the convertible debt instrument over the amount allocated to the liability component.	
A convertible debt instrument may contain a beneficial conversion feature (BCF) when the strike price on the conversion option is “in the money.” The BCF is generally recognized and measured by allocating a portion of the proceeds received, equal to the intrinsic value of the conversion feature, to equity.	

## 10.8 Puttable shares/redeemable upon liquidation

### 10.8.1 Puttable shares

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

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

US GAAP	IFRS
<b>Puttable shares</b>	<b>Puttable shares</b>
The redemption of puttable shares is conditional upon the holder exercising the put option. This contingency removes puttable shares from the scope of instruments that ASC 480 requires to be classified as a financial liability.	Puttable instruments generally are classified as financial liabilities because the issuer does not have the unconditional right to avoid delivering cash or other financial assets. Under IFRS, the legal form of an instrument (i.e., debt or equity) does not necessarily influence the classification of a particular instrument.
As discussed for contingently redeemable instruments, SEC registrants would classify these instruments as “mezzanine.” Such classification is encouraged, but not required, for private companies.	Under this principle, IFRS may require certain interests in open-ended mutual funds, unit trusts, partnerships, and the like to be classified as liabilities (because holders can require cash settlement). This could lead to situations where some entities have no equity capital in their financial statements.



US GAAP	IFRS
	However, an entity is required to classify puttable instruments as equity when they have particular features and meet certain specific conditions in IAS 32. This exemption does not apply to puttable instruments issued by a subsidiary. Even if the puttable instruments are classified as equity in the financial statements of the issuing subsidiary, they are always shown as financial liabilities in the consolidated financial statements of the parent.

### 10.8.2 *Redeemable upon liquidation*

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

US GAAP	IFRS
<p><b>Redeemable upon liquidation</b></p> <p>ASC 480 scopes out instruments that are redeemable only upon liquidation. Therefore, such instruments may achieve equity classification for finite-lived entities.</p> <p>In classifying these financial instruments issued by a subsidiary in a parent's consolidated financial statements, US GAAP scopes out mandatorily redeemable noncontrolling interests from ASC 480; the result is that the redeemable noncontrolling interests issued by a subsidiary are not financial liabilities in the parent's consolidated financial statements.</p>	<p><b>Redeemable upon liquidation</b></p> <p>For instruments issued out of finite-lived entities that are redeemable upon liquidation, equity classification is appropriate only if certain conditions are met.</p> <p>However, when classifying redeemable financial instruments issued by a subsidiary (either puttable or redeemable upon liquidation) in the parent's consolidated accounts, equity classification at the subsidiary level is not extended to the parent's classification of the redeemable noncontrolling interests in the consolidated financial statements, as the same instrument would not meet the specific IAS 32 criteria from the parent's perspective.</p>

## 10.9 *Receivables from shareholders*

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

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

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

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

US GAAP	IFRS
When an instrument is issued to a related party at off-market terms, one should consider which model the instrument falls within the scope of as well as the facts and circumstances of the transaction (i.e., the existence of unstated rights and privileges) in determining how the transaction should be recorded. There is, however, no requirement to initially record the transaction at fair value.  The presumption in ASC 850 that related party transactions are not at arm's length and the associated disclosure requirements also should be considered.	When an instrument is issued to a related party, the financial liability initially should be recorded at fair value, which may not be the value of the consideration received.  The difference between fair value and the consideration received (i.e., any additional amount lent or borrowed) is accounted for as a current-period expense, income, or as a capital transaction based on its substance.  IAS 24 sets out the disclosure requirements associated with related party transactions.

## 10.11 *Effective-interest-rate calculation*

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

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

US GAAP	IFRS
<p>The effective interest rate used for calculating amortization under the effective interest method generally discounts contractual cash flows through the contractual life of the instrument. However, a shorter life may be used in some circumstances. For example, puttable debt is generally amortized over the period from the date of issuance to the first put date and callable debt can be amortized either over the contractual life or the estimated life as a policy decision.</p>	<p>The effective interest rate used for calculating amortization under the effective interest method discounts estimated cash flows through the expected—not the contractual—life of the instrument.</p> <p>Generally, if the entity revises its estimate after initial recognition (for reasons unrelated to a modification), the carrying amount of the financial liability should be revised to reflect actual and revised estimated cash flows at the original effective interest rate, with a cumulative-catch-up adjustment being recorded in profit and loss. Revisions of the estimated life or of the estimated future cash flows may exist, for example, in connection with debt instruments</p> <p>that contain a put or call option that does not need to be bifurcated or whose coupon payments vary. Payments may vary because of an embedded feature that does not meet the definition of a derivative because its underlying is a nonfinancial variable specific to a party to the contract (e.g., cash flows that are linked to earnings before interest, taxes, depreciation, and amortization; sales volume; or the earnings of one party to the contract).</p> <p>Generally, floating rate instruments (e.g., LIBOR plus spread) issued at par are not subject to the cumulative-catch-up approach; rather, the effective interest rate is revised as market rates change.</p>

## 10.12 *Modification/exchange of debt and convertible debt*

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

US GAAP	IFRS
<p>When a debt modification or exchange of debt instruments occurs, the first step is to consider whether the modification or exchange qualifies for troubled debt restructuring. If this is the case, the restructuring follows the specific troubled debt restructuring guidance.</p> <p>If the modification or exchange of debt instruments does not qualify for troubled debt restructuring, one has to consider whether the modification or exchange of debt instruments</p>	<p>Under IFRS, there is no concept of troubled debt restructuring.</p> <p>A substantial modification of the terms of an existing financial liability or part of the financial liability should be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.</p> <p>In this regard, the terms are substantially different if the present value of the cash flows</p>

**US GAAP**

has to be accounted for as a debt extinguishment.

An exchange or modification of debt instruments with substantially different terms is accounted for as a debt extinguishment. In order to determine whether the debt is substantively different, a quantitative assessment must be performed.

If the present value of the cash flows under the new terms of the new debt instrument differs by at least 10% from the present value of the remaining cash flows under the original debt, the exchange is considered an extinguishment. The discount rate for determining the present value is the effective rate on the old debt. If either the new or the original debt instrument is callable/puttable, separate cash flow analyses are performed assuming exercise and non-exercise of the call or put.

If the debt modifications involve changes in noncash embedded conversion features, the following two-step test is required:

**Step 1**—If the change in cash flows as described above is greater than 10% of the carrying value of the original debt instrument, the exchange or modification should be accounted for as an extinguishment. This test would not include any changes in fair value of the embedded conversion option.

**Step 2**—If the test in Step 1 is not met, the following should be assessed:

- If the modification or exchange affects the terms of an embedded conversion option, whether the difference between the fair value of the option before and after the modification or exchange is at least 10% of the carrying value of the original debt instrument prior to the modification or exchange.
- Whether a substantive conversion option is added or a conversion option that was substantive at the date of modification is eliminated.

If either of these criteria is met, the exchange or modification would be accounted for as an extinguishment.

Generally, when a term loan or debt security are modified and the modification is accounted for as an extinguishment, new fees paid to, or received from, the existing lender are expensed. New fees paid to third parties are capitalized and amortized as a debt issuance cost.

**IFRS**

discounted using the original effective interest rate under the new terms is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. Unlike US GAAP, there is no specific guidance for callable/puttable debt. However, in applying the 10% test under IFRS, entities generally use the expected cash flows of the borrowing rather than assume immediate prepayment.

If this test is met, the exchange is considered an extinguishment. It is clear that if the discounted cash flows change by at least 10%, the original debt should be extinguished. It is not clear, however, in IFRS 9 whether the quantitative analysis is an example or is the definition of substantially different. Accordingly, there is an accounting policy choice where entities can perform either (1) an additional *qualitative* analysis of any modification of terms when the change in discounted cash flows is less than 10% or (2) only the 10% test (quantitative test) as discussed above.

For debt instruments with embedded derivatives that are bifurcated and measured at FVTPL, the modification of the host contract and the embedded derivative should be assessed together when applying the 10% test as the host debt and the embedded derivative are interdependent. However, a conversion option that is accounted for as an equity component would not be considered in the 10% test.

IFRS 9 does not distinguish between costs and fees payable to third parties, such as lawyers and accountants, and those payable directly to the lender.

If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognized as part of the gain or loss on the extinguishment.

## 10.13 *Accounting for debt modifications*

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

US GAAP	IFRS
Under US GAAP, when debt is modified, generally no gain or loss is recorded. A new effective interest rate is established based on the carrying value of the debt and the revised cash flows.	Under IFRS, when renegotiation or modification of terms do not result in derecognition, the carrying amount of the liability is recalculated using the modified cash flows discounted at the original effective interest rate. A modification gain or loss is recognized in profit or loss.  However, in some cases when the changes in cash flows represent movements in market rates of interest, a treatment similar to US GAAP (where the interest rate is reset) could be applied. This would be the case, for example, for instruments prepayable by the borrower at par or with only an insignificant penalty, which effectively enables the borrower to have the lender agree to reset the cash flows to the then market rate.
New fees paid to, or received from, existing lenders are capitalized and amortized as part of the effective yield, whereas new fees paid to third parties are expensed.	Costs and fees that are incremental and directly attributable to the modification are spread over the expected life by adjusting the effective interest rate. Conversely, payments that represent compensation for the change in the cash flows of the liability should be expensed as part of the gain or loss on modification.  Incremental and directly attributable costs or fees might include amounts paid to third parties. Some amounts paid directly to the lender might also qualify – for example, if they compensate the lender for similar costs that it pays to third parties.

## 10.14 *Transaction costs (also known as debt issue costs)*

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

US GAAP	IFRS
<p>When the financial liability is not carried at fair value through income, transaction costs, including third party costs and creditor fees, are deducted from the carrying value of the financial liability and are not recorded as separate assets. Rather, they are accounted for as a debt discount and amortized using the effective interest method.</p> <p>Transaction costs are expensed immediately when the financial liability is carried at fair value, with changes recognized in profit and loss.</p> <p>The commitment fee incurred to obtain a line of credit represents the benefit of being able to access capital over the contractual term, and therefore, meets the definition of an asset. Reporting entities should subsequently amortize the asset ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line of credit. Only in the limited circumstances when a reporting entity draws down on a line of credit and does not intend to repay the borrowing until the contractual maturity of the arrangement (i.e., the borrowing is treated like a term loan) do we believe the portion of the costs related to each respective draw down could be presented as a direct deduction from the carrying value of the debt when drawn.</p>	<p>When the financial liability is not carried at fair value through income, transaction costs including third party costs and creditor fees are deducted from the carrying value of the financial liability and are not recorded as separate assets. Rather, they are accounted for as a debt discount and amortized using the effective interest method.</p> <p>Transaction costs are expensed immediately when the financial liability is carried at fair value, with changes recognized in profit and loss.</p> <p>The accounting for commitment fees incurred to obtain a line of credit under IFRS requires allocation between amounts that are expected to be drawn down and those that are not. To the extent there is evidence that it is probable that some or all of the facility will be drawn down, the commitment fee is allocated between the amounts that are expected to be drawn down and the amounts that are not expected to be drawn down. The fee related to the portion expected to be drawn down is accounted for as a transaction cost under IFRS 9 (i.e., the fee is deferred and deducted from the carrying value of the financial liabilities when the draw down occurs). The fee related to the portion not expected to be drawn down is capitalized as a prepayment for liquidity services and amortized over the period of the facility.</p>

## 10.15 Eligibility for fair value option

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

US GAAP	IFRS
<p>With some limited exceptions for certain financial liabilities addressed by other applicable guidance (e.g., financial instruments that are in whole or in part classified by the issuer as a component of shareholder's equity, such as a convertible debt security with a non-contingent BCF), US GAAP permits entities to elect the fair value option for any recognized financial liability.</p>	<p>IFRS permits entities to elect the fair value option for financial liabilities when:</p> <ul style="list-style-type: none"> <li>□ a contract contains one or more embedded derivatives and the entire contract is not measured at fair value through profit or loss (unless the embedded derivative does not significantly modify the cash flows or it is clear with little or no analysis that separation of the embedded derivative(s) is prohibited), or</li> <li>□ it eliminates or significantly reduces a measurement or recognition inconsistency</li> </ul>

US GAAP	IFRS
	(sometimes referred to as “an accounting mismatch”), or
	<ul style="list-style-type: none"> <li>□ a group of financial instruments is managed and its performance is evaluated on a fair value basis in accordance with a risk management strategy.</li> </ul>
The fair value option may only be elected upon initial recognition of the financial liability or upon some other specified events identified in ASC 825-10-25-4 and ASC 825-10-25-5.	The fair value option may only be elected upon initial recognition of the financial liability.
See SD 11.3 for information on the normal purchase normal sale exception.	See SD 11.3 for information on the use of the fair value options for contracts that meet the “own use” scope exception.

## 10.16 *Own credit risk—financial liabilities under fair value option*

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

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

## 10.17 *Nonrecourse liabilities*

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

**US GAAP****IFRS**

US GAAP provides an alternative measurement for CFEs that allows the use of the more observable of the fair value of the financial assets or the fair value of the financial liabilities of the CFE to measure both the financial assets and the financial liabilities.

This eliminates the measurement difference that may exist when financial assets and financial liabilities of the CFE are measured at fair value independently.

IFRS does not provide a separate measurement approach for nonrecourse liabilities. Financial assets and liabilities follow their respective classification and measurement models.



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***Chapter 11:***  
***Derivatives and hedging—***  
***updated October 2019***

## 11.1 *Derivatives and hedging*

Derivatives and hedging represent some of the more complex and nuanced topical areas within both US GAAP and IFRS. While IFRS generally is viewed as less rules-laden than US GAAP, the difference is less dramatic in relation to derivatives and hedging, wherein both frameworks embody a significant volume of detailed and complex guidance.

### 11.1.1 *Derivatives and embedded derivatives*

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

#### *Hedge accounting models*

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

The FASB updated its hedge accounting guidance when it issued ASU 2017-12 in August 2017. The IASB's hedge accounting guidance, IFRS 9, *Financial Instruments*, was effective for annual periods beginning on or after January 1, 2018. Under IFRS, entities have an accounting policy choice to apply the IFRS 9 hedge accounting guidance or to continue applying the IAS 39 hedge accounting guidance. This policy choice is applied to all of the entity's hedges. The IASB is planning to propose a macro hedge accounting model in a separate project, which is still ongoing. In the meantime, if an entity adopts IFRS 9 for hedge accounting, it may apply the "macro hedging" provisions of IAS 39 for a fair value hedge of the interest rate exposure of a portfolio of financial assets and/or financial liabilities (and only for such hedges) rather than the new IFRS 9 requirements. If an entity chooses not to adopt IFRS 9 for hedge accounting when it adopts the other parts of IFRS 9, it continues to apply the IAS 39 hedging guidance, and it can still choose to adopt IFRS 9's hedging provisions at a later date. However, once an entity has adopted IFRS 9 for hedge accounting, it cannot revert back to IAS 39.

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

This chapter compares the IFRS 9 hedge accounting model and the ASC 815 hedge accounting model (after adoption of ASU 2017-12, but prior to the adoption of ASU 2019-04).

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

### **Technical references**

*US GAAP*

ASC 815, ASC 830

*IFRS*

IFRS 9, IFRS 7, IFRIC 16

### **Note**

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

## **11.2 Derivative definition—net settlement provisions**

More instruments will qualify as derivatives under IFRS.

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

<b>US GAAP</b>	<b>IFRS</b>
To meet the definition of a derivative, a financial instrument or other contract must require or permit net settlement.	IFRS does not include a requirement for net settlement within the definition of a derivative. It only requires settlement at a future date.
The scope of ASC 815 excludes instruments linked to unlisted equity securities when such instruments fail the net settlement requirement and are, therefore, not accounted for as derivatives.	Under IFRS, instruments linked to unlisted equity securities are required to be recorded at fair value.
An option contract between an acquirer and a seller to buy or sell stock of an acquiree at a future date that results in a business combination may not meet the definition of a derivative as it may fail the net settlement requirement (e.g., the acquiree's shares are not listed so the shares may not be readily convertible to cash).	An option contract between an acquirer and a seller to buy or sell stock of an acquiree at a future date that results in a business combination would be considered a derivative under IFRS 9 for the acquirer (a similar forward contract is scoped out of IFRS 9); however, the option may be classified as equity from the seller's perspective.

## **11.3 Own use versus normal purchase normal sale**

Under IFRS, contracts that meet the "own use" criteria are scoped out of derivative accounting. However, a fair value option is available if it eliminates or significantly reduces an accounting

mismatch. Under US GAAP, these contracts are accounted for as derivatives unless an entity elects the “normal purchase normal sale” (NPNS) exception.

## US GAAP

There are many factors to consider in determining whether a contract related to nonfinancial items can qualify for the NPNS exception.

If a contract meets the requirements of the NPNS exception, the reporting entity must document that it qualifies in order to apply the exception—otherwise, it will be considered a derivative.

## IFRS

Similar to US GAAP, there are many factors to consider in determining whether a contract related to nonfinancial items qualifies for the “own use” exception.

While US GAAP requires documentation to apply the NPNS exception, IFRS requires a contract to be accounted for as own use (i.e., not accounted for as a derivative) if the own use criteria are satisfied.

However, IFRS 9 provides a fair value option for own use contracts in situations in which the use of the option would eliminate or significantly reduce an accounting mismatch. For example, an entity in the utility industry that hedges its physically settled contracts with energy derivatives could use the option for the physically settled contracts to reduce the measurement inconsistency between these contracts and the energy derivatives, and thus achieve offsetting effects without the need to apply hedge accounting.

This fair value option is irrevocable and only available at inception.

## 11.4 *Embedded derivatives: hosts and reassessment*

Under IFRS, embedded derivatives are not bifurcated from hybrid financial assets, and instead are part of the classification assessment of the entire financial asset (see SD 7.7 for further information on financial assets).

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

## US GAAP

If a hybrid instrument (such as financial asset or liability, insurance or lease) contains an embedded derivative that is not clearly and closely related at inception, and it is not bifurcated (because it does not meet the definition of a derivative), it must be continually reassessed to determine whether bifurcation is required at a later date. Once it meets the definition of a derivative, the embedded derivative is bifurcated and measured at fair value with changes in fair value recognized in earnings.

## IFRS

A financial asset that is within the scope of IFRS 9 is not assessed for embedded derivatives because the solely payment of principal and interest (SPPI) test is applied to the entire hybrid contract to determine the appropriate measurement category. See SD 7.4.

IFRS precludes reassessment of embedded derivatives after inception of the contract unless there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required under the contract.

**US GAAP****IFRS**

Similarly, the embedded derivative in a hybrid instrument that is not clearly and closely related at inception and is bifurcated must also be continually reassessed to determine whether it subsequently fails to meet the definition of a derivative. Such an embedded derivative should cease to be bifurcated at the point at which it fails to meet the requirements for bifurcation.

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

## 11.5 *Calls and puts in debt instruments*

IFRS and US GAAP have fundamentally different approaches to assessing whether calls and puts embedded in debt host instruments require bifurcation. Additionally, under IFRS, the embedded derivative analysis is only performed for the issuer of the debt instrument and not the holder, since there is no assessment of embedded derivatives for financial assets (see SD 7.7).

**US GAAP****IFRS**

Multiple tests are required to evaluate whether an embedded call or put (i.e., a feature that can accelerate repayment of principal of a debt instrument) is clearly and closely related to the debt host. If any of the conditions outlined in the following tests occurs, the call or put is not clearly and closely related to the debt host and bifurcation is generally required.

**Test 1**—Upon exercise of the call or put, a debt instrument’s settlement amount changes based on anything other than interest rates or credit risk.

**Test 2**—A debt instrument involves a substantial premium or discount and the call or put that can accelerate repayment of principal is contingently exercisable.

**Test 3**—If the only underlying is an interest rate or interest rate index and either (a) there is a substantial premium or discount (but the put or call is not contingently exercisable), or (b) there is no substantial premium or discount, an additional test is required. If the debt instrument can either (a) be settled in such a way that the holder would not recover

Calls, puts, or prepayment options embedded in a hybrid debt instrument are closely related to the debt host instrument if either (1) the exercise price approximates the amortized cost on each exercise date or (2) the exercise price of a prepayment option reimburses the lender for an amount up to the approximate present value of the lost interest for the remaining term of the host contract. Once determined to be closely related as outlined above, these features do not require bifurcation.

**US GAAP****IFRS**

substantially all of its recorded investment or (b) the embedded derivative would both (1) at least double the holder's initial rate of return and (2) the resulting rate of return would be double the then current market rate of return, then the call or put is not clearly and closely related. However, certain exceptions are provided for this test. See FG 1.6.1.2.

## **11.6 *Nonfinancial host contracts—currencies commonly used***

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

**US GAAP****IFRS**

US GAAP requires bifurcation of a foreign currency embedded derivative from a nonfinancial host unless the payment is denominated in (1) the functional currency of a substantial party to the contract, (2) the currency in which the price of the good or service is routinely denominated in international commerce (e.g., US dollar for crude oil transactions), (3) the local currency of a substantial party to the contract, or (4) a foreign currency used because a substantial party to the contract uses the currency as if it were the functional currency because it operates in a highly inflationary environment.

Criteria (1) and (2) cited for US GAAP also apply under IFRS. However, bifurcation of a foreign currency embedded derivative from a nonfinancial host is not required under IFRS if payments are denominated in a currency that is commonly used in contracts to purchase or sell such nonfinancial items in the economic environment in which the transaction takes place, provided the host contract is not leveraged and does not contain an option feature.

For example, Company X, in Russia (functional currency and local currency is Russian ruble), sells timber to another Russian company (with a ruble functional currency) in euros. If the company determines that the euro is a currency commonly used in Russia, bifurcation of a foreign currency embedded derivative from the nonfinancial host contract would not be required under IFRS.

## **11.7 *Measurement—Day one gains and losses***

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

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

**US GAAP**

In some circumstances, the transaction price is not equal to fair value, usually when the market in which the transaction occurs differs from the market in which the reporting entity could transact. For example, banks can access wholesale and retail markets; the wholesale price may result in a day one gain compared to the transaction price in the retail market.

In these cases, entities must recognize day one gains and losses even if some inputs to the measurement model are not observable.

**IFRS**

Day one gains and losses are recognized only when the fair value is evidenced by a quoted price in an active market for the same instrument or is based on a valuation technique that only uses data from observable markets.

## 11.8 *Hedge effectiveness criterion*

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

**US GAAP**

Hedging relationships are required to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk.

The term “highly effective” has been interpreted in practice to mean that the change in fair value/cash flows of the designated component of the hedging instrument is within 80 to 125% of the change in fair value/cash flows of the designated proportion of the hedged item attributable to the risk being hedged.

**IFRS**

A hedging relationship needs to meet the following effectiveness requirements:

1. There is an economic relationship between the hedged item and the hedging instrument that gives rise to offset.
2. The effect of credit risk does not dominate the value changes that result from that economic relationship.
3. The hedge ratio is the one the entity actually uses under its risk management strategy unless it would create ineffectiveness inconsistent with the purpose of hedge accounting.

### 11.8.1 *Nature and timing of effectiveness assessments*

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

**US GAAP**

In certain cases, an initial quantitative assessment is required. In addition, periodic effectiveness assessments need to be performed on both a prospective basis (to reconfirm forward-looking expectations) and a retrospective basis (to determine whether the hedge was highly effective).

Effectiveness assessments are required at hedge inception and periodically thereafter, with an assessment required whenever financial statements or earnings are reported, and at least every three months. The initial assessment may be completed by the end of the quarter. Additionally, simplified approaches exist for nonpublic nonfinancial institutions.

When assessing effectiveness of hedges of forecasted transactions, entities can ignore timing differences between the hedged transactions and the maturity date of the hedging instrument within 31 days or a fiscal month (when that is the only difference between the derivative and the hedged forecasted transactions).

**IFRS**

A retrospective effectiveness assessment is not required. However, an entity must make an ongoing assessment of whether the hedge continues to meet the three hedge effectiveness criteria described in SD 11.8.

There is no requirement to perform effectiveness assessments every three months. The ongoing effectiveness assessment needs to be performed at each reporting date (which may only be semi-annually or annually) or upon a significant change in circumstances. It is only a forward-looking test.

The requirement to maintain the hedge ratio (#3 in SD 11.8) ensures alignment with the economic hedging strategy. The hedge ratio must be rebalanced to maintain the hedge ratio that the entity actually uses to achieve its economic hedging strategy. Entities should not need to rebalance very often if they have a good risk management strategy in place and the economic relationship is stable.

**11.8.2 Recognition of ineffectiveness**

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

**US GAAP**

For cash flow and net investment hedges, hedge ineffectiveness is not separately measured and recognized in income each reporting period. If the hedge is highly effective, all changes in the fair value of the derivative hedging instrument will be recorded in other comprehensive income (OCI) (in cumulative translation adjustment (CTA) for net investment hedges), unless different recognition is prescribed/elected for any excluded components. Any difference between the gain or loss on the hedged item and the derivative (except for the excluded component) is recognized when the hedged item affects earnings, at which time the amount

**IFRS**

For cash flow hedges, the effective portion of the change in the fair value of the hedging instrument is recognized

in OCI. The amount recognized in OCI should be the lower of (1) the cumulative gain or loss on the hedging instrument from the inception of the hedge, and (2) the cumulative change in the fair value (present value) of the expected cash flows on the hedged item from the inception of the hedge. The remaining ineffective portion of the change in the fair value of the hedging instrument (if any) is recognized in profit or loss.

For hedges of a net investment in a foreign



**US GAAP**

deferred in AOCI from the hedging instrument is released to earnings.

On the other hand, for fair value hedges, because the change in fair value of the hedged item attributable to the hedged risk and the derivative hedging instrument are both recorded in current earnings, if the hedge is not perfectly effective, there will be an income statement impact. While not identified as ineffectiveness, a reporting entity is required to disclose the change in fair value of the hedged item attributable to the hedged risk and the change in fair value of the derivative.

**IFRS**

operation, the effective portion of the change in the fair value of the hedging instrument is recognized in OCI and the ineffective portion of the hedging relationship is recognized in profit or loss.

For fair value hedges, both the effective and ineffective portions of the hedge relationship are recorded in profit or loss.

IFRS 7 requires disclosure of ineffectiveness.

**11.8.3 Amounts excluded from effectiveness assessment**

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

**US GAAP**

An entity may elect to exclude certain components of the change in value of the derivative from the assessment of effectiveness for fair value and cash flow hedges:

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

**IFRS**

IFRS 9 only permits three components to be excluded from the effectiveness assessment:

- the forward element of a forward contract,
- the foreign currency basis spread, and
- the time value of an option.

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

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

**US GAAP****IFRS**

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

US GAAP prohibits the exclusion of any other components of the hedging instrument.

### 11.8.3.1 *Accounting for amounts excluded from effectiveness assessment*

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

**US GAAP****IFRS**

For cash flow, fair value, and net investment hedges, an entity may choose between two methods to account for an excluded component:

*Amortization approach*

The initial value of the excluded component is recognized in earnings using a systematic and rational method over the life of the hedging instrument, with any difference between the change in fair value of the excluded component and the amount in earnings recognized in OCI (CTA for net investment hedges).

*Mark-to-market approach*

The changes in fair value of the excluded component are recognized in current earnings.

Unlike IFRS, US GAAP does not have a specific concept of aligned time value (i.e., time value that only relates to the hedged item) or aligned forward element.

When using the spot method, discounting of the spot rate is not required (and in the case of a net investment hedge, discounting is not permitted).

IFRS 9 has specific guidance by type of derivative.

*Options*

For cash flow, fair value, and net investment hedges, if an entity elects to designate only the intrinsic value of the option as the hedging instrument, it must account for the changes in the “aligned time value” (i.e., when the critical terms of the option and hedged item are aligned) in OCI and hold those changes in a hedging reserve in equity.

Recognition of the aligned time value in profit or loss will depend on whether the hedge is transaction-related (and recorded in profit or loss at the same time as the hedged item) or time period-related (and recorded in profit or loss using a systematic and rational basis over the period of the hedge).

*Forwards points and currency basis spread*

An entity may recognize changes in value due to changes in forward points or foreign currency basis spread in profit or loss immediately or defer them using the recognition guidance for options.

*Aligned portion*

Recognition of the excluded component applies to the aligned portion, i.e., the portion for which the critical terms such as notional, price, term and underlying of the derivative and the hedged

**US GAAP****IFRS**

item are aligned. This is called the “aligned time value” or “aligned forward element.”

IFRS 9 specifies a particular calculation methodology that can be complex to apply when the actual time value or forward element is lower than the aligned time value or forward element at inception of the hedge.

When the change in spot rate is the designated hedged risk, entities still need to consider the time value of money and, when appropriate, measure the hedged item using the discounted spot rate. However, for a net investment hedge, we believe that an entity can choose not to impute a time period into the hedging relationship and designate the hedged risk without discounting.

## **11.9 Eligible hedged items**

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

### **11.9.1 Hedging components of nonfinancial items**

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

**US GAAP****IFRS**

US GAAP permits cash flow hedges of the variability in cash flows attributable to changes in contractually specified components of forecasted purchases or sales of nonfinancial items, subject to specific criteria.

A contractually specified component is an index or price explicitly stated in the contract or governing agreements to purchase or sell the nonfinancial item that is not solely linked to the entity's own operations.

IFRS 9 permits entities to hedge risk components for nonfinancial items, provided such components are separately identifiable and reliably measurable. They do not have to be contractually specified, as under US GAAP.

In assessing whether a risk component of a nonfinancial item is eligible for designation as a hedged risk, an entity should take into consideration factors such as:

- Whether the risk component is contractually specified (the contract entails a formula based pricing structure such as “commodity X plus a margin”)
- If not, the particular market structure to which the risk relates and in which the hedging activity takes place

### 11.9.2 Hedging groups of items

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

#### US GAAP

If an entity wishes to designate a group of individual items as the hedged item in a hedging relationship, the individual items or transactions must share the same risk exposure for which they are designated as being hedged.

A quantitative evaluation, known as the “similar assets/liabilities test,” of whether a portfolio of assets or liabilities share the same risk exposure is generally required.

#### IFRS

IFRS 9 allows hedges of:

- groups of similar items without a requirement that the fair value change of each individual item be proportional to the overall group (e.g., hedging a portfolio of S&P 500 shares with a S&P 500 futures contract), and
- groups of offsetting exposures (e.g., exposures resulting from forecasted sale and purchase transactions).

IFRS 9 stipulates additional qualifying criteria. These include:

- The group consists of items that are eligible as hedged items on an individual basis
- The hedged items are managed together on a group basis for risk management purposes
- A cash flow hedge in which the variability in cash flows is not expected to be approximately proportional to the overall group is a hedge of foreign currency risk, and the hedge designation specifies the reporting period when the forecasted transactions are expected to affect profit or loss and their nature and volume.

See SD 11.12 on presentation of gains and losses on hedging instruments for a discussion of grouping items with offsetting disclosures.

### 11.9.3 Hedging prepayable financial assets

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

#### US GAAP

A “last-of-layer approach” permits the designation of a portion of a closed pool of prepayable assets, beneficial interests secured by prepayable assets, or a combination that is not expected to be prepaid during the hedge period

#### IFRS

IFRS 9 allows a layer of a group to be designated as the hedged item. A layer component can be specified from a defined, but open, population or from a defined nominal amount. If a layer component is designated in a fair value hedge,

**US GAAP**

as the hedged item in a fair value hedge of the benchmark interest rate.

When an entity executes a partial-term hedge of the benchmark interest rate, the entity is able to ignore the impact of prepayment and credit risk by assuming that prepayments and defaults relate to the portion of the portfolio that is not part of the designated hedged item (the “last of layer”). For this strategy, a similar assets test may be performed qualitatively and only at inception.

**IFRS**

an entity must specify it from a defined nominal amount.

A layer of a contract that includes a prepayment option that is affected by changes in the hedged risk is only eligible as a hedged item in a fair value hedge if the layer includes the effect of the prepayment option when determining the change in fair value of the hedged item. In other words, the prepayment option cannot be ignored. In this situation, if an entity hedges with a hedging instrument that does not have option features that mirror the layer’s prepayment option, hedge ineffectiveness would arise.

For macro hedges of interest rate risk, IFRS 9 permits an entity to elect to apply the requirements in IAS 39 for fair value portfolio hedges instead of applying IFRS 9 in full. Under IAS 39’s portfolio hedge model, it may apply fair value hedge accounting in a portfolio of dissimilar items (i.e., macro hedging) whereby the hedged portion may be designated as an amount of currency of a prepayable item, rather than individual assets or liabilities.

Further, under this approach in IAS 39, an entity is able to incorporate changes in prepayment risk by using a simplified method set out in the guidance, rather than specifically calculating the fair value of the prepayment option on a prepayable item by item basis. Expected rather than contractual repricing dates may be used. In such a strategy, the change in fair value of the hedged item is presented as a separate line item in the balance sheet and is not allocated to individual assets or liabilities.

#### **11.9.4 Hedging aggregated exposures**

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

**US GAAP**

US GAAP does not permit hedge accounting for hedged items that are remeasured for changes in fair value through earnings (or a forecasted acquisition of an asset or incurrence of a liability that subsequently will be similarly remeasured at fair value). Therefore, items meeting the definition of a derivative are not permitted to be

**IFRS**

Aggregated exposures can be designated as hedged items. An aggregated exposure is a combination of (1) an exposure that qualifies as a hedged item and (2) a derivative. This includes a forecasted transaction of an aggregated exposure (i.e., uncommitted but anticipated future transactions that would give rise to an exposure

**US GAAP**

the hedged item in a hedging relationship either by themselves or when combined with other nonderivatives.

**IFRS**

and a derivative) as long as the aggregated exposure is highly probable and, once it has occurred, would be eligible as a hedged item.

For example, an entity could hedge the forecasted issuance of variable-rate debt even if the currency of issuance is not yet known. If the debt is not issued in the entity's functional currency, but the entity plans to enter into a cross-currency swap to convert the exposure back into its functional currency, it can designate as the hedged item highly probable variable interest payments arising from either (1) debt denominated in the functional currency or (2) a combination of foreign currency debt and a cross-currency swap that will swap the foreign currency debt to functional currency debt.

**11.9.5 Partial term hedging**

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

**US GAAP**

US GAAP allows a partial-term fair value hedge of interest rate risk in which the hedged item is designated as selected consecutive contractual interest payments. For example, entities can hedge the interest rate payments in the first two years, the last two years, or in years two through four in debt with a five-year term.

Or, for hedges of a single financial instrument, an entity could simultaneously enter into a hedge of year 1 with a swap in one hedging relationship and years 3 and 4 with another swap in a different hedging relationship.

Partial-term hedging is achieved by assuming that (1) the term begins when the first hedged cash flow begins to accrue, and (2) the maturity of the hedged item is the same date as the last hedged cash flow. To achieve #2, the payments made at the contractual maturity of the hedged item are assumed to be made at the conclusion of the hedged term.

In a cash flow hedge of interest rate risk, the hedged forecasted transactions are future interest payments. An entity may choose to hedge only certain selected interest payments to be paid under the terms of a debt agreement.

**IFRS**

IFRS similarly permits designation of a derivative as hedging a financial instrument (the hedged item) for only a portion of its cash flows or fair value, if effectiveness can be measured and the other hedge accounting criteria are met.

Under IFRS 9, partial-term hedging of forecasted transactions of nonfinancial items, such as purchases and sales, is not permitted. However, the terms of the hedged item and hedging instrument do not need to match exactly to achieve hedge accounting. If the mismatch is not so long as to invalidate the economic relationship, an entity can designate the hedge for the full period. However, the difference in terms will result in ineffectiveness.

Ineffectiveness arises regardless of whether the designated hedged risk is the forward or the spot foreign currency rate because the requirement in IFRS 9 to consider the time value of money is applicable in both circumstances.

### 11.9.6 *Hedging variable-rate financial assets and liabilities*

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

#### US GAAP

US GAAP allows hedging the interest rate risk associated with the contractually specified index rate of an existing or forecasted issuance/purchase of a variable rate financial instrument. The rate does not need to be a benchmark interest rate.

If an entity desires to hedge interest payments from a forecasted issuance/purchase and does not know whether it will be variable rate or fixed rate, the entity must designate a rate that would qualify both as a contractually specified rate and a benchmark interest rate.

#### IFRS

IFRS similarly allows a portion of specific interest payments to qualify as a hedged risk, provided it is separately identifiable and reliably measurable. It does not have to be contractually specified.

However, under IFRS 9, a designated portion of the cash flows cannot be greater than the cash flows of the whole financial asset or financial liability. Consequently, an entity that issues a debt instrument whose effective interest rate at designation is below the designated interest rate component cannot designate a component of the liability equal to the benchmark interest rate. For example, if an entity issues debt that pays a rate of LIBOR minus 1%, it cannot designate the hedged item as only the LIBOR component of the cash flows. However, IFRS permits the entity to designate as a hedged item the change in cash flows of the entire liability (LIBOR minus 1%) that is attributable to changes in LIBOR. In practice, this may have a similar result, unless the debt contains a floor or contractually permits other variability besides the referenced interest rate.

### 11.9.7 *Hedging fixed-rate financial assets and liabilities*

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

#### US GAAP

The interest rate risk that can be hedged in a fixed-rate financial asset or liability is explicitly limited to benchmark interest rates. In each financial market, generally only the most widely used and quoted rates are considered benchmark interest rates.

#### IFRS

Similar to US GAAP, IFRS 9 permits an entity to hedge the full contractual coupon or just the interest rate component of the contractual coupon. IFRS allows a portion of a specific risk in a fixed-rate financial asset or liability to be designated as a hedged item, provided it is separately identifiable and reliably measurable.



**US GAAP**

In the United States, the benchmark rates currently allowed to be hedged under US GAAP are:

- the interest rates on direct Treasury obligations of the US government,
- the London Interbank Offered Rate (LIBOR) swap rate,
- the Fed Funds Effective Swap Rate (also referred to as the Overnight Index Swap Rate or OIS), and
- the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate.
- OIS rate based on the Secured Overnight Financing Rate (SOFR)

In calculating the change in value of the hedged item for interest rate changes, an entity can use either the full contractual coupon cash flows or the benchmark rate component as determined at hedge inception.

A hedge of the benchmark component of coupons is permitted for all fair value hedges, regardless of whether the coupon or yield is more or less than the benchmark rate. In other words, sub-benchmark hedging is allowed.

Under US GAAP, an entity should consider the effect of a prepayment option that is exercisable during the hedged term when hedging interest rate risk of a prepayable item. In evaluating the impact to the prepayment option, an entity is explicitly permitted to consider either (1) all factors that would cause a borrower to prepay, or (2) only how changes in the benchmark interest rate affect prepayments.

**IFRS**

In certain circumstances, an inflation risk component could be considered separately identifiable and reliably measurable even if not contractually specified.

Unlike US GAAP, IFRS 9 does not contain a list of acceptable benchmark rates. Additionally, IFRS 9 does not permit use of a designated component of the cash flows that exceeds the total fair value or cash flows of a hedged item. For a fixed rate sub-LIBOR debt, an entity would designate changes in fair value of all the cash flows attributable to changes in LIBOR. If a fixed-rate financial instrument is hedged after its origination/issuance and interest rates have risen, the entity can designate a risk component equal to a benchmark rate that is higher than the contractual rate paid on the item as long as LIBOR is less than the effective interest rate based on the hedged item's fair value at designation. In that case, the cash flows used for the hedged item would consist of the contractual interest and the difference between the hedged item's fair value at designation and the amount repayable at maturity (discount).

While IFRS 9 allows an entity to designate the interest rate component as the hedged risk, it does not specifically provide the approach laid out under US GAAP when considering the impact of a prepayment option. However, in practice, changes in fair value attributable to the referenced interest rate may be designated as the hedged risk, which has the same effect.

### **11.9.8 Hedging more than one risk**

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



**US GAAP**

US GAAP does not allow a single hedging instrument to hedge more than one risk in two or more hedged items and does not permit creation of a hypothetical component in a hedging relationship of more than one risk with a single hedging instrument. An exception is a basis swap designated as a cash flow hedge of both a floating rate asset and a floating rate liability.

**IFRS**

IFRS 9 permits designation of a single hedging instrument to hedge more than one risk in two or more hedged items. A single hedging instrument may be designated as a hedge of more than one type of risk, provided that there is a specific designation of the hedging instrument and of the different risk positions as hedged items. Those hedged items can be in different hedging relationships. In the application of this guidance, a single derivative may be separated by inserting an additional (hypothetical) leg if each portion of the contract is designated as a hedging instrument in a qualifying and effective hedge relationship.

For example, an entity whose functional currency is the Japanese yen (JPY) that has a fixed-rate loan receivable denominated in British pounds (GBP) and a variable-rate liability denominated in US dollars (USD) with the same principal amount can enter into a single foreign currency forward contract to hedge the FX exposure on the principal payments of the liability and the note receivable. This would be achieved by splitting a GBP / USD forward into two forwards by imputing two JPY legs into the contract.

**11.9.9 Hedging business combinations**

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

**US GAAP**

US GAAP specifically prohibits a firm commitment to enter into a business combination, or acquire or dispose of a subsidiary, minority interest, or equity method investee from qualifying as a hedged item for hedge accounting purposes (even if it is with respect to foreign currency risk). Additionally, US GAAP does not permit cash flow hedges of forecasted transactions involving business combinations.

**IFRS**

An entity is permitted to hedge foreign exchange risk in a firm commitment to acquire a business or a forecasted business combination if the transaction is highly probable.

**11.10 Eligible hedging instruments**

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

### 11.10.1 *Eligible hedging instruments - nonderivatives*

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

#### US GAAP

Generally, a nonderivative may not be used as a hedging instrument. However, certain nonderivative financial instruments that may give rise to a foreign currency transaction gain or loss may be designated in a hedge of foreign currency risk in fair value hedges of firm commitments and net investment hedges.

#### IFRS

Nonderivative financial instruments classified at fair value through profit or loss are permitted to be used as hedging instruments for all types of risks (except for financial liabilities when changes in fair value as a result of credit risk are presented in OCI).

The foreign currency component of nonderivative financial instruments can be designated as a hedge of FX risk (except for equity instruments for which changes in fair value are recorded in OCI).

### 11.10.2 *Foreign currency risk - location of hedging instrument*

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

#### US GAAP

Either the operating unit that has the foreign currency exposure or another member of the consolidated group that has the same functional currency as that operating unit must be a party to the hedging instrument. However, for another member of the consolidated group to enter into the hedging instrument, there cannot be an intervening entity with a different functional currency. Instead, entities may designate intercompany derivatives between the subsidiary with the exposure and the entity that is a party to an offsetting external derivative if certain criteria are met.

#### IFRS

IFRS does not require the entity with the hedging instrument to have the same functional currency as the entity with the hedged item or the operating unit exposed to the risk being hedged within the consolidated group to be a party to the hedging instrument. For example, IFRS allows a parent company with a functional currency different from that of a subsidiary to achieve cash flow hedge accounting for the subsidiary's transactional foreign currency exposure (i.e., an exposure in a currency other than the subsidiary's functional currency).

The same flexibility regarding location of the hedging instrument applies to net investment hedges.

## 11.11 Cash flow hedging and basis adjustments

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

### US GAAP

US GAAP prohibits adjusting the basis of the hedged item in a cash flow hedge, and requires the fair value changes deferred in AOCI to be released out of AOCI into earnings when the hedged forecasted transaction impacts earnings.

### IFRS

IFRS 9 requires mandatory basis adjustment of the nonfinancial hedged item once it is recognized. Accordingly, fair value changes in the hedging instrument that are deferred in AOCI (referred to as the “cash flow hedge reserve”) are included in the value of the hedged item on its initial recognition. The basis adjustment does not flow back through OCI. It is a direct transfer from equity to the hedged item.

Similar accounting is required if a hedged forecasted transaction for a nonfinancial asset or a nonfinancial liability becomes a firm commitment for which fair value hedge accounting is applied.

## 11.12 Presentation of hedging instrument gains or losses

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

### US GAAP

For fair value hedges, the entire change in the fair value of the hedging instrument is presented in the same income statement line item as the earnings effect of the hedged item.

For cash flow hedges, the entire change in fair value of the hedging instrument (except for excluded components) should be recorded in other comprehensive income (OCI) and reclassified to earnings in the same income statement line item used to present the earnings effect of the hedged item when the hedged item impacts earnings.

Splitting gains and losses into more than one income statement line item is generally not appropriate. However, if the hedging instrument offsets changes in fair value or cash flows that are reported in more than one income statement line item, the changes in fair value of the hedging

### IFRS

IFRS 9 generally has no requirements regarding the income statement presentation of gains and losses from a hedging instrument. However, in practice, we believe most entities present gains and losses from a hedging instrument in the same income statement line item as the hedged transaction.

We believe ineffectiveness should be presented in a manner consistent with the entity’s policy for trading derivatives. This might mean that the results of hedge ineffectiveness are included in the same line item as the impact of the related hedged item or in “other operating income and expense” or a separate line item if the amount is significant.

For cash flow hedges of a group of items with no offsetting risk position, the presentation of gains and losses should be apportioned to the line

**US GAAP**

instrument is split among the line items that include the earnings effect of the hedged item.

For cash flow and fair value hedges, amounts excluded from the assessment of effectiveness are presented in the same income statement line item that is used for the hedged item.

For net investment hedges, the entire change in fair value of the hedging instrument included in the hedge effectiveness assessment is recorded in CTA and reclassified to earnings in the same income statement line item used to present the earnings effect of the hedged item (when the subsidiary is sold or substantially liquidated). US GAAP is silent on the income statement geography for excluded components for net investment hedges.

**IFRS**

items affected by the hedged items on a systematic and rational basis.

The net gains or losses arising from a single hedging instrument should not be presented as gross amounts in different line items.

For a hedge of a group of items with offsetting risk positions whose hedged risk affects different line items in the statement of profit or loss and OCI, any hedging gains or losses in that statement must be presented in a separate line from those affected by the hedged items. Consequently, the amount in the line item that relates to the hedged item itself (e.g., revenue or cost of sales) remains unaffected. In practice, this makes hedges of a group of items less attractive, and we expect many entities to designate just a part of one of the gross positions (rather than the net position).

### **11.13 *Voluntary dedesignation of a hedging relationship***

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

**US GAAP**

An entity is permitted to dedesignate a hedging relationship voluntarily at any time.

**IFRS**

Under IFRS 9, an entity cannot voluntarily dedesignate a hedging relationship that:

- still meets the risk management objective on the basis of which it qualified for hedge accounting (i.e., the entity still pursues that risk management objective), and
- continues to meet all other qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable).

## 11.14 *Novations, rollovers, and replacements*

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

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

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# ***Chapter 12:***

# ***Consolidation—Updated June***

# ***2023***

## 12.1 Consolidation

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

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

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

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

Even when both US GAAP and IFRS Accounting Standards indicate that an entity should be consolidated, the initial consolidation could differ (e.g., acquisition of a VIE that is not a business would follow specific guidance under US GAAP as described in SD 12.4.1 that differs from the accounting treatment under IFRS Accounting Standards).

### ***Technical references***

#### *US GAAP*

ASC 205, ASC 323, ASC 323-10-15-8 to ASC 323-10-15-11, ASC 325-20, ASC 810, ASC 810-10-25-1 to ASC 810-10-25-14, ASC 810-10-60-4, SAB Topic 5H

*IFRS Accounting Standards*

IAS 1, IAS 27, IAS 28, IAS 36, IAS 39, IFRS 9, IFRS 5, IFRS 10, IFRS 11, IFRS 12

**Note**

The following discussion captures a number of the more significant GAAP differences; it is not inclusive of all GAAP differences in this area.

## 12.2 **Requirements to prepare consolidated financial statements**

The requirements for consolidated financial statements are fairly similar under both frameworks. Neither IFRS Accounting Standards nor US GAAP provide for the consolidation of a pension plan by its sponsor. In addition, both have provisions that prevent the consolidation of many investment entities. IFRS Accounting Standards do not provide industry-specific exceptions to the requirement for consolidation of controlled entities, with the exception of specific guidance for investment entities. In addition, in limited circumstances, IFRS Accounting Standards may be more flexible with respect to the ability to issue nonconsolidated financial statements (i.e., parent-only, separate financial statements).

US GAAP	IFRS Accounting Standards
<p>Absent a scope exception, any legal entity—regardless of its legal form and the scope of its activities—may be subject to consolidation under ASC 810. The guidance applies to legal structures, including corporations, partnerships, limited liability companies, grantor trusts, and other trusts.</p> <p>Scope exceptions include the following legal entities (see CG 2.2):</p> <ul style="list-style-type: none"> <li>□ Registered money market funds and similar unregistered money market funds</li> <li>□ Investment companies and broker/dealers (see SD 12.3)</li> <li>□ Governmental organizations</li> </ul>	<p>IFRS 10 requires parent entities to present consolidated financial statements, with certain exceptions, which differs from US GAAP. Parent entities are exempt from preparing consolidated financial statements when all of the following conditions apply (IFRS 10.4):</p> <ul style="list-style-type: none"> <li>□ The parent is a wholly- or partially-owned subsidiary and the owners of the noncontrolling interests have been informed about and do not object to the parent not presenting consolidated financial statements</li> <li>□ The parent's debt or equity securities are not publicly traded and the parent is not in the process of issuing any class of instruments in public securities markets</li> <li>□ The ultimate or any intermediate parent of the parent publishes consolidated financial statements available for public use that comply with IFRS Accounting Standards</li> </ul>



**US GAAP**

Consolidated financial statements are presumed to be more meaningful and are required for SEC registrants.

With the exception of the items noted above, there are no exemptions for consolidating subsidiaries in general-purpose financial statements.

**IFRS Accounting Standards**

A subsidiary is not excluded from consolidation simply because the investor is a venture capital organization, mutual fund, unit trust, or similar entity. However, an exception is provided for an investment entity (as defined in SD 12.3) from consolidating its subsidiaries unless those subsidiaries are providing investment-related services. Instead, the investment entity measures those investments at fair value through profit or loss. The exception from consolidation only applies to an investment entity's financial reporting. This exception does not apply to the financial reporting by a non-investment entity, even if it is the parent of an investment entity.

When separate financial statements are prepared, investments in subsidiaries, joint ventures, and associates can be accounted for:

- at cost,
- using the equity method, or
- at fair value.

The same accounting is required for each category of investments.

However, investments in associates or joint ventures held by venture capital organizations, mutual funds, unit trusts or similar entities or investments entities accounted for at fair value in the consolidated financial statements should be measured at fair value in the separate financial statements.

## **12.3 Investment company/entity definition**

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

**US GAAP**

An investment company is an entity with the following fundamental characteristics:

**IFRS Accounting Standards**

The IFRS Accounting Standards definition of an investment entity is substantially converged with the US GAAP definition with the following exceptions:

- The IFRS Accounting Standards definition requires an entity to measure and evaluate

**US GAAP****IFRS Accounting Standards**

- It is an entity that does both of the following:
  - Obtains funds from one or more investors and provides the investor(s) with investment management services
  - Commits to its investor(s) that 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

the performance of substantially all of its investments on a fair value basis

- The IFRS Accounting Standards definition does not provide for entities that are subject to certain regulatory requirements (such as the Investment Company Act of 1940) to qualify as investment entities without meeting the stated criteria

An investment company would also be expected to have all of the following typical characteristics:

- It has more than one investment
- It has more than one investor
- It has investors that are not related parties of the parent and the investment manager
- It has ownership interests in the form of equity or partnership interests
- It manages substantially all of its investments on a fair value basis

An entity may still be considered an investment company if it does not exhibit one or more of the typical characteristics, depending on facts and circumstances.

- All entities subject to the Investment Company Act of 1940 are investment companies.

Unlike IFRS Accounting Standards, under US GAAP a reporting entity that consolidates an investment company retains the investment company's specialized accounting in the reporting entity's consolidated financial statements (ASC 810-10-25-15).

## 12.4 Consolidation model

The consolidation models under US GAAP and IFRS Accounting Standards are very similar. Both US GAAP and IFRS Accounting Standards require a reporting entity to consolidate an entity that it controls as a result of holding a majority of the voting rights. In circumstances when the entity is structured such that voting and economic rights of the owners are meaningfully different, the analysis is more complex under both frameworks. In certain circumstances, this can lead to different conclusions on consolidation. In addition, in certain situations, consolidation can result under IFRS Accounting Standards due to potential voting rights (e.g., options), which is much less likely under US GAAP.

Specific drivers of differences in consolidation under US GAAP and IFRS Accounting Standards can arise as a result of the following:

- Differences in how economic benefits are evaluated when the consolidation assessment considers more than just voting rights (i.e., differences in methodology)
- Specific differences or exceptions, such as:
  - The consideration of variable interests (see SD 12.4.1)
  - De facto control (see SD 12.4.2)
  - How potential voting rights are evaluated (see SD 12.4.3)
  - Guidance related to de facto agents and related parties (see SD 12.4.4)
  - Reconsideration events

US GAAP	IFRS Accounting Standards
<p>A reporting entity must first determine whether it holds a “variable interest” in an entity being evaluated for potential consolidation under ASC 810. A variable interest is an economic arrangement that exposes or entitles a reporting entity to the economic risks and/or rewards of the entity—that is, the instrument or contract exposes its holder to the entity’s variability. If a reporting entity concludes that it holds a variable interest in an entity, it must evaluate whether that entity is a variable interest entity (VIE). That assessment, in turn, will dictate which of the two consolidation models—the VIE model or the voting interest model—applies to the entity in question. In applying the VIE model, the following conditions indicate that the entity is a VIE:</p> <ul style="list-style-type: none"> <li>□ Insufficient equity investment at risk</li> </ul>	<p>IFRS Accounting Standards focus on the concept of control in determining whether a parent-subsidiary relationship exists.</p> <p>An investor controls an investee when it has all of the following:</p> <ul style="list-style-type: none"> <li>□ Power over the investee through rights that give it the current ability to direct the relevant activities that significantly affect the investee’s returns</li> <li>□ Exposure, or rights, to variable returns from its involvement with the investee (returns must vary and can be positive, negative, or both)</li> <li>□ The ability to use its power over the investee to affect the amount of the investor’s returns</li> </ul>

**US GAAP**

- Equity lacks decision making rights
- Equity with nonsubstantive voting rights
- Lack of obligation to absorb losses
- Lack of right to receive residual returns

Limited partnerships are generally VIEs because the limited partners lack decision making rights. For a limited partnership (or similar entity) to be a voting interest entity, the limited partners (or members of a limited liability company that is similar to a limited partnership) must have, at minimum, substantive kick-out or participating rights. Any of these rights, if present, are considered analogous to voting rights held by corporate shareholders that provide those shareholders with power over the entity being evaluated for consolidation.

If a reporting entity determines it has a variable interest in a VIE, US GAAP requires the reporting entity to qualitatively assess the determination of the primary beneficiary of the VIE. In applying the qualitative model, an entity is deemed to have a controlling financial interest if it meets both of the following criteria:

- Power to direct activities of the VIE that most significantly impact the VIE's economic performance (power criterion)
- Obligation to absorb losses from or right to receive benefits of the VIE that could potentially be significant to the VIE (economics criterion)

In assessing whether an enterprise has a controlling financial interest in an entity, it should consider the entity's purpose and design, including the risks that the entity was designed to create and pass through to its variable interest holders.

**IFRS Accounting Standards**

In assessing control of an entity, an investor should consider the entity's purpose and design to identify the relevant activities, how decisions about the relevant activities are made, who has the current ability to direct those activities, and who is exposed or has rights to the returns from those activities. Only substantive rights can provide power.

The greater an investor's exposure to variability of returns, the greater its incentive to obtain rights to give it power (i.e., it is an indicator of power and is not by itself determinative of having power).

**US GAAP****IFRS Accounting Standards**

Only one enterprise, if any, is expected to be identified as the primary beneficiary of a VIE. Although more than one enterprise could meet the losses/benefits criterion, only one enterprise, if any, will have the power to direct the activities of a VIE that most significantly impact the entity's economic performance.

Increased skepticism should be given to situations in which an enterprise's economic interest in a VIE is disproportionately greater than its stated power to direct the activities of the VIE that most significantly impact the entity's economic performance. As the level of disparity increases, the level of skepticism about an enterprise's lack of power is expected to increase.

All other entities are evaluated under the voting interest model. Unlike IFRS Accounting Standards, only actual voting rights are considered. Under the voting interest model, control can be direct or indirect. The usual condition for a controlling financial interest under the voting interest model is ownership of over 50% of the outstanding voting shares. In certain unusual circumstances, control may exist with less than 50% ownership, when contractually supported.

When an entity is controlled by voting rights, control is presumed to exist when a parent owns, directly or indirectly, more than 50% of an entity's voting power. Control also exists when a parent owns half or less of the voting power but has legal or contractual rights to control either the majority of the entity's voting power or the board of directors. Control may exist even in cases where an entity owns little or none of a structured equity. The application of the control concept requires, in each case, judgment in the context of all relevant factors.

**12.4.1 Consolidation model—VIEs**

IFRS Accounting Standards use a single control model to determine consolidation. US GAAP has a two-tier consolidation model—the VIE model and the voting interest model. If applying the VIE model, ASC 810 provides specific guidance to address the accounting for the acquisition of a VIE that is not a business. Additionally, if applying the VIE model, ASC 810 provides an accounting alternative for private companies in specific circumstances.

**US GAAP****IFRS Accounting Standards**

When the acquired group is a VIE that does not meet the definition of a business, the primary beneficiary should account for the initial consolidation pursuant to the guidance in ASC 810-10-30-4. No goodwill would be recognized if the variable interest entity is not a business. See CG 6.1 and BCG 2.11 for additional guidance on accounting for a legal entity that is a VIE that is not a business.

The US GAAP requirements do not exist under IFRS Accounting Standards since there is no VIE guidance.

**US GAAP****IFRS Accounting Standards**


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Private companies may elect not to apply the VIE guidance to legal entities under common control (including common control leasing arrangements) if both the parent and the legal entity being evaluated for consolidation are not public business entities. The accounting alternative is an accounting policy election that must be applied to all current and future legal entities under common control.

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**12.4.2 Consolidation model—de facto control**

De facto control is considered when evaluating control under IFRS Accounting Standards, while US GAAP does not have the concept of de facto control.

**US GAAP****IFRS Accounting Standards**


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The concept of de facto control does not exist under US GAAP.

De facto control is considered when evaluating control under IFRS Accounting Standards. Despite having less than 50% of the voting shares in an investee, an investor may still have power over the investee if it has the practical ability to direct the relevant activities (e.g., the respective size of the investor's share of voting rights are significantly greater than the size and dispersion of the holdings of other investors).

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**12.4.3 Consolidation model—potential voting rights**

Potential voting rights are considered when evaluating control under IFRS Accounting Standards and under the VIE model under US GAAP, while such potential voting rights are generally not considered in the voting interest model under US GAAP.

US GAAP	IFRS Accounting Standards
<p>Entities may issue various financial instruments to reporting entities that provide the reporting entities with potential voting rights (i.e., instruments that, if exercised or converted, give the entity power over the relevant activities of another entity). Potential voting rights might take various forms, including call options, convertible instruments, and forward contracts.</p> <p>Under the VIE model, potential voting rights are considered in determining whether an entity is a VIE and in determining the primary beneficiary.</p> <p>Under the voting interest entity model, potential voting rights are generally not included in the determination of whether the reporting entity has a controlling financial interest in the entity as the voting interest entity model is not an effective control model. See CG 7.2.3 for additional information.</p>	<p>Potential voting rights are considered in the evaluation of control. Only potential voting rights that are substantive should be considered by an investor in its assessment of control over an investee.</p>

#### 12.4.4 Consolidation model—related parties

Related parties are considered under the VIE model under US GAAP in certain circumstances, including in the evaluation of the related party tiebreaker test. Related parties are not assumed to act in concert under IFRS 10; rather, the investor must evaluate whether the other party is acting on the investor's behalf (i.e., a "de facto agent"). Therefore, related parties are less likely to be consolidated under IFRS Accounting Standards.

US GAAP	IFRS Accounting Standards
<p>There is no specific guidance on related party considerations under the voting interest model.</p> <p>Under the VIE model, even when a reporting entity is not the primary beneficiary on a standalone basis, it may still need to consolidate the entity if its related party group has control and it is deemed to be the party that is most closely associated with the entity. This concept is referred to as the related party tiebreaker. See CG 5.8 for additional information.</p>	<p>An investor should consider the nature of its relationships with other parties when assessing control, including whether those other parties are acting on behalf of the investor. However, judgment is required in determining whether these other parties are considered de facto agents, and the investor should consider the nature of its relationship with those other parties and how those parties interact with each other and the investor. There is no related party tiebreaker test.</p>

## 12.5 Consolidated financial statements—accounting policies and periods

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

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

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

## 12.6 Consolidation—changes in interest

Differences exist between US GAAP and IFRS Accounting Standards in the accounting for a change in ownership interest. Such differences depend on whether control is lost or retained.

### 12.6.1 Consolidation—change in interest without loss of control

Under US GAAP, a change in ownership interest that does not result in a loss of control is generally accounted for as an equity transaction; however, there are exceptions which may result in different accounting. Under IFRS Accounting Standards, a change in ownership interest without a loss of control is accounted for as an equity transaction (i.e., no gain or loss is recognized in earnings).

US GAAP	IFRS Accounting Standards
Changes in a parent's ownership interest that do not result in a loss of control of the subsidiary are accounted for as equity transactions (i.e., no gain or loss is recognized in earnings) when: <ul style="list-style-type: none"> <li>□ the subsidiary is a business or nonprofit activity (except a conveyance of oil and gas mineral rights in the scope of ASC 932-360 or a transfer of a good or service in a contract with a customer in the scope of ASC 606), or</li> </ul>	Changes in a parent's ownership interest that do not result in a loss of control of the subsidiary are accounted for as equity transactions (i.e., no gain or loss is recognized in earnings). There are no exceptions for certain industries (e.g., conveyance of oil and gas mineral rights), types of transactions (e.g., contracts with customers), or when the subsidiary is not a business.



**US GAAP****IFRS Accounting Standards**

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- the subsidiary is not a business or nonprofit activity, but the substance of the transaction is not addressed directly by other guidance.

For additional information, see BCG 5.4.

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**12.6.2 Consolidation—change in interest with loss of control**

Under both US GAAP and IFRS Accounting Standards, the loss of control of a subsidiary that is a business results in the recognition of a gain or loss on the sale of the interest sold and on the revaluation of any retained noncontrolling investment. However, US GAAP provides certain exceptions which may result in different accounting; there are no such exceptions under IFRS Accounting Standards.

**US GAAP****IFRS Accounting Standards**


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The loss of control of a subsidiary that is a business results in the recognition of a gain or loss on the sale of the interest sold and on the revaluation of any retained noncontrolling investment, when:

- the subsidiary is a business or nonprofit activity (except a conveyance of oil and gas mineral rights in the scope of ASC 932-360 or a transfer of a good or service in a contract with a customer in the scope of ASC 606), or
- the subsidiary is not a business or nonprofit activity, but the substance of the transaction is not addressed directly by other guidance.

However, there is specific guidance under US GAAP if a reporting entity loses control of a subsidiary that is a business through a nonreciprocal transfer to owners (see SD 12.6.3).  
For additional information, see BCG 5.5.

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The loss of control of a subsidiary results in recognition of a gain or loss on (1) sale of the interest and (2) revaluation of any retained noncontrolling investment. There are no exceptions for certain industries (e.g., conveyance of oil and gas mineral rights), types of transactions (e.g., contracts with customers), or when the subsidiary is not a business.

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**12.6.3 Consolidation—loss of control – spinoffs and split-offs**

A nonreciprocal transfer of assets to owners of a reporting entity may be in the form of a pro rata spinoff or a non-pro rata split-off. A pro rata spinoff of assets that constitute a business is accounted for by the spinnor under US GAAP based on the recorded amount of the assets transferred; under IFRS Accounting Standards, this transaction is accounted for by the spinnor at fair value with any gain or loss recognized in earnings. While a non-pro rata split-off transaction is accounted for by the spinnor at fair value under US GAAP, there is no specific guidance on split-offs under IFRS Accounting Standards.

**US GAAP****IFRS Accounting Standards**

A spinoff is the transfer of assets that constitute a business into a new legal entity, upon which the shares of the spinnee are subsequently distributed to its shareholders, and the shareholders do not surrender any stock of the spinnor. In accordance with ASC 845-10-30-10, a transfer of long-lived assets that constitute a business to owners in a spinoff should be accounted for based on the recorded amount of the assets transferred (after reduction, if appropriate, for any impairment). In contrast, if the long-lived assets transferred do not constitute a business, the transaction is not a spinoff even though the distribution is pro rata. Rather, it would be considered a dividend in kind, which is generally accounted for based on the fair value of the assets transferred.

A nonreciprocal, non-cash distribution to owners is accounted for under IFRIC 17 at fair value with any gain or loss recognized in earnings. IFRIC 17 applies to distributions of non-cash assets (e.g., property, plant, and equipment) and businesses.

A non-pro rata split-off transaction is a non-pro rata distribution that may or may not involve all shareholders. A split-off transaction usually involves a substantive parent entity offering its noncontrolling shareholders the ability to exchange any or all of their equity shares of the parent entity, subject to a cap if oversubscribed, for shares of a subsidiary at a specified exchange rate. A non-pro rata split-off is akin to a sale and is accounted for at fair value.

There is no specific guidance for non-pro rata split-offs under IFRS Accounting Standards.

## **12.7 Consolidation—accounting by the spinnee**

Under US GAAP, a transfer of long-lived assets that constitute a business to owners in a spinoff is accounted for based on the recorded amount of the assets transferred. The assets continue to be accounted for as held and used, and any test for impairment is performed under ASC 360-10. Accordingly, the recoverability test performed on an undiscounted basis under US GAAP may result in fewer impairments as compared with the fair value model and impairment assessment under IFRS Accounting Standards. Consequently, the assets may be recorded at a lower amount by the spinnee under IFRS Accounting Standards as compared with US GAAP.

US GAAP	IFRS Accounting Standards
A spinoff of long-lived assets that constitute a business is accounted for based on the recorded amount of the assets transferred. The impairment test for such assets is performed under ASC 360-10, including the recoverability test, which is performed on an undiscounted basis. If the assets are recoverable (i.e., no impairment is recognized), the assets may be recorded at a higher amount by the spinnee under US GAAP.	Under IFRIC 17, a nonreciprocal, non-cash distribution to owners (regardless of whether or not the long-lived assets constitute a business) is accounted for at fair value with any gain or loss recognized in earnings. Any impairment recognized at the spinnor level may result in the assets being recorded at a lower amount by the spinnee under IFRS Accounting Standards.

## 12.8 *Equity method*

Differences exist between US GAAP and IFRS Accounting Standards in the accounting for equity method investments.

### 12.8.1 *Equity method—significant influence*

Under US GAAP and IFRS Accounting Standards, an investor should generally apply the equity method of accounting when the investor does not control the investee but has the ability to exercise significant influence. However, there is specific guidance under US GAAP related to limited partnerships and LLCs that does not exist under IFRS Accounting Standards. In addition, the equity method under US GAAP only applies to investments in common stock or in-substance common stock. IFRS Accounting Standards does not have this limitation.

US GAAP	IFRS Accounting Standards
Significant influence is presumed to exist for investments of 20% or more in common stock or in-substance common stock of a corporation. However, an ownership interest greater than 3-5% in limited partnerships (in accordance with ASC 323-30-S99-1), unincorporated joint ventures, and limited liability companies (LLCs) is presumed to provide an investor with significant influence.	Significant influence is presumed to exist for investments of 20% or more of the voting rights of another entity. There is no specific guidance on assessing significant influence in limited partnerships, LLCs, or similar entities.

### 12.8.2 *Equity method—potential voting rights*

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

US GAAP	IFRS Accounting Standards
Potential voting rights are generally not considered in the assessment of whether an investor has significant influence.	Potential voting rights that are currently exercisable or currently convertible are considered in determining whether the investor exerts significant influence over the investee. Potential voting rights are generally not, however, considered in the measurement of the equity earnings recorded by the investor.

### 12.8.3 *Equity method—investments other than common equity*

US GAAP is more restrictive than IFRS Accounting Standards regarding the types of investments that are subject to the scope of the equity method guidance (i.e., under US GAAP, the guidance only applies if there is at least some amount of investment in common stock or in-substance common stock).

US GAAP	IFRS Accounting Standards
<p>The equity method is used to account for investments in common stock or other eligible investments by recognizing the investor's share of the economic resources underlying those investments. Investments within the scope of the equity method include investments in common stock and/or in-substance common stock (i.e., an investor may hold stock or other instruments that have risk and reward characteristics that are substantially similar to common stock, such as an LP interest), although all types of investments in the investee would be included when considering whether the investor has the ability to exert significant influence over the investee. Additionally, once subject to the equity method, losses can continue to be recognized against the basis of these other securities.</p> <p>If an investor does not hold any investments in common stock or in-substance common stock of an investee, it would be precluded from applying the equity method.</p>	<p>Significant influence is presumed to exist for investments of 20% or more of the voting rights of another entity. There is no specific guidance on whether the equity method is applied to instruments that have risk and reward characteristics that are substantially similar to common stock.</p>

### 12.8.4 *Equity method—reporting periods*

In the event the investor and investee do not have uniform reporting periods, the treatment of significant transactions in any gap period varies under the two frameworks, with a potential for earlier recognition under IFRS Accounting Standards.

US GAAP	IFRS Accounting Standards
<p>The financial statements of the investor and equity method investee should have the same reporting period. However, when this is impracticable, the investee's accounts may be reported as of a different date, provided the difference between the reporting dates is no more than three months.</p> <p>The effects of intervening events that would materially affect the investor's financial statements are recognized through disclosure or adjustment based on the investor's policy (see EM 4.4).</p>	<p>The financial statements of the investor and the equity method investee should have the same reporting period. However, when this is impracticable, the investee's accounts may be reported as of a different date, provided the difference between the reporting dates is no more than three months.</p> <p>Adjustments are made to the financial statements for significant transactions that occur in the gap period.</p>

### 12.8.5 *Equity method—exemptions and FVO election*

The exemptions from applying the equity method differ between IFRS Accounting Standards and US GAAP. Exemptions from applying the equity method of accounting are available to a broader group of entities under US GAAP. Additionally, more entities may elect the fair value option (FVO) for equity method investments under US GAAP.

US GAAP	IFRS Accounting Standards
<p>The equity method of accounting does not apply to certain investments as detailed in ASC 323, including the following:</p> <ul style="list-style-type: none"> <li>□ An investment accounted for in accordance with ASC 815-10</li> <li>□ Investments in common stock held by a nonbusiness entity</li> <li>□ Investments in common stock within the scope of ASC 810</li> <li>□ Investment in common stock held by an investment company</li> <li>□ Investments in LLCs accounted for as debt securities</li> </ul>	<p>An entity does not need to apply the equity method to its investment in an associate or a joint venture if the entity is a parent that is exempt from preparing consolidated financial statements by the scope exception in IFRS 10.4(a) or if all the following conditions apply (IAS 28.17):</p> <ul style="list-style-type: none"> <li>□ The entity is a wholly- or partially-owned subsidiary and the owners of the noncontrolling interests have been informed about and do not object to the entity not applying the equity method</li> <li>□ The entity's debt or equity securities are not publicly traded and the parent is not in the process of issuing any class of instruments in public securities markets</li> <li>□ The ultimate or any intermediate parent of the entity publishes consolidated financial statements available for public use that comply with IFRS Accounting Standards, in which the subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with IFRS 10</li> </ul>

**US GAAP**

Equity method investments are considered financial assets and therefore are eligible for the fair value option (see EM 1.4.5). If this option is elected, an entity measures its investment in associates or joint ventures at fair value through profit or loss, regardless of whether it is a venture capital or similar organization.

**IFRS Accounting Standards**

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

**12.8.6 Equity method—classification as held for sale**

Application of the equity method of accounting may cease before significant influence is lost under IFRS Accounting Standards but not under US GAAP if an equity method investment meets the held for sale criteria.

**US GAAP**

Under US GAAP, if an equity method investment is classified as held for sale, an investor applies equity method accounting until significant influence is lost. That is, in accordance with ASC 360-10-15-5(d), equity method investments are not within the scope of the held-for-sale guidance in ASC 360.

An equity method investment can be classified as held for sale in accordance with ASC 205-20-45-1E only if it meets the definition of a discontinued operation.

**IFRS Accounting Standards**

If an equity method investment meets the held for sale criteria in accordance with IFRS 5, an investor records the investment at the lower of its (1) fair value less costs to sell or (2) carrying amount as of the date the investment is classified as held for sale.

Equity method investments are included in the scope of IFRS 5, which includes criteria for held for sale classification and discontinued operations. Under IFRS 5, it is possible for an equity method investment to be classified as held for sale even if the discontinued operations criteria are not met.

**12.8.7 Equity method—acquisition date excess of investor's share**

IFRS Accounting Standards requires day one gain recognition of an investor's share of the fair value of an associates' net identifiable assets and liabilities over the cost of its investment (whereas US GAAP would not).

**US GAAP****IFRS Accounting Standards**

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

Any acquisition date excess of the investor's share of net fair value of the associates' identifiable assets and liabilities over the cost of the investment is recognized as income in the period in which the investment is acquired.

**12.8.8 Equity method—conforming accounting policies**

A greater degree of accounting policy conformity is required for equity method investments under IFRS Accounting Standards.

**US GAAP****IFRS Accounting Standards**

The equity investee's accounting policies do not have to conform to the investor's accounting policies if the investee follows an acceptable alternative US GAAP treatment. Further, if an investee uses industry-specific accounting principles when preparing its own financial statements, the investor is required to retain the industry-specific accounting principles in its application of the equity method (ASC 323-10-25-7).

An investor's financial statements are prepared using uniform accounting policies for similar transactions and events. This also applies to equity method investees.

**12.8.9 Equity method—impairment**

Differences exist in the impairment models for equity method investments under US GAAP and IFRS Accounting Standards, including the fact that impairments potentially may be reversed under IFRS Accounting Standards.

**US GAAP****IFRS Accounting Standards**

An investor should determine whether a loss in the fair value of an investment below its carrying value is a temporary decline. If it is other than temporary, the investor calculates an impairment as the excess of the investment's carrying amount over the fair value.

Reversals of impairments on equity method investments are prohibited.

An investor should assess whether objective indicators of impairment exist based on the "loss event" criteria in IAS 28. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is considered objective evidence of impairment. If there are objective indicators that the investment may be impaired, the investment is tested for impairment in accordance with IAS 36.

Impairments of equity method investments can be reversed in accordance with IAS 36.

**12.8.10 Equity method—losses in excess of an investor's interest**

Equity method losses in excess of an investor's interest may be recognized earlier under US GAAP.

<b>US GAAP</b>	<b>IFRS Accounting Standards</b>
Even without a legal or constructive obligation to fund losses, a loss in excess of the investment amount (i.e., a negative or liability investment balance) should be recognized when the imminent return to profitable operations by an investee appears to be assured.	Unless an entity has incurred a legal or constructive obligation, losses in excess of the investment are not recognized (IAS 28.39). The concept of an imminent return to profitable operations does not exist under IFRS Accounting Standards.
US GAAP does not contain detailed guidance on how to record profits or losses under the equity method when an investor also has other investments in the investee that are not subject to the equity method of accounting.	IFRS Accounting Standards contain detailed guidance on how to record profits or losses under the equity method when an investor also has other investments in the investee that are not subject to the equity method of accounting (e.g., debt or preferred shares) (IAS 28.38). Therefore, differences could arise.

**12.8.11 Equity method—loss of significant influence/joint control**

When an investor discontinues applying the equity method due to the loss of significant influence, the retained interest is generally accounted for by the investor at fair value. Under US GAAP, the investment is subsequently measured at fair value unless the measurement alternative practical expedient is elected. No such measurement alternative exists under IFRS Accounting Standards.

<b>US GAAP</b>	<b>IFRS Accounting Standards</b>
If an investment no longer qualifies for equity method accounting (for example, due to a decrease in the level of ownership), the investment's initial basis is the previous carrying amount of the investment.	If an entity loses significant influence or joint control over an equity method investment and the retained interest is a financial asset, the entity should measure the retained interest at fair value. The resulting gain or loss is recognized in the income statement. There is no measurement alternative for such an investment under IFRS Accounting Standards (see SD 7.7).
Under ASC 321, an initial gain or loss is generally recorded to recognize the investment at fair value and the investment is subsequently measured at fair value with gains or losses recorded to earnings. If the investment does not have a readily determinable fair value, a practical expedient can be elected to measure it at cost minus impairment, adjusted for changes for observable transactions (measurement alternative). Under this expedient, if the investor identifies observable price changes in orderly transactions for the identical or a similar investment of the same issuer that results in it discontinuing the equity method, the entity remeasures its retained investment at fair value immediately after discontinuing the equity method.	In contrast, if an investment in an associate becomes an investment in a joint venture, or vice versa, such that the equity method of accounting continues to apply, no gain or loss is recognized in the income statement.



## 12.9 Joint arrangements

Differences exist between US GAAP and IFRS Accounting Standards in the accounting for joint arrangements.

### 12.9.1 Joint arrangements—definition and types

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

US GAAP	IFRS Accounting Standards
<p>The term <i>joint venture</i> refers only to jointly controlled entities, where the arrangement is carried on through a separate entity.</p> <p>Joint control is not defined in US GAAP. However, the definition of joint control from a non-authoritative AcSEC Issue Paper is widely applied in practice (see EM 6.2.2). Joint control exists when the investors are able to participate in all of the significant decisions of an entity and unanimous consent over all significant decisions by all the venturers (investors) is required.</p> <p>A <i>corporate joint venture</i> is defined as a corporation owned and operated by a small group of businesses as a separate and specific business or project for the mutual benefit of the members of the group.</p> <p>Most joint venture arrangements give each venturer (investor) participating rights over the joint venture (with no single venturer having unilateral control), and each party sharing control must consent to the venture's operating, investing, and financing decisions.</p>	<p>A <i>joint arrangement</i> is a contractual agreement whereby two or more parties undertake an economic activity that is subject to joint control. <i>Joint control</i> is the contractually agreed sharing of control of an economic activity. Unanimous consent is required for the relevant activities (as discussed in SD 12.4) of the parties sharing control, but not necessarily of all parties in the arrangement.</p> <p>IFRS Accounting Standards classify joint arrangements into two types:</p> <ul style="list-style-type: none"> <li>□ Joint operations, which give parties that have joint control of the arrangement the direct rights to the assets and obligations for the liabilities</li> <li>□ Joint ventures, which give the parties that have joint control of the arrangement the rights to the net assets of the arrangement. This typically involves establishing a separate legal entity.</li> </ul>

### 12.9.2 Joint arrangements—accounting

Under IFRS Accounting Standards, classification of a joint arrangement as a joint venture or a joint operation determines the accounting by the investor. Under US GAAP, in order for an arrangement to be accounted for by the investor as a joint venture it must meet the accounting definition of a joint venture (i.e., a corporate joint venture as defined in ASC 323-10-20). There is no definition of a joint arrangement, nor is there a concept of a joint operation in US GAAP.

**US GAAP**

At the formation of a joint venture, an entity first assesses whether the joint venture is a VIE. If the joint venture entity is a VIE and is required to be consolidated by one of the investors, the accounting model discussed in SD 12.4 is applied (and the joint venture entity does not meet the definition of a joint venture). Joint ventures often have a variety of service, purchase, and/or sales agreements, as well as funding and other arrangements that may affect the entity's status as a VIE. Equity interests are often split 50-50 or near 50-50, making nonequity interests (i.e., any variable interests) highly relevant in consolidation decisions. Careful consideration of all relevant contracts and governing documents is critical in the determination of whether a joint venture is within the scope of the variable interest model and, if so, whether consolidation is required.

If the joint venture is not a VIE, the investor should assess if it is required to consolidate the joint venture under the VOE model. If the investor is not required to consolidate the joint venture under either the VIE model or the VOE model, the investor should determine if the entity meets the definition of a joint venture. If so, the investor would apply the equity method to recognize the investment in a jointly controlled entity. Proportionate consolidation is generally not permitted except for unincorporated entities operating in certain industries. A full understanding of the rights and responsibilities conveyed in management, shareholder, and other governing documents is necessary. See EM 6.3 for additional information.

When an investor is evaluating whether it has entered into a joint venture arrangement, the investor should consider whether the arrangement is instead a collaborative arrangement, which may be accounted for differently under ASC 808. See EM 6.2.4 and CG 8.3 for additional information.

**IFRS Accounting Standards**

IFRS 11 establishes two types of joint arrangements. The classification of a joint arrangement as a joint venture or a joint operation determines the investor's accounting. An investor in a joint venture must account for its interest using the equity method in accordance with IAS 28.

An investor in a joint operation accounts for its share of assets, liabilities, revenues, and expenses based on its direct rights and obligations in accordance with the relevant guidance applicable to the specific assets, liabilities, revenues, and expenses.

If the arrangement is not structured through a separate vehicle, it is a joint operation. Each party in a joint operation usually uses its own resources and carries out its own part of a joint operation separate from the activities of the other party or parties. Each party incurs its own expenses and raises its own financing.

If the joint operation constitutes a business, the investor must apply the relevant principles on business combination accounting contained in IFRS 3, *Business Combinations*, and other standards, and disclose the related information required under those standards.

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

### 12.9.3 Joint arrangements—contributions

Differences exist in the accounting for contributions to a jointly controlled entity under IFRS Accounting Standards and US GAAP. US GAAP provides prescriptive guidance under ASC 610-20 for circumstances in which an investor contributes nonfinancial assets that are not a business. IFRS Accounting Standards do not have such specific guidance.

US GAAP	IFRS Accounting Standards
<p>If an investor contributes a subsidiary (or group of assets) that is a nonfinancial asset or in substance nonfinancial asset that is not a business to a joint venture, the investor should record its joint venture investment at fair value in accordance with ASC 610-20, <i>Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets</i>. The US GAAP model is control-based; therefore, repurchase arrangements (e.g., call options, forward agreements, put options) may preclude derecognition because while physical possession (i.e., risks and rewards) has transferred, another party has the right to dictate the future ownership of the asset, which indicates that control has not transferred.</p> <p>When an investor contributes a subsidiary or group of assets that constitute a business to a joint venture, the investor should apply the deconsolidation and derecognition guidance in ASC 810-10-40 and record any consideration received for its contribution at fair value (including its interest in the joint venture). This generally results in a gain or loss on the contribution.</p>	<p>A venturer that contributes nonmonetary assets that do not represent a business—such as shares; property, plant, and equipment; or intangible assets—to a jointly controlled entity in exchange for an equity interest in the jointly controlled entity generally recognizes in its consolidated income statement the portion of the gain or loss attributable to the equity interests of the other unrelated venturers, except when:</p> <ul style="list-style-type: none"> <li>□ The significant risks and rewards of ownership of the contributed assets have not been transferred to the jointly controlled entity,</li> <li>□ The gain or loss on the assets contributed cannot be measured reliably, or</li> <li>□ The contribution transaction lacks commercial substance.</li> </ul> <p>When an investor contributes a business, a policy choice is currently available for full gain or loss recognition (IFRS 10 approach) or partial gain or loss recognition (IAS 28 approach). See note about ongoing standard setting below.</p> <p>IAS 28 provides an exception to the recognition of gains or losses only when the transaction lacks commercial substance.</p>

#### Note about ongoing standard setting

In September 2014, the IASB published amendments to IFRS 10 and IAS 28 to resolve the conflict between the requirements on accounting for this type of transaction. The published amendments clarify that a full gain or loss is recognized by the investor upon the contribution of a business, and a partial gain or loss is recognized upon the contribution of assets that do not meet the definition of a business. The amendments can be adopted immediately, but the IASB has deferred the mandatory effective date of the amendment indefinitely, pending finalization of its research project on the equity method.

## 12.10 Investments in tax credit structures

US GAAP permits reporting entities to make an accounting policy election to account for their investments in limited partnerships or limited liability companies that generate various tax credits using the proportional amortization method if certain conditions are met. Historically, this election was only available for investments in qualified affordable housing projects. However, ASU 2023-02, *Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*, issued in March 2023, expanded the use of the proportional amortization method of accounting to equity investments in other tax credit structures that meet certain criteria, such as renewable energy tax credit programs.

ASU 2023-02 is effective for public business entities for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2024, including interim periods within those fiscal years. Early adoption is permitted. IFRS Accounting Standards do not have such specific guidance.

US GAAP	IFRS Accounting Standards
<p>An investor that owns a passive investment in limited liability entities that manage or invest in projects that generate various tax credits and other tax benefits can use the proportional amortization method if certain conditions are met.</p> <p>Under the proportional amortization method, the initial cost of the investment, less any expected residual value, is amortized in proportion to the tax benefits received over the period that the investor expects to receive the tax credits and other benefits.</p> <p>Both the amortization expense determined under the proportional amortization method and the tax benefits received are recognized as a component of income taxes.</p> <p>Use of the proportional amortization method for investments that meet the requisite conditions is an accounting policy election made for each type of tax credit program. Once elected, the proportional amortization method should be applied to all qualifying investments in that type of tax credit program.</p> <p>If an investor does not meet the requisite conditions for use of the proportional amortization method (or has elected not to apply this method for a particular type of tax credit program), the investor will account for its equity interests using either the equity method or ASC 321, depending on the facts and circumstances, or ASC 310 if the investor has a loan.</p>	<p>IFRS Accounting Standards do not contain any guidance specific to accounting for investments in tax credit structures.</p>

**US GAAP****IFRS Accounting Standards**

Before adoption of ASU 2023-02, the use of the proportional amortization method of accounting is limited to investments in qualified affordable housing projects.

## **12.11 Disclosures — interests, risks, and restrictions**

US GAAP and IFRS Accounting Standards both require extensive disclosure about an entity's involvement in VIEs/structured entities, including those that are not consolidated. The below table includes highlights of the disclosures required for interests, risks, and restrictions under both frameworks. For more on these and other disclosures required under US GAAP, see FSP 10 and FSP 18.

**US GAAP****IFRS Accounting Standards**

Guidance applies to both nonpublic and public enterprises.

The principal objectives of VIE disclosures are to provide financial statement users with an understanding of the following:

- Significant judgments and assumptions made by an enterprise in determining whether it must consolidate a VIE and/or disclose information about its involvement in a VIE
- The nature of restrictions on a consolidated VIE's assets and on the settlement of its liabilities reported by an enterprise in its statement of financial position, including the carrying amounts of such assets and liabilities
- The nature of, and changes in, the risks associated with an enterprise's involvement with the VIE
- How an enterprise's involvement with the VIE affects the enterprise's financial position, financial performance, and cash flows

The level of disclosure to achieve these objectives may depend on the facts and circumstances surrounding the VIE and the enterprise's interest in that entity.

Additional detailed disclosure guidance is provided for meeting the objectives described above.

IFRS Accounting Standards have disclosure requirements for interests in subsidiaries, joint arrangements, associates, and unconsolidated structured entities which include the following:

- Significant judgments and assumptions in determining if an investor has control or joint control over another entity, and the type of joint arrangement
- The composition of the group and interests that noncontrolling interests have in the group's activities and cash flows
- The nature and extent of any significant restrictions on the ability of the investor to access or use assets, and settle liabilities
- The nature and extent of an investor's interest in unconsolidated structured entities
- The nature of, and changes in, the risks associated with an investor's interest in consolidated and unconsolidated structured entities
- The nature, extent, and financial effects of an investor's interests in joint arrangements and associates, and the nature of the risks associated with those interests
- The consequences of changes in ownership interest of a subsidiary that do not result in loss of control
- The consequences of a loss of control of a subsidiary during the period

**US GAAP**

Specific disclosures are required for (1) a primary beneficiary of a VIE and (2) an entity that holds a variable interest in a VIE (but is not the primary beneficiary).

**IFRS Accounting Standards**

An entity is required to consider the level of detail necessary to satisfy the disclosure objectives of enabling users to evaluate the nature and associated risks of its interests, and the effects of those interests on its financial statements.

Additional detailed disclosure guidance is provided for meeting the objectives described above.

If control of a subsidiary is lost, the parent shall disclose the gain or loss, if any, and:

- Portion of that gain or loss attributable to recognizing any investment retained in former subsidiary at its fair value at date when control is lost
- Line item(s) in the statement of comprehensive income in which the gain or loss is recognized (if not presented separately in the statement of comprehensive income)

Additional disclosures are required in instances when separate financial statements are prepared for a parent that elects not to prepare consolidated financial statements, or when a parent, venturer with an interest in a jointly controlled entity, or investor in an associate prepares separate financial statements.

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***Chapter 13:***  
***Business combinations—***  
***updated February 2022***

## 13.1 Business combinations

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

### Technical references

#### US GAAP

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

#### IFRS

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

## 13.2 Definition of a business

Determining whether the acquisition method applies to a transaction begins with understanding whether the transaction involves the acquisition of one or more businesses. The definition of a business affects whether an acquisition is within the scope of the business combination standards. While the definition of a business is largely converged, there are differences between the standards, including with regard to the screen (concentration) test and how an organized workforce is considered.

It is critical to determine whether an integrated set of activities and assets is a business because the accounting treatment for a business combination differs from the accounting for an asset acquisition under US GAAP and IFRS. See PPE 2.7 and PwC Manual of Accounting 29.247.3 for additional information on the accounting for asset acquisitions versus business combinations.

US GAAP	IFRS
The screen test is required under US GAAP. The screen test is designed to identify, with little cost or effort, a transaction that is clearly more akin to an asset acquisition and remove it from the scope of the business combinations guidance. If substantially all of the fair value of gross assets acquired is concentrated in a single identifiable asset (or a group of similar identifiable assets), the assets acquired would not represent a business. This provision provides gating criteria that, if met, eliminates the need for further assessment.	The IFRS equivalent to the mandatory US GAAP screen test (i.e., the concentration test) is optional under IFRS. An entity can choose to apply or bypass the concentration test on an acquisition by acquisition basis under IFRS.



US GAAP	IFRS
<p>A business includes, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. The framework to evaluate when an input and substantive process is present includes different criteria to consider depending on whether the set has outputs. The framework includes more stringent criteria for sets without outputs to be considered businesses. When a set does not have outputs, in order to demonstrate an input and substantive process that together significantly contribute to the ability to create outputs, the set will need to include (1) employees that form an organized workforce and (2) an input that the workforce could develop or convert into outputs.</p>	<p>In order to be a business, a set needs to have an input and a substantive process that together significantly contribute to the ability to create outputs. The framework to evaluate whether an input and a substantive process are present includes different criteria depending on whether the set has outputs or does not have outputs. When a set does not have outputs, the set will need to include (1) an organized workforce and (2) an input that the workforce could develop or convert into outputs. However, under IFRS an organized workforce can be comprised of an acquired outsourcing contract while US GAAP only considers an organized workforce that is comprised of employees.</p>
<p>The definition of outputs is consistent with ASC 606, <i>Revenue from Contracts with Customers</i> (i.e., the ability to generate goods or services provided to customers). Outputs are the result of inputs and processes applied to those inputs that provide goods or services to customers, other revenue, or investment income (e.g., dividends, interest).</p>	<ul style="list-style-type: none"> <li>□ In addition, difficulty replacing an organized workforce is an indicator that the workforce performed a substantive process. This clarification is not made under US GAAP.</li> <li>□ The definition of “outputs” is consistent with the description of outputs in IFRS 15, <i>Revenue from Contracts with Customers</i> (i.e., the result of inputs and processes applied to those inputs that provide goods or services to customers). In addition, because not all businesses have revenue within the scope of IFRS 15, the definition of outputs also includes outputs that generate investment income (such as dividends or interest) or generate other income from ordinary activities.</li> </ul>
<p>Under US GAAP, the presence of more than an insignificant amount of goodwill may be an indicator that a substantive process has been acquired. However, the presence of economic goodwill is not determinative as to whether the acquired activities constitute a business.</p>	<ul style="list-style-type: none"> <li>□ The presence of more than an insignificant amount of goodwill is not considered an indicator of a substantive process under IFRS.</li> </ul>

### 13.3 Definition of control

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

US GAAP	IFRS
Consolidation decisions are evaluated first under the variable interest entity model.	An investor has control over an investee when all of the following elements are present:
<ul style="list-style-type: none"> <li>□ Qualitatively assess if the variable interest meets both criteria: <ul style="list-style-type: none"> <li>○ Power to direct activities that most significantly impact economic performance</li> <li>○ Potential to receive significant benefits or absorb significant losses</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>□ Power over the investee</li> <li>□ Exposure, or rights, to variable returns from its involvement with the investee</li> <li>□ Ability to use power to affect the returns</li> </ul>
All other entities are evaluated under the voting interest model.	See SD 12 for further information on the concept of control and the consolidation model under IFRS.
See SD 12 for further information on the concept of control and the consolidation model under US GAAP.	

### 13.4 Acquired contingencies (post-IFRS 3 narrow scope amendment)

There are significant differences related to the recognition of contingent liabilities and contingent assets. The IASB issued *Reference to the Conceptual Framework* in May 2020, which amended IFRS 3, including creating additional exceptions to the general recognition principle under IFRS. The amendments apply to business combinations in years beginning on or after January 1, 2022. Earlier application is permitted.

US GAAP	IFRS
Acquired assets and liabilities subject to contingencies are recognized at fair value if fair value can be determined as of the acquisition date or during the measurement period. If fair value cannot be determined, the acquirer should recognize the estimated amount of the asset or liability as part of the acquisition accounting if both of the following criteria are met: (1) it is probable that an asset existed or a liability had been incurred at the acquisition date based on information available prior to the end of the measurement period, and (2) the amount of asset or liability can be reasonably estimated.	Liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 if they were incurred separately rather than assumed in a business combination, should apply IFRS 3.21B. For a provision or contingent liability that would be within the scope of IAS 37, the acquirer should apply IAS 37.15 through IAS 37.22 to determine whether, at the acquisition date, a present obligation exists as a result of past events. For a levy that would be within the scope of IFRIC 21, the acquirer should apply IFRIC 21 to determine whether the obligating event that gives rise to a liability to pay the levy has occurred by the acquisition date.
If recognized at fair value on acquisition, an acquirer should develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature. If the acquirer recognized an asset or liability under ASC 450 on the acquisition date, the acquirer should continue to follow the guidance in ASC 450 in subsequent periods. If the acquirer did not recognize an asset or liability at the	A contingent liability is recognized in a business combination if it meets the definition of a liability and if it can be measured reliably. A contingent liability that is a present obligation arising from past events is recognized whether or not it is probable that an outflow of economic benefits will take place, but only if it can be measured reliably. An entity would not normally assume a significant contingent liability in a

US GAAP	IFRS
acquisition date because none of the recognition criteria were met, the acquirer should account for such assets or liabilities in subsequent periods in accordance with other GAAP, including ASC 450, as appropriate.	business combination without an assessment of the likelihood and magnitude of any potential outflow. Thus, entities are usually able to determine fair value with sufficient reliability.  The contingent liability is measured subsequently at the higher of (1) the amount initially recognized less, if appropriate, cumulative amortization recognized under the revenue guidance (IFRS 15), or (2) the best estimate of the amount required to settle the present obligation at the end of the reporting period under the provisions guidance (IAS 37).  Contingent assets are not recognized.

### 13.4A Acquired contingencies (pre-IFRS 3 narrow scope amendment)

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

US GAAP	IFRS
<p>Acquired assets and liabilities subject to contingencies are recognized at fair value if fair value can be determined as of the acquisition date or during the measurement period. If fair value cannot be determined, the acquirer should recognize the estimated amount of the asset or liability as part of the acquisition accounting if both of the following criteria are met: (1) it is probable that an asset existed or a liability had been incurred at the acquisition date based on information available prior to the end of the measurement period, and (2) the amount of asset or liability can be reasonably estimated.</p> <p>If recognized at fair value on acquisition, an acquirer should develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature. If the acquirer recognized an asset or liability under ASC 450 on the acquisition date, the acquirer should continue to follow the guidance in ASC 450 in subsequent periods. If the acquirer did not recognize an asset or liability at the acquisition date because none of the recognition criteria were met, the acquirer should account for such assets or liabilities in subsequent periods in accordance with other GAAP, including ASC 450, as appropriate.</p>	<p>A contingent liability is recognized in a business combination if it meets the definition of a liability and can be measured reliably. A contingent liability that is a present obligation arising from past events is recognized whether or not it is probable that an outflow of economic benefits will take place, but only if it can be measured reliably. An entity would not normally assume a significant contingent liability in a business combination without an assessment of the likelihood and magnitude of any potential outflow. Thus, entities are usually able to determine fair value with sufficient reliability.</p> <p>The contingent liability is measured subsequently at the higher of (1) the amount initially recognized less, if appropriate, cumulative amortization recognized under the revenue guidance (IFRS 15), or (2) the best estimate of the amount required to settle the present obligation at the end of the reporting period under the provisions guidance (IAS 37).</p> <p>Contingent assets are not recognized.</p>

## 13.5 Assignment and impairment of goodwill (post-ASU 2017-04)

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

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

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

The revised guidance was effective for public business entities that are SEC filers, excluding entities eligible to be smaller reporting companies as defined by the SEC, for annual and interim goodwill impairment tests in fiscal years that began after December 15, 2019. All other entities that have not elected the goodwill alternative will be required to apply the guidance in fiscal years beginning after December 15, 2022. Early adoption is permitted and must be applied to all goodwill impairment tests within that fiscal year. See BCG 9.1 for detailed guidance on effective dates.

US GAAP	IFRS
Goodwill is assigned to an entity's reporting units, defined as the same as, or one level below, an operating segment. The determination of reporting units is based on a segment reporting structure.	Goodwill is allocated to a cash-generating unit (CGU) or group of CGUs (not larger than an operating segment) based on how goodwill is monitored for internal management purposes. A CGU is the smallest identifiable group of assets that generates cash inflows largely independently of other assets or groups of assets.
Goodwill is tested for impairment at least on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount in accordance with ASC 350-20-35-30.	Goodwill is tested for impairment at least on an annual basis and between annual tests at the end of each reporting period if an event occurs or circumstances change that may indicate an impairment in accordance with IAS 36.9.
When performing the goodwill impairment test, an entity may first assess qualitative factors to determine whether the quantitative goodwill impairment test is necessary. If the entity determines, based on the qualitative assessment, that it is more likely than not that the fair value of a reporting unit is below its carrying amount, the impairment test is performed. An entity can bypass the qualitative assessment for any reporting unit in any period and proceed directly to the quantitative assessment.	Goodwill impairment testing is performed using a one-step approach:  The recoverable amount of the CGU or group of CGUs (i.e., the higher of its fair value less costs of disposal and its value in use) is compared with its carrying amount.  Any impairment loss is recognized as the excess of the carrying amount over the recoverable amount.

US GAAP	IFRS
<p>Upon adoption of ASU 2017-04, Step 2 of the goodwill impairment test is removed. As a result, goodwill impairment is the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill.</p> <p>The same one-step impairment test is applied to goodwill at all reporting units, even those with zero or negative carrying amounts. Entities are required to disclose the amount of goodwill at reporting units with zero or negative carrying amounts.</p> <p>Private companies/NFP entities have the option to amortize goodwill on a straight-line basis over a period of up to ten years, and apply a trigger-based, single-step impairment test at either the entity level or the reporting unit level at the company's election.</p>	<p>When testing a CGU to which goodwill has been allocated for impairment, there may be an impairment indicator related to an asset within the unit containing the goodwill. In such circumstances, the entity tests the asset for impairment first and recognizes any impairment loss for that asset, before testing the CGU containing the goodwill for impairment. Then, if there is an impairment loss on the CGU, the impairment loss is allocated first to goodwill and then on a pro rata basis to the other assets of the CGU or group of CGUs to the extent that the impairment loss exceeds the carrying value of goodwill.</p>

### **13.5A Assignment and impairment of goodwill (pre-ASU 2017-04)**

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

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

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

The revised guidance was effective for public business entities that are SEC filers, excluding entities eligible to be smaller reporting companies as defined by the SEC, for annual and interim goodwill impairment tests in fiscal years that began after December 15, 2019. All other entities that have not elected the goodwill alternative will be required to apply the guidance in fiscal years beginning after December 15, 2022. Early adoption is permitted and must be applied to all goodwill impairment tests within that fiscal year. See BCG 9.1 for detailed guidance on effective dates.

US GAAP	IFRS
<p>Goodwill is assigned to an entity's reporting units, defined as the same as, or one level below, an operating segment. The determination of reporting units is based on a segment reporting structure.</p>	<p>Goodwill is allocated to a cash-generating unit (CGU) or group of CGUs (not larger than an operating segment) based on how goodwill is monitored for internal management purposes. A CGU is the smallest identifiable group of assets</p>

**US GAAP**

Goodwill is tested for impairment at least on an annual basis and between annual tests if an event occurs or circumstances change that may indicate an impairment.

When performing the goodwill impairment test, an entity may first assess qualitative factors to determine whether the quantitative goodwill impairment test is necessary. If the entity determines, based on the qualitative assessment, that it is more likely than not that the fair value of a reporting unit is below its carrying amount, the impairment test is performed. An entity can bypass the qualitative assessment for any reporting unit in any period and proceed directly to the quantitative assessment.

Prior to adoption of ASU 2017-04, goodwill is tested for impairment using a two-step test:

- In Step 1, the fair value and the carrying amount of the reporting unit, including goodwill, are compared. If the fair value of the reporting unit is less than the carrying amount, Step 2 is completed to determine the amount of the goodwill impairment loss, if any.
- Goodwill impairment is measured as the excess of the carrying amount of goodwill over its implied fair value. The implied fair value of goodwill—calculated in the same manner that goodwill is determined in a business combination—is the difference between the fair value of the reporting unit and the fair value of the various assets and liabilities included in the reporting unit.

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

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

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

**IFRS**

that generates cash inflows largely independently of other assets or groups of assets.

Goodwill is tested for impairment at least on an annual basis and between annual tests if an event occurs or circumstances change that may indicate an impairment.

Goodwill impairment testing is performed using a one-step approach:

The recoverable amount of the CGU or group of CGUs (i.e., the higher of its fair value less costs of disposal and its value in use) is compared with its carrying amount.

Any impairment loss is recognized as the excess of the carrying amount over the recoverable amount.

When testing a CGU to which goodwill has been allocated for impairment, there may be an impairment indicator related to an asset within the unit containing the goodwill. In such circumstances, the entity tests the asset for impairment first and recognizes any impairment loss for that asset, before testing the CGU containing the goodwill for impairment. Then, if there is an impairment loss on the CGU, the impairment loss is allocated first to goodwill and then on a pro rata basis to the other assets of the CGU or group of CGUs to the extent that the impairment loss exceeds the carrying value of goodwill.



## 13.6 *Contingent consideration of an acquiree*

A preexisting contingent consideration arrangement of the acquiree assumed by the acquirer in a business combination should be initially measured and recognized at fair value. However, diversity in practice exists as there is no specific guidance under US GAAP or IFRS addressing the treatment of contingent consideration of an acquiree (i.e., as either contingent consideration that is part of the of the consideration transferred or as an assumed liability that is not part of the consideration transferred).

US GAAP	IFRS
After initial recognition of the contingent consideration of an acquiree, some believe the assumed contingent consideration should be treated as an assumed liability. A preexisting contingent consideration arrangement of the acquiree may be considered an assumed liability because it is payable to a third party rather than the seller in the business combination. Others believe the contingent consideration should be accounted for as part of the consideration transferred (as would be the case, for example, in a contingent consideration arrangement agreed upon between the acquirer and acquiree).	Under IFRS, we believe contingent consideration of an acquiree should be accounted for as an assumed liability. Preexisting contingent consideration does not meet the definition of contingent consideration in the acquirer's business combination because it is not paid to the sellers of the acquired business. It is an identifiable liability assumed in the subsequent acquisition.

## 13.7 *Contingent consideration—seller accounting*

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

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

## 13.8 *Noncontrolling interests*

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

US GAAP	IFRS
Noncontrolling interests are measured at fair value.	<p>Entities have an option, on a transaction-by-transaction basis, to measure noncontrolling interests at fair value or the noncontrolling interests' proportion of the fair value of the identifiable net assets (i.e., excluding goodwill). This option applies only to instruments that represent present ownership interests and entitle their holders to a proportionate share of the net assets in the event of liquidation. All other components of noncontrolling interest are measured at fair value unless another measurement basis is required by IFRS.</p> <p>The use of the fair value option results in full goodwill being recorded on both the controlling and noncontrolling interest, consistent with US GAAP.</p>

## 13.9 Combinations involving entities under common control

Under US GAAP, there are specific rules for common control transactions. Under IFRS, there is no specific guidance as combinations involving entities or businesses under common control are excluded from the scope of IFRS 3.

### *Note about ongoing standard setting*

The IASB has an active project on the topic of business combinations under common control. Several issues were raised with the IFRS IC, and subsequently the IASB decided to address the topic as part of a wider project starting with the issuance of a discussion paper in November 2020, *Business Combinations under Common Control*. The comment period ended September 1, 2021, and the IASB started to discuss feedback received at its December 2021 meeting. Financial statement preparers and other users of this publication are therefore encouraged to monitor the status of the project. Once finalized, financial statement preparers and users should evaluate the effective date of the new guidance and the implications on presentation and disclosure.

US GAAP	IFRS
<p>Combinations of entities under common control are generally recorded at predecessor cost, reflecting the ultimate parent's carrying amount of the assets and liabilities transferred.</p> <p>When an entity receives a business from an entity under common control, the transaction is reflected retrospectively.</p>	<p>IFRS does not specifically address the accounting for a business combination under common control. In practice, entities develop and consistently apply an accounting policy. Entities generally apply the predecessor value method; however, entities can make an accounting policy election to apply acquisition accounting in certain circumstances. The accounting policy can be changed only when criteria for a change in an accounting policy are met in the applicable guidance in IAS 8 (i.e., it provides more reliable and more relevant information). Entities will also need to elect an</p>



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accounting policy to record businesses obtained through common control transactions on either a retrospective or prospective basis.

In addition, the controlling party might not prepare consolidated financial statements. In such situations, the book values used are generally those from the highest set of consolidated financial statements available. If no consolidated financial statements are produced, the values used would be those from the financial statements of the acquired entity.

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## 13.10 Identifying the acquirer

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

Impacted entities should refer to SD 12 for a more detailed discussion of differences related to the consolidation models between the frameworks that might create significant differences in this area.

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

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## 13.11 Pushdown accounting

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

US GAAP	IFRS
Reporting entities have the option to apply pushdown accounting in their separate financial statements upon a change-in-control event. The election is available to the acquired company, as well as to any direct or indirect subsidiaries of the acquired company.  If an acquired company elects to apply pushdown accounting, the acquired company should reflect the new basis of accounting established by the parent for the individual assets and liabilities of the acquired company arising from the acquisition in its standalone financial statements.	There is no discussion of pushdown accounting under IFRS. There may be situations in which transactions, such as capital reorganizations, common control transactions, etc., may result in an accounting outcome that is similar to pushdown accounting where the new basis of accounting established by the parent, including goodwill and fair value differences on acquisition is reflected in the company's standalone financial statements.

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**US GAAP****IFRS**

Goodwill should be calculated and recognized consistent with business combination accounting. Bargain purchase gains, however, should not be recognized in the income statement of the acquired company that applies pushdown accounting. Instead, they should be recognized in additional paid-in capital within equity.

Debt (including acquisition related debt) and any other liabilities of the acquirer should be recognized by the acquired company only if they represent an obligation of the acquired company pursuant to other applicable guidance in US GAAP.

## **13.12 Measurement period adjustments**

Differences exist related to how measurement period adjustments are recorded in US GAAP and IFRS. Measurement period adjustments are recorded in the period of the adjustment under US GAAP, but such adjustments are recognized retrospectively under IFRS.

**US GAAP****IFRS**

An acquirer has up to one year from the acquisition date (referred to as the measurement period) to finalize the accounting for a business combination. If during the measurement period, the measurements are not finalized as of the end of a reporting period, the acquirer should record the cumulative impact of measurement period adjustments made to provisional amounts in the period that the adjustment is determined.

However, the acquirer should present separately on the face of the income statement or disclose in the notes the portion of the adjustment to each income statement line items that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date.

An acquirer has up to one year from the acquisition date (referred to as the measurement period) to finalize the accounting for a business combination. An acquirer should retrospectively record measurement period adjustments made to provisional amounts as if the accounting was completed at the acquisition date. The acquirer should revise comparative information for prior periods presented in the financial statements as needed, including making any change in depreciation, amortization, or other income effects recognized in completing the initial accounting.

## **13.13 Employee benefit arrangements and income taxes**

Accounting for share-based payments and income taxes in accordance with separate standards not at fair value might result in different results being recorded as part of acquisition accounting based on underlying differences between US GAAP and IFRS in these areas.

## 13.14 *Payables and debt assumed in a business combination*

An acquiree's payables and debt assumed by the acquirer are recognized at fair value in a business combination. An acquirer may settle (i.e., pay-off) some or all of the outstanding debt of the acquiree on, or in close proximity to, the date of the business combination. In these situations, it is important to determine whether the cash paid to settle the acquiree's debt should be recognized (1) as a component of the consideration transferred or (2) as the acquirer's settlement of an assumed liability of the acquiree post-acquisition. Under IFRS, it is also important to determine if the cash is paid to the seller in exchange for control of the acquiree.

US GAAP	IFRS
Cash paid by the acquirer to settle the acquiree's outstanding debt on, or in close proximity to, the date of the business combination is generally recognized as a component of the consideration transferred if the acquirer does not legally assume the outstanding debt. In this scenario, an assumed liability for the outstanding debt of the acquiree would not be recognized in acquisition accounting. However, if the acquirer legally assumes the acquiree's outstanding debt through the business combination, an assumed liability should be recognized at fair value on the acquisition date. Any subsequent repayment of the debt is a separate transaction from the business combination and would not be a component of consideration transferred.	The acquirer might transfer cash to the acquiree in order to repay third-party debt on the business combination. Alternatively, the acquirer might pay the bank directly. Because this is a cash cost to the acquirer, it might be viewed commercially by the acquirer as part of the consideration for the business combination. However, since this is not part of the consideration transferred to the seller in exchange for control of the acquiree, it cannot be treated as part of the consideration for the business combination from an IFRS 3 perspective.

## 13.15 *Remeasurement of previously held equity interest*

Differences exist between US GAAP and IFRS related to the recognition of any difference between the fair value and the carrying value of the previously held equity interest. Under US GAAP, the acquirer remeasures the previously held equity interest to fair value and recognizes any difference between the fair value and carrying value, if any, as a gain or loss in income. Under IFRS, the acquirer remeasures the previously held equity to fair value at the acquisition date, and a gain or loss is recognized in profit or loss, or other comprehensive income, as appropriate.

US GAAP	IFRS
The acquirer's previously held equity interest is remeasured to fair value at the date the controlling interest is acquired. Any difference in the previously held equity interest is recognized as a gain or loss in the income statement in accordance with ASC 805-10-25-10.	The acquirer's previously held equity interest is remeasured to fair value at the acquisition date, and a gain or loss is recognized in profit or loss, or other comprehensive income, as appropriate (depending on whether the previously held equity interest was measured at fair value through profit or loss or fair value through other comprehensive income).

### 13.16 *Lease classification when an acquiree is a lessee (ASC 842)*

Differences exist in lease classification when an acquiree is the lessee under US GAAP and IFRS. Under US GAAP, the acquirer is required to retain the lease classification of the acquiree (unless the lease is modified), regardless of whether the acquiree is the lessee or the lessor. Under IFRS, the acquirer is required to retain the lease classification of the acquiree if the acquiree is the lessor. However, there is no explicit guidance to retain the lease classification when the acquiree is the lessee.

US GAAP	IFRS
ASC 842-10-55-11 requires the acquirer to retain the acquiree's previous lease classification (unless the lease is modified), regardless of whether the acquiree is the lessee or lessor in the lease arrangement.	The classification of the contract in which the acquiree is a lessor as a finance or an operating lease under IFRS 16 does not change in a business combination. That is, the acquirer is required to retain the lease classification of the acquiree if the acquiree is the lessor. However, there is no explicit guidance to retain the lease classification when the acquiree is the lessee.

### 13.17 *Acquiree is a lessor in an operating lease (ASC 842)*

Differences exist when an acquiree is the lessor in an operating lease under US GAAP and IFRS. Under US GAAP, a separate intangible asset is recorded for the favorable/unfavorable terms relative to market terms. Under IFRS, such favorable/unfavorable terms are included in the estimated fair value of the asset subject to lease, and no separate intangible asset is recorded.

US GAAP	IFRS
When the acquiree is the lessor in an operating lease, the leased asset should be measured and recognized at fair value unencumbered by the related lease. The acquirer recognizes an intangible asset if the terms of an operating lease are favorable relative to market terms and a liability if the terms are unfavorable relative to market terms.	When the acquiree is the lessor in an operating lease, the acquirer takes into account any favorable/unfavorable terms of the lease in measuring the acquisition-date fair value of the leased asset. That is, the acquirer does not recognize a separate intangible asset or liability if the terms of an operating lease are favorable/unfavorable when compared with market terms.

### 13.18 *Acquired contract assets and contract liabilities (after adoption of ASU 2021-08)*

Currently, ASC 805 and IFRS 3 state that the assets acquired and liabilities assumed in a business combination generally should be recognized and measured at fair value on the acquisition date. ASU No. 2021-08, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*, creates a difference between US GAAP and IFRS, as under US GAAP, contract assets and contract liabilities acquired in a business combination will now be recognized and measured in accordance with ASC 606, largely based on their contractual terms as if the acquirer entered into the original contract on the same date with the same terms.

ASU 2021-08 is effective for public business entities for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. For all other entities, the new guidance is effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. Entities should apply the guidance in ASU 2021-08 on a prospective basis to all business combinations with an acquisition date on or after the effective date. Early adoption is permitted, including in an interim period, for any period for which financial statements have not yet been issued.

US GAAP	IFRS
<p>ASU 2021-08 requires contract assets and contract liabilities acquired in a business combination to be recognized and measured in accordance with ASC 606, the revenue standard. The new guidance creates an exception to the general recognition and measurement principles of ASC 805.</p>	<p>Contract assets and liabilities acquired in a business combination are recognized and measured by the acquirer at their acquisition date fair values, which may be different from the amounts that the acquiree had previously recognized under IFRS 15. For contract assets and contract liabilities acquired in a business combination, there is no exception to the general recognition and measurement principles of IFRS 3.</p>

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***Chapter 14:***  
***Leases—updated October***  
***2019***

## 14.1 Leases (ASC 842 and IFRS 16)

The FASB and IASB issued their respective standards in the first quarter of 2016. The issuance of the standards are the culmination of multiple years of deliberating a leasing model with the primary objective of bringing almost all leases onto the balance sheet for lessees. The leases standard was initially intended to be a converged standard; however, the Boards ultimately diverged and as a result there are some differences between the two new standards.

The FASB discussed numerous lease-related questions since issuing ASC 842, and issued five Accounting Standards Updates during 2018 and 2019 relating to: the accounting for easements, certain technical corrections, targeted improvements to the transition provisions, a lessor's separation of lease and nonlease components, and practical expedients related to the lessor's accounting for certain taxes and lessor costs paid directly by the lessee.

Summarized below is an overview of the respective leases models highlighting the key differences between the standards.

### 14.1.1 Embedded leases and scope of the leasing guidance (ASC 842/IFRS 16)

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

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

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

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

However, there are additional differences in scope between ASC 842 and IFRS 16.

US GAAP	IFRS
ASC 842 has a scope exception that excludes all types of intangible assets, leases of inventory, and leases of assets under construction from its scope.	Under IFRS 16, a lessee may, but is not required to, apply lease accounting to leases of intangible assets other than rights held under licensing agreements within the scope of IAS 38, <i>Intangible Assets</i> . Under IFRS 16, a lessor is

US GAAP	IFRS
	required to apply lease accounting to leases of intangible assets other than licenses of intellectual property within the scope of IFRS 15.
A lessee can make a policy election by class of underlying asset for leases that are short term in nature (i.e., a lease without a purchase option, and with a lease term of 12 months or less). A “short-term” lease that includes extension options may still qualify as a short-term lease, provided the lease term, as defined, is no longer than 12 months. Upon exercise of an extension that was not included in the determination of the original lease term, a lease may still qualify for the short-term lease exemption if the lease term is no longer than 12 months from the expiration of the original lease term.	Similar to US GAAP, however, upon exercise of an extension not included in the determination of the original lease term, a lease would qualify for the short-term lease exemption only if the remaining lease term is no longer than 12 months at the date of the extension of the lease (i.e., when the lessee notifies the lessor of its decision to extend).
Entities may be able to establish reasonable capitalization thresholds below which assets and liabilities related to a lease are not recognized, similar to accounting policies in other areas of US GAAP.	IFRS 16 provides an additional policy election for lessees, on a lease-by-lease basis, to exclude leases of low-value assets from the initial recognition requirements. IFRS 16 does not define the term “low value,” but the Basis for Conclusions explains that the Board had in mind assets of a value of USD 5,000 or less when new.

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

#### **14.1.2 Separating components and combining contracts (ASC 842/IFRS 16)**

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

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

Once the separate lease and nonlease components have been identified, the consideration in the contract should be allocated to the separate components. The contract consideration is allocated based on relative standalone prices for lessees. Lessors base the allocation on the ASC 606 and IFRS 15 allocation methodologies.

Both ASC 842 and IFRS 16 provide an accounting policy election under which a lessee is not required to separate nonlease components from the lease components and can account for each lease



component and any associated nonlease components as a single lease component. This policy election is made by class of underlying asset.

US GAAP	IFRS
Under ASC 842, a lessee or lessor accounts for the right to use land as a separate lease component from the right to use a building unless the accounting effect of doing so would be insignificant.	For a lease of land and building under IFRS, a lessor is required to assess the land separate from the building unless the land element is immaterial to the lease. If lease payments cannot be allocated reliably between land and building, the lease is classified as a finance lease unless it is clear that both elements are operating leases. (Note that this would not apply to lessees as lessees do not classify leases.)
Lessors can elect, by class of asset, to not separate nonlease components from associated lease components under qualifying circumstances. If elected, the lessor would account for the combined component as either an operating lease under ASC 842, or under the guidance for the nonlease component (e.g., as revenue under ASC 606) depending on which is the predominant component.	Under IFRS 16, lessors are required to separate lease and nonlease components. Unlike US GAAP, there is no election available.
Under ASC 842, both lessors and lessees have explicit guidance on allocating consideration between lease and nonlease components. Specifically, both fixed and variable lease payments are allocated between all components based on their relative standalone values (absent appropriately applying applicable practical expedients to combine lease and nonlease components). Lessees and lessors would also allocate consideration that arise from optional subsequent purchases of nonlease components under an arrangement or combined contracts.	IFRS 16 also requires lessors and lessees to allocate consideration based on relative standalone prices. However, IFRS is not as prescriptive as US GAAP as it relates to whether both fixed and variable payments are each allocated to all components within the arrangements. For example, if an arrangement contains fixed payments that are equal to the standalone rents for the lease component, and variable payments that are equal the standalone price of a nonlease service component (e.g., maintenance of the leased asset), a lessee could elect to assign all the fixed payments to the lease, and all the variable payments to the nonlease maintenance service.

### 14.1.3 Lessee accounting – Classification (ASC 842 and IFRS 16)

US GAAP	IFRS
Under ASC 842, a lessee can have either a finance or operating lease. If any of the following classification criteria are met, the lease is a finance lease.	In contrast, under IFRS 16, lessees have only one lease classification, which is similar to the finance lease classification under US GAAP.
<ul style="list-style-type: none"> <li>□ The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.</li> </ul>	

US GAAP	IFRS
<ul style="list-style-type: none"> <li>□ The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.</li> <li>□ The lease term is for the major part of the remaining economic life of the underlying asset. However, if the commencement date falls at or near the end of the economic life of the underlying asset, this criterion will not be used for lease classification purposes.</li> <li>□ The present value of the sum of lease payments and any residual value guaranteed by the lessee that is not already reflected in lease payments equals or exceeds substantially all of the fair value of the underlying asset.</li> <li>□ The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.</li> </ul>	

#### 14.1.3.1 Lessee accounting – Balance sheet (ASC 842 and IFRS 16)

Under both standards, lessees record, regardless of the lease classification, a right-of-use asset and lease liability at the lease commencement date. The initial right-of-use asset and lease liability is measured based on the present value of the lease payments (as defined in the standards) using the interest rate implicit in the lease (unless the rate cannot be readily determined, in which case the incremental borrowing rate of the lessee will be used).

However, differences in application exist, as described below.

US GAAP	IFRS
To determine the incremental borrowing rate, US GAAP requires the use of a collateralized rate for an amount equal to the lease payments.	<p>IFRS requires use of a borrowing rate with a similar security to borrow a similar value to the right-of-use asset. The rate should reflect the amount that the entity could borrow to acquire an asset of similar value to the right-of-use asset, rather than to acquire the entire underlying asset. Thus, the incremental borrowing rate under IFRS 16 would be more considerate of a company's typical borrowing practices (e.g., loan to value considerations).</p> <p>Under IFRS, if an entity has elected to apply the fair value model under IAS 40, the lessee would also apply that model to subsequently measure the right-of-use assets that meet the definition of investment property. Additionally, if the right-of-use assets relate to a class of property, plant, and equipment measured using the revaluation model under IAS 16, that class of right-of-use asset may also be measured using the revaluation model, if elected.</p>

### 14.1.3.2 Lessee accounting – Income statement (ASC 842 and IFRS 16)

Under both US GAAP and IFRS, the income statement recognition for finance leases of lessees consists of the amortization of the right-of-use asset and interest expense related to the lease liability. However, there are differences between IFRS and US GAAP for operating leases.

US GAAP	IFRS
Under ASC 842, for operating leases, the amortization of the right-of-use asset and interest expense related to the lease liability are recorded together as lease expense to produce a straight-line recognition effect in the income statement.	Under IFRS 16, lessees account for all leases like finance leases in ASC 842.  Under IFRS, if an entity has elected to apply the fair value model under IAS 40, the lessee would also apply that model to subsequently measure the right-of-use assets that meet the definition of investment property. The change in fair value will be recognized in the income statement.

### 14.1.4 Lessor accounting – Classification (ASC 842 and IFRS 16)

The criteria used for lessor classification of leases are substantially the same between IFRS and US GAAP. However, detailed differences in application exist.

US GAAP	IFRS
Under ASC 842, a lease is classified as a finance lease if it meets any one of the lease classification criteria.	IFRS 16 refers to the criteria used for lessor classification as “examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease.”
Under ASC 842, a lessor cannot recognize a sales-type lease when collectibility of the lease payments is not probable.	IFRS 16 does not require the collection of the lease payments to be probable for a lease to be classified as a finance lease.
The classification of a lease is performed at lease commencement under ASC 842.	The classification of a lease is performed at the lease inception date under IFRS 16.
Lessors should apply the sales-type lease classification guidance, even for transactions that contain relatively little fixed consideration. Because a lessor cannot include many variable payments in the measurement of its net investment in a lease, such sales-type leases may result in a lessor recognizing a “Day 1” loss (because lessors would derecognize the entire “sold” asset, but would not recognize a receivable for most variable payments).	Under IFRS 16, variable lease payments could mean that the lessor does not transfer the risks and rewards of ownership. As a result, such leases may be classified as operating leases, and the asset would not be derecognized, unlike US GAAP.
Under US GAAP, the specialized accounting for leveraged leases in ASC 840 was not carried forward to ASC 842. There is, however, transition relief in ASC 842 to continue to account for leveraged leases entered into before adoption of ASC 842.	There are no leveraged leases under IFRS 16. The leveraged lease concept did not exist under IAS 17, so there is no transition relief.

**14.1.4.1 Lessor accounting – Balance sheet (ASC 842 and IFRS 16)**

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

**14.1.4.2 Lessor accounting – Income statement (ASC 842 and IFRS 16)**

Income from operating leases is typically recognized on a straight-line basis under both standards. For finance leases, interest income is recognized on the net investment in the lease. The most significant difference between the standards relates to profit recognition for a finance lease, and impairment models for the net investment in a lease.

US GAAP	IFRS
To recognize profit at the commencement date of a finance lease, ASC 842 requires the lessor to transfer control of the asset to the lessee (a third-party provided residual value guarantee is not a factor in this determination).	Transfer of control is not a requirement under IFRS 16 to recognize profit under a finance lease for manufacturer and dealer lessors.
ASC 842 contains explicit guidance regarding the collectibility of lease payments. If collectibility is not deemed probable at lease commencement, a lessor would not recognize a sales-type lease, and would not recognize lease income in excess of its cash receipts.	IFRS 16 does not contain guidance around the collectibility of lease payments.
Impairment of a net investment in a lease, including any unguaranteed residual value, is governed by the applicable credit loss standards (ASC 310 or ASC 326).	Impairment of a net investment in a lease, excluding any unguaranteed residual value, is governed by the credit loss guidance in IFRS 9. Lessors review unguaranteed residual values under the explicit guidance in IFRS 16. In case of a reduction in the value, the income allocation over the lease term is revised and any reduction with respect to amounts already accrued would be recognized immediately.

**14.1.5 Lease re-assessments and modifications (ASC 842 and IFRS 16)**

The guidance for lease re-assessments and modifications is similar under both standards, except for changes in an index or rate.

US GAAP	IFRS
Under ASC 842, a change in the lease payments that occurs as a result of a change in an index or rate is not a reassessment and remeasurement event.	Under IFRS, a change in the lease payments that occurs as a result of a change in an index or rate triggers a reassessment and remeasurement of the lease.

US GAAP	IFRS
When a modification decreases the scope of a lease other than to shorten the lease (e.g., reduces the amount of space leased), both standards require the lessee to remeasure the lease liability, adjust the right-of-use asset, and recognize a gain or loss. When calculating the gain or loss under ASC 842, the lessee may adjust the right-of-use asset by either the reduction in the right of use, or by the percentage change in the premodification lease liability.	Under IFRS, when a modification decreases the scope of a lease, the lessee adjusts the right-of-use asset by the reduction in the right of use to calculate the gain or loss.
A lessee recognizes the change in lease liability resulting from a modification that shortens the lease term (other than through the exercise of a pre-existing contractual option) as a corresponding change in the right-of-use asset, and records a gain or loss when the right-of-use asset is reduced to zero.	A lessee accounts for a modification that shortens the lease term in the same manner as any other modification that decreases the scope of a lease, i.e., it calculates and recognizes a gain or loss.

#### 14.1.6 *Sublease transactions (ASC 842 and IFRS 16)*

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

#### 14.1.7 *Sale and leaseback transactions (ASC 842 and IFRS 16)*

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

In a sale-lease back transaction, the seller-lessee follows sale-lease back accounting when the sale criteria in ASC 606 (for US GAAP) or IFRS 15 (for IFRS) are met.

If a sale is recognized, the transaction is measured based on the fair value of the asset transferred. Any proceeds from the sale that are either above or below the fair value of the asset will be treated as a financing or prepaid rent. The asset is removed from the balance sheet and replaced with a right-of-use asset and lease liability. If a sale is not recognized, the arrangement is treated as a financing. However, certain detailed differences in application exist.

US GAAP	IFRS
Under ASC 842, the seller-lessee's gain recognized at the sale date will be measured as the difference between the adjusted sale proceeds (total proceeds less any financing component) and the book value of the asset transferred. The right of use asset arising from the leaseback is measured under the normal ASC 842 principles.	Under IFRS 16, the gain (or loss) is limited to the proportion of the total gain (or loss) that relates to the rights transferred to the buyer-lessee. The right-of-use asset arising from the leaseback is measured as the proportion of the previous carrying amount of the asset that relates to the right of use retained.
ASC 842 contains guidance for build-to-suit accounting for the lessee. The criteria focus on control during the construction period.	IFRS 16 does not contain guidance for build-to-suit accounting for lessees during construction period.

#### 14.1.8 **Presentation and disclosure (ASC 842 and IFRS 16)**

For lessees, the presentation of the right-of-use assets and lease liabilities are similar under the standards. Amounts relating to leases are presented separate from other assets and liabilities on the balance sheet or in the notes to the financial statements. However, some detailed differences in application exist.

US GAAP	IFRS
ASC 842 prohibits right-of-use assets and lease liabilities related to operating leases from being presented in the same balance sheet line item as those arising from finance leases.	This requirement does not exist under IFRS, since there is no lease classification for lessees.
ASC 842 requires presentation of operating lease expense within income from continuing operations.	Under IFRS, amortization and interest expense are required to be presented in separate line items by the lessee.
Under ASC 842, lessees will typically present payments under operating leases within operating activities in the cash flow statement, since interest and depreciation are not presented in the income statement for operating leases.	Under IFRS, amortization and interest are presented separately in the cash flow statement and follow their respective classification guidance.
ASC 842 contains incremental guidance and accounting elections related to how lessors should account for lessor costs (such as property taxes and insurance of the leased asset) that are paid for directly by a lessee. There are practical expedients that allow lessors to report certain of these costs on a net basis.	There is no specific guidance under IFRS for these items.

### 14.1.9 Transition (ASC 842 and IFRS 16)

US GAAP	IFRS
<p>ASC 842 is effective for public business entities (“PBEs”) for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, and for fiscal years beginning after December 15, 2019 for non PBEs. In August 2019, the FASB exposed a proposal to allow non-PBEs an additional year to adopt ASC 842.</p> <p>ASC 842 does not permit a full retrospective adoption. It provides for a single transition approach: a modified retrospective application with the option to elect hindsight and/or a package of practical expedients. Entities may elect not to restate the comparative prior periods (similar to the IFRS 16 “simplified approach”).</p>	<p>IFRS 16 is effective for periods beginning on or after January 1, 2019.</p> <p>IFRS 16 allows full retrospective application (with certain exceptions), as well as a “simplified approach” in which the comparative periods are not restated and the cumulative effect of applying the new standard is recorded as an adjustment to the opening balance of retained earnings.</p>
<p>Under both ASC 842 and IFRS 16, a lessee or lessor may elect, as a practical expedient in transition, to not reassess whether an arrangement is or contains a lease. However, under ASC 842, entities may only elect to use this expedient as part of a “package” of expedients to also not reassess lease classification, or existing initial direct costs.</p>	<p>A similar election exists under IFRS 16, but it is not part a package of expedients (as required under US GAAP).</p>
<p>A lessee or lessor may apply hindsight when determining lease term, or impairment of right-of-use assets. If elected, it must do so for all of its leases, whether as a lessee or lessor.</p>	<p>Under IFRS 16, when using the “simplified approach,” a lessee (but not a lessor) may apply hindsight to lease term, impairment, and other areas involving judgment or estimation, e.g., dismantling costs. A lessee may apply these practical expedients on a lease by lease basis.</p>
<p>Under ASC 842, an entity electing to use the “package” of practical expedients would generally not alter its allocations of consideration in the arrangement.</p>	<p>Under IFRS 16, an entity can elect to allocate consideration in an arrangement containing a lease using stand-alone selling prices at either the commencement date of the lease or the transition date.</p>
<p>Entities that previously reported “good” sale and leaseback transactions do not reassess those transactions upon adopting ASC 842. Lessees that “failed” sale and leaseback transactions (this does not apply to lessors, as the previous leases guidance was not symmetrical) reassess whether those transactions meet the sale and leaseback guidance in ASC 842 before its effective date. If so, lessees retroactively account for the sale and leaseback as of the later of the beginning of the earliest period presented, or the date the transaction qualified as a sale under ASC 842 (or the date they apply ASC 842, if they elect not to restate prior periods).</p>	<p>Entities that elected to use a full retrospective approach nevertheless do not retrospectively apply IFRS 16 guidance to pre-adoption sale-leaseback transactions, or to pre-adoption business combinations, but, instead, apply the specific transition guidance in IFRS 16.</p>

US GAAP	IFRS
Entities only reassess initial direct costs if they do not elect to use the “package” of practical expedients.	Under IFRS 16, lessees do not classify leases; and, if using the “simplified approach,” they can separately elect to exclude initial direct costs from the measurement of the right-of-use asset.
Under US GAAP, entities are allowed to not revisit the accounting for easement arrangements that existed at the transition date that were not previously accounted for as leases. However, easement arrangements entered into or modified after the effective date of ASC 842 would have to be evaluated under the new lease identification guidance.	The IASB has not provided equivalent relief for easement arrangements.

## 14.1.A Leases (ASC 840 and IAS 17)

The FASB and IASB issued their new leases standards, ASC 842 and IFRS 16, respectively, in early 2016. Those standards are generally applicable for most companies for years beginning in 2019. The guidance in this section describes the similarities and differences between the previously applicable US GAAP guidance (ASC 840, *Leases*) and IFRS guidance (IAS 17, *Leases*).

### 14.1A.1 Lease scope (ASC 840 and IAS 17)

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

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

### 14.1A.2 Lease classification—general (ASC 840 and IAS 17)

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



**US GAAP**

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

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

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

Events of default must be evaluated pursuant to ASC 840-10-25-14 to assess whether remedies payable upon default are minimum lease payments for purposes of applying the 90% test. The guidance indicates that the maximum amount of potential payments under all non-performance events of default must be included in the lease classification 90% test unless each of the following 4 criteria are met: (i) the covenant is customary; (ii) predefined criteria relating solely to the lessee and its operations have been established for the determination of the event of default; (iii) the occurrence of the event of default is objectively determinable; and (iv) it is reasonable to assume at lease inception that an event of default will not occur.

For a lessor to classify a lease as a direct financing or sales-type lease under the guidance, two additional criteria must be met: collectibility of the minimum lease payments must be reasonably predictable; and there cannot be any important uncertainty as to the amount of the unreimbursable costs yet to be incurred by the lessor during the lease term.

**IFRS**

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

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

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

There are no incremental criteria for a lessor to consider in classifying a lease under IFRS.

**14.1A.3 Sale-leaseback arrangements (ASC 840 and IAS 17)**

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

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

**14.1A.4 Leases involving land and buildings (ASC 840 and IAS 17)**

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

US GAAP	IFRS
Under ASC 840, land and building elements generally are accounted for as a single unit of account, unless the land represents 25% or more of the total fair value of the leased property.	Under IAS 17, land and building elements must be considered separately, unless the land element is not material. This means that nearly all leases involving land and buildings should be bifurcated into two components, with separate classification considerations and accounting for each component.
When considering the classification of land that is considered its own unit of account, ASC 840 would require the lease to be classified as an operating lease unless either the transfer-of-ownership criterion or the bargain-purchase-option criterion is met. In those cases the lessee should account for the land lease as a capital lease.	The lease of the land element should be classified based on a consideration of all of the risks and rewards indicators that apply to leases of other assets. Accordingly, a land lease would be classified as a finance lease if the lease term were long enough to cause the present value of the minimum lease payments to be at least substantially all of the fair value of the land, even if legal ownership is not transferred.
	In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life. Accordingly, in a single lease transaction, the lease of the building and the underlying land may be classified differently.

#### 14.1A.5 *Lease—other (ASC 840 and IAS 17)*

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

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

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

US GAAP	IFRS
The lessor can classify leases that would otherwise be classified as direct-financing leases as leveraged leases if certain additional criteria are met. Financial lessors sometimes prefer	The guidance does not permit leveraged lease accounting. Leases that would qualify as leveraged leases under US GAAP typically would be classified as finance leases under IFRS.

US GAAP	IFRS
leveraged lease accounting because it often results in faster income recognition.	
It also permits the lessor to net the related nonrecourse debt against the leveraged lease investment on the balance sheet.	Any nonrecourse debt would be reflected gross on the balance sheet.

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

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

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

US GAAP	IFRS
Lessee involvement in the construction of an asset to be leased upon construction completion is subject to specific detailed guidance to determine whether the lessee should be considered the owner of the asset during construction. If the lessee has substantially all of the construction period risks, as determined by specific criterion included in ASC 840-40-55, the lessee must account for construction in progress as if it were the legal owner and recognize landlord financed construction costs as debt. Once construction is complete, the arrangement is evaluated as a sale-leaseback.	No specific guidance relating to lessee involvement in the construction of an asset exists under IFRS.
ASC 840 provides guidance with respect to accounting for a “construction project” and can be applied not only to new construction but also to the renovation or re-development of an existing asset.	

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***Chapter 15:***  
***Other accounting and***  
***reporting topics—updated***  
***February 2022***

## 15.1 Other accounting and reporting topics

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

### Technical references

#### US GAAP

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

#### IFRS

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

### Note

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

## 15.2 Balance sheet—offsetting

While balance sheet offsetting is permitted when a right of setoff exists, there are differences in the required conditions to meet the right of setoff under US GAAP compared to IFRS.

### 15.2.1 Balance sheet—offsetting assets and liabilities

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

US GAAP	IFRS
The guidance states that “it is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except where a right of setoff exists.” A right of setoff is a debtor’s legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor. A debtor having a valid right of setoff may offset the related asset and liability and report the net	Under the guidance, a right of setoff is a debtor’s legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. Two conditions must exist for an entity to offset a financial asset and a financial liability (and thus present the net amount on the balance sheet). The entity must both:

US GAAP	IFRS
<p>amount. A right of setoff exists when all of the following conditions are met:</p> <ul style="list-style-type: none"> <li>□ Each of two parties owes the other determinable amounts</li> <li>□ The reporting party has the right to set off the amount owed with the amount owed by the other party</li> <li>□ The reporting party intends to set off</li> <li>□ The right of setoff is enforceable by law.</li> </ul> <p>The guidance provides an exception to the previously described intent condition for derivative instruments executed with the same counterparty under a master netting arrangement. An entity may offset (1) fair value amounts recognized for derivative instruments and (2) fair value amounts (or amounts that approximate fair value) recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) arising from derivative instruments recognized at fair value. Entities must adopt an accounting policy to offset fair value amounts under this guidance and apply that policy consistently.</p> <p>Repurchase agreements and reverse-repurchase agreements that meet certain conditions are permitted, but not required, to be offset in the balance sheet.</p>	<ul style="list-style-type: none"> <li>□ Currently have a legally enforceable right to set off, and</li> <li>□ Intend either to settle on a net basis or to realize the asset and settle the liability simultaneously.</li> </ul> <p>If both criteria are met, offsetting is required.</p> <p>In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor, provided that there is an agreement among the three parties that clearly establishes the debtor's right of setoff.</p> <p>Master netting arrangements do not provide a basis for offsetting unless both of the criteria described earlier have been satisfied.</p>

### 15.2.2 *Balance sheet—offsetting asset and liability disclosures*

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

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

## 15.3 *Not used*

## 15.4 *Balance sheet classification—post-balance sheet refinancing*

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

US GAAP	IFRS
Entities may classify debt instruments due within the next 12 months as noncurrent at the balance sheet date, provided that agreements to refinance or to reschedule payments on a long-term basis (including waivers for certain debt covenants) are completed before the financial statements are issued.	If completed after the balance sheet date, neither an agreement to refinance or reschedule payments on a long-term basis nor the negotiation of a debt covenant waiver would result in noncurrent classification of debt, even if executed before the financial statements are issued.
SEC registrants subject to S-X Article 5 for commercial and industrial companies are required to present a classified balance sheet, but no other Articles within S-X contain this requirement. ASC 210-10-05-4 notes that most reporting entities present a classified balance sheet.	The presentation of a classified balance sheet is required, except when a liquidity presentation is reliable and more relevant.

## 15.5 *Balance sheet: classification—refinancing counterparty*

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

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

## 15.6 *Income statement and statement of comprehensive income*

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



US GAAP	IFRS
The income statement may be presented in either (1) a single-step format, whereby all expenses are classified by function and then deducted from total income to arrive at income before tax, or (2) a multiple-step format separating operating and nonoperating activities before presenting income before tax.	While certain minimum line items are required, no prescribed statement of comprehensive income format exists.
SEC regulations require all registrants to categorize expenses in the income statement by their function. However, depreciation expense may be presented as a separate income statement line item. In such instances, the caption “cost of sales” should be accompanied by the phrase “exclusive of depreciation shown below” and presentation of a gross margin subtotal is precluded.	Entities that disclose an operating result should include all items of an operating nature, including those that occur irregularly or infrequently or are unusual in amount, within that caption.
All items included in other comprehensive income are subject to recycling.	Expenses may be presented either by function or by nature, whichever provides information that is reliable and more relevant depending on historical and industry factors and the nature of the entity. Additional disclosure of expenses by nature, including depreciation and amortization expense and employee benefit expense, is required in the notes to the financial statements if functional presentation is used on the face of the income statement.
	Entities should not mix functional and nature classifications of expenses by excluding certain expenses from the functional classifications to which they relate.
	Entities are required to present items included in other comprehensive income that may be reclassified into profit or loss in future periods separately from those that will not be reclassified.
	The share of other comprehensive income of associates and joint ventures accounted for using the equity method must be grouped into those that will and will not be reclassified to profit or loss.

## 15.7 Statements of equity

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

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

## 15.8 Statement of cash flows

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

US GAAP	IFRS
<p>Under US GAAP, restricted cash is presented together with cash and cash equivalents on the statement of cash flows. The statement of cash flows shows the change during the period in total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. As a result, transfers between restricted cash and unrestricted cash are not presented in the statement of cash flows and direct changes in restricted cash are not disclosed as noncash transactions. Entities are, however, required to reconcile the total amount of cash, cash equivalents, and restricted cash presented on the statement of cash flows to the balance sheet, as well as disclose the nature and extent of the restrictions.</p>	<p>Entities need to consider whether restricted funds meet the definition of cash and cash equivalents. This is to ensure that only those items that are available to meet short-term cash commitments are classified as cash or cash equivalents. Funds that do not meet the criteria should not be presented as part of cash and cash equivalents.</p>
<p>Bank overdrafts are not included in cash and cash equivalents; changes in the balances of bank overdrafts are classified as financing cash flows.</p>	<p>Cash and cash equivalents may also include bank overdrafts repayable on demand that form an integral part of an entity's cash management. Short-term bank borrowings are not included in cash or cash equivalents and are considered to be financing cash flows.</p>
<p>There is no requirement for expenditures to be recognized as an asset in order to be classified as investing activities.</p>	<p>Only expenditures that result in a recognized asset are eligible for classification as investing activities.</p>
<p>US GAAP is prescriptive on the cash flow classification of certain items. For example, specific guidance exists in areas such as distributions received from equity method investees, debt prepayments and extinguishments costs and sales of trade receivables.</p>	<p>IFRS is generally less prescriptive in the classification of certain items in the statement of cash flows. The general principle is that cash flows are classified in the manner most appropriate to the business.</p>
<p>Dividends paid are required to be classified in the financing section of the cash flow statement and interest paid (and expensed), interest received, and dividends received from investments are required to be classified as cash flows from operations. If the indirect method is used, amounts of interest paid (net of amounts capitalized) during the period must be disclosed.</p>	<p>Interest and dividends received should be classified in either operating or investing activities. Interest and dividends paid should be classified in either operating or financing cash flows. The total amount of interest paid during a period, whether expensed or capitalized, is disclosed in the statement of cash flows.</p>
<p>Taxes paid are generally classified as operating cash flows.</p>	<p>Taxes paid should be classified within operating cash flows unless specific identification with a financing or investing activity exists.</p>
<p>If the indirect method is used, amounts of taxes paid during the period must be disclosed.</p>	<p>When taxation cash flows are disclosed under different activities, disclosure of the total amount of tax paid in relation to income is required.</p>

## 15.9 Disclosure of critical judgments and significant estimates

Disclosures of an entity's critical judgments and significant accounting estimates have greater prominence under IFRS in comparison to the requirements of US GAAP.

US GAAP	IFRS
For SEC registrants, disclosure of the application of critical accounting policies and significant estimates is normally made in the <i>Management's Discussion and Analysis</i> section of SEC filings such as Forms 10-K or 20-F.	<p>Within the notes to the financial statements, entities are required to disclose both:</p> <ul style="list-style-type: none"> <li>□ The judgments that management has made in the process of applying its accounting policies that have the most significant effect on the amounts recognized in those financial statements</li> <li>□ Information about the key assumptions concerning the future—and other key sources of estimation uncertainty at the balance sheet date—that have significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year</li> </ul>

## 15.10 Capital management disclosures

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

US GAAP	IFRS
<p>There are no specific capital management disclosure requirements under US GAAP.</p> <p>For SEC registrants, disclosure of capital resources is normally made in the <i>Management's Discussion and Analysis</i> section of SEC filings such as Forms 10-K or 20-F.</p>	<p>Entities are required to disclose the following:</p> <ul style="list-style-type: none"> <li>□ Qualitative information about their objectives, policies, and processes for managing capital</li> <li>□ Summary quantitative data about what they manage as capital</li> <li>□ Changes in the above from the previous period</li> <li>□ Whether during the period they complied with any externally imposed capital requirements to which they are subject and, if not, the consequences of such non-compliance</li> </ul> <p>The above disclosure should be based on information provided internally to key management personnel.</p>

## 15.11 Comparative financial information

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

US GAAP	IFRS
Comparative financial statements are not required; however, SEC requirements specify that most registrants provide two years of comparatives for all statements except for the balance sheet, which requires only one comparative year.	<p>One year of comparatives is required for all numerical information in the financial statements, with limited exceptions for certain disclosures.</p> <p>A third statement of financial position at the beginning of preceding period is required for first-time adopters of IFRS and in situations where a retrospective application of an accounting policy, retrospective restatement or reclassification having a material effect on the information in the statement of financial position at the beginning of the preceding period have occurred. Restatements or reclassifications in this context are in relation to correction of errors, or changes in presentation of previously issued financial statements.</p>

## 15.12 Basic EPS calculation

The calculation of basic earnings-per-share (EPS) may be different under US GAAP compared with IFRS due to differences in the calculation methodology related to mandatorily convertible instruments and participating securities.

### 15.12.1 Mandatorily convertible instruments

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

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

### 15.12.2 *Participating securities and the two-class method*

The scope of instruments to which the two-class method applies is wider under US GAAP. In addition, under US GAAP, losses are allocated to participating instruments only if certain conditions are met.

US GAAP	IFRS
The two-class method is applied to all instruments that participate in dividends with common stock according to a predetermined formula. It applies regardless of whether the instrument is convertible or non-convertible. It also applies to both instruments classified as liabilities and those classified as equity.	The two-class method applies to equity instruments that participate in dividends with ordinary shares according to a predetermined formula; it does not apply to participating instruments classified as liabilities. Also, the two-class method is only explicitly required to be applied to participating equity instruments that are not convertible to ordinary shares.
A reporting entity should only allocate losses to participating securities if, based on the contractual terms of the participating securities, the securities have a contractual obligation to share in the losses of the reporting entity on a basis that is objectively determinable.	No explicit guidance limits allocation of losses to participating securities.

## 15.13 *Diluted EPS*

The calculation of diluted earnings-per-share (EPS) may be different under US GAAP compared with IFRS due to differences in the calculation methodology for the year-to-date period calculation, the treatment of convertible debt securities, and the treatment of contingency features.

### 15.13.1 *Diluted EPS —year-to-date period calculation*

Differences in the calculation methodology could result in different denominators being utilized in the diluted EPS year-to-date period calculation.

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

**15.13.2 Diluted EPS—settlement in stock or cash at issuer's choice**

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

US GAAP	IFRS
Certain securities give the issuer a choice of either cash or share settlement. These contracts would typically follow the if-converted or treasury stock method, as applicable. US GAAP contains the presumption that contracts that may be settled in common shares or in cash at the election of the entity will be settled in common shares. However, that presumption may be overcome if past experience or a stated policy provides a reasonable basis to believe it is probable that the contract will be settled in cash.	Contracts that can be settled in either common shares or cash at the election of the issuer are always presumed to be settled in common shares and are included in diluted EPS if the effect is dilutive; that presumption may not be rebutted.

**15.13.3 Diluted EPS—contingently convertible instruments**

The treatment of contingency features in the dilutive EPS calculation may result in higher diluted EPS under IFRS.

US GAAP	IFRS
Contingently convertible debt securities with a market price trigger (e.g., debt instruments that contain a conversion feature that is triggered upon an entity's stock price reaching a predetermined price) should always be included in diluted EPS computations if dilutive—regardless of whether the market price trigger has been met. That is, this type of contingency feature should be ignored.	The potential common shares arising from contingently convertible debt securities would be included in the dilutive EPS computation only if the contingency condition was met as of the reporting date.

**15.14 Not used****15.15 Not used****15.16 Not used****15.17 Foreign currency**

Differences exist in the accounting under US GAAP compared to IFRS for foreign currency topics, including translation, functional currency, and hyperinflation.

**15.17.1 Releasing amounts from the currency translation account**

Different recognition triggers for amounts captured in the currency translation account (CTA) could result in more instances where amounts included in CTA are released through the income statement under IFRS compared with US GAAP.

**US GAAP****IFRS**

CTA is released through the income statement in the following situations:

- When control of a foreign entity, as defined, is lost, the entire CTA balance is released.
- Complete or substantially complete liquidation of a foreign entity, as defined, results in full release of CTA.

When a portion of an equity method investment that is itself a foreign entity, as defined, is sold but significant influence or joint control is retained, a portion of CTA is released, on a proportionate basis.

- When a reporting entity has an investment in a foreign entity accounted for by the equity method, and the reporting entity increases its stake in the subject foreign entity such that control is acquired. It is treated as if the equity method investment were sold, and used to purchase a controlling interest in the foreign entity.
- When significant influence or joint control over an equity method investee is lost, a proportionate amount of CTA is released into the income statement (through the level at which significant influence or joint control is lost). The remaining CTA balance becomes part of the carrying value of the investment retained. Provided the equity security does not qualify for the measurement alternative in ASC 321, the retained equity interests should be carried at fair value with changes in value recorded in net income. Any initial difference between the investment's carrying value and fair value should be recognized in net income.

If a company settles or partially settles an intercompany transaction for which settlement was not previously planned (and therefore had been considered of a long-term-investment nature), the related foreign currency exchanges gains and losses previously included in CTA are not released to the income statement, unless the repayment transaction effectively constitutes a substantial liquidation of the foreign entity.

The triggers for CTA release noted in the US GAAP column apply for IFRS, except with regard to the loss of significant influence or joint control, when IFRS requires that the entire balance of CTA be released into the income statement. However, due to the remeasurement of the retained interest to fair value under ASC 321, the net profit or loss impact might be the same. In addition, when a partial liquidation occurs, an entity has an accounting policy choice whether to (1) treat such an event as a partial disposal and release a portion of the CTA on a proportionate basis or (2) not recognize any disposal as the parent continues to own the same percentage share of the subsidiary.

Under US GAAP, release of CTA is only appropriate on complete or substantially complete liquidation.

Where a subsidiary that is a foreign operation repays a quasi-equity loan, but there is no change in the parent's proportionate percentage shareholding, there is an accounting policy choice regarding whether the CTA should be released.

**15.17.2 Translation of equity accounts**

IFRS does not require equity accounts to be translated at historical rates.

US GAAP	IFRS
Equity is required to be translated at historical rates.	IFRS does not specify how to translate equity items. Entities have a policy choice to use either the historical rate or the closing rate. The chosen policy should be applied consistently. If the closing rate is used, the resulting exchange differences are recognized in equity and thus the policy choice has no impact on the amount of total equity.

**15.17.3 Determination of functional currency**

Under US GAAP, there is no hierarchy of indicators to determine the functional currency of an entity, whereas a hierarchy exists under IFRS.

US GAAP	IFRS
There is no hierarchy of indicators to determine the functional currency of an entity. In those instances in which the indicators are mixed and the functional currency is not obvious, management's judgment is required to determine the currency that most faithfully portrays the primary economic environment of the entity's operations.	Primary and secondary indicators should be considered in the determination of the functional currency of an entity. If indicators are mixed and the functional currency is not obvious, management should use its judgment to determine the functional currency that most faithfully represents the economic results of the entity's operations by focusing on the currency of the economy that determines the pricing of transactions (not the currency in which transactions are denominated).

**15.17.4 Hyperinflation**

Basis of accounting in the case of hyperinflationary economies are different under US GAAP and IFRS.

US GAAP	IFRS
Under US GAAP inflation-adjusted financial statements are not permitted. Instead, the financial statements of a foreign entity in a highly inflationary economy shall be remeasured as if the functional currency were the reporting currency.  Once a reporting entity determines that it has a foreign entity operating in a highly inflationary economy, the reporting currency should be considered the foreign entity's functional currency on a prospective basis. The new accounting basis of monetary and nonmonetary assets and liabilities should be the last translated balances prior to the designation as highly inflationary.	IFRS require financial statements prepared in the currency of a hyper-inflationary economy to be stated in terms of the measuring unit current at the end of the reporting period.  Prior year comparatives must be restated in terms of the measuring unit current at the end of the latest reporting period.



**15.18 Not used****15.19 Not used****15.20 Not used****15.21 Interim financial reporting—allocation of costs**

IFRS requires entities to account for interim financial statements via the discrete-period method. The spreading of costs that affect the full year is not appropriate. This could result in increased volatility in interim financial statements under IFRS as compared to US GAAP.

However, under both frameworks, the interim tax provision is based on an estimate of the annual effective tax rate applied to the interim results plus or minus the income tax effects of certain discrete transactions during the quarter in which they occur. See SD 8.16 for related discussion.

US GAAP	IFRS
US GAAP views interim periods primarily as integral parts of an annual cycle. As such, it allows entities to allocate among the interim periods certain costs that benefit more than one of those periods. On the other hand, an entity may not record an accrual of cost at an interim period if one is not needed at year end, for example, for a vacation accrual.	Interim financial statements are prepared via the discrete-period approach, wherein the interim period is viewed as a separate and distinct accounting period, rather than as part of an annual cycle. Regardless of whether an accrual is needed at year end, if the entity has an obligation at an interim period, it should be recorded.

**15.22 Long-lived assets held for sale**

IFRS and US GAAP are largely converged in this area. A long-lived asset (noncurrent asset) or disposal group should be classified as held for sale in the period in which all the criteria set forth in the guidance are met. The six criteria are similar in IFRS (IFRS 5.7 and IFRS 5.8) and US GAAP (ASC 360-10-45-9). A disposal group classified as held for sale is measured at the lower of its carrying amount or fair value less cost to sell under both frameworks. Under both IFRS and US GAAP, a long-lived asset (noncurrent asset) is not depreciated while classified as held for sale. Both frameworks similarly require the assets and liabilities of a disposal group classified as held for sale to be presented separately in the asset and liability sections, respectively, of the balance sheet (i.e., those assets and liabilities should not be offset and presented as a single amount).

**15.23 Long-lived assets to be distributed to owners**

Differences exist between US GAAP and IFRS related to the accounting for long-lived assets to be distributed to owners, which results in different classification and measurement models under the two frameworks.

US GAAP	IFRS
In accordance with ASC 360-10-45-15, long-lived assets to be disposed of other than by sale (e.g., by abandonment, in an exchange measured based on the recorded amount of the nonmonetary asset relinquished, or in a distribution to owners in a spinoff) should continue to be classified as held and used until they are disposed. Therefore, if long-lived assets are to be disposed of in a distribution to owners in a spinoff, the assets are not measured at the lower of their carrying amount or fair value less cost to sell (as would be the case, for example, if the asset were classified as held for sale).	In accordance with IFRS 5.5A, the classification, presentation, and measurement requirements applicable to assets classified as held for sale also apply to assets that are classified as held for distribution to owners. Therefore, if a long-lived asset is to be disposed of in a distribution to owners, the asset is measured at the lower of carrying amount and fair value less costs to distribute.

## 15.24 *Discontinued operations*

Differences exist between IFRS and US GAAP for discontinued operations, including the definition, unit of account, and presentation and disclosure.

### 15.24.1 *Discontinued operations—definition*

The definitions of discontinued operations under IFRS and US GAAP focus on similar principles and apply to a component of an entity that has either been disposed of or is classified as held for sale. However, a disposal must result in a strategic shift that has a major effect on an entity's operations and financial results to qualify as a discontinued operation under US GAAP. Examples of a strategic shift are more limited under IFRS. US GAAP also includes several examples that provide guidance on how to interpret a major effect on the reporting entity's operations and financial results for the disposal to be considered a discontinued operation.. IFRS does not contain similar examples.

US GAAP	IFRS
<p>A disposal of a component of an entity or a group of components of an entity shall be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. A strategic shift that has (or will have) a major effect on an entity's operations and financial results may include a disposal of a major geographical area, a major line of business, a major equity method investment, or other major parts of an entity.</p> <p>In addition, any business or nonprofit activity that upon acquisition meets the held for sale criteria is required to be presented as a discontinued operation regardless of whether it represents a strategic shift that has (or will have) a major effect on a reporting entity's operations and financial results.</p>	<p>A discontinued operation is a component of an entity that either has been disposed of or is classified as held for sale and (a) represents a separate major line of business or geographic area of operations, (b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations, or (c) is a subsidiary acquired exclusively with a view to resale.</p>

**15.24.2 Discontinued operations—unit of account**

IFRS and US GAAP both refer to a component of an entity when describing those operations that may qualify for discontinued operations reporting; however, the definition of “component of an entity” for purposes of applying the discontinued operations guidance differs under IFRS and US GAAP. In practice, this difference generally does not result in different conclusions regarding whether or not a component of an entity that either has been disposed of, or is classified as held for sale, qualifies for discontinued operations reporting.

US GAAP	IFRS
In accordance with ASC 205-20-20, a component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. A component of an entity may be a reportable segment or an operating segment, a reporting unit, a subsidiary, or an asset group. We do not believe that a component can be at a lower level than an asset group because, in order to be a component, the cash flows must be clearly distinguishable from the rest of the reporting entity.	In accordance with IFRS 5.31, a component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. In other words, a component of an entity will have been a cash-generating unit or a group of cash-generating units while being held for use.

**15.24.3 Discontinued operations—presentation and disclosure**

Presentation and disclosure requirements related to discontinued operations differ under US GAAP and IFRS. Differences exist related to the presentation of comparative periods on the balance sheet and disclosure of significant continuing involvement with a discontinued operation after the disposal date.

US GAAP	IFRS
When a discontinued operation is disposed of or classified as held for sale, the assets and liabilities of the discontinued operation are presented separately in the asset and liability sections, respectively, of the balance sheet for that period and for all prior periods presented. Even if a discontinued operation is disposed of by sale before the end of a reporting period and therefore there are no assets and liabilities held for sale to be presented at the current balance sheet date, the assets and liabilities of the discontinued operation must be presented separately as held for sale in the prior period balance sheet.	In accordance with IFRS 5.40, when a discontinued operation is disposed of or classified as held for sale, the assets and liabilities of the disposal groups should be classified as held for sale in the balance sheet in the current period, but should not be reclassified in the prior periods to reflect the classification as held for sale.
A reporting entity is required to disclose information about its significant continuing involvement with a discontinued operation after the disposal date. It must continue to make these disclosures until the results of operations	IFRS does not require disclosure about significant continuing involvement with a discontinued operation after the disposal date.

US GAAP	IFRS
of that discontinued operation are no longer presented in the income statement. If a reporting entity retains a noncontrolling investment in a disposed component and accounts for the component under the equity method, additional disclosures are required related to the equity method investment retained.	

## 15.25 *Related party disclosures*

IFRS requires specific related party disclosures for commitments and compensation of key management personnel which are not specifically required under US GAAP.

### 15.25.1 *Related party disclosures—commitments*

Disclosures of related party transactions under IFRS should include commitments to related parties.

US GAAP	IFRS
There is no specific requirement to disclose commitments to related parties under US GAAP.	Disclosure of related party transactions includes commitments if a particular event occurs or does not occur in the future, including recognized and unrecognized executory contracts.  Commitments to members of key management personnel would also need to be disclosed.

### 15.25.2 *Related party disclosures—management compensation*

Under IFRS, a financial statement requirement exists to disclose the compensation of key management personnel.

US GAAP	IFRS
Disclosure of the compensation of key management personnel is not required within the financial statements.  SEC regulations require key management compensation to be disclosed outside the financial statements.	The compensation of key management personnel is disclosed within the financial statements in total and by category of compensation. Other transactions with key management personnel also must be disclosed.

### 15.25.3 *Related party disclosures—government-related entities*

There are exemptions from certain related party disclosure requirements under IFRS that do not exist under US GAAP.

US GAAP	IFRS
There are no exemptions available to reporting entities from the disclosure requirements for related party transactions with governments and/or government-related entities.	<p>A partial exemption is available to reporting entities from the disclosure requirements for related party transactions and outstanding balances with both:</p> <ul style="list-style-type: none"> <li>□ A government that has control, joint control, or significant influence over the reporting entity</li> <li>□ Another entity that is a related party because the same government has control, joint control, or significant influence over both the reporting entity and the other entity</li> </ul>

## 15.26 *Not used*

## 15.27 *Segment reporting*

Differences exist between US GAAP and IFRS related to the determination of operating segments and the disclosure of reportable segments. A principles-based approach to the determination of operating segments in a matrix-style organizational structure could result in entities disclosing different operating segments. Based on a reporting entity's facts and circumstances, additional disclosures may be required under IFRS compared to US GAAP.

US GAAP	IFRS
Entities that utilize a matrix form of organizational structure are required to determine their operating segments on the basis of products or services offered, rather than geography or other metrics.	Entities that utilize a matrix form of organizational structure are required to determine their operating segments by reference to the core principle (i.e., an entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates).
Disclosure of liabilities for each reportable segment is not required under US GAAP, even if the information is regularly reviewed by the chief operating decision maker (CODM).	Reporting entities are required to report total liabilities for each reportable segment if such information is regularly provided to the CODM.
While reporting entities are required to disclose the factors used to identify its reportable segments, and whether two or more operating segments have been aggregated into a reportable segment, there is no requirement to disclose the judgments made in applying the aggregation criteria.	Reporting entities are required to disclose the factors used to identify its reportable segments, and whether two or more operating segments have been aggregated into a reportable segment. If two or more operating segments have been aggregated, reporting entities are required to disclose the judgments made in applying the aggregation criteria, specifically (1) a brief description of the operating segments that have been aggregated and (2) the economic indicators that have been assessed in determining that the aggregated operating segments have similar economic characteristics.

## 15.28 Service concession arrangements

Service concession arrangements may be in the scope of ASC 853, *Service Concession Arrangements*, for US GAAP or IFRIC 12, *Service Concession Arrangements*, for IFRS if they meet certain criteria. The authoritative literature provides guidance on the accounting by private entity operators for public-to-private service concession arrangements (for example, airports, roads, and bridges) that are controlled by the public sector entity grantor. The operator also may provide construction, upgrading, or maintenance services in addition to operations. Under both US GAAP and IFRS, the infrastructure used in these arrangements should not be recognized as property, plant, and equipment by the operator. ASC 853 does not specify how an operator should account for the various aspects of a service concession arrangement other than to refer the operator to follow other applicable US GAAP. IFRIC 12 requires the operator to follow specific existing IFRS for various aspects of a service concession arrangement and provides additional guidance for other aspects.

US GAAP	IFRS
The operator should not account for these arrangements as leases.	Generally, the operator would not account for these arrangements as leases, unless the operator has a right to use some physically separable, independent, and cash generating portion of the infrastructure, or if the facilities are used to provide purely ancillary unregulated services. In these cases, there may in substance be a lease from the grantor to the operator, which should be accounted for in accordance with IFRS 16.
For the operator's revenue and costs relating to the construction, upgrade, or operation services, the standard refers the operator to the revenue recognition and other applicable guidance.	The operator will account for construction or upgrade services and operation services in accordance with IFRS 15.
In the absence of specific guidance, the operator needs to determine if it is able to recognize an asset for the consideration to be received by the operator in exchange for construction and upgrade services, and/or defer the costs associated with such services. An intangible asset would not be recognized as the consideration received for construction services.	The consideration to be received by the operator in exchange for construction or upgrade services may result in the recognition of a financial asset, an intangible asset or a combination of both. It is necessary to account for each component separately.
	The operator recognizes a financial asset to the extent that it has an unconditional right to receive a specified or determinable amount of cash or other financial assets for the construction services.
	The operator recognizes an intangible asset to the extent that it has a right to charge fees to users of the public services.
	Accordingly, determining who is the customer in a service concession arrangement depends on the nature of the consideration received by the operating entity and the facts and circumstances of the arrangement.

**US GAAP**

Additionally, in some of these arrangements, the operator will pay the grantor to enter into an operating agreement. This would be considered consideration payable to a customer under US GAAP because the grantor is determined to be the customer of the operating services in all service concession arrangements. This may result in an asset that will be amortized against revenue over the term of the operating agreement.

**IFRS**

Additionally, in some of these service concession arrangements, the operator will make payments to the grantor.

If payments are for a right to a separate good or service, the operator applies the applicable IFRS guidance for that good or service.

If payments are for the right to use a separate asset, the operator assesses whether the arrangement contains a lease.

If the service concession arrangement results in the operator having only a contractual right to receive cash from the grantor, the operator accounts for those payments as a reduction of the transaction price under IFRS 15.

If the service concession arrangement results in the operator having only a right to charge users of the public service, the operator has received an

intangible asset in exchange for the payments to be made to the grantor.

The operator may have a contractual obligation to maintain or restore the infrastructure to a specified condition before it is returned to the grantor at the end of the arrangement, which should be recognized and measured in accordance with IAS 37.

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***Chapter 16:  
IFRS for small and  
medium-sized entities—  
updated October 2019***



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

IFRS for Small and Medium-sized Entities (SMEs) provides an alternative accounting framework for entities meeting certain eligibility criteria. IFRS for SMEs is a self-contained, comprehensive standard specifically designed for entities that do not have public accountability and publish general purpose financial statements for external users.

This section is intended to provide an overview of IFRS for SMEs, its eligibility criteria, and some examples of the differences between IFRS for SMEs, full IFRS, and US GAAP.

### 16.1.1 *What companies can use IFRS for SMEs?*

The IASB has determined that any entity that does not have public accountability may use IFRS for SMEs. An entity has public accountability if (1) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market, or (2) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, pension fund, or securities broker/dealer. The definition of a SME is, therefore, based on the nature of the entity rather than on its size.

To clarify, a subsidiary of a listed company that uses full IFRS is eligible to use IFRS for SMEs when preparing its own separate financial statements, provided that the subsidiary itself does not have public accountability. However, a subsidiary using IFRS for SMEs would need to convert its financial statements to full IFRS for consolidation into its parent's financial statements, as there are differences between the two accounting frameworks.

Beyond the scope determined by the IASB, companies are also subject to the laws of their local jurisdiction. Many countries require statutory reporting, and each country will individually decide whether IFRS for SMEs is an acceptable basis for such reporting. Some countries that use full IFRS for public company reporting have replaced their local GAAP with IFRS for SMEs (e.g., South Africa), or with a standard based on the IFRS for SMEs (e.g., the United Kingdom), while others currently have no plans to allow use of IFRS for SMEs for statutory purposes (e.g., France). Companies will need to understand on a country-by-country basis where IFRS for SMEs is allowed or required for statutory reporting.

### 16.1.2 *Differences between full IFRS and IFRS for SMEs*

IFRS for SMEs retains many of the accounting principles of full IFRS but simplifies a number of accounting principles that are generally less relevant for small and medium-sized entities. In addition, IFRS for SMEs significantly streamlines the volume and depth of disclosures required by full IFRS, yielding a complement of disclosures that are more user-friendly for SME stakeholders.

Certain more complex areas of full IFRS deemed less relevant to SMEs, including earnings per share, segment reporting, insurance, and interim financial reporting, are omitted from the IFRS for SMEs. In other instances, certain full IFRS principles are simplified to take into account the special needs of SMEs. Some examples of the differences between full IFRS and IFRS for SMEs include:

**Business combinations**—Under full IFRS, transaction costs are excluded from the consideration included in the accounting for business combinations (i.e., expensed as incurred), and a liability for contingent consideration that will be paid in cash is recognized regardless of the probability of

payment. Under IFRS for SMEs, transaction costs are included in the cost of the acquisition, and contingent consideration is recognized only if it is probable the amount will be paid and its amount can be reliably measured.

**Capitalization of interest**—Under full IFRS, interest directly attributable to the acquisition, construction, or production of qualifying assets should be capitalized. Under IFRS for SMEs, all interest must be expensed.

**Investments in associates**—Under full IFRS, investments in associates are accounted for using the equity method. Under IFRS for SMEs, investments in associates may be accounted for using the cost model, equity method, or at fair value through profit and loss.

**Goodwill and indefinite-lived intangibles**—Under full IFRS, goodwill and indefinite-lived intangible assets must be tested at least annually for impairment, or more often when an indicator of impairment exists. Under IFRS for SMEs, there is no concept of indefinite-lived intangible assets. IFRS for SMEs requires that goodwill and intangible assets be amortized over the useful life of the asset (or a term not to exceed 10 years if the useful life cannot be determined). Goodwill and intangible assets are also tested for impairment only when an indicator of impairment exists.

**Research and development costs**—Under full IFRS, research costs are expensed but development costs meeting certain criteria are capitalized. Under IFRS for SMEs, all research and development costs are expensed.

**Recognition of exchange differences**—Under full IFRS, exchange differences that form part of an entity's net investment in a foreign operation (subject to strict criteria of what qualifies as net investment) are recognized initially in other comprehensive income and are recycled from equity to profit or loss on disposal of the foreign operation. Under IFRS for SMEs, recycling through profit or loss of any cumulative exchange differences that were previously recognized in OCI on disposal of a foreign operation is not permitted.

### 16.1.3 *Differences between US GAAP and IFRS for SMEs*

In areas where US GAAP and IFRS are mostly converged (e.g., business combinations), the differences between US GAAP and IFRS for SMEs likely will seem similar to the differences noted above between full IFRS and IFRS for SMEs. However, there are other examples of differences between US GAAP and IFRS for SMEs:

**Inventory**—Under US GAAP, last in, first out (LIFO) is an acceptable method of measuring the cost of inventory. In addition, impairments to inventory value are permanent. Under IFRS for SMEs, use of LIFO is not allowed, and impairments of inventory may be reversed under certain circumstances.

**Provisions**—Under US GAAP, a provision is recorded if it is probable (generally regarded as 75 percent or greater) that an outflow will occur. If no best estimate of the outflow is determinable but a range of possibilities exists, then the lowest point of the range is the value that should be recorded. Under IFRS for SMEs, a provision is recorded if it is more likely than not (generally considered to be greater than 50 percent) that an outflow will occur. If no best estimate of the outflow is determinable but a range of possibilities exists, and each point in that range is as likely as any other, the midpoint of the range should be recorded.

**Equity instruments**—Under US GAAP, complex equity instruments, such as puttable stock and certain mandatorily redeemable preferred shares, may qualify as equity (or mezzanine equity). Under IFRS for SMEs, these types of instruments are more likely to be classified as a liability, depending on the specifics of the individual instrument.

Finally, the Private Company Council (PCC) was established in 2012. The PCC is a sister entity to the FASB and is tasked with (1) identifying, deliberating and voting on proposed alternatives within existing US GAAP for private companies and (2) acting as the primary advisory body to the FASB for private company matters on its current technical agenda. Contrary to IFRS for SMEs, the alternatives proposed by the PCC do not represent a single comprehensive standard but separate individual accounting alternatives for private companies that are optional to adopt. As additional alternatives to existing US GAAP for private companies are proposed by the PCC and endorsed by the FASB, additional differences may be created for private companies between US GAAP and full IFRS or IFRS for SMEs.

While the PCC alternatives create optional simplifications to existing US GAAP, entities applying IFRS for SMEs may not generally elect to revert to full IFRS if they do not like the simplified accounting required by IFRS for SMEs. The one exception is in the area of financial instruments, when IFRS for SMEs specifically allows entities to choose to apply the recognition and measurement requirements of IFRS 9 as a policy election.

The FASB has issued accounting standards updates to US GAAP for private companies. These standards represent alternatives for private companies to existing US GAAP related to the accounting for goodwill subsequent to a business combination, the accounting for certain types of interest rate swaps, the application of variable interest entities guidance to common control leasing arrangements, and the accounting for identifiable intangible assets in a business combination. These alternatives to US GAAP are presented in each relevant chapter of this publication.

#### **16.1.4 2019 comprehensive review of IFRS for SMEs**

The Board intends to update IFRS for SMEs periodically (i.e., every three years or so) to minimize the impact of changing accounting standards on SME financial statement preparers and users of such financial statements. The last update was in 2015, with the related amendments being effective January 1, 2017. Accordingly, recently issued new standards, including IFRS 9, *Financial Instruments*, IFRS 15, *Revenue from Contracts with Customers*, and IFRS 16, *Leases*, were not considered in the last update. The next comprehensive review of the IFRS for SMEs started in early 2019.

As IFRS for SMEs is designed to be a stable, stand-alone standard, the IASB decided not to incorporate some significant changes in new or amended IFRS standards into the last update, including those in IFRS 10, *Consolidated Financial Statements*, IFRS 11, *Joint Arrangements*, and IFRS 13, *Fair Value Measurement*, and amendments to IFRS 3, *Business Combinations*, (2008) and IAS 19, *Employee Benefits*, (2011).

In addition to the IASB's periodic updates to IFRS for SMEs, the SME Implementation Group (SMEIG) considers implementation questions raised by users of IFRS for SMEs. When deemed appropriate, the SMEIG develops proposed guidance in the form of questions and answers (Q&As) which, if approved by the IASB, are issued as non-mandatory guidance. Over time, these Q&As are generally incorporated into either *IFRS for SMEs* (and made mandatory) and/or the IFRS Foundation's educational material (remaining non-mandatory).

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## ***Chapter 17: Reference rate reform—updated September 2021***

## 17.1 Overview of reference rate reform

To compensate counterparties for the time value of money, many contracts reference interest rate indices (reference rates). For example, a debt instrument may have a coupon that periodically resets based upon the then-current reference rate. The London Interbank Offered Rate (LIBOR) has been one of the most commonly used reference rates in the global financial markets. In July 2017, the United Kingdom's Financial Conduct Authority announced that it would no longer persuade or compel banks to submit LIBOR as of the end of 2021. In November 2020, the ICE Benchmark Administration (the administrator of LIBOR) announced its intention to cease publication of the one-week and two-month US dollar (USD) LIBOR settings as well as all non-USD LIBOR settings immediately following the LIBOR publication on December 31, 2021. It will cease publication of the remaining USD LIBOR settings immediately following the LIBOR publication on June 30, 2023. Concerns about the sustainability of LIBOR and other interbank offered rates (IBORs) globally has led to an effort to identify alternative reference rates.

The shift away from the most widely used interest rate benchmarks to alternative reference rates is a significant change for the global financial markets. The impact of this change is not limited to financial services companies; it will impact all companies. IBOR rates are frequently used in financial instruments, such as debt agreements, investments, and derivatives, but may also be present in leases, compensation arrangements, and contracts with customers. Preparing for the impact of IBOR reform is likely to be a significant effort and will require a multidisciplinary team to identify where IBOR is used and negotiate changes to arrangements. Many institutions are already working to insert provisions frequently referred to as "fallback language" into new or existing agreements. These provisions specify how a replacement rate will be identified (and other terms, such as how the spread above the reference rate will be changed) once a trigger event (such as LIBOR no longer being quoted) occurs. Industry working groups continue to develop standard fallback terms for a number of financial instruments that they are recommending entities adopt.

From an accounting perspective, IBOR reform has the potential to create challenges when accounting for contract modifications and hedging relationships. For example, there may be a significant volume of contracts that will need to be modified and then assessed to determine whether the modification results in the establishment of a new contract or a continuation of the existing contract for accounting purposes. In addition, modifications related to reference rate reform to derivatives or hedged items involved in hedging relationships could result in de-designations of otherwise highly effective hedges. As a result, both the FASB and the IASB have issued accounting relief from the effects of reference rate reform.

On March 12, 2020, the FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848), Facilitation of the Effects of Reference Rate Reform on Financial Reporting* (the "ASU"). This ASU provides relief that, if elected, will require less accounting analysis and less accounting recognition for modifications related to reference rate reform. The ASU provides specific guidance relating to instruments subject to ASC 310, *Receivables*, ASC 470, *Debt*, ASC 840 and ASC 842, *Leases*, and ASC 815, *Derivatives and Hedging*. It also includes a principle that provides relief from contract modification requirements in other guidance not explicitly addressed.

In January 2021, the FASB issued ASU 2021-01, *Reference Rate Reform (Topic 848): Scope*, to clarify that the scope of ASC 848 includes derivatives that are affected by a change in the interest rate used for margining, discounting, or contract price alignment that do not also reference LIBOR or another reference rate that is expected to be discontinued as a result of reference rate reform.

The IASB pursued a two-phase project. Phase 1 led to amendments to IFRS 9, IAS 39, and IFRS 7 in September 2019. Similar to the relief offered by the FASB under US GAAP, these amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR reform. The amendments have the effect that hedge accounting will generally not need to be discontinued due to the uncertainties created by interest rate benchmark reform. However, any hedge ineffectiveness should continue to be recorded in the income statement under both IAS 39 and IFRS 9. Furthermore, the amendments establish triggers for when the relief will end, which includes when the uncertainty arising from interest rate benchmark reform no longer exists.

The Phase 2 amendments, issued in August 2020, primarily address issues that arise as benchmark reform is implemented (e.g., the actual replacement of one benchmark rate with an alternative one). Phase 2 amendments (1) provide specific relief when there is a change in the basis for determining contractual cash flows of financial assets or financial liabilities (including lease liabilities) as a result of IBOR reform and (2) enabling the continuation of hedge accounting when changes are made to hedging relationships as a result of the transition to alternative benchmark rates.

This chapter compares the IASB Phase 1 and Phase 2 IBOR reform amendments to the FASB reference rate reform standard (ASC 848).

For more detailed guidance on ASC 848, see PwC's *Reference rate reform* guide. For more detailed guidance on the IASB's amendments, see PwC's In depth, *Practical Guide to Phase 2 amendments IFRS 9, IAS 39, IFRS 7, IFRS 4, and IFRS 16 for interest rate benchmark (IBOR) reform*.

### ***Technical references***

#### ***US GAAP***

ASC 310, ASC 470, ASC 842, ASC 815, ASC 848

#### ***IFRS***

IFRS 9, IAS 39, IFRS 7, IFRS 4, IFRS 16

### ***Note***

The following discussion captures the differences between ASC 848 and the IASB IBOR reform amendments that we consider to be the most significant or pervasive. It should be read in combination with the authoritative literature and a thorough analysis of all the facts and circumstances.

Entities that had adopted IFRS 9 had a choice to continue to apply existing IAS 39 hedge accounting guidance or to apply the revised hedging guidance included in IFRS 9. The following discussion assumes that an entity has adopted the amended IFRS 9 hedge accounting requirements.

Certain insurance entities elected to temporarily defer the adoption of IFRS 9 in its entirety based on an optional election provided by the IASB. The impact of differences for those entities is not addressed in this publication.

## 17.2 Transition and adoption

There are significant differences in the adoption of the amendments offered under US GAAP and IFRS as well as when the practical expedients are discontinued. However, both allowed for early adoption of the relief as soon as the standards/amendments were issued.

US GAAP	IFRS
<p>All relief offered under ASC 848 is optional. Additionally, each practical expedient may be adopted separately such that an entity can choose to apply certain of the practical expedients but not all. However, if an election is made to apply the contract modification relief, the relief must be applied to all contract modifications that meet the scope of ASC 848 and are accounted for in accordance with the same ASC Topic or Subtopic.</p> <p>ASC 848 has a specific sunset date of December 31, 2022 (i.e., the relief is temporary). The guidance within ASC 848 cannot be applied to contract modifications or hedging relationships after December 31, 2022, with limited exceptions for certain optional expedients related to hedging.</p>	<p>All amendments in Phase 1 and Phase 2 are required to be adopted. The Phase 1 amendments have to be applied for annual periods beginning on or after January 1, 2020 and the Phase 2 amendments have to be applied for annual periods beginning on or after January 1, 2021. Early adoption is permitted for both phases of the amendments.</p> <p>IFRS does not specify a date when the relief will end, but Phase 1 and Phase 2 provide certain guidance on what events would cause the various reliefs to cease being applied. Phase 1 provides that some of the amendments will end at the earlier of (a) when there is no longer uncertainty arising from IBOR reform over the timing and amount of the IBOR-based cash flows of the relevant item and (b) when the hedging relationship to which the relief is applied is discontinued.</p> <p>This will result in more judgment being applied than under US GAAP since US GAAP sets a specific date on which the relief must stop being applied.</p>

## 17.3 Scope of reference rate reform guidance

Both the US GAAP guidance and IFRS amendments allow for contracts that are modified as a direct result of reference rate reform to qualify for the relief offered by the amendments, though there are certain differences in how qualifying contracts are determined and how to treat contemporaneous changes. It is expected, however, that the scope of contract modifications and hedge accounting relationships that qualify for the relief would be similar under US GAAP and IFRS. Both frameworks also allow for the addition of contract fallback language to qualify for the relief.

There may be additional considerations when applying the amendments under IFRS that do not need to be considered when applying US GAAP, such as the “economically equivalent” requirement discussed below.



**US GAAP**

In order to qualify for the contract modification relief under ASC 848, modifications to terms must directly replace or have the potential to replace a reference rate that is expected to be discontinued with another interest rate index. If modifications are made that change or have the potential to change the amount or timing of contractual cash flows that are unrelated to the replacement of the reference rate, the guidance in ASC 848 cannot be applied even if such modifications are made contemporaneous with amendments related to reference rate reform.

ASC 848 provides a list of specific terms that can be modified that would be considered to be directly related to reference rate reform. It also lists changes that would be considered unrelated to reference rate reform.

**IFRS**

Under the IFRS amendments, changes in the basis for determining contractual cash flows as a result of interest rate benchmark reform are eligible for the practical expedient only to the extent that the changes are necessary as a direct consequence of interest rate benchmark reform, and the new basis is economically equivalent to the previous basis.

Under IFRS, if there are changes in addition to those required by IBOR reform made to financial assets or financial liabilities, an entity will generally first apply the practical expedient to the economically equivalent amendments and then apply other applicable IFRS to the additional changes to which the practical expedient does not apply.

However, this two-step accounting does not apply when lease modifications are made by lessees in addition to those required by IBOR reform. In such cases, an entity will be required to apply applicable IFRS 16 requirements to account for all lease modifications made at the same time, including those required by IBOR reform.

Under US GAAP, all entities would be disqualified from applying the reference rate reform practical expedients if a contemporaneous change unrelated to reference rate reform is made.

## 17.4 *Contract modifications*

Under the relief offered by US GAAP and the amendments to IFRS, the accounting for contract modifications that are the result of reference rate reform result in no immediate gain or loss recognition. The relief allows an entity to disregard certain aspects of existing US GAAP and IFRS in order to account for the modifications of financial instruments by adjusting the effective yield prospectively. The exact guidance depends on the modification guidance in existing standards, including ASC 310, ASC 470, and ASC 842 for US GAAP and IFRS 9 and IFRS 16 for IFRS.

**US GAAP**

For qualifying contract modifications to contracts accounted for under ASC 310 or ASC 470, no gain or loss will be recorded as a result of the modification. The amortized cost basis will remain unchanged (with the exception of any additional fees that are eligible to be capitalized) and a new effective yield will be established.

**IFRS**

Similar to US GAAP, the IFRS amendments allow an entity to account for qualifying modifications for financial assets and financial liabilities under IFRS 9 by updating the effective interest rate and not recognizing an immediate gain or loss.

The IFRS amendments to IFRS 16 for lease contracts provide a practical expedient such that



US GAAP	IFRS
For qualifying modifications to lease contracts accounted for under ASC 840 or ASC 842, an entity is not required to reassess lease classification or the discount rate, or remeasure lease payments, or the lease contract.	for qualifying modifications, a lessee will remeasure the lease liability by discounting the revised lease payments using a discount rate that reflects the change in the interest rate.
Under ASC 848, a reporting entity is not required to reassess its original conclusions as to whether a contract contains an embedded derivative that is clearly and closely related to the host contract.	The IASB did not provide specific guidance for embedded derivatives and did not provide a similar principle to extend the relief to other areas not specifically discussed in the amendments.
The contract modification relief in ASC 848 can be applied to other areas of US GAAP not specifically listed in ASC 848 as long as the contract modification meets the scope requirements of the standard.	

## 17.5 *Hedge accounting*

The FASB and IASB shared the goal of providing relief to allow hedge accounting relationships affected by reference rate reform to continue without being dedesignated/discontinued. However, differences in the hedge accounting models between ASC 815 and IFRS 9 necessitate differences in how that relief is applied.

Under both ASC 848 and the amendments to IFRS 9, entities are allowed to change the risk being hedged in a hedge relationship affected by reference rate reform without dedesignating the hedge relationship. For instance, in a cash flow hedge when the hedged risk is the variability in cash flows due to changes in IBOR, the relief under both US GAAP and IFRS would allow an entity to change the hedged risk to an alternative reference rate such as SOFR or SONIA without discontinuing the hedge relationship.

With slight differences described below, both US GAAP and IFRS require updates to the designation of the hedge relationship following changes such as substituting an alternative benchmark rate as the hedged risk or amending the description of the hedged item or hedging instrument. Updating of the hedge designation/documentation does not cause automatic dedesignation of the hedge relationship under either US GAAP or IFRS.

The US GAAP and IFRS relief allow an entity that has a cash flow hedge of a forecasted transaction based on a reference rate expected to be discontinued to disregard the potential for the rate to be discontinued when assessing if the transaction is probable (IFRS - highly probable) of occurring. This would prevent amounts in other comprehensive income for US GAAP and amounts in the cash flow hedge reserve under IFRS from needing to be recycled into earnings.

There is also additional relief under both US GAAP and IFRS when performing the prospective assessment of effectiveness. An entity can assume that the interest rate benchmark upon which the cash flows of the hedged item, hedging instrument, or hedged risk are based is not altered by IBOR reform.

**US GAAP**

An entity may make an election to change the method of assessing effectiveness used in a cash flow hedge if either the hedging instrument or hedged forecasted transaction references a rate expected to be discontinued and the new method for assessing effectiveness is an allowed optional expedient within ASC 848. Under this relief, an entity is not required to prove that the new effectiveness method is an improved methodology as would have been required under ASC 815.

ASC 848 requires an entity to update its hedge documentation upon changing a critical term of a hedging relationship due to the election of an optional expedient no later than when the reporting entity is required to perform its first assessment of hedge effectiveness after electing the optional expedient. This is also required if an entity changes its method of assessing hedge effectiveness for the hedging relationship.

ASC 848 also allows for an entity to prospectively change its systematic and rational method used to recognize excluded components in earnings if the changes to the contractual terms of a hedging instrument replace or have the potential to replace a reference rate expected to be discontinued and do not modify any terms unrelated to reference rate reform.

When hedging a group of forecasted transactions, ASC 815 requires that individual transactions in the group share the same risk exposure. However, ASC 848 allows an entity to ignore this criteria if the group of forecasted transactions references a rate expected to be discontinued.

**IFRS**

IFRS 9 requires a forward-looking prospective assessment of an economic relationship between the hedged item and the hedging instrument. During the period of relief, an entity assumes that the interest rate benchmark on which the cash flows of the hedged item, hedging instrument, or hedged risk are based is not altered by IBOR reform.

IFRS requires quantitative ineffectiveness to be recorded in net income (subject to the “lower of” test in cash flow hedging relationships). There is no relief provided in relation to the ongoing recording of ineffectiveness.

The IFRS amendments require an entity to make changes to the formal designation of the hedge relationship to reflect the changes that are required by IBOR reform when the entity ceases to apply the Phase 1 relief. The hedge designation is required to be amended to make one or more of the following changes:

- Designating an alternative benchmark rate as a hedged risk
- Amending the description of the hedged item (including the description of the designated portion of the cash flows or fair value being hedged)
- Amending the description of the hedging instrument

The hedge documentation is required to be amended by the end of the reporting period during which a change required by IBOR reform is made to the hedged risk, hedged item, or hedging instrument.

Certain reliefs are provided related to the measurement of amounts accumulated in a cash flow hedging reserve at the point when an entity amends the description of a hedged item. Certain additional reliefs are also provided for non-contractually specified risk components that are not separately identifiable at the time of designation.

US GAAP	IFRS
	<p>When applying the “changes to hedge designations and hedge documentation” temporary exception to hedges of groups of items under IFRS 9, hedged items must be allocated to sub-groups based on the benchmark rate being hedged, and the benchmark rate for each sub-group is designated as the hedged risk. As a result, some items in the group could be changed at different times. Each sub-group must be assessed separately to determine if it meets the requirements for eligible hedged items. Hedge accounting must be discontinued prospectively, for the hedge relationship in its entirety, if any sub-group fails to meet the eligible hedged item requirements. An entity should also account for the ineffectiveness related to the hedging relationship in its entirety.</p>

## 17.6 Discounting transition change

In January 2021, the FASB issued ASU 2021-01, *Reference Rate Reform (Topic 848): Scope*, to clarify that the scope of ASC 848 included derivatives that are affected by a change in the interest rate used for margining, discounting, or contract price alignment that do not also reference LIBOR or another reference rate that is expected to be discontinued as a result of reference rate reform (“the discounting transition”). This was in response to a market-wide transition initiated by certain central clearing houses to change the discount rate on cleared interest rate derivatives to alternative reference rates. The change in fair value of the derivative instrument as a result of the discounting transition was settled by a cash payment or receipt.

No additional amendments were issued by the IASB.

US GAAP	IFRS
<p>The FASB expanded the relief of the reference rate reform guidance to also include derivative instruments that use an interest rate for margining, discounting, or contract price alignment that is modified as a result of reference rate reform regardless of whether the derivative references LIBOR or another rate not expected to be discontinued.</p> <p>The updated amendments allow the derivative instruments impacted by this event to qualify for the contract modification relief and certain of the hedge accounting relief provisions within ASC 848, including the ability to not dedesignate a hedge relationship due to a change in critical terms.</p>	<p>No specific IFRS amendments were made as a result of the discounting transition. Accordingly, entities need to evaluate whether similar results could be achieved under existing IFRS guidance and accounting policies.</p>

**US GAAP****IFRS**

The amendments also provided the option for an entity to adjust the basis adjustment for a fair value hedge by the payment or receipt of a cash settlement intended to compensate for the change in fair value due to the change in discount rate and similarly to adjust the amount in AOCI for a cash flow hedge by the payment or receipt of a cash settlement intended to compensate for the change in fair value.

## 17.7 *Disclosures*

The disclosure requirements when adopting the amendments for IFRS are significantly more comprehensive than the requirements for US GAAP.

**US GAAP****IFRS**

US GAAP requires disclosing the nature and reason for electing to apply the optional expedients starting in the period when any practical expedient is first adopted.

IFRS disclosure requirements include:

- Significant interest rate benchmarks to which the entity's hedging relationships are exposed and the nominal amount of the hedging instruments in such relationships
- How an entity is managing the transition to alternative benchmark rates, including its progress at the reporting date and the risks to which it is exposed arising from financial instruments because of transition
- Disaggregated by significant interest rate benchmark subject to IBOR reform, quantitative information about financial instruments that have yet to transition to an alternative benchmark rate at the end of the reporting period, showing separately non-derivative financial assets and liabilities and derivatives
- A description of significant assumptions and judgments that the entity made in applying the amendments
- If the risks identified have resulted in any changes to an entity's risk management strategy, a description of these changes.