KPMG

IFRS® compared to US GAAP

Handbook

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Be clear in times of uncertainty

In times of uncertainty, investors, regulators and other users look for clarity in the annual report. They want to know how an entity is affected and how it addresses the challenges, and what judgements, estimates and assumptions management makes.

Both the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) are responding to drive clarity. A new accounting standard – *IFRS 18 Presentation and Disclosure in Financial Statements* – is effective in 2027, introducing a revised structure for the statement of profit or loss and bringing management performance measures into the spotlight. The FASB has also introduced new disclosure requirements to enhance transparency and comparability in the income statement. This edition of *IFRS compared to US GAAP* includes a new chapter highlighting the key differences related to these requirements.

Both standard-setters are also responding to the need for better information about intangible assets. The IASB is performing research as part of its comprehensive review of the intangible assets standard; the FASB has developed specific new requirements and proposals for emerging topics – e.g. newly effective requirements for crypto assets and proposals for environmental credit programmes. With new differences between IFRS Accounting Standards and US GAAP on the horizon, dual reporters need to monitor these developments closely.

We are pleased to publish this 2025 edition of *IFRS compared US GAAP*, highlighting the key differences between the two frameworks.

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About this publication

Purpose

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

Scope

This publication highlights what we believe are the main differences of principle, emphasis or application between IFRS Accounting Standards and US GAAP.

It does not address the requirements of the *IFRS for SMEs*® Accounting Standard or the initiative of the FASB and the Private Company Council in determining accounting alternatives for private companies under US GAAP. It also does not address the requirements of IAS 26 *Accounting and Reporting by Retirement Benefit Plans* or the equivalent US GAAP. Otherwise, this publication addresses the types of businesses and activities that IFRS Accounting Standards address. For example, the accounting for biological assets is included, but accounting by not-for-profit entities is not. In addition, this publication focuses on consolidated financial statements – it does not address separate (i.e. unconsolidated) financial statements.

The transition requirements to adopt specific accounting standards are not addressed. In addition, the requirements for adopting IFRS Accounting Standards as a framework are discussed on the basis that the entity has adopted them already. Therefore, the following are excluded from this publication: IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IFRS 14 *Regulatory Deferral Accounts*. The special transition requirements that apply in the period in which an entity changes its GAAP to IFRS Accounting Standards, including the implications for an entity in the scope of IFRS 14, are discussed in our practical guide to IFRS Accounting Standards, Insights into IFRS®.

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Organisation of the text

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

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

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

Our commentary is referenced to current requirements of IFRS Accounting Standards and the FASB's Accounting Standards Codification® as follows.

- For IFRS Accounting Standards, references in square brackets identify any relevant paragraphs of the accounting standards or other literature – e.g. *IFRS 3.18* is paragraph 18 of IFRS 3; *IFRS 2.IGEx2* is Example 2 of the IFRS 2 implementation guidance. References to IFRS Interpretations Committee decisions, addressed in its publication *IFRIC® Update*, are also indicated – e.g. *IU 01-13* is *IFRIC Update January 2013*.
- For US GAAP, references in square brackets identify any relevant paragraphs of the Codification – e.g. *220-10-45-3* is paragraph 45-3 of ASC Subtopic 220-10; *TQA 1300.15* is paragraph 15 of Technical Questions & Answers 1300, issued by the American Institute of Certified Public Accountants. References to SEC Regulations are also indicated – e.g. *Reg S-X Rule 10-01(b)(6)*.

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

Effective dates

Generally, the accounting standards and interpretations included in this publication are those that are mandatory for an annual reporting period beginning on 1 January 2025. Accounting standards and interpretations published by 31 October 2025 that are effective for an annual reporting period beginning on a later date are briefly mentioned at the end of the relevant chapter (as forthcoming requirements) when we believe their significance to understanding the differences between IFRS Accounting Standards and US GAAP. See below for our approach for financial instruments, insurance and presentation.

The IASB and the FASB take different approaches to the effective dates of new pronouncements.

- New accounting standards and interpretations issued by the IASB have a single effective date. For effective dates under IFRS Accounting Standards, see our Newly effective and forthcoming requirements page.

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- For many Accounting Standards Updates (ASUs) under US GAAP, the effective date distinguishes between entities that are public business entities and other entities. In some cases, the FASB may make a further distinction between SEC filers and non-SEC filers, and SEC filers may be further categorised as 'smaller reporting companies' vs other SEC filers. This means that the effective dates of a pronouncement can be spread over a number of years. The appendix provides a table of effective dates under US GAAP to help you navigate the new requirements included in the forthcoming requirements that are not yet (fully) effective.

This publication distinguishes the accounting for those US GAAP requirements that are not yet (fully) effective. However, for ease of reference we typically refer to 'public entities' vs 'non-public entities', with more nuanced discussion included in the appendix.

Financial instruments, insurance and presentation

IFRS 9 *Financial Instruments* became effective for annual periods beginning on or after 1 January 2018. The equivalent new accounting standards under US GAAP are also now effective for all entities. This edition compares the hedging requirements under US GAAP with the requirements in IAS 39 *Financial Instruments: Recognition and Measurement* – this is the subject of chapter 7.9B. This is because many entities applying IFRS Accounting Standards will continue to apply the hedge accounting requirements in IAS 39 in full or in part. When an entity reporting under IFRS Accounting Standards first applied IFRS 9, it could choose an accounting policy to either continue applying the hedge accounting requirements in the superseded IAS 39 in their entirety or apply those in chapter 6 of IFRS 9. It can do this until a new accounting standard resulting from the ongoing project on accounting for dynamic risk management becomes effective. An entity making this election is required to comply with the disclosure requirements for hedge accounting in IFRS 9. Even if an entity did not make this election, it may still apply the hedge accounting requirements in IAS 39 for a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities.

IFRS 17 *Insurance Contracts* became effective for annual periods beginning on or after 1 January 2023. ASU 2018-12 *Targeted Improvements to the Accounting for Long-Duration Contracts* was effective in 2023 for SEC filers that are not eligible to be smaller reporting companies and is effective in 2025 for other entities. This edition compares the new requirements under both IFRS Accounting Standards and US GAAP in chapter 8.1.

IFRS 18 *Presentation and Disclosure in Financial Statements* is effective for annual reporting periods beginning on or after 1 January 2027. IFRS 18 replaces IAS 1 *Presentation of Financial Statements*. The impacts of IFRS 18 are pervasive with many aspects of financial statement presentation and disclosure affected, particularly the income statement. Our First Impressions publication provides detailed insights and comprehensive analysis on applying the new standard. There are currently no equivalent forthcoming requirements under US GAAP, except for the forthcoming requirement for public entities to disclose selling expenses and disaggregated income statement expenses based on natural expense categories. This edition includes a new chapter 4.1A covering these requirements.

Reporting date and reporting period

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

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

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Abbreviations

The following abbreviations are used often in this publication.

CGU	Cash-generating unit
CODM	Chief operating decision maker
E&E	Exploration and evaluation
EBIT	Earnings before interest and taxes
EBITDA	Earnings before interest, taxes, depreciation and amortisation
ECLs	Expected credit losses
EPS	Earnings per share
ESOP	Employee share ownership plan
ESPP	Employee share purchase plan
FASB	US Financial Accounting Standards Board
FIFO	First-in, first-out
FVOCI	Fair value through other comprehensive income
FVTPL	Fair value through profit or loss
GAAP	Generally accepted accounting principles/practices
IASB	International Accounting Standards Board
IBOR	Interbank offered rates
IP	Intellectual property
ITCs	Investment tax credits
LIBOR	London Interbank Offered Rate
LIFO	Last-in, first-out
MD&A	Management's discussion and analysis
NCI	Non-controlling interests
OCI	Other comprehensive income
R&D	Research and development
SEC	US Securities and Exchange Commission
VAT	Value-added tax
VIE	Variable interest entity
WACC	Weighted-average cost of capital

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1 Background

1.1 Introduction

(IFRS Foundation Constitution, IFRS Foundation Due Process Handbook, Preface to IFRS Accounting Standards, IAS 1)

Overview

- **'IFRS Accounting Standards' is the term used to indicate the whole body of authoritative literature published by the IASB.**
- **Individual accounting standards and interpretations are developed and maintained by the IASB and the IFRS Interpretations Committee.**
- **IFRS Accounting Standards are designed for use by profit-oriented entities.**
- **Any entity claiming compliance with IFRS Accounting Standards complies with all accounting standards and interpretations, including disclosure requirements, and makes an explicit and unreserved statement of compliance with them.**
- **The overriding requirement of IFRS Accounting Standards is for the financial statements to give a fair presentation (or a true and fair view).**

1.1 Introduction

(Topic 105, Topic 250, SEC Rules and Regulations, AICPA Code of Professional Conduct)

Overview

- **'US GAAP' is the term used to indicate the body of authoritative literature that comprises accounting and reporting standards in the US. Rules and interpretative releases of the SEC under authority of federal securities laws are also sources of authoritative US GAAP for SEC registrants.**
- **Authoritative US GAAP is primarily developed and maintained by the FASB, with the assistance of the Emerging Issues Task Force and the Private Company Council.**
- **Unlike IFRS Accounting Standards, US GAAP is designed for use by both profit-oriented and not-for-profit entities, with additional Codification topics that apply specifically to not-for-profit entities.**
- **Like IFRS Accounting Standards, any entity claiming compliance with US GAAP complies with all applicable sections of the Codification, including disclosure requirements. However, unlike IFRS Accounting Standards, an explicit and unreserved statement of compliance with US GAAP is not required.**
- **The objective of financial statements is fair presentation in accordance with US GAAP, which is similar to the overriding requirement of IFRS Accounting Standards.**

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IFRS Accounting Standards

'IFRS Accounting Standards' is the term used to indicate the whole body of authoritative literature published by the IASB, including:

- Accounting Standards issued by the IASB;
- International Accounting Standards (IAS® Standards) issued by the IASB's predecessor, the International Accounting Standards Committee (IASC), or revisions thereof issued by the IASB;
- interpretations developed by the IFRS Interpretations Committee (IFRIC Interpretations) and approved for issue by the IASB; and
- interpretations developed by the IFRS Interpretations Committee's predecessor, the Standing Interpretations Committee (SIC® Interpretations) and approved for issue by the IASB or the IASC. [P.2]

Emerging issues related to the application of IFRS Accounting Standards are generally referred to the IFRS Interpretations Committee. If the Committee decides not to add an issue to its work programme or refer it to the IASB, then it publishes an agenda decision. An entity reporting under IFRS Accounting Standards applies agenda decisions relevant to its facts and circumstances. Although they do not change the requirements of the Accounting Standards, agenda decisions may provide new insights on how to interpret and apply them. An entity may have to change its accounting policy as a result of the publication of a final agenda decision and may need 'sufficient time' to implement it.

The term 'IFRS Accounting Standards' is used in this publication to indicate any of the above material.

IFRS Accounting Standards are designed for use by profit-oriented entities, although their use by not-for-profit entities is not prohibited. [P5, 9]

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

US Generally Accepted Accounting Principles

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

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

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

Emerging issues related to the application of US GAAP are generally referred to the EITF. Unlike IFRS Accounting Standards, the EITF does not publish agenda decisions when it decides not to add an issue to its work programme.

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

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

US private entities that are required, or otherwise decide, to prepare financial statements may do so in accordance with US GAAP, full IFRS Accounting Standards as issued by the IASB or the *IFRS for SMEs* Accounting Standard if they have no public accountability.

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IFRS Accounting Standards

Financial statements prepared in accordance with the IFRS for SMEs Accounting Standard are not in compliance with IFRS Accounting Standards.

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

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

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

IFRS Accounting Standards comprise a series of bold and plain-type paragraphs. Generally, the bold paragraphs outline the main principle, and the plain-type paragraphs provide further explanation. Bold and plain-type paragraphs have equal authority. Some IFRS Accounting Standards contain appendices; a statement at the top of each appendix specifies its status. The bases for conclusions that accompany accounting standards are not an integral part of those accounting standards and do not have the same level of authority. [P.14]

US GAAP

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

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

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

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

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

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

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IFRS Accounting Standards

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

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

Compliance with IFRS Accounting Standards

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

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

US GAAP

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

Unlike IFRS Accounting Standards, ASUs issued by the FASB usually have at least two effective dates, distinguish between at least public and non-public entities, and may apply in interim periods following application in the annual period. See appendix for further discussion based on ASUs that are forthcoming requirements in this publication.

Compliance with US GAAP

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

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

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

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Most foreign SEC registrants are required to prepare and file their Annual Report on Form 20-F in accordance with either US GAAP or another comprehensive basis of accounting, in which case net income and shareholders' equity are reconciled to US GAAP. The reconciliation is accompanied by a discussion of significant variations in accounting policies, practices and methods used in preparing the financial statements from US GAAP and Regulation S-X. However, a foreign private issuer that prepares its financial statements in accordance with IFRS Accounting Standards as issued by the IASB is not required to present such a reconciliation or the accompanying discussion of variations from US GAAP and Regulation S-X. This exemption is permitted only if the financial statements filed with the SEC contain an explicit and unreserved statement of compliance with IFRS Accounting Standards as issued by the IASB, which is also referred to in the auditor's report. [SEC Release 33-8879]

Entities' filings on Forms 10-K (generally used for US domestic issuers) or 20-F (generally used for foreign private issuers) are reviewed by the SEC Staff at least once every three years in accordance with the requirements of the Sarbanes-Oxley Act. The filings are reviewed for compliance with the stated basis of accounting and other relevant regulations. The review findings are communicated by comment letters from the SEC Staff to the entity.

When a foreign business is acquired by an SEC registrant, Regulation S-X allows for the inclusion of financial statements prepared in accordance with IFRS Accounting Standards as adopted in a specific jurisdiction or local GAAP (without reconciliation to US GAAP) if the acquired business is below the 30 percent level for all 'significance tests'. At or above 30 percent, a reconciliation to US GAAP is included for the annual and interim periods presented. This reconciliation may instead be to IFRS Accounting Standards as issued by the IASB if the acquirer is a foreign private issuer that prepares its financial statements under those Accounting Standards. The reconciliation to IFRS Accounting Standards as issued by the IASB is generally required to follow the form and content requirements in Item 17(c) of Form 20-F. However, no US GAAP reconciliation is required for the inclusion of financial statements of an acquired foreign business if that business uses IFRS Accounting Standards as issued by the IASB, regardless of the significance of the acquired business. [SEC FRM 6350.1, Rule 3-05(c), and SEC Release No. 33-10786]

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XBRL

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

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

Fair presentation

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

If compliance with a requirement of an IFRS accounting standard would be so misleading that it would conflict with the objective of financial reporting set out in the Conceptual Framework (see chapter 1.2), then an entity departs from the required treatment to give a fair presentation, unless the relevant regulator prohibits such an override. If an override cannot be used because it is prohibited by the regulator, then additional disclosure is required in the notes to the financial statements. When an entity departs from a requirement of an accounting standard, extensive disclosures are required, including details of the departure, the reasons for the departure and its effect. The use of a true and fair override is very rare under IFRS Accounting Standards. [IAS 1.19–24]

XBRL

eXtensible Business Reporting Language (XBRL) is a form of electronic communication whose main feature includes interactive electronic tagging of both financial and non-financial data. US domestic SEC registrants are required to either:

- supplement their filed financial statements with a secondary machine-readable XBRL format submitted as an exhibit; or
- file financial statements with embedded XBRL (Inline XBRL); this approach is required for large accelerated filers in annual periods ending on or after 15 June 2019; and for other filers at progressive dates after that. [SEC Release 33-10154, 34-83551]

Foreign private issuers who prepare financial statements in accordance with IFRS Accounting Standards as issued by the IASB are required to submit XBRL data files to the SEC with their annual filings (Form 20-F or Form 40-F) for annual periods ending on or after 15 December 2017. [SEC Release 33-10320, 34-80128]

Fair presentation in accordance with US GAAP

The objective of US GAAP is fair presentation in accordance with US GAAP, which is similar to the overriding requirement of IFRS Accounting Standards. Like IFRS Accounting Standards, compliance with US GAAP, with additional disclosure when necessary, is presumed to result in a fair presentation. [105-10-10-1, 15-1]

Like IFRS Accounting Standards, when compliance with the Codification would be misleading due to unusual circumstances, an entity departs from the Codification topic so that the financial statements will not be misleading. In this case, the entity discloses the effects of the departure and why compliance would render the financial statements misleading, like IFRS Accounting Standards. However, in our experience the use of such an override does not occur in practice. [AICPA Code of Professional Conduct 1.320.001, 030]

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Forthcoming requirements

IFRS 19 *Subsidiaries without Public Accountability: Disclosures* is effective for annual periods beginning on or after 1 January 2027.

Under the new standard, an eligible subsidiary is permitted to apply the requirements of IFRS Accounting Standards and the reduced disclosure requirements of IFRS 19 provided that, at the reporting date:

- it does not have public accountability; and
- it has an ultimate or intermediate parent that produces consolidated financial statements available for public use and prepared in compliance with IFRS Accounting Standards.

Forthcoming requirements

There are no forthcoming requirements under US GAAP.

Unlike IFRS Accounting Standards, when the FASB distinguishes disclosure requirements between public and non-public entities, the requirements are included in individual Codification topics/subtopics.

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1.2 The Conceptual Framework

(Conceptual Framework for Financial Reporting)

Overview

- **The Conceptual Framework is used in developing and maintaining accounting standards and interpretations.**
- **The Conceptual Framework is a point of reference for preparers of financial statements in the absence of specific guidance in IFRS Accounting Standards.**
- **Transactions with shareholders in their capacity as shareholders are recognised directly in equity.**

Introduction

The IASB and the IFRS Interpretations Committee use the *Conceptual Framework for Financial Reporting* (Conceptual Framework) in developing and maintaining accounting standards and interpretations. The Conceptual Framework also provides a point of reference for preparers of financial statements in the absence of any specific guidance in IFRS Accounting Standards (see chapter 1.1).

The Conceptual Framework does not override any specific accounting standard.

The Conceptual Framework provides a broad discussion of the concepts that underlie the preparation and presentation of financial statements. It discusses the:

- objective of general purpose financial reporting;
- qualitative characteristics of useful financial information, such as relevance and faithful presentation;
- concept of the reporting entity;
- elements of financial statements;
- general guiding principles for recognition and derecognition;
- measurement bases; and
- high-level concepts for presentation and disclosure.

1.2 The Conceptual Framework

(CON Statements, Topic 105, SAB Topics 1M, 1N, 5T)

Overview

- **Like IFRS Accounting Standards, the Conceptual Framework establishes the objectives and concepts that the FASB uses in developing guidance.**
- **Unlike IFRS Accounting Standards, the Conceptual Framework is non-authoritative guidance and is not referred to routinely by preparers of financial statements.**
- **Like IFRS Accounting Standards, transactions with shareholders in their capacity as shareholders are recognised directly in equity.**

Introduction

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

Like IFRS Accounting Standards, the Conceptual Framework does not override any specific requirements of the Codification.

Like IFRS Accounting Standards, the Conceptual Framework establishes the objectives of financial reporting, identifies the qualitative characteristics of accounting information, defines the elements of financial statements and discusses recognition, measurement, presentation of a complete set of financial statements and disclosure in the notes to the financial statements. [CON 8]

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Materiality

IFRS Accounting Standards do not apply to items that are 'immaterial'. The Conceptual Framework refers to materiality as an entity-specific aspect of relevance. Information is material if omitting it, misstating it or obscuring it could reasonably be expected to influence decisions that primary users make on the basis of financial information about a specific reporting entity. Materiality is not defined quantitatively, and depends on the facts and circumstances of a particular case; both the size and the nature of an item are relevant. Consideration of materiality is relevant to judgements about both the selection and the application of accounting policies and to the omission or disclosure of information in the financial statements. [CF 2.11, IAS 1.7, 8.5]

Accounting policies in accordance with IFRS Accounting Standards do not need to be applied when their effect is immaterial. [IAS 8.8]

Materiality

Unlike IFRS Accounting Standards, materiality is not specifically defined under authoritative US GAAP. However, it provides a framework that is consistent with the precedent on materiality established by the Supreme Court, and with the SEC staff's interpretative guidance that is derived from the Supreme Court precedent. For this reason, we believe that all entities should consider the SEC staff's interpretative guidance on materiality in conjunction with financial statement preparation by management. The Supreme Court has held that a fact is material if there is a substantial likelihood that the fact would have been viewed by a reasonable investor as having significantly altered the 'total mix' of information made available. [CON 8.QC11 – QC11B, SAB Topic 1M]

Like IFRS Accounting Standards, materiality is entity-specific, and an item can be material by its size (quantitatively material) or its nature (qualitatively material). Items are assessed individually and in the aggregate in relation to specific financial statement captions and disclosures, and to the financial statements as a whole. [SAB Topic 1M]

In considering the effects of prior-year misstatements, an entity evaluates materiality using one or both of the following methods; a registrant is required to apply both methods (collectively referred to as the 'dual method').

- *'Rollover' method:* This method quantifies a misstatement based on the effects of correcting the misstatement existing in each relevant financial statement. It quantifies the 'actual' financial statement misstatements considering the amounts that would have been in the financial statements if no misstatement existed.
- *'Iron curtain' method:* This method quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current period, irrespective of the misstatement's period(s) of origin. [SAB Topic 1M]

Once an entity has quantified the error, it evaluates the error individually and in combination with other errors, considering both quantitative and qualitative factors. Prior-period financial statements that are materially misstated are restated (see chapter 2.8). [SAB Topic 1M]

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

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Consideration of materiality is also relevant when making judgements about disclosure, including decisions about whether to aggregate items, and/or use additional line items, headings or subtotals. Material items that have different natures or functions cannot be aggregated. In addition, IFRS Accounting Standards do not permit an entity to obscure material information with immaterial information. [IAS 1.7, 29, 30A–31]

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

Reporting entity

A 'reporting entity' is one that is required, or chooses, to prepare financial statements. It need not be a legal entity but can comprise a single entity, multiple entities or a portion of an entity. [CF 3.10, 12]

In the case of multiple entities, if a reporting entity comprises two or more entities that are not all linked by a parent-subsidiary relationship (see chapter 2.5), then its financial statements are referred to as 'combined financial statements'. The preparation of combined financial statements is outside the scope of this publication. [CF 3.10, 12]

Assets and liabilities

An 'asset' is a present economic resource controlled by the entity as a result of past events. [CF 4.3]

A 'liability' is a present obligation of the entity to transfer an economic resource as a result of past events. An 'obligation' is a duty or responsibility that an entity has no practical ability to avoid. If it is conditional on an entity's future action, then an obligation exists if the entity has no practical ability to avoid taking that action. [CF 4.26–29, 32]

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

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

Reporting entity

Unlike IFRS Accounting Standards, the Conceptual Framework does not have a broad definition of 'reporting entity' that applies across all Codification topics, although the term is used throughout US GAAP. In practice, 'reporting entity' refers to an entity or group that presents financial statements as a single economic entity, like IFRS Accounting Standards. Like IFRS Accounting Standards, it need not be a legal entity but can comprise a single entity, multiple entities or a portion of an entity.

If a reporting entity comprises two or more entities that are commonly controlled or commonly managed, then its financial statements are referred to as 'combined financial statements'. The preparation of combined financial statements is outside the scope of this publication. [810-10-20, 55-1B]

Assets and liabilities

Unlike IFRS Accounting Standards, the definition of 'assets' encompasses a present right to an economic benefit. [CON 8.E17]

Unlike IFRS Accounting Standards, the definition of 'liabilities' encompasses a present obligation requiring an entity to transfer or otherwise provide economic benefits to others. [CON 8.E38]

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An 'economic resource' is a right or a set of rights that has the potential to produce economic benefits. The probability of economic benefits is not relevant for determining whether an asset or a liability exists; however, a low probability of economic benefits may affect the recognition and measurement analysis. [CF 4.4, 14–15, 37–38]

An 'executory contract' is one in which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. If the terms of the exchange under the contract are currently favourable for the entity, then it has an asset. Conversely, if the terms are currently unfavourable for the entity, then it has a liability. The asset or liability is reflected in the financial statements if it is required by a specific accounting standard (e.g. onerous contracts – see chapter 3.12). [CF 4.56–57]

Recognition and derecognition

An entity recognises any item meeting the definition of an asset or a liability in the financial statements unless it affects the relevance or the faithful representation of the information provided:

- its 'relevance' may be affected if there is uncertainty about the existence of an asset or liability or the probability of an inflow or outflow of economic benefits from the asset or liability is low; and
- its 'faithful representation' may be affected by high measurement uncertainty. [CF 5.6–7, 12, 18–22]

An item is derecognised from the financial statements when it no longer meets the definition of an asset or liability. This is accompanied by appropriate presentation and disclosure. [CF 5.26]

Measurement

The Conceptual Framework describes two measurement bases and the factors to consider when selecting a measurement basis.

- *Historical cost:* measurement is based on information derived from the transaction price and that measurement is not changed unless it relates to impairment of an asset or a liability becoming onerous.

Like IFRS Accounting Standards, the probability of economic benefits is not relevant for determining whether an asset or liability exists; however, a low probability of economic benefits may affect the recognition and measurement analysis. [CON 8.BC4.11]

Unlike IFRS Accounting Standards, US GAAP does not define an executory contract. However, the US Bankruptcy Code (Chapter 11) defines an executory contract and states as the standard feature that each party to the contract has duties remaining under the contract. Further, the FASB's Emerging Issues Task Force has discussed the term 'executory contract' in broadly the same manner as under IFRS Accounting Standards. Practice under US GAAP is not to recognise executory contracts unless a specific Codification topic requires recognition, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, US GAAP does not have a general requirement to recognise onerous contracts (see chapter 3.12).

Recognition and derecognition

Unlike IFRS Accounting Standards, an item and its financial information needs to meet three criteria to be recognised in the financial statements, subject to the pervasive cost constraint and materiality considerations. Those criteria are as follows.

- *Definitions:* The item meets the definition of an element of financial statements.
- *Measurability:* The item is measurable and has a relevant measurement attribute.
- *Faithful representation:* The item can be depicted and measured with faithful representation. [CON 8.RD5]

Unlike IFRS Accounting Standards, an item that no longer meets any one of the three recognition criteria is derecognised from the financial statements. [CON 8.RD13]

Measurement

The Conceptual Framework discusses two relevant and representationally faithful measurement systems.

- *Entry Price:* the price paid (the value of what was given up) to acquire an asset, or received to assume a liability, in an exchange transaction.
- *Exit price:* the price received (the value of what was received) to sell an asset, or paid to transfer or settle a liability, in an exchange transaction. [CON 8.M7]

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- *Current value:* measurement is based on information that reflects current conditions at the measurement date. It includes the following:
  - *fair value:* i.e. the price received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (see chapter 2.4);
  - *value in use and fulfilment value that are based on the present values of cash flows:* i.e. entity-specific expectations about the amount, timing and uncertainty of those future cash flows; and
  - *current cost:* i.e. the current amount that an entity would pay to acquire an asset or would receive to take on a liability. [CF 6.4, 10–12, 17, 21]

Transactions with equity holders

The definitions of income and expenses exclude capital transactions with equity holders acting in that capacity. Accordingly, capital contributions from shareholders are recognised directly in equity, as are dividends paid (see chapter 7.3). However, the position is less clear when a transaction with a shareholder equally could have been with a third party. In these cases, the accounting is generally based on whether the shareholder was acting as a 'normal' counterparty. [CF 4.1, 70]

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

Although these concepts are articulated differently from IFRS Accounting Standards, they broadly align with the bases under IFRS Accounting Standards. However, the measurement definitions used in specific Codification topics take precedence over these general concepts.

Transactions with equity holders

Like IFRS Accounting Standards, all transfers between an entity and its equity holders acting in that capacity, including investments by owners and distributions to owners, are recognised directly in equity (see chapter 7.3). However, because there are circumstances in which an entity evaluates whether the transaction was with the party in its role as a shareholder or on behalf of the entity, differences from IFRS Accounting Standards may arise in practice. [CON 8.E71–E72]

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

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2 General issues

2.1 Basis of preparation of financial statements

(IAS 1)

Overview

- Financial statements are prepared on a going concern basis, unless management intends or has no realistic alternative other than to liquidate the entity or to stop trading.
- If management concludes that the entity is a going concern, but there are nonetheless material uncertainties that cast significant doubt on the entity's ability to continue as a going concern, then the entity discloses those uncertainties.
- In carrying out its assessment of going concern, management considers all available information about the future for at least, but not limited to, 12 months from the reporting date. This assessment determines the basis of preparation of the financial statements.
- If the entity is not a going concern and the financial statements are being prepared in accordance with IFRS Accounting Standards, then in our view there is no general dispensation from their measurement, recognition and disclosure requirements.

2.1 Basis of preparation of financial statements

(Topics 205, 852, 855)

Overview

- Financial statements are generally prepared on a going concern basis (i.e. the usual requirements of US GAAP apply) unless liquidation is imminent. Although this wording differs from IFRS Accounting Standards, we would not generally expect significant differences in practice.
- If management concludes that the entity is a going concern, but there is substantial doubt about the entity's ability to continue as a going concern, then disclosures are required, like IFRS Accounting Standards. However, the disclosures are more prescriptive than IFRS Accounting Standards, which may lead to differences in practice. Additionally, if management's plans mitigate the doubt, then other disclosures are required, which may give rise to differences from IFRS Accounting Standards in practice.
- Unlike IFRS Accounting Standards, the assessment of going concern is for a period of one year from the financial statements being issued (or available to be issued). Unlike IFRS Accounting Standards, this assessment is for the purpose of determining whether the disclosures in the financial statements are appropriate, and the basis of preparation is not affected unless liquidation is imminent.
- Unlike IFRS Accounting Standards, if liquidation is imminent, then there are specific requirements for the measurement, recognition and disclosures under US GAAP.

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Going concern assessment

Financial statements are prepared on a going concern basis, unless management intends or has no realistic alternative other than to liquidate the entity or to stop trading. [IAS 1.25]

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

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

IFRS Accounting Standards are not prescriptive about the events and conditions that should be considered as part of the going concern assessment and do not provide specific guidance on the mitigating effects of management's plans.

Going concern assessment

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

Liquidation is 'imminent' when a plan for liquidation:

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

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

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

In making this assessment, management considers both known and reasonably knowable events and conditions. The evaluation follows a two-step process.

- *Step 1:* Assess whether substantial doubt is raised – i.e. whether it is probable that the entity will be unable to meet its obligations when they become due within the one-year period. Step 1 does not take into consideration the potential mitigating effects of management's plans.
- *Step 2:* If substantial doubt is raised in Step 1, then assess whether substantial doubt exists or is alleviated by management's plans. [205-40-50-3 – 50-11]

Although this two-step process is more prescriptive than IFRS Accounting Standards, we would not generally expect significant differences in the types of events or conditions considered.

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If an entity ceases to be a going concern after the reporting date but before the financial statements are authorised for issue, then the financial statements are not prepared on a going concern basis. [IAS 1.25–26, 10.14]

Disclosures about the going concern assessment

If management concludes that the entity is a going concern, but there are nonetheless material uncertainties that cast significant doubt on the entity's ability to continue as a going concern, then the entity discloses those uncertainties. In our view, if there are such material uncertainties, then an entity should, at a minimum, disclose the following information:

- details of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's evaluation of their significance in relation to the going concern assessment;
- management's plans to mitigate the effect of these events or conditions;
- significant judgements made by management in their going concern assessment, including their determination of whether there are material uncertainties; and
- an explicit statement that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, and therefore that it may be unable to realise its assets and discharge its liabilities in the normal course of business. [IAS 1.25, IU 07-10]

If there are no material uncertainties about an entity's ability to continue as a going concern, but reaching that conclusion involved significant judgement (i.e. a 'close call' scenario), then in our view similar information to that in respect of material uncertainties (see first three points above) may be relevant to the users' understanding of the entity's financial statements. [IAS 1.122, IU 07-14]

Unlike IFRS Accounting Standards, if liquidation becomes imminent after the reporting date but before the financial statements are issued (which may be later than when the financial statements are authorised for issue) or available to be issued, then the financial statements are prepared on a going concern basis. In this case, specific disclosures are required. [855-10-25-3 – 25-4]

Disclosures about the going concern assessment

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

If substantial doubt is raised in Step 1 but alleviated by management's plans in Step 2 (i.e. substantial doubt does not exist), then the entity discloses:

- the principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern (before consideration of management's plans);
- management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations; and
- management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern. [205-40-50-12]

If substantial doubt is raised in Step 1 but not alleviated by management's plans in Step 2 (i.e. substantial doubt exists), then the entity discloses (in addition to the above) a statement that there is substantial doubt about the entity's ability to continue as a going concern. [205-40-50-13 – 50-14]

In principle, these disclosures are similar to the types of disclosures that might be expected under IFRS Accounting Standards. However, the more specific wording under US GAAP may lead to differences in practice – e.g. as a result of the specific definition of the term 'substantial doubt', the use of a probability threshold in determining whether the reporting entity will be unable to meet its obligations, and the two-step process used to determine the specific categories of disclosures applicable to an entity's circumstances.

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Entity is not a going concern

If the entity is not a going concern but the financial statements are being prepared in accordance with IFRS Accounting Standards, then in our view there is no general dispensation from their measurement, recognition and disclosure requirements. We believe that even if the going concern assumption is not appropriate, IFRS Accounting Standards should be applied, with particular attention paid to the requirements for assets that are held for sale (see chapter 5.4), the classification of debt and equity instruments (see chapter 7.3), the impairment of non-financial assets (see chapter 3.10) and the recognition of provisions (see chapter 3.12).

For an entity in liquidation, all liabilities continue to be recognised and measured in accordance with the applicable accounting standard until the obligations are discharged or cancelled or expire (see chapters 3.12 and 7.6).

Subsidiary expected to be liquidated

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

Liquidation basis of accounting

Unlike IFRS Accounting Standards, if liquidation is imminent, then there are specific requirements for measurement, recognition and disclosures under US GAAP, including the following.

- The entity recognises previously unrecognised items (e.g. trademarks) that it expects either to sell in liquidation or to use to settle liabilities. Such items may be recognised in the aggregate.
- The entity recognises liabilities in accordance with the usual requirements of US GAAP, but also accrues the estimated costs to dispose of items that it expects to sell in liquidation.
- The entity accrues costs and income that it expects to incur or earn through the end of its liquidation if and when it has a reasonable basis for estimation.

[205-30-25-4 – 25-7]

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

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

Unlike IFRS Accounting Standards, as a minimum the entity prepares:

- a statement of net assets in liquidation; and
- a statement of changes in net assets in liquidation, incorporating only changes in net assets that occurred during the period since liquidation became imminent.

[205-30-45-1 – 45-2]

Liquidation of a subsidiary is imminent

The liquidation of a subsidiary (that is still controlled by the parent – see chapter 2.5) may be imminent and its stand-alone financial statements be prepared on the liquidation basis of accounting. If the parent is expected to continue as a going concern, then, unlike IFRS Accounting Standards, in our view it may choose an accounting policy, to be applied consistently, of whether to retain or not to retain the subsidiary's liquidation basis accounting in the consolidated financial statements.

[205-30-45-2]

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Bankruptcy accounting

IFRS Accounting Standards do not provide specific guidance on the accounting by entities before, during or emerging from bankruptcy; instead, the usual requirements of IFRS Accounting Standards apply.

Bankruptcy accounting

Unlike IFRS Accounting Standards, US GAAP provides specific guidance on accounting issues related to bankruptcy proceedings under Chapter 11 of the US Bankruptcy Code.

Like IFRS Accounting Standards, in the period preceding bankruptcy an entity continues to apply US GAAP in the usual way. However, the facts and circumstances causing the entity to contemplate bankruptcy may trigger incremental accounting considerations given the entity's financial standing.

During bankruptcy proceedings, US GAAP contains specific guidance related to the classification and accounting for certain financial liabilities and the presentation of the income statement (statement of operations). [852-10]

Unlike IFRS Accounting Standards, fresh-start reporting is applied by entities emerging from bankruptcy if:

- the entity's reorganisation value immediately before the date of confirmation is less than the total of all post-petition liabilities and allowed claims; and
- the holders of existing voting shares immediately before confirmation lose control of the entity and the loss of control is not temporary. [852-10-45-19]

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2.2 Form and components of financial statements

(IAS 1, IFRS 10, IFRS Practice Statement 2)

Overview

- **An entity with one or more subsidiaries presents consolidated financial statements unless specific criteria are met.**
- **The following are presented as a complete set of financial statements: a statement of financial position; a statement of profit or loss and OCI; a statement of changes in equity; a statement of cash flows; and notes, including accounting policies.**
- **All owner-related changes in equity are presented in the statement of changes in equity, separately from non-owner changes in equity.**
- **IFRS Accounting Standards specify minimum disclosures for material information; however, they do not prescribe specific formats.**
- **Comparative information is required for the preceding period only, but additional periods and information may be presented.**

2.2 Form and components of financial statements

(Subtopic 205-10, Subtopic 220-10, Topic 250, Subtopic 505-10, Subtopic 810-10, Reg S-X)

Overview

- **Unlike IFRS Accounting Standards, there are no exemptions, other than for investment companies, from preparing consolidated financial statements if an entity has one or more subsidiaries.**
- **Like IFRS Accounting Standards, the following are presented as a complete set of financial statements: a statement of financial position; a statement of comprehensive income; a statement of cash flows; and notes, including accounting policies. Changes in equity may be presented either within a separate statement (like IFRS Accounting Standards) or in the notes to the financial statements (unlike IFRS Accounting Standards).**
- **Like IFRS Accounting Standards, all owner-related changes in equity are presented separately from non-owner changes in equity.**
- **Like IFRS Accounting Standards, although minimum disclosures are required, which may differ from IFRS Accounting Standards, specific formats are not prescribed. Unlike IFRS Accounting Standards, there are more specific format and line item presentation and disclosure requirements for SEC registrants.**
- **Unlike IFRS Accounting Standards, US GAAP encourages but does not require presentation of comparative information. However, like IFRS Accounting Standards, SEC registrants are generally required to present statements of financial position as at the end of the current and prior reporting periods; unlike IFRS Accounting Standards, all other statements are generally presented for the three most recent reporting periods.**

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Overview (continued)

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

Consolidated financial statements

A parent entity does not present consolidated financial statements if it is an investment entity that is required to measure all of its subsidiaries at FVTPL (see chapter 5.6). [IFRS 10.4B]

In addition, a parent entity is not required to present consolidated financial statements if all of the following criteria are met:

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

Overview (continued)

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

Consolidated financial statements

Like IFRS Accounting Standards, a parent entity generally does not present consolidated financial statements if it is an investment company that is required to measure its investments in subsidiaries at FVTPL, except in limited circumstances. In addition, unlike IFRS Accounting Standards, in certain circumstances an entity may qualify for a consolidation exception under US GAAP by virtue of being regulated under the Investment Company Act of 1940 (see chapter 5.6). [810-10-15-12]

Unlike IFRS Accounting Standards, there is no exemption from preparing consolidated financial statements for a parent that is itself a wholly owned subsidiary, or a partially owned subsidiary for which the owners agree that consolidated financial statements are not required. Other consolidation scope exceptions are discussed in chapter 2.5.

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Reporting period

Financial statements are presented for the reporting period ending on the date of the statement of financial position (reporting date). [IAS 1.10]

An entity presents a complete set of financial statements (see below) at least annually and consistently prepares them for a one-year period. [IAS 1.36–37]

The reporting date may change in certain circumstances – e.g. following a change of major shareholder. When the reporting date changes, the annual financial statements are presented for a period that is longer or shorter than a year. In this case, the entity discloses the reasons for using a longer or shorter period and the fact that information in the financial statements is not fully comparable. There is no requirement to adjust historical comparative information. However, pro forma information for the comparable preceding reporting period might be presented. [IAS 1.36]

Components of the financial statements

The following is presented as a complete set of financial statements:

- a statement of financial position (see chapter 3.1);
- a statement of profit or loss and OCI (see chapter 4.1);
- a statement of changes in equity (see below);
- a statement of cash flows (see chapter 2.3); and
- notes to the financial statements, comprising material accounting policy information and other explanatory information. [IAS 1.10]

Reporting period

Like IFRS Accounting Standards, financial statements are presented for the reporting period ending on the date of the statement of financial position (reporting date). [205-10-45-1A]

Like IFRS Accounting Standards, an entity generally presents a complete set of financial statements (see below), referred to as a full set of financial statements under US GAAP, at least annually and consistently prepares them for a one-year period. [S-X Rule 1-02(k), S-X Rule 4-03]

Unlike IFRS Accounting Standards, an entity can change its reporting date under any circumstances. Unlike IFRS Accounting Standards, even when the reporting date changes, the reporting period for SEC registrants cannot be greater than 12 months. Therefore, in these situations, the registrant is required to prepare financial statements for the transition period, which covers from the end of the most recent annual reporting period to the new reporting date. Like IFRS Accounting Standards, there is no requirement to adjust historical comparative information (i.e. recast); however, adjusted historical comparative information may be presented. [Reg S-X 210.3-06]

Components of the financial statements

The following is presented as a complete (full) set of financial statements:

- a statement of financial position (see chapter 3.1), like IFRS Accounting Standards;
- a statement of comprehensive income (see chapter 4.1), like IFRS Accounting Standards;
- a statement of changes in equity, which may differ in some respects from IFRS Accounting Standards (see below);
- a statement of cash flows (see chapter 2.3), like IFRS Accounting Standards; and
- notes to the financial statements, comprising a summary of significant accounting policies and other explanatory information, like IFRS Accounting Standards. [205-10-45-1A, 45-4]

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IFRS Accounting Standards

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

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

Disclosures that are not material need not be included in the financial statements, even if an accounting standard includes a specific requirement or describes it as a minimum requirement. This also applies to accounting policy information that is immaterial (see below). An entity is not permitted to obscure material information with immaterial information because this reduces the understandability of its financial statements. [IAS 1.30A, 31, 117–117E, BC30H–BC30I]

An entity is required to disclose its 'material' accounting policies. In assessing whether accounting policy information is material, an entity considers whether the users of its financial statements would need that information to understand other material information in the financial statements and considers both the size and nature of the transactions, other events or conditions. [IAS 1.117–117E]

In addition to the information required to be disclosed in the financial statements, many entities provide additional information outside the financial statements, either because of local regulations or stock exchange requirements, or voluntarily (see chapter 5.8). [IAS 1.13, 54–55A, 82–85B]

US GAAP

Like IFRS Accounting Standards, an entity presents a statement of comprehensive income as part of a complete set of financial statements. Entities may present changes in equity for each caption of shareholders' equity presented in the statement of financial position within a statement of changes in equity (like IFRS Accounting Standards) or in the notes to the financial statements (unlike IFRS Accounting Standards). Like IFRS Accounting Standards, the statements of comprehensive income and changes in equity are not combined. [505-10-50-2, Reg S-X 210.3-04]

Like IFRS Accounting Standards, US GAAP requires entities to present certain items on the face of the financial statements, whereas other items may be disclosed in the notes to the financial statements; however, the specific items differ between US GAAP and IFRS Accounting Standards. Unlike IFRS Accounting Standards, more prescriptive guidance applies to SEC registrants, with requirements for various line items and additional presentation requirements and disclosures to appear either on the face of the financial statements or in the related notes.

Like IFRS Accounting Standards, US GAAP states that the provisions of the Codification do not apply to immaterial items. [105-10-05-6]

Like IFRS Accounting Standards, US GAAP requires an entity to disclose the accounting policies that materially affect the determination of financial position, cash flows or results of operations. While the Codification refers to these accounting policies as 'significant accounting policies', we would not generally expect significant differences from IFRS Accounting Standards in practice. [235-10-50-1, 50-3]

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

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Statement of changes in equity

The following information is presented in the statement of changes in equity:

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

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

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

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

Capital disclosure

An entity discloses information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital. [IAS 1.134]

Information on changes in equity

Like IFRS Accounting Standards, the following information is presented in respect of changes in equity:

- net income and total comprehensive income for the period, showing separately for net income and OCI the amounts attributable to owners of the parent and to NCI;
- for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with the Codification Topic on accounting policies, changes in estimates and errors (see chapter 2.8); and
- for each component of equity, a reconciliation between the carrying amount at the beginning and at the end of the period, separately disclosing changes resulting from:
  - profit or loss;
  - OCI; and
  - transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control. [505-10-50-2, 810-10-50-1A, Reg S-X 210.3-04]

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

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

Dividends and related per-share amounts are disclosed either in the statement of changes in equity or in the notes to the financial statements, like IFRS Accounting Standards, or in the statement of financial position, unlike IFRS Accounting Standards. [505-10-50-2, Reg S-X 210.3-04]

Capital disclosure

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

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Comparative information

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

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

Unless there is a specific exemption provided in an accounting standard, an entity discloses comparative information in respect of the previous period for all amounts reported in the current period's financial statements. Generally, the previous period's related narrative and descriptive information is required only if it is relevant for an understanding of the current period's financial statements and regardless of whether it was provided in the prior period. [IAS 1.38, 2.70]

Restatements and retrospective adjustments

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

Comparative information

Unlike IFRS Accounting Standards, for non-SEC registrants financial statements for the comparative period are encouraged but not required; however, in our experience comparative information for the preceding period is generally presented. [205-10-45-1 – 45-2]

Unlike IFRS Accounting Standards, SEC registrants filing financial statements in accordance with US GAAP are generally required to present statements of earnings, statements of comprehensive income (if presented as a separate financial statement), statements of equity and statements of cash flows for each of the most recent three years (two years for 'smaller reporting companies', like IFRS Accounting Standards). Like IFRS Accounting Standards, SEC registrants are required to present statements of financial position for each of the most recent two years. [Reg S-X 210.3-01 – 3-04, 210.8-02]

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

Unlike IFRS Accounting Standards, the notes, explanations and accountants' reports containing qualifications that appeared on the statements for the preceding years are repeated, or at least referenced to, in the comparative information, to the extent that they continue to be of significance. [205-10-50-2]

Restatements and retrospective adjustments

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

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Forthcoming requirements

A new presentation and disclosure standard (see chapter 4.1A) is effective for annual periods beginning on or after 1 January 2027; early adoption is permitted. [IFRS 18.C1]

The presentation and disclosure standard provides guidance on how entities group (aggregate and disaggregate) information in the primary financial statements and the notes. This includes:

- defined roles of the primary financial statements and the notes;
- principles of aggregation based on shared characteristics and disaggregation based on characteristics that are not shared; and
- guidance for labelling and describing items presented or disclosed in a way that faithfully represents the characteristics of the item.

Forthcoming requirements

There are no forthcoming requirements under US GAAP affecting the form and components of financial statements.

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2.3 Statement of cash flows

(IAS 7)

Overview

- 'Cash and cash equivalents' include certain short-term investments and, in some cases, bank overdrafts.
- The statement of cash flows presents cash flows during the period, classified by operating, investing and financing activities.
- The separate components of a single transaction are classified as operating, investing or financing.
- Cash flows from operating activities may be presented under either the direct method or the indirect method. If the indirect method is used, then an entity presents a reconciliation of profit or loss to net cash flows from operating activities; however, in our experience practice varies regarding the measure of profit or loss used.
- An entity chooses its own policy for classifying each of interest and dividends paid as operating or financing activities, and interest and dividends received as operating or investing activities.
- Income taxes paid are generally classified as operating activities.
- Foreign currency cash flows are translated at the exchange rates at the dates of the cash flows (or using averages when appropriate).

2.3 Statement of cash flows

(Topic 230, Subtopic 405-50)

Overview

- Like IFRS Accounting Standards, 'cash and cash equivalents' include certain short-term investments. Unlike IFRS Accounting Standards, bank overdrafts are classified as liabilities and included in financing activities.
- Like IFRS Accounting Standards, the statement of cash flows presents cash flows during the period, classified by operating, investing and financing activities.
- The separate components of a single cash flow are each classified as operating, investing or financing if such a distinction can reasonably be made based on its identifiable sources and uses, like IFRS Accounting Standards. Otherwise, unlike IFRS Accounting Standards, classification is based on the activity that is likely to be the predominant source or use of the cash flow.
- Like IFRS Accounting Standards, cash flows from operating activities may be presented under either the direct method or the indirect method. Like IFRS Accounting Standards, if the indirect method is used, then an entity presents a reconciliation of income to net cash flows from operating activities; unlike IFRS Accounting Standards, the starting point of the reconciliation is required to be net income.
- Unlike IFRS Accounting Standards, interest received and paid (net of interest capitalised) and dividends received from previously undistributed earnings are required to be classified as operating activities. Also unlike IFRS Accounting Standards, dividends paid are required to be classified as financing activities.
- Income taxes are generally required to be classified as operating activities, like IFRS Accounting Standards.
- Like IFRS Accounting Standards, foreign currency cash flows are translated at the exchange rates at the dates of the cash flows (or using averages when appropriate).

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Overview (continued)

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

Cash and cash equivalents

'Cash flows' are movements in cash and cash equivalents. IFRS Accounting Standards do not define 'restricted' amounts but amounts subject to restrictions may meet the definition of 'cash' or of 'cash equivalents' (see below). [IAS 7.6]

'Cash' comprises cash on hand and demand deposits. 'Demand deposits' are not defined in IFRS Accounting Standards, but in our view they should have the same level of liquidity as cash and therefore should be available to be withdrawn at any time without penalty. 'Cash equivalents' are short-term highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value. [IAS 7.6–7]

An overriding test for 'cash equivalents' is that they are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. This test is commonly referred to as the 'purpose test'. [IAS 7.7]

'Short-term' is not defined, but the accounting standard encourages a cut-off of three months' maturity from the date of acquisition. In our view, three months is a presumption that may be rebutted only in rare cases when facts and circumstances indicate that the investment is held for the purpose of meeting short-term cash commitments and when the instrument otherwise meets the definition of a cash equivalent. [IAS 7.7, IU 05-13]

Overview (continued)

- **Like IFRS Accounting Standards, financing and investing cash flows are generally reported gross. Cash flows are offset only in limited circumstances, which are more specific than those under IFRS Accounting Standards, although differences in practice would not generally be expected.**

Cash and cash equivalents

Unlike IFRS Accounting Standards, 'cash flows' are movements in cash, cash equivalents and amounts generally described as restricted cash and restricted cash equivalents. [230-10-45-4]

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

Unlike IFRS Accounting Standards, the US GAAP definition of 'cash equivalents' does not include the 'purpose test'. Instead, an entity develops an accounting policy to determine which investments meeting the definition of 'cash equivalents' are treated as such. In practice, investments that are treated as cash equivalents are generally held for the purpose of meeting short-term cash commitments, like IFRS Accounting Standards. [230-10-45-6]

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

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IFRS Accounting Standards

An investment that is redeemable at any time is a cash equivalent only if the amount of cash that would be received is known at the time of the initial investment, is subject to an insignificant risk of changes in value, and the other criteria for cash equivalents are met. The fact that an investment can be converted at the market price at any time does not necessarily mean that the 'readily convertible to known amounts of cash' criterion has been met. [IU 07-09]

Bank overdrafts that are repayable on demand are included in cash and cash equivalents only if they form an integral part of the entity's cash management. [IAS 7.8]

Short-term borrowing arrangements (e.g. short-term loans and credit facilities with a short contractual notice period) are generally not included in cash and cash equivalents because they are not repayable on demand. If the balance of such an arrangement does not often fluctuate from being negative to positive, then there is an indication that it does not form an integral part of the entity's cash management but instead represents a form of financing. [IU 06-18]

IFRS Accounting Standards do not define 'restricted' amounts. Amounts subject to restrictions qualify as cash and cash equivalents if they meet the definition of 'cash' (see above) or 'cash equivalents' (see above). For example, a demand deposit subject to restrictions on use arising from a contract with a third party is cash, unless those restrictions change the nature of the demand deposit in a way that it would no longer meet the definition of cash. [IAS 7.6–7, IU 03-22]

Restricted amounts that meet the definition of cash and cash equivalents under IFRS Accounting Standards are included in cash and cash equivalents in the statement of financial position (see chapter 3.1). In addition, where relevant to an understanding of an entity's financial position, restricted amounts are presented separately from other components of cash and cash equivalents in an additional line item in its statement of financial position. [IAS 1.54(i), 55, IU 03-22]

IFRS Accounting Standards include a general requirement to reconcile cash and cash equivalents in the statement of cash flows to the equivalent amount presented in the statement of financial position and this reconciliation may be included in the notes to the financial statements. [IAS 7.45]

US GAAP

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

Unlike IFRS Accounting Standards, bank overdrafts are classified as liabilities. Bank overdrafts are considered a form of short-term financing; we believe changes therein are classified as financing activities in the statement of cash flows. [TQA 1300.15]

Like IFRS Accounting Standards, short-term debt obligations are not included in cash and cash equivalents and are classified as liabilities. [470-10-45-13]

Like IFRS Accounting Standards, US GAAP does not include a specific definition of 'restricted' cash and cash equivalents. However, in practice restricted amounts are commonly understood to include cash and cash equivalents whose withdrawal or usage is restricted, such as:

- legally restricted deposits held as compensating balances against short-term borrowing arrangements;
- contracts entered into with others; and
- statements of intention regarding particular deposits. [S-X Rule 5-02(1)]

Unlike IFRS Accounting Standards, restricted amounts are excluded from cash and cash equivalents in the statement of financial position (see chapter 3.1). However, they are included in total cash in the statement of cash flows. If total cash in the statement of cash flows includes restricted amounts, then the title of the line item so indicates and the nature of the restrictions is disclosed. [230-10-45-4]

Like IFRS Accounting Standards, US GAAP includes a general requirement to reconcile cash and cash equivalents in the statement of cash flows to the equivalent amount presented in the statement of financial position and this reconciliation may be included in the notes to the financial statements. [230-10-50-7 – 50-8]

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Operating, investing and financing activities

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

- 'Operating activities' are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities, and generally result from transactions and events that enter into the determination of profit or loss.
- 'Investing activities' relate to the acquisition and disposal of long-term assets and other investments that are not included in cash equivalents.
- 'Financing activities' relate to transactions with shareholders in their capacity as shareholders and borrowings of the entity. [IAS 7.6, 10]

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

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

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

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

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

Operating, investing and financing activities

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

- Like IFRS Accounting Standards, 'operating activities' are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities, and generally result from the cash effect of transactions that enter into the determination of net income.
- Like IFRS Accounting Standards, 'investing activities' relate to the acquisition and disposal of long-term assets and other investments that are not included in cash equivalents.
- Like IFRS Accounting Standards, 'financing activities' relate to transactions with shareholders in their capacity as shareholders and borrowings of the entity. [230-10-45-10 – 45-17]

In general, it is the nature of the activity and its related accounting that determines the appropriate classification of the cash outflows, which could result in differences in practice from IFRS Accounting Standards. [230-10-45-12 – 45-17]

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

Like IFRS Accounting Standards, non-cash investing or financing transactions are disclosed rather than being included in the statement of cash flows. [230-10-50-3]

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

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

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IFRS Accounting Standards

Direct vs indirect method

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

Interest and dividends

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

IFRS Accounting Standards do not contain specific guidance on the classification of capitalised interest. In our view, to the extent that borrowing costs are capitalised in respect of qualifying assets (see chapter 4.6), an entity should choose an accounting policy, to be applied consistently, to classify cash flows related to capitalised interest as follows:

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

Business combinations

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

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

US GAAP

Direct vs indirect method

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

Interest and dividends

Unlike IFRS Accounting Standards, interest received and paid (net of interest capitalised) and dividends received from previously undistributed earnings are classified as operating activities. Also unlike IFRS Accounting Standards, dividends paid are required to be classified as financing activities. [230-10-45-15 – 45-16]

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

Business combinations

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

There is no specific guidance under US GAAP on the cash flow classification of the cash payment for deferred consideration in a business combination.

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

Other changes in ownership interests

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

Income taxes

Income taxes are classified as operating activities, unless it is practicable to identify them with, and therefore classify them as, financing or investing activities. [IAS 7.35–36]

Assets held for rental and subsequently held for sale

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

Hedging instruments

If a hedging instrument is accounted for as a hedge of an identifiable position (see chapter 7.9), then the cash flows of the hedging instrument are classified in the same manner as the cash flows of the position being hedged. [IAS 7.16]

Unlike IFRS Accounting Standards, cash payments for contingent consideration in a business combination made 'soon after' the date of acquisition are classified as investing activities; in our view, three months or less is an appropriate interpretation of 'soon after'. Unlike IFRS Accounting Standards, payments not made soon after the date of acquisition are split between operating and financing activities. Payment up to the fair value of the consideration recognised on initial recognition is classified as a financing activity, and any excess is classified as an operating activity. This may result in differences from IFRS Accounting Standards. [230-10-45-13, 45-15, 45-17, ASU 2016-15.BC15]

Other changes in ownership interests

Like IFRS Accounting Standards, we believe cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control (see chapter 2.5) are presented as cash flows from financing activities. [810-10-45-23]

Income taxes

Unlike IFRS Accounting Standards, generally all income taxes are required to be classified as operating activities. [230-10-45-17]

Assets held for rental and subsequently held for sale

Unlike IFRS Accounting Standards, the classification of cash flows related to the manufacture or acquisition of assets that will be used for rental to others and subsequently sold depends on the activity that is likely to be the predominant source or use of cash flows for the asset. For example, the cash flows from the purchase and sale of equipment rented to others would be classified as investing activities, unless the equipment is rented for a short period of time before its sale, in which case the cash flows would be classified as operating activities. [230-10-45-22A]

Hedging instruments

Cash flows resulting from hedging instruments that are accounted for as hedges of identifiable transactions are generally classified in the same cash flow category as the cash flows from the hedged items, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, these cash flows can also be classified based on the nature of the hedging instruments. This accounting policy choice should be disclosed. Unlike IFRS Accounting Standards, if a derivative instrument contains a financing element that is 'other-than-insignificant' at inception, then the counterparty considered the borrower in the transaction classifies all cash inflows and outflows from that derivative as financing activities, regardless of whether the derivative is used as a hedging instrument. Conversely, we believe that the lender classifies all cash inflows and outflows from that derivative as investing activities. [230-10-45-27]

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Factoring and reverse factoring

There is no specific guidance in IFRS Accounting Standards on the classification of cash flows from traditional factoring or reverse factoring arrangements, although some matters related to reverse factoring have been addressed in an agenda decision published by the IFRS Interpretations Committee (see below).

In determining how to classify cash flows in a traditional or reverse factoring arrangement, an entity primarily considers the nature of the activity. Judgement may be required considering the specific legal form and structure of a factoring or a reverse factoring arrangement.

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

If receivables are factored with recourse and the customer remits cash directly to the factor, then in our view, in determining the appropriate classification, an entity should apply judgement and assess whether a single cash inflow or multiple cash flows occur for the entity. We believe that this assessment is based on the specific facts and circumstances and the entity may consider whether the factor in substance acts on behalf of the entity in the factoring arrangement. If it is determined that cash flows do not occur for an entity when the customer settles the liability to the factor, then it presents a single cash inflow for the payment received from the factor. Conversely, if it is determined that cash flows occur for an entity when the customer settles the liability to the factor, then it presents the cash flows on a gross basis.

- *Single cash inflow:* Present a single financing cash inflow or a single operating cash inflow for the proceeds received from the factor against receivables due from the entity's customers. An entity applies judgement in determining the appropriate classification, primarily based on the nature of the activity to which the cash inflow relates.
- *Multiple cash flows:* Present gross cash flows – i.e. a financing cash inflow for the proceeds received from the factor, followed by an operating cash inflow when the factor collects the amounts from the customer in respect of goods or services sold by the entity and a financing cash outflow for settlement of amounts due to the factor. [IAS 7.43, IU 12-20]

Factoring and reverse factoring

Unlike IFRS Accounting Standards, there is specific guidance in US GAAP on the classification of cash flows from traditional factoring arrangements (which are understood under US GAAP to be different from securitisations). Like IFRS Accounting Standards, there is no specific guidance on reverse factoring arrangements.

Unlike IFRS Accounting Standards, the classification of cash flows related to factored receivables does not depend on the nature of the activity. Instead, unlike IFRS Accounting Standards, the classification is driven by whether the underlying financial assets qualify for derecognition under the transfers and servicing Codification Topic; in making that determination, recourse is a significant consideration.

Unlike IFRS Accounting Standards, the proceeds received from the factor are presented as:

- operating activities if the underlying financial assets *are derecognised*; and
- financing activities if the underlying financial assets *are not derecognised*; this is similar to a secured borrowing. [230-10-45-16(a)]

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If receivables are factored with recourse and the customer remits cash directly to the entity, then the entity presents multiple cash flows.

In a reverse factoring arrangement, a finance provider (factor) agrees to pay amounts to a supplier in respect of invoices that the entity (the customer) owes to the supplier; the entity pays the factor rather than the supplier. These arrangements are generally designed to provide the customer with extended payment terms or the supplier with the benefit of early payment. Cash flows are typically classified as cash flows from operating or financing activities. If a cash inflow and cash outflow occur for an entity when an invoice is factored as part of the arrangement, then the entity presents those cash flows in its statement of cash flows. If no cash inflow or cash outflow occurs for an entity in a financing transaction, then the entity discloses the transaction elsewhere in the financial statements. In our view, in determining the appropriate classification, an entity should apply judgement and assess whether a single cash outflow or multiple cash flows occur for the entity. We believe that this assessment is based on the specific facts and circumstances and the entity may consider whether the factor in substance acts on behalf of the entity in the reverse factoring arrangement. If it is determined that cash flows do not occur for an entity when an invoice is factored, then it presents a single cash outflow for the payments made to the factor. Conversely, if it is determined that cash flows occur for an entity, then it presents the cash flows on a gross basis.

- *Single cash outflow:* Present a single operating cash outflow or a single financing cash outflow for the payments made to the factor. An entity applies judgement in determining the appropriate classification, based on the nature of the activity to which the cash flow relates.
- *Multiple cash flows:* Present gross cash flows – i.e. a financing cash inflow and an operating cash outflow when the factor makes a payment to the supplier in respect of the purchase of goods or services made by the entity, together with a financing cash outflow for settlement of amounts due to the factor. [IAS 7.43, IU 12-20]

Cost to obtain or fulfil a contract

Cash flows are generally classified based on the nature of the activity to which they relate, rather than on the classification of the related item in the statement of financial position (see above). Cash flows from operating activities are primarily derived from the principal revenue-producing activities of an entity. Some entities therefore classify all cash flows related to their revenue-producing activity, including costs to obtain and costs to fulfil a contract with a customer, as operating activities. However, other entities may determine that costs to obtain a contract are more closely linked to their long-term business objective of obtaining and building a customer relationship and therefore classify the related cash flows as investing activities. [IAS 7.11, 14(c), 16(a)]

In a reverse factoring arrangement (referred to as 'supplier finance programme' in US GAAP, which is defined slightly differently from a reverse factoring arrangement in IFRS Accounting Standards), a finance provider (factor) agrees to pay amounts to a supplier in respect of invoices that the entity (the customer) owes to the supplier; the entity pays the factor rather than the supplier. These arrangements are generally designed to provide the customer with extended payment terms or the supplier with the benefit of early payment. Unlike IFRS Accounting Standards, in our view presenting a single cash outflow is not permitted if the factor's payment to the supplier triggers a reclassification of the trade payable to borrowings. Instead, we believe that the entity should present gross (multiple) cash flows. The entity should present a financing cash inflow and an operating cash outflow when the factor makes a payment to the supplier in respect of the purchase of goods or services made by the entity, together with a financing cash outflow for settlement of amounts due to the factor.

Cost to obtain or fulfil a contract

Like IFRS Accounting Standards, we believe that cash payments to fulfil a customer contract should be classified as cash flows from operating activities.

Unlike IFRS Accounting Standards, we believe that cash payments to obtain a customer contract should always be classified as cash flows from operating activities. [230-10-45-17]

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Crypto assets

There is no specific guidance on the classification of crypto asset transactions and the general requirements outlined above apply.

Leases – Lessees

Lessees apply a single on-balance sheet lease accounting model, except for leases to which they elect to apply the recognition exemptions for short-term leases or leases of low-value assets (see chapter 5.1). Payments for the principal portion of the lease liability are classified as financing activities. Interest payments on the lease liability are classified in accordance with the entity's policy for classifying other interest paid (see above). Variable lease payments, payments for short-term leases and leases of low-value assets are classified as operating activities. [IFRS 16.50]

Some lease contracts may require full payment up-front – i.e. before or at the lease commencement date – if, for example, there is a large up-front payment and a small notional amount for the annual lease payment. In our view, if a lessee makes such an up-front payment, then it should classify the related cash outflow within investing activities because the nature of the activity to which this cash flow relates is the acquisition of the right-of-use asset.

Initial direct costs are included by a lessee in the cost of the right-of-use asset at the lease commencement date (see chapter 5.1). In our view, a lessee should classify initial direct costs within investing activities because the nature of the activity to which this cash outflow relates is the acquisition of the right-of-use asset.

Leases – Sub-leases

An intermediate lessor in a sub-lease accounts for the head lease and the sub-lease as two different contracts, applying both the lessee and the lessor accounting requirements (see chapter 5.1). Therefore, in our view the cash flows from sub-leases should not be netted against those from the head leases in the intermediate lessor's statement of cash flows.

Crypto assets

Unlike IFRS Accounting Standards, there is specific guidance on digital assets in the scope of the crypto assets Codification Subtopic (see chapter 3.3). Cash flows from in-scope crypto assets received as non-cash consideration in the ordinary course of business and converted nearly immediately to cash are classified as operating activities. [230-10-45-27A, 350-60-45-3]

Leases – Lessees

Unlike IFRS Accounting Standards, lessees apply a dual classification on-balance sheet lease accounting model (operating leases vs finance leases), except for leases to which they elect to apply the recognition exemption for short-term leases. There is no exemption for leases of low-value assets (see chapter 5.1).

For on-balance sheet leases, payments for the principal portion of the lease liability are classified as financing activities only in a finance lease, unlike IFRS Accounting Standards. Interest payments on the lease liability in a finance lease are classified as operating activities like other interest paid, unlike IFRS Accounting Standards (see above). All payments in an operating lease are classified as operating activities. [842-20-45-5]

Like IFRS Accounting Standards, variable lease payments and payments for short-term leases under the exemption are classified as operating activities. [842-20-45-5]

Like IFRS Accounting Standards, non-refundable lease prepayments made before the lease commencement date are generally classified as investing activities. Unlike IFRS Accounting Standards, we believe that it is also acceptable for a lessee to classify such payments in the same manner it expects to classify lease payments made after lease commencement – i.e. based on the expected lease classification (determined at lease commencement).

Like IFRS Accounting Standards, initial direct costs are included by a lessee in the cost of the right-of-use asset at the lease commencement date (see chapter 5.1). We believe a lessee should classify initial direct costs within investing activities.

Leases – Sub-leases

Like IFRS Accounting Standards, an intermediate lessor in a sub-lease accounts for the head lease and the sub-lease as two different contracts, applying both the lessee and the lessor accounting requirements (see chapter 5.1). Therefore, we believe that the cash flows from sub-leases should not be netted against those from the head leases in the intermediate lessor's statement of cash flows.

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Other cash flows

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

Foreign currency differences

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

Offsetting

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

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

Other cash flows

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

- *Cash payment for debt prepayment or extinguishment costs:* financing activity.
- *Cash payment for the settlement of a zero-coupon bond or a bond with a coupon interest rate that is insignificant in relation to its effective interest rate:* operating activity (portion attributable to accreted interest) and financing activity (portion attributable to original principal).
- *Proceeds from the settlement of an insurance claim:* based on the nature of the loss.
- *Distributions from equity-method investees:* operating activity (distributions that are a return on investment) and investing activity (distributions that are a return of investment). There is a policy choice as how to determine whether the distribution is a return on or return of investment.
- *Cash receipts from payments on a transferor's beneficial interests in securitised trade receivables:* investing activity.
- *Cash payment for broadcasting licence for programme material:* operating activity.

[230-10-45-1, 45-12, 45-15, 45-17, 45-21B, 45-21D, 920-230-45-1]

Foreign currency differences

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

Offsetting

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

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

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

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Disclosures: financing activities

An entity provides disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including changes from cash flows and non-cash changes. One way to meet this requirement is to provide a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities, including:

- changes from financing cash flows;
- changes from obtaining or losing control of subsidiaries or other business;
- the effect of changes in foreign exchange rates;
- changes in fair values; and
- other changes. [IAS 7.44B–44D, IU 09-19]

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

Disclosures: reverse factoring arrangements

An entity with reverse factoring arrangements discloses information that enables users of the financial statements to assess the effects of the arrangements on the entity's liabilities and cash flows and its exposure to liquidity risk (see chapter 7.10). These disclosures, which are generally provided on an aggregated basis, include qualitative and quantitative information such as:

- terms and conditions of the arrangements;
- carrying amounts and associated line items in the statement of financial position for financial liabilities that are part of the arrangements and amounts for which the supplier has already been paid;
- the range of payment due dates; and
- the type and effect of non-cash changes in carrying amounts of financial liabilities that are part of the arrangements. [IAS 7.44F, BC29]

Reporting cash flows for financial institutions

Cash advances and loans made by financial institutions are usually classified as operating activities because they relate to the main revenue-producing activities of that entity. [IAS 7.15]

Although the offsetting requirements of US GAAP are more specific than the general requirements under IFRS Accounting Standards, differences in practice would not generally be expected.

Disclosures: financing activities

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

Disclosures: reverse factoring arrangements

Like IFRS Accounting Standards, a buyer of goods or services is required to provide specific disclosures about its reverse factoring (i.e. supplier finance) arrangements that enable users of financial statements to analyse the effect of such arrangements on the buyer's working capital, liquidity and cash flows over time. [405-50]

Unlike IFRS Accounting Standards, US GAAP does not require disclosure of:

- the carrying amount of the outstanding financial liabilities that are part of the arrangements for which suppliers have already received payment from the finance provider or intermediary; or
- the range of payment due dates for both outstanding financial liabilities that are part of the arrangements and trade payables that are not.

Reporting cash flows for financial institutions

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

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IFRS Accounting Standards

Deposits from banks and customers are usually classified as operating activities. [IAS 7.IEB]

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

Forthcoming requirements

Amendments to the statement of cash flows standard as a result of the new presentation and disclosure standard (see chapter 4.1A) are effective for annual periods beginning on or after 1 January 2027; early adoption is permitted. [IAS 7.64]

Indirect method

Under the amendments, an entity applying the indirect method for presenting operating cash flows is required to use the operating profit or loss subtotal in the statement of profit or loss as the starting point in a reconciliation to the total net cash flow from operating activities. [IAS 7.20]

Interest and dividends

Under the amendments, an entity classifies dividends paid as cash flows from financing activities. [IAS 7.33A]

The classification of interest received and paid and dividends received depends on an entity's main business activities (see chapter 4.1A). An entity that does not have a specified main business activity classifies these cash flows as follows:

- *interest paid:* as cash flows from financing activities; and
- *interest and dividends received:* as cash flows from investing activities. [IAS 7.31, 34A]

An entity that has a specified main business activity classifies interest received, interest paid and dividends received based on how it classifies interest income, interest expenses and dividend income in the statement of profit or loss. [IAS 7.31, 34B–34D]

US GAAP

Unlike IFRS Accounting Standards, increases or decreases in net deposits from banks and customers are classified as financing activities. [AAG-DEP6.20]

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

Forthcoming requirements

There are no forthcoming requirements under US GAAP.

Indirect method

Unlike IFRS Accounting Standards, when using the indirect method, the reconciliation is required to begin with net income (net profit or loss). [230-10-45-28]

Interest and dividends

Like IFRS Accounting Standards, dividends paid are classified as financing activities. [230-10-45-15]

Unlike IFRS Accounting Standards, interest received and paid (net of interest capitalised) and dividends received from previously undistributed earnings are classified as operating activities. Unlike IFRS Accounting Standards, there is no concept of specified main business activities. [230-10-45-16 – 45-17]

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2.4 Fair value measurement

(IFRS 13)

Overview

- The fair value measurement standard applies to most fair value measurements and disclosures (including measurements based on fair value) that are required or permitted by other accounting standards.
- 'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- What is being measured – e.g. a stand-alone asset or a group of assets and/or liabilities – generally depends on the unit of account, which is established under the relevant accounting standard.
- Fair value is based on assumptions that market participants would use in pricing the asset or liability. 'Market participants' are independent of each other, they are knowledgeable and have a reasonable understanding of the asset or liability, and they are willing and able to transact.
- Fair value measurement assumes that a transaction takes place in the principal market for the asset or liability or, in the absence of a principal market, in the most advantageous market for the asset or liability.

2.4 Fair value measurement

(Topic 820)

Overview

- Like IFRS Accounting Standards, the fair value measurement Codification Topic applies to most fair value measurements and disclosures (including measurements based on fair value) that are required or permitted by other Codification topics/subtopics. However, the scope exemptions differ in some respects from IFRS Accounting Standards because of differences from IFRS Accounting Standards in the underlying Codification topics/subtopics with which the fair value measurement Codification Topic interacts.
- Like IFRS Accounting Standards, 'fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- Like IFRS Accounting Standards, what is being measured – e.g. a stand-alone asset or a group of assets and/or liabilities – generally depends on the unit of account, which is established under the relevant Codification topics/subtopics. However, these differ in some respects from IFRS Accounting Standards.
- Like IFRS Accounting Standards, fair value is based on assumptions that market participants would use in pricing the asset or liability. Like IFRS Accounting Standards, 'market participants' are independent of each other, they are knowledgeable and have a reasonable understanding of the asset or liability, and they are willing and able to transact.
- Like IFRS Accounting Standards, fair value measurement assumes that a transaction takes place in the principal market for the asset or liability or, in the absence of a principal market, in the most advantageous market for the asset or liability.

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Overview (continued)

- In measuring the fair value of an asset or a liability, an entity selects those valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value. The technique used should maximise the use of relevant observable inputs and minimise the use of unobservable inputs.
- A fair value hierarchy is used to categorise fair value measurements for disclosure purposes. Fair value measurements are categorised in their entirety based on the lowest level input that is significant to the entire measurement.
- A day one gain or loss arises when the transaction price for an asset or liability differs from its fair value on initial recognition. Such gain or loss is recognised in profit or loss, unless the accounting standard that requires or permits fair value measurement specifies otherwise. For example, the financial instruments standard prohibits the immediate recognition of a day one gain or loss, unless fair value is evidenced by a quoted price in an active market for an identical financial asset or financial liability, or is based on a valuation technique whose variables include only data from observable markets.
- A fair value measurement of a non-financial asset considers a market participant's ability to generate economic benefits by using the asset in its highest and best use, or by selling it to another market participant who will use the asset in its highest and best use.
- If certain conditions are met, then an entity is permitted to measure the fair value of a group of items with offsetting risk positions on the basis of its net exposure (portfolio measurement exception). Such items may be a group of financial assets and financial liabilities or other contracts that are in the scope of the financial instruments standard.
- There is no practical expedient that allows entities to measure the fair value of certain investments at net asset value.

Overview (continued)

- Like IFRS Accounting Standards, in measuring the fair value of an asset or a liability, an entity selects those valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value. The technique used should maximise the use of relevant observable inputs and minimise the use of unobservable inputs, like IFRS Accounting Standards.
- Like IFRS Accounting Standards, a fair value hierarchy is used to categorise fair value measurements for disclosure purposes. Like IFRS Accounting Standards, fair value measurements are categorised in their entirety based on the lowest level input that is significant to the entire measurement.
- Like IFRS Accounting Standards, a day one gain or loss arises when the transaction price for an asset or liability differs from its fair value on initial recognition. Like IFRS Accounting Standards, such gain or loss is recognised in profit or loss, unless the Codification topic/subtopic that requires or permits fair value measurement specifies otherwise. However, US GAAP is less restrictive than IFRS Accounting Standards on the recognition of such gains or losses.
- Like IFRS Accounting Standards, a fair value measurement of a non-financial asset considers a market participant's ability to generate economic benefits by using the asset in its highest and best use, or by selling it to another market participant who will use the asset in its highest and best use.
- Like IFRS Accounting Standards, if certain conditions are met, then an entity is permitted to measure the fair value of a group of items with offsetting risk positions on the basis of its net exposure (portfolio measurement exception). Like IFRS Accounting Standards, such items may be a group of financial assets, financial liabilities, non-financial items accounted for as derivatives or combinations of these items.
- Unlike IFRS Accounting Standards, a practical expedient allows entities to measure the fair value of certain investments at net asset value.

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Overview (continued)

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

This chapter highlights only the key differences between the requirements in IFRS Accounting Standards and US GAAP. For further discussion, see the KPMG Fair value measurement handbook.

General principles

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

'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date – i.e. it is an 'exit price'. [IFRS 13.9, A]

Scope

The fair value measurement standard applies to:

- fair value measurements (both initial and subsequent) that are required or permitted by other accounting standards;
- fair value measurements that are required or permitted to be disclosed by other accounting standards, but which are not included in the statement of financial position; and
- measurements based on fair value, or disclosures about those measurements.

[IFRS 13.5–8, BC24–BC25]

Overview (continued)

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

General principles

The fair value measurement Codification Topic defines fair value, establishes a framework for measuring fair value and sets out related disclosure requirements, which differ from IFRS Accounting Standards in certain respects. The Codification Topic does not give rise to any requirements on when fair value measurements are required, but instead provides guidance on how to measure and disclose fair value when it is required or permitted under other Codification topics/subtopics, like IFRS Accounting Standards.

Like IFRS Accounting Standards, 'fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date – i.e. it is an 'exit price'. [820-10-05-1B, 10-20]

Scope

Like IFRS Accounting Standards, the fair value measurement Codification Topic applies to:

- fair value measurements that are required or permitted by other Codification topics/subtopics;
- fair value measurements that are required or permitted to be disclosed by other Codification topics/subtopics, but which are not included in the statement of financial position; and
- measurements based on fair value, or disclosures about those measurements.

[820-10-15-1]

However, because of differences from IFRS Accounting Standards in the underlying Codification topics/subtopics with which the fair value measurement Codification Topic interacts, there are scope differences between IFRS Accounting Standards and US GAAP in relation to fair value measurement.

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IFRS Accounting Standards

The fair value measurement standard contains the following specific exclusions in respect of measurement and disclosure:

- share-based payment transactions (see chapter 4.5);
- leasing transactions (see chapter 5.1); and
- measurements that are similar to fair value but that are not fair value – e.g. net realisable value in measuring inventories (see chapter 3.8). [IFRS 13.6]

IFRS Accounting Standards do not include practical expedients that override the requirements of the fair value measurement standard.

The fair value measurement standard has the following specific exclusions in respect of disclosure only:

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

US GAAP

Like IFRS Accounting Standards, the fair value measurement Codification Topic contains the following specific exclusions in respect of measurement and disclosure:

- share-based payment transactions (see chapter 4.5), except for those that relate to employee stock ownership plans (unlike IFRS Accounting Standards); and
- measurements that are similar to fair value but that are not fair value – e.g. market value in measuring inventories (see chapter 3.8).

The scope of the fair value measurement Codification Topic excludes the measurement of leased property (the underlying asset) in the financial statements of lessors that are not manufacturers or dealers. However, the exception does not apply if significant time lapses between the acquisition of the underlying asset and lease commencement (see chapter 5.1). This is narrower than the broad scope exclusion for leasing transactions under IFRS Accounting Standards.

Additionally, unlike IFRS Accounting Standards, the fair value measurement Codification Topic contains the following specific exclusions for the recognition and measurement of:

- revenue from contracts with customers, although there are limited circumstances in which the revenue Codification Topic refers to fair value; in those cases, in our view it would be appropriate to refer to the fair value definition in the fair value measurement Codification Topic, like IFRS Accounting Standards; and
- gains and losses on the derecognition of non-financial assets. [820-10-15-2]

Unlike IFRS Accounting Standards, US GAAP provides certain practical expedients to fair value measurements in other Codification topics/subtopics. Additionally, the fair value measurement Codification Topic contains a practical expedient that allows entities to measure the fair value of certain investments at net asset value, unlike IFRS Accounting Standards. [820-10-15-3, 35-59]

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

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

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The item being measured and the unit of account

The unit of account drives the level at which an asset or a liability is aggregated or disaggregated for the purpose of measuring fair value. The fair value measurement standard does not generally specify the unit of account. Instead, this is established under the specific accounting standard that requires or permits the fair value measurement or disclosure. [IFRS 13.14]

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

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

The unit of account is not a concept that has been used explicitly in IFRS Accounting Standards; therefore, there may be uncertainty regarding the unit of account depending on the underlying item. For example, when the unit of account is an investment in a listed subsidiary, in our view the unit of valuation and therefore the measurement of fair value may be based on the fair value of the individual shares making up the investment or the investment as a whole.

The impact of a restriction on the sale (or transfer) of an equity security on its fair value depends on whether the restriction is security-specific or entity-specific. IFRS Accounting Standards do not include detailed guidance on whether a contractual sale restriction is entity-specific or security-specific. For entity-specific restrictions, the price used in the fair value measurement is not adjusted to reflect the restriction. For security-specific restrictions, the price used in the fair value measurement reflects the effect of the restriction if it would be considered by a market participant in pricing the security. [IFRS 13.11, IE28]

The item being measured and the unit of account

Like IFRS Accounting Standards, the unit of account drives the level at which an asset or a liability is aggregated or disaggregated for the purpose of measuring fair value. The fair value measurement Codification Topic does not generally specify the unit of account, like IFRS Accounting Standards. Instead, the unit of account is established under the specific Codification topic/subtopic that requires or permits the fair value measurement or disclosure, which may differ from IFRS Accounting Standards. [820-10-35-2E]

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

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

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

Unlike IFRS Accounting Standards, US GAAP specifically indicates that a contractual sale restriction on the sale of an equity security is an entity-specific characteristic and therefore should not be considered in measuring fair value. Additionally, the contractual sale restriction is not a separate unit of account and should not be recognised separately (i.e. as a contra-asset or separate liability). [820-10-35-2B, 35-36B]

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Market participants

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

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

[IFRS 13.22, A]

Fair value takes into account characteristics of the asset or liability that would be considered by market participants and is not based on the entity's specific use or plans. Such characteristics may include the condition and location of an asset or restrictions on an asset's sale or use. [IFRS 13.11]

Principal and most advantageous markets

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

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

The price used to measure fair value is not adjusted for transaction costs, although they are considered in determining the most advantageous market. 'Transaction costs' do not include transport costs. If location is a characteristic of an asset, then the price in the principal (or most advantageous) market is adjusted for transport costs. [IFRS 13.25–26, A, BC62]

Market participants

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

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

[820-10-20, 35-9]

Like IFRS Accounting Standards, fair value takes into account characteristics of the asset or liability that would be considered by market participants and is not based on the entity's specific use or plans. Such characteristics may include the condition and location of an asset or restrictions on an asset's sale or use, like IFRS Accounting Standards. [820-10-35-2B]

Principal and most advantageous markets

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

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

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

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Valuation approaches and techniques

In measuring the fair value of an asset or a liability, an entity selects those valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value. The technique used should maximise the use of relevant observable inputs and minimise the use of unobservable inputs. [IFRS 13.61, 67]

Valuation techniques used to measure fair value fall into three approaches:

- market approach;
- income approach; and
- cost approach. [IFRS 13.62]

Inputs to valuation techniques

Inputs to valuation techniques are the assumptions that market participants would use in pricing the asset or liability. [IFRS 13.A]

Inputs are categorised into three levels.

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

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

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

Valuation approaches and techniques

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

Like IFRS Accounting Standards, valuation techniques used to measure fair value fall into three approaches:

- market approach;
- income approach; and
- cost approach. [820-10-35-24A]

Inputs to valuation techniques

Like IFRS Accounting Standards, inputs to valuation techniques are the assumptions that market participants would use in pricing the asset or liability. [820-10-20]

Like IFRS Accounting Standards, inputs are categorised into three levels.

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

Like IFRS Accounting Standards, inputs to valuation techniques include assumptions about risk, such as the risk inherent in a particular valuation technique used to measure fair value and the risk inherent in the inputs to the valuation technique. [820-10-20, 35-54]

Like IFRS Accounting Standards, the most reliable evidence of fair value is a quoted price in an active market. If this is not available, then an entity uses a valuation technique to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs, like IFRS Accounting Standards. [820-10-35-24, 35-36, 35-41]

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

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

A blockage factor is a discount that adjusts the quoted price of an asset or a liability because the market's normal trading volume is not sufficient to absorb the quantity held by the entity. It is a characteristic of the size of an entity's holding and not a characteristic of the asset or liability. An entity is prohibited from applying a blockage factor for a fair value measurement for all three levels of the fair value hierarchy. [IFRS 13.69, 80]

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

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

Fair value hierarchy

The fair value measurement standard includes a fair value hierarchy based on the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs). [IFRS 13.72]

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

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

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

- it is inconsistent with the relevant unit of account;
- it reflects size as a characteristic of the entity's holding – e.g. a blockage factor;
- the characteristic is already reflected in the preliminary value indication; or
- there is a quoted price in an active market for an identical asset or liability – i.e. a Level 1 input. [820-10-35-36B]

Like IFRS Accounting Standards, a blockage factor is a discount that reflects a characteristic of the size of an entity's holding and not a characteristic of the asset or liability. Like IFRS Accounting Standards, an entity is prohibited from applying a blockage factor for a fair value measurement for all three levels of the fair value hierarchy. [820-10-35-36B, 35-44]

Like IFRS Accounting Standards, a control premium is not applied in measuring the fair value of financial instruments if the unit of account is the individual instrument and the individual instrument does not convey control; this is regardless of the level in the fair value hierarchy. However, differences from IFRS Accounting Standards may arise because an entity may reach a different unit of account conclusion under US GAAP. [820-10-35-36B]

Like IFRS Accounting Standards, if assets or liabilities have a bid and an ask price, then an entity uses the price within the bid-ask spread that is most representative of fair value in the circumstances. The use of bid prices for long positions and ask prices for short positions is permitted but not required, like IFRS Accounting Standards. [820-10-35-36C]

Fair value hierarchy

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

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

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

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Fair value on initial recognition

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

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

The financial instruments standard prohibits the immediate recognition of a day one gain or loss unless fair value is evidenced by a quoted price in an active market for an identical financial asset or liability, or is based on a valuation technique whose variables include only data from observable markets (see chapter 7.7). [IFRS 9.5.1.1A, B5.1.2A]

If the entity determines that the fair value on initial recognition differs from the transaction price but it is *not* evidenced by a quoted price in an active market for an identical asset or liability or a valuation technique that uses only data from observable markets, then the carrying amount of the financial asset or financial liability on initial recognition is adjusted to defer the difference between the fair value measurement and the transaction price. This deferred difference is subsequently recognised as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability. [IFRS 9.5.1.1A, B5.1.2A]

Highest and best use

A fair value measurement of a non-financial asset considers a market participant's ability to generate economic benefits by using the asset at its highest and best use or by selling it to another market participant who will use the asset in its highest and best use. In the absence of evidence to the contrary, the entity's current use of an asset is assumed to be its highest and best use. [IFRS 13.27, 29]

Fair value on initial recognition

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

Like IFRS Accounting Standards, a day one gain or loss arises when the transaction price for an asset and/or liability differs from its fair value on initial recognition. Like IFRS Accounting Standards, the fair value measurement Codification Topic requires day one gains or losses to be recognised in profit or loss unless the relevant Codification topic/subtopic that requires or permits the fair value measurement specifies otherwise. However, US GAAP is less restrictive than IFRS Accounting Standards on the recognition of such gains or losses (see below). [820-10-30-6]

Unlike IFRS Accounting Standards, for assets or liabilities that are initially measured at fair value, if an entity determines that the fair value on initial recognition is different from the transaction price, then recognition in profit or loss of any difference does not depend on where in the fair value hierarchy the entity's fair value measurement falls (i.e. Level 1, 2 or 3). As such, an entity can recognise a day one gain or loss even when the fair value measurement is categorised in Level 3 of the hierarchy (see chapter 7.7). [820-10-30-6]

Unlike IFRS Accounting Standards, any day one gains or losses resulting from the difference between the fair value and the transaction price are recognised in profit or loss, unless the relevant Codification topic that requires or permits fair value measurement specifies otherwise. [820-10-30-6]

Highest and best use

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

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A fair value measurement of a non-financial asset is based on its use either:

- in combination with other assets as a group or in combination with other assets and liabilities; or
- on a stand-alone basis. [IFRS 13.31]

Liabilities and own equity instruments

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

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

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

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

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

The fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid. [IFRS 13.47]

Like IFRS Accounting Standards, a fair value measurement of a non-financial asset is based on its use either:

- in combination with other assets as a group or in combination with other assets and liabilities; or
- on a stand-alone basis. [820-10-35-10E]

Liabilities and own equity instruments

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

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

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

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

Like IFRS Accounting Standards, the issuer of a liability with an inseparable third party credit enhancement excludes the enhancement in measuring the fair value of the liability, if the liability and the enhancement are separate units of account. However, unlike IFRS Accounting Standards, US GAAP includes specific guidance that separation is generally required except when the enhancement is granted to the issuer of the liability, such as deposit insurance provided by a government or government agency, or is provided between a parent and a subsidiary or between entities under common control. [820-10-35-18A, 825-10-25-13]

Although there is no explicit guidance under US GAAP, we would generally expect the fair value of demand deposits, savings accounts and certain money market deposits to be measured at the amount payable on demand on the measurement date, like IFRS Accounting Standards.

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Portfolio measurement exception

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

The portfolio measurement exception applies to a group of financial assets and financial liabilities or other contracts that are in the scope of the financial instruments standard (i.e. the portfolio may include contracts to buy or sell a non-financial item that are accounted for under this accounting standard; see chapter 7.1). [IFRS 13.52, BC119A–BC119B]

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

If the entity is permitted to use the exception, then it chooses an accounting policy, to be applied consistently, for a particular portfolio. However, an entity is not required to maintain a static portfolio to use the exception. [IFRS 13.51, BC121]

Net asset value

IFRS Accounting Standards do not include an exception that allows the use of net asset value (NAV) as a practical expedient. In our view, an entity may only measure an investment in a fund (or a similar investment vehicle) on the basis of NAV when NAV is representative of the amount at which an orderly transaction between market participants would occur at the measurement date.

Inactive markets

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

Portfolio measurement exception

Like IFRS Accounting Standards, an entity that holds a group of financial assets and financial liabilities is exposed to market risks (i.e. interest rate risk, currency risk and other price risk) and to the credit risk of each of the counterparties. Like IFRS Accounting Standards, if certain conditions are met, then an entity is permitted (but not required) to measure the fair value of a group of items (see below) with offsetting risk positions on the basis of its net exposure (portfolio measurement exception). [820-10-35-18D – 35-18E]

Like IFRS Accounting Standards, the portfolio measurement exception applies to a group of financial assets, financial liabilities, non-financial items accounted for as derivatives or combinations of these items. [820-10-35-18D]

Like IFRS Accounting Standards, under the exception, the fair value of the group is measured on the basis of the price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure in an orderly transaction between market participants at the measurement date. [820-10-35-18D]

Like IFRS Accounting Standards, if the entity is permitted to use the exception, then it chooses an accounting policy, to be applied consistently, for a particular portfolio. However, an entity is not required to maintain a static portfolio to use the exception. [820-10-35-18G]

Net asset value practical expedient

Unlike IFRS Accounting Standards, NAV may be used as a practical expedient to measure fair value when:

- the investment does not have a readily determinable fair value; and
- the investment is in an investment company (see chapter 5.6), or is an investment in a real estate fund for which it is industry practice to measure assets at fair value on a recurring basis and to issue financial statements that are consistent with the measurement principles applied to investment companies. [820-10-35-59 – 35-62]

Inactive markets

Like IFRS Accounting Standards, in an active market, transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. [820-10-20]

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An orderly transaction assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities. [IFRS 13.A]

A fair value measurement may be affected if there has been a significant decrease in the volume or level of activity for that item compared with normal market activity for that item. Judgement may be required in determining whether, based on the evidence available, there has been such a significant decrease. [IFRS 13.B37, B42]

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

Disclosures

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

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

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

Like IFRS Accounting Standards, an orderly transaction assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities. [820-10-20]

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

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

Disclosures

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

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

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

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2.5 Consolidation

(IFRS 10)

Overview

- Subsidiaries are generally consolidated. As an exception, investment entities generally account for investments in subsidiaries at fair value.
- Consolidation is based on what can be referred to as a 'power-to-direct' model. An investor 'controls' an investee if it is exposed to (has rights to) variable returns from its involvement with the investee, and has the ability to affect those returns through its power over the investee. Although there is a practical distinction between structured and non-structured entities, the same control model applies to both.
- For a structured entity, voting rights are not the dominant factor in assessing whether the investor has power over the investee.
- Control is assessed on a continuous basis.
- Control is usually assessed over a legal entity, but can also be assessed over only specified assets and liabilities of an entity (a 'silo') if certain conditions are met.

2.5 Consolidation

(Topic 810, Subtopic 610-20, 845-10)

Overview

- Subsidiaries are generally consolidated, like IFRS Accounting Standards. As an exception, investment companies generally account for investments in subsidiaries at fair value, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, there are additional exceptions for certain other specialised industries.
- Unlike IFRS Accounting Standards, consolidation is based on a controlling financial interest model, which differs in certain respects from IFRS Accounting Standards.
  - For voting interest entities (VOEs), 'control' is the ability to control the financial and operating policies of an entity expected to be made in the ordinary course of business.
  - For variable interest entities (VIEs), 'control' is the power to direct the activities that most significantly impact the VIE's economic performance and either the obligation to absorb losses of the VIE, or the right to receive benefits from the VIE, that could potentially be significant to the VIE.
- A VIE is an entity for which the amount of equity investment at risk is insufficient for the entity to finance its own operations without additional subordinated financial support, or the equity investment at risk lacks one of a number of specified characteristics of a controlling financial interest. A VIE may or may not be a structured entity under IFRS Accounting Standards.
- Like IFRS Accounting Standards, control is assessed on a continuous basis.
- Like IFRS Accounting Standards, control is usually assessed over a legal entity and, in the case of VIEs, can also be assessed over only specified assets and liabilities of an entity (a 'silo') if certain conditions are met. Unlike IFRS Accounting Standards, control is assessed over only legal entities in the voting interest model (VOE model).

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Overview (continued)

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

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

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

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

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

Overview (continued)

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

- Power is assessed with reference to the activities of the VIE that most significantly affect its financial performance, like IFRS Accounting Standards. As part of its analysis, the investor considers the purpose and design of the VIE, and the nature of the VIE's activities and operations, broadly like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, for VOEs, control is derived through either voting or contractual control of the financial and operating policies of the investee expected to be made in the ordinary course of business.

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

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

- Unlike IFRS Accounting Standards, the VIE consolidation model does not have an explicit test to assess the link between power and obligations/ benefits when a decision maker has a variable interest in a VIE. For VOEs, the investor with a controlling financial interest consolidates its investee without a principal/agent evaluation.

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Overview (continued)

- A parent and its subsidiaries generally use the same reporting date when preparing consolidated financial statements. If this is impracticable, then the difference between the reporting date of a parent and its subsidiary cannot be more than three months. Adjustments are made for the effects of significant transactions and events between the two dates.
- Uniform accounting policies are used throughout the group.
- The acquirer in a business combination can elect, on a transaction-by-transaction basis, to measure 'ordinary' NCI at fair value, or at their proportionate interest in the net assets of the acquiree, at the date of acquisition. 'Ordinary NCI' are present ownership interests that entitle their holders to a proportionate share of the entity's net assets in the event of liquidation. Other NCI are generally measured at fair value.
- An entity recognises a liability for the present value of the exercise price of put options or forward price of forwards held by NCI, but there is less detailed guidance on the accounting for such derivatives.
- Losses in a subsidiary may create a deficit balance in NCI.
- NCI in the statement of financial position are classified as equity but are presented separately from the parent shareholders' equity.
- Profit or loss and comprehensive income for the period are allocated between shareholders of the parent and NCI.

Overview (continued)

- Like IFRS Accounting Standards, the difference between the reporting date of a parent and its subsidiary cannot be more than about three months. However, unlike IFRS Accounting Standards, use of the same reporting date need not be impracticable to have a difference; adjustments may be made for the effects of material transactions and events between these dates, or disclosures regarding those effects are provided.
- In our view, uniform accounting policies should be used throughout the group unless dissimilar operations provide a basis for different accounting policies, or the subsidiary is applying industry-specific guidance.
- Unlike IFRS Accounting Standards, NCI are generally measured initially at fair value.
- Unlike IFRS Accounting Standards, there is specific guidance on the accounting for put options held by NCI, which results in a liability recognised at fair value or redemption amount, or the presentation of NCI as 'temporary equity', depending on the terms of the arrangement and whether the entity is an SEC registrant.
- Like IFRS Accounting Standards, losses in a subsidiary may create a deficit balance in NCI.
- Like IFRS Accounting Standards, non-redeemable NCI in the statement of financial position are classified as equity but are presented separately from the parent shareholders' equity. Unlike IFRS Accounting Standards, redeemable NCI are presented as 'temporary equity', if the entity is an SEC registrant.
- Like IFRS Accounting Standards, profit or loss and comprehensive income for the period are allocated between shareholders of the parent and NCI.

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Overview (continued)

- **Intra-group transactions are eliminated in full.**

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

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

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

Overview (continued)

- **Intra-group transactions are generally eliminated in full, like IFRS Accounting Standards. However, for a consolidated VIE, the effect of eliminating fees or other income or expense on the net income or expense of the VIE is attributed entirely to the primary beneficiary, unlike IFRS Accounting Standards.**

- **On the loss of control of a subsidiary that is a business (which is more restrictive than IFRS Accounting Standards) the assets and liabilities of the subsidiary and the carrying amount of the NCI are derecognised. Like IFRS Accounting Standards, the consideration received and any retained interest (measured at fair value) are recognised. Amounts recognised in accumulated OCI are reclassified, like IFRS Accounting Standards, with all amounts being reclassified to profit or loss, unlike IFRS Accounting Standards. Any resulting gain or loss is recognised in profit or loss, like IFRS Accounting Standards. If the subsidiary is not a business and substantially all of the fair value of the assets in the subsidiary is concentrated in non-financial assets, then the entity accounts for the transaction under the derecognition of non-financial assets Subtopic of the other income Codification Topic, which results in similar accounting upon derecognition to that described above, like IFRS Accounting Standards.**

- **Unlike IFRS Accounting Standards, pro rata spin-offs are accounted for on the basis of book values, and no gain or loss is recognised. Unlike IFRS Accounting Standards, non-pro rata spin-offs are accounted for on the basis of fair values (gain or loss recognised in profit or loss).**

- **Changes in the parent's ownership interest in a subsidiary without a loss of control are accounted for as equity transactions and generally no gain or loss is recognised, like IFRS Accounting Standards.**

Entities included in the consolidated financial statements

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

- With limited exceptions, investment entities (as defined) account for investments in subsidiaries at FVTPL (see chapter 5.6).

Entities included in the consolidated financial statements

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

- Like IFRS Accounting Standards, investment companies account for investments in subsidiaries at FVTPL, with limited exceptions (see chapter 5.6).

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IFRS Accounting Standards

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

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

Structured vs non-structured entities

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

Although there is no distinction between different types of entities in determining whether one entity controls another, there is a 'gating' question in the analysis that distinguishes between entities for which:

- voting rights are the dominant factor in assessing whether the investor has power over the investee – i.e. the investee is controlled by voting instruments; and
- voting rights are not the dominant factor in assessing whether the investor has power over the investee – i.e. the investee is controlled by means of other rights. [IFRS 10.B6]

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

Non-structured entities

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

US GAAP

- An entity does not consolidate employee benefit plans, like IFRS Accounting Standards (see chapter 4.4).
- Unlike IFRS Accounting Standards, an entity does not consolidate registered money market funds under the Investment Company Act of 1940, or similar entities.
- Unlike IFRS Accounting Standards, an entity does not consolidate a governmental organisation, and generally does not consolidate a financing entity that is established by a governmental organisation. [810-10-15-12]

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

Variable interest vs non-variable interest entities

Consolidation is based on a controlling financial interest model, which differs in certain respects from IFRS Accounting Standards.

Unlike IFRS Accounting Standards, US GAAP distinguishes between VIEs and VOEs and applies the controlling financial interest model differently to each category of investees. This distinction between VIEs and VOEs is not necessarily the same as the distinction between structured and non-structured entities under IFRS Accounting Standards. In addition, unlike IFRS Accounting Standards, US GAAP distinguishes between limited partnerships (and similar entities) and entities other than limited partnerships in certain respects.

Voting interest entities

Consolidation is based on 'control', which is the ability to control the financial and operating policies of an entity expected to be made in the ordinary course of business, which differs from IFRS Accounting Standards in certain respects. [810-10-15-8, 810-10-25]

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IFRS Accounting Standards

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

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

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

In assessing control, an investor considers its potential voting rights – e.g. a call option over shares of the investee – as well as potential voting rights held by other parties, to determine whether it has power. Potential voting rights are considered only if they are substantive (see above). [IFRS 10.B47]

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

The assessment of control is performed on a continuous basis and an investor reassesses whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the elements of the control model. [IFRS 10.8, B80–B85, IU 09-13]

US GAAP

Like IFRS Accounting Standards, if the investee is controlled by means of equity instruments, with associated and proportionate voting rights, then the assessment of control focuses on which investor, if any, has sufficient voting rights to direct the investee's ordinary course of business activities; this is in the absence of any additional arrangements that alter the decision making. Unlike IFRS Accounting Standards, the application guidance is applied differently to limited partnerships and similar entities vs entities other than limited partnerships. Like IFRS Accounting Standards, in the most straightforward cases the investor holding the majority of the voting rights controls the VOE. [810-10-15-8]

An investor considers 'substantive' kick-out and participating rights held by others, which is narrower than the guidance under IFRS Accounting Standards. These rights can be substantive if they are exercisable by a simple majority of the investors in a VOE with no significant barriers to exercise such rights. [810-10-25-10, 25-38C]

Like IFRS Accounting Standards, under the VOE model, protective rights are related to fundamental changes in the activities of an investee, or are rights that apply only in exceptional circumstances. As such, they cannot give the holder control or prevent other parties from having control over the investee, like IFRS Accounting Standards. [810-10-25-10, 25-38C]

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

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

Although there is no specific guidance, in practice the assessment of control is performed on a continuous basis and an entity reassesses whether it controls a VOE if factors and circumstances indicate that there are changes to one or more elements of the control model, like IFRS Accounting Standards.

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

Structured entities

Definition

'Structured entities' are entities designed such that voting or similar rights are not the dominant factor in assessing control. There is no concept of VIEs in IFRS Accounting Standards. [IFRS 12.A]

As for non-structured entities, control is usually assessed over a legal entity, but can also be assessed over only specified assets and liabilities of the entity (a 'silo') if the following criteria are met:

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

Unlike IFRS Accounting Standards, the factors discussed below for VIEs do not apply to VOE investees.

Variable interest entities

Definition

Unlike IFRS Accounting Standards, other than for not-for-profit entities (outside the scope of this publication), US GAAP has no concept of structured entities. Instead, a VIE is an entity that has any of the following characteristics:

- the amount of equity investment at risk is insufficient for the entity to finance its own operations without additional subordinated financial support;
- the equity investment at risk lacks one of the following characteristics of a controlling financial interest:
  - the power, through voting or similar rights, to direct the activities that most significantly impact the entity's economic performance (evaluated differently for limited partnerships and similar entities vs entities other than limited partnerships);
  - the obligation to absorb the entity's expected losses; or
  - the right to receive the entity's expected residual returns; or
- substantially all the entity's activities either involve or are conducted on behalf of an equity investor (and its related parties) that has disproportionately few voting rights in relation to its economic interests. [810-10-05-8, 15-14]

Some entities that are VIEs under US GAAP meet the definition of a structured entity under IFRS Accounting Standards. However, other VIEs under US GAAP are not structured entities under IFRS Accounting Standards, and some entities that are not VIEs under US GAAP may be structured entities under IFRS Accounting Standards. Additionally, aspects of the controlling financial interest model that applies to VIEs differ from the control model that applies to structured entities under IFRS Accounting Standards.

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

- the specified assets held by the legal entity are essentially the only source of payment for specified liabilities of, or specified other interests in, the legal entity; and
- parties other than those with the specified liability have no rights or obligations in respect of the assets related to that liability (specified assets) or to residual cash flows from those assets. [810-10-25-57 – 25-58]

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The controlling party

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

As for non-structured entities, a structured entity cannot have more than one controlling party at any given time. If no single investor, or group of investors acting collectively, has control, then no controlling party is identified and the entity is not consolidated. [IFRS 10.9, 16]

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

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

Power over relevant activities

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

The investor needs to be exposed to (have rights to) variable returns from its involvement with the investee (see below), but its power does not necessarily need to be conveyed through these variable returns. Power may be derived through a management or servicing agreement, or through other agreements.

The controlling party

Under the controlling financial interest model, an investor 'controls' a VIE if the variable interest holder has both: (1) the power to direct the activities that most significantly impact the VIE's economic performance; and (2) the obligation to absorb losses of the VIE, or the right to receive benefits from the VIE, that could potentially be significant to the VIE. 'Potentially significant' is generally interpreted in practice to mean 10 percent. Certain aspects of this analysis, as explained below, differ from IFRS Accounting Standards. [810-10-25-38A]

A VIE cannot have more than one primary beneficiary at any given time, like IFRS Accounting Standards. If no single variable interest holder, or group of related party variable interest holders, has the power to direct the activities that most significantly impact the VIE's economic performance, then no primary beneficiary is identified and the VIE is not consolidated, like IFRS Accounting Standards. [810-10-25-38A, 25-38D]

An entity is required to perform ongoing reassessments of whether it is the primary beneficiary of a VIE, like IFRS Accounting Standards. [810-10-25-38A]

Unlike IFRS Accounting Standards, reporting entities need to explicitly determine whether an entity is a VIE and to reconsider whether it is a VIE when changes in facts and circumstances occur. [810-10-35-4]

Power over activities that most significantly impact economic performance

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

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

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The assessment of power over a structured entity includes considering the following factors:

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

For a leasing vehicle that is a structured entity created to lease a single asset to a single lessee, the lessee's right to use the underlying asset for a period of time would not, in isolation, typically give the lessee decision-making rights over the relevant activities of the vehicle (e.g. managing the credit risk on rentals, and/or managing the leased asset at the end of the lease term); this is regardless of whether the lease is a finance or an operating lease. However, this does not mean that the lessee can never control the lessor vehicle. [IU 05-15]

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

Determining whether rights are substantive requires judgement, taking into account all available facts and circumstances. Factors to consider include:

- whether there are barriers that prevent the holder from exercising the rights;
- how many parties need to agree for the rights to become exercisable or operational; and
- whether the party holding the rights would benefit from their exercise – e.g. because the rights are in the money. [IFRS 10.B23]

The assessment of power over a VIE includes considering the following factors:

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

Although the precise wording of US GAAP differs from IFRS Accounting Standards, we expect that similar factors will often be considered in the assessment.

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

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

Determining whether participating rights are substantive requires judgement. US GAAP provides no examples of what may constitute substantive participating rights when evaluating power over a VIE. However, unlike IFRS Accounting Standards, US GAAP provides the factors to consider when determining whether participating rights are substantive when evaluating control over a VOE. The following factors are used in practice as a starting point for determining whether participating rights are substantive for VIEs:

- the ability to select, terminate or set the compensation of management responsible for implementing the investee's policies and procedures; and
- establishing operating and capital decisions of the investee, including budgets, in the ordinary course of business. [810-10-25-11]

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Exposure to variability in returns

To have control over an investee, an investor needs to be exposed to (have rights to) variable returns from its involvement with the investee. Returns might be only positive, only negative, or either positive or negative. Sources of returns include:

- dividends or other economic benefits, such as interest from debt securities and changes in the value of the investor's investment in the investee;
- remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support;
- tax benefits;
- residual interests in the investee's assets and liabilities on liquidation; and/or
- returns that are not available to other interest holders, such as the investor's ability to use the investee's assets in combination with its own to achieve economies of scale, cost savings or other synergies. [IFRS 10.15, B55–B57]

These rights may represent substantive participating rights for VIEs if the activities subject to these powers are those that most significantly impact the VIE's economic performance.

Determining whether kick-out rights are substantive requires judgement. For kick-out rights to be considered substantive in limited partnerships, the limited partners holding the kick-out rights must have the ability to exercise those rights if they choose to do so; that is, there are no significant barriers to the exercise of the rights. [810-10-25-14A]

Obligation to absorb losses or rights to receive benefits

Unlike IFRS Accounting Standards, to have control over an investee, a variable interest holder must have the obligation to absorb losses or right to receive benefits that could potentially be significant to a VIE. A variable interest is an interest through which an enterprise involved with a legal entity shares in that entity's economic risks and rewards. The interest absorbs some of the entity's expected losses, expected residual returns or both. [810-10-25-38A(b)] [810-10 Glossary]

Unlike IFRS Accounting Standards, 'expected losses' and 'expected residual returns' are defined as the expected negative and positive variability, respectively, in the fair value of net assets exclusive of variable interests. Factors to consider when evaluating whether the obligation to absorb losses or right to receive benefits could potentially be significant include:

- the purpose, design and structure of the VIE, including the terms of the VIE's variable interests and nature of its variability;
- whether any of the entity's or VIE's exposure to losses or benefits is capped;
- the nature of the VIE's capital structure, including where in the structure the entity's interest resides;
- the magnitude of the VIE's variable interests held by the reporting entity; and
- the rationale for the entity holding a variable interest in the VIE. For example, holding an interest for reputational reasons may indicate that the reporting entity is exposed to losses or benefits that may be significant to the VIE. [810-10-25-38A(b), 810-10-55-61, 55-64, 55-67, 55-70, 55-74, 55-77, 55-80, 55-83 – 55-84]

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

Link between power and returns

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

Unlike IFRS Accounting Standards, an entity's fees paid to a decision maker or service provider are not variable interests (and therefore the decision maker or service provider will not consolidate) if:

- they are commensurate with the level of effort required to provide the services;
- the service arrangement has terms and conditions consistent with an arm's length arrangement; and
- the decision maker or service provider does not hold other interests that would absorb (receive) more than an insignificant amount of the VIE's expected losses (residual returns). [810-10-55-37]

Even if the fees paid to a decision maker or service provider are variable interests, they are not considered when evaluating whether the decision maker or service provider's obligation to absorb losses or rights to receive benefits are potentially significant to the VIE if the first two criteria are met (i.e. the fees are commensurate with the effort to provide the services and the terms are at arm's length). [810-10-25-38H]

Unlike IFRS Accounting Standards, when the guidance on fees is being applied, interests in the VIE held by a related party of the decision maker or service provider are considered as outlined below. For this purpose, employees and employee benefit plans of the decision maker or service provider are not related parties unless they are being used to circumvent the VIE consolidation requirements.

- The indirect variable interests in the VIE held through the related party are considered interests of the decision maker on a proportionate basis if the decision maker or service provider holds an interest in the related party.
- If a group of entities under common control has power over the VIE (or a related party group shares power) and has an obligation to absorb losses that could potentially be significant to the entity (or it has the right to receive benefits from the entity that could potentially be significant to the entity), but no individual entity within the group does, then the entity within the common control group that is most closely associated with the entity is the primary beneficiary. [810-10-55-37D]

Link between power and obligation to absorb losses or rights to receive benefits

Unlike IFRS Accounting Standards, the VIE consolidation model has no explicit test to assess the link between the power to direct the activities that most significantly impact the economic performance and the obligation to absorb losses or rights to receive benefits of the investee. Instead, this evaluation is integrated into the guidance on identifying whether the terms of the arrangement (e.g. stated power) are substantive, which entities have a variable interest in a VIE and which entity, if any, has a controlling financial interest (see above).

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The following is a summary of the linkage analysis.

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

This analysis is often particularly relevant for fund managers. In applying the guidance, two tests are determinative.

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

Subsidiaries' accounting periods and policies

If the reporting dates of the parent and subsidiary are different, then additional financial statements of the subsidiary are prepared as at the parent's reporting date, unless it is impracticable to do so. In any case, the difference between the reporting dates of the parent and subsidiary should not be greater than three months and adjustments are made for the effects of significant transactions and events between these dates. [IFRS 10.B92–B93]

IFRS Accounting Standards do not provide specific guidance on a change in a subsidiary's reporting date, or the elimination of an existing lag period between the reporting dates of a parent and its subsidiary. In our view, when a subsidiary's reporting date changes, the consolidated financial statements for the current period should include the results of the parent for the 12 months and the results of the subsidiary for a longer or shorter period, unless the parent has already adjusted its consolidated financial statements in the previous period for the effects of the difference.

US GAAP includes general consolidation guidance that can be compared with the guidance in IFRS Accounting Standards on fund managers and the link between power and returns as follows.

- If a single party (limited partner or member) holds substantive kick-out or participating rights, then the limited partnership or similar entity is not a VIE and the VOE model applies. In that case, consolidation may result under US GAAP but not under IFRS Accounting Standards.
- If the decision maker's remuneration is not commensurate with the services provided, or the terms and conditions are not on an arm's length basis, then the decision maker is deemed to hold a variable interest in the investee, which means that consolidation will be more likely (but not determinative as under IFRS Accounting Standards). [810-10-15-14(b)(1)(i), 55-37]

Subsidiaries' accounting periods and policies

Unlike IFRS Accounting Standards, a parent may elect to use a date of no more than about three months from its reporting date for a subsidiary without demonstrating that it is impracticable to use the parent's reporting date. Unlike IFRS Accounting Standards, adjustments may be made for the effects of material transactions and events between these dates, and if not disclosures regarding those effects are provided. [810-10-45-12]

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

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IFRS Accounting Standards

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

Non-controlling interests

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

NCI are generally recognised in the consolidated financial statements of the parent, even if the non-wholly owned subsidiary does not constitute a business, because there is no exception from the general requirements of the accounting standard. [IFRS 10.22, A]

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

In our view, the acquirer in an asset acquisition (i.e. the acquisition of a subsidiary that does not constitute a business) can elect, on a transaction-by-transaction basis, to measure 'ordinary' NCI either at fair value or at the holders' proportionate interest in the recognised amount of the assets acquired and liabilities assumed.

Even though control of an entity takes into account potential voting rights that are substantive, the calculation of NCI is based on current ownership interests. [IFRS 10.B89]

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

US GAAP

For the purposes of consolidation, the financial information of all subsidiaries is prepared on the basis of US GAAP, which is equivalent to the IFRS Accounting Standards requirement. Although US GAAP does not specifically address this issue, we believe that accounting policies should be conformed unless dissimilar operations provide a basis for different accounting policies, or the subsidiary is applying industry-specific guidance; we do not expect significant differences from IFRS Accounting Standards. [810-10-25-15]

Non-controlling interests

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

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

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

In our view, the acquirer in an asset acquisition (i.e. the acquisition of a subsidiary that does not constitute a business) may measure NCI based on either their proportionate share of the carrying amounts in the acquired entity (unlike IFRS Accounting Standards) or fair value (like IFRS Accounting Standards). Unlike IFRS Accounting Standards, the chosen accounting policy should be applied consistently.

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

Like IFRS Accounting Standards, losses that are attributable to NCI are allocated to the NCI even if doing so causes the NCI to have a deficit balance. [810-10-45-21]

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If an entity writes a put option or enters into a forward purchase agreement (that provides for settlement in cash or in another financial asset of the entity) with the NCI in an existing subsidiary on their shares in that subsidiary, then the entity recognises a financial liability for the present value of the exercise price of the option or of the forward price. The corresponding debit entry and accounting for the NCI depend on whether the NCI have present access to the returns associated with the underlying ownership interest.

- If the NCI no longer have present access to those returns, then in our view the entity should apply the anticipated-acquisition method – i.e. account for NCI as if they had been acquired already.
- If the NCI still have present access to those returns, then in our view the entity could choose an accounting policy, to be applied consistently, to use either the anticipated-acquisition method (see above) or the present-access method – i.e. continue to recognise NCI and debit 'other equity'.

In our view, for the purpose of determining whether NCI still have present access to the 'returns associated with the underlying ownership interest', returns comprise:

- distributions of the subsidiary, which in our experience are often neutral to the analysis because distributions to NCI can usually be prevented by the parent or the exercise price is adjusted for them; and
- both positive and negative changes in the fair value of the underlying ownership interest.

We believe that the wider concept of returns that is used for the test of control – e.g. synergistic benefits due to economies of scale, cost savings and tax benefits (see above) – does not apply.

In our view, present access is with the legal owner of the equity interest unless *substantially all* of the returns associated with the underlying ownership interest are in substance transferred to another party. We believe that substantially all of the returns associated with the underlying ownership interest are transferred to the parent only if both of the following tests are met.

- *Test 1:* From an economic perspective, the instrument will be exercised in substantially all cases.
- *Test 2:* The sensitivity of the exercise price to the variations in the fair value of the ownership interest is sufficiently low that substantially all of that variation accrues to the parent. [IAS 32.23, IFRS 10.B90]

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

- If the put option is issued as a single freestanding instrument for a fixed exercise price, then it is accounted for at fair value and the NCI continue to be recognised.
- If the put option is embedded in the non-controlling shares and there is also an offsetting embedded mirror call option held by the parent, then the parent recognises no NCI and accounts for the arrangement as a financing of the parent's acquisition of NCI. This guidance generally applies to fixed-price embedded put and call options exercisable at a stated future date.
- If the put option is embedded in the non-controlling shares and causes them to be mandatorily redeemable financial instruments, the non-controlling shares are classified as financial liabilities. Mandatorily redeemable instruments are initially measured at fair value, and subsequently measured depending on the specific terms of settlement.
- If the put option is embedded in the non-controlling shares and there is no offsetting embedded call option held by the parent, which is an SEC registrant (i.e. the non-controlling shares are 'redeemable'), then:
  - if the NCI are currently redeemable for cash (or other assets of the issuer) at a fixed or determinable price, then they should generally be reported outside equity and measured at the greater of the carrying amount and maximum redemption amount; or
  - if the NCI are redeemable for cash (or other assets of the issuer) at a fixed or determinable price, but are not currently redeemable, then they would generally be reported outside equity and measured:
    - like currently redeemable NCI; or
    - at an amount that reflects periodic accretion to the redemption amount.

    [480-10-55-54, 55-59, S99-3A]

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

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

Intra-group transactions

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

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

Changes in ownership interests while retaining control

Changes in ownership interests without gaining or losing control (i.e. increases and decreases in NCI) are accounted for as transactions with equity holders in their capacity as equity holders. As a result, no gain or loss on such changes is recognised in profit or loss. [IFRS 10.23, IU 07-09]

Like IFRS Accounting Standards, in the consolidated statement of financial position, NCI are classified as equity but are presented separately from the parent shareholders' equity. However, if the NCI are redeemable for cash (or other assets of the issuer) upon events outside the control of the issuer, then SEC registrants are required to present NCI outside 'permanent' equity and doing so changes the measurement of NCI (see above). This may give rise to differences from IFRS Accounting Standards in practice. Like IFRS Accounting Standards, NCI that are mandatorily redeemable are accounted for as liabilities if certain conditions are met (see chapter 7.3). [480-10-25-4 – 25-7, 10-S99, 810-10-45-16]

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

Intra-group transactions

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

Unlike IFRS Accounting Standards, the elimination of fees or other sources of income or expense between a primary beneficiary and a consolidated VIE is attributed entirely to the primary beneficiary, rather than being allocated between the primary beneficiary and NCI holders. [810-10-35-3]

Changes in ownership interests while retaining control

Like IFRS Accounting Standards, increases in ownership interests without gaining control are accounted for as transactions with equity holders in their capacity as equity holders. As a result, no gain or loss on such changes is recognised in profit or loss, like IFRS Accounting Standards. [810-10-45-23]

Transactions resulting in a decrease in ownership interests of a subsidiary that is a business or a group of net assets that meets the definition of a business, other than a conveyance of oil and gas mineral rights or a transfer of a good or service in the scope of the revenue Codification Topic, that do not result in a loss of control are accounted for as transactions with equity holders in their capacity as equity holders, like IFRS Accounting Standards. As a result, no gain or loss on such changes is recognised in profit or loss, like IFRS Accounting Standards. [810-10-45-23]

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

The calculation of the adjustment of NCI on purchases or sales of equity interests in the subsidiary when control of the subsidiary by the parent exists before and after the transaction depends on the initial measurement of NCI.

- When NCI were initially measured based on their proportionate interest in the recognised amount of the identifiable net assets of the acquiree, there is no specific guidance on how to calculate the adjustment, and practice varies.
- In our view, when NCI were initially measured at fair value, the adjustment of NCI should include a portion of any goodwill.

Costs relating to transactions with NCI holders while retaining control are recognised in equity. [IU 07-09]

Loss of control

A subsidiary is consolidated until the date on which control ceases. When a parent loses control of a subsidiary other than in a spin-off (see below), it:

- derecognises the assets (including goodwill), liabilities and NCI in the subsidiary, including any components of OCI attributable to them;
- recognises the fair value of the consideration received, if there is any;
- recognises any non-controlling equity investment retained at fair value; and
- reclassifies to profit or loss, or transfers directly to retained earnings, amounts recognised in OCI in relation to the subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities. [IFRS 10.25, B98–B99]

Decreases in ownership interests of a subsidiary that is not a business without losing control are generally accounted for in accordance with other US GAAP, which may result in partial gain recognition in profit or loss, unlike IFRS Accounting Standards. [810-10-45-21A]

Like IFRS Accounting Standards, the interests of the parent and NCI are adjusted to reflect the relative change in their interests in the subsidiary's equity. Like IFRS Accounting Standards, any difference between the amount by which the NCI are adjusted and the fair value of the consideration paid or received, if there is any, is recognised directly in equity and attributed to the owners of the parent. [810-10-45-23]

The adjustment of NCI on purchases or sales of equity interests in the subsidiary when control of the subsidiary by the parent exists before and after the transaction includes a portion of any goodwill. This is regardless of the initial measurement of NCI, unlike IFRS Accounting Standards. [810-10-45-23]

Unlike IFRS Accounting Standards, an entity may choose an accounting policy, to be applied consistently, to recognise costs relating to transactions with the NCI holders while retaining control in equity or in profit or loss.

Loss of control

Like IFRS Accounting Standards, a subsidiary is consolidated until the date on which control ceases. When a parent loses control of a subsidiary that is a business other than in a spin-off (see below), unless the transaction is a transfer of oil and gas mineral rights or a transfer in the scope of the revenue Codification Topic (unlike IFRS Accounting Standards), it:

- derecognises the assets (including goodwill), liabilities and NCI in the subsidiary, including any components of accumulated OCI attributable to them, like IFRS Accounting Standards;
- recognises the fair value of the consideration received, if there is any, like IFRS Accounting Standards;
- recognises any non-controlling equity investment retained at fair value, like IFRS Accounting Standards; and
- reclassifies to profit or loss amounts recognised in accumulated OCI in relation to the subsidiary, which may differ from IFRS Accounting Standards depending on the nature of the underlying item. [810-10-40-5, 40-3A]

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When control of a subsidiary is lost other than in a spin-off (see below), any resulting gain or loss is recognised in profit or loss, and is measured as the difference between:

- the sum of:
  - the fair value of the consideration received, if there is any;
  - the fair value of any retained non-controlling equity investment; and
  - the carrying amount of the NCI in the former subsidiary, including amounts recognised in OCI (e.g. foreign exchange differences – see chapter 2.7) attributable to the NCI; and
- the carrying amount of the former subsidiary's net assets. [IFRS 10.25(c), B98(d)]

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

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

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

Like IFRS Accounting Standards, when control of a subsidiary that is a business is lost other than in a spin-off (see below), unless the transaction is a transfer of oil and gas mineral rights or a transfer in the scope of the revenue Codification Topic (unlike IFRS Accounting Standards), any resulting gain or loss is recognised in profit or loss, and is measured as the difference between:

- the sum of:
  - the fair value of the consideration received, if there is any;
  - the fair value of any retained non-controlling equity investment; and
  - the carrying amount of the NCI in the former subsidiary, including accumulated OCI attributable to the NCI; and
- the carrying amount of the former subsidiary's net assets. [810-10-40-5]

Like IFRS Accounting Standards, the gain or loss recognised in profit or loss comprises a 'realised' gain or loss on the interest disposed of (unless, unlike IFRS Accounting Standards, the portion is disposed of through a non-reciprocal pro rata transfer to owners), and an 'unrealised' gain or loss from remeasurement to fair value of any retained non-controlling equity investment in the former subsidiary. [810-10-40-5]

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

If the subsidiary is not a business and substantially all of the fair value of the assets in the subsidiary is concentrated in non-financial assets, then the entity accounts for the transaction under the derecognition of non-financial assets Subtopic of the other income Codification Topic, which results in similar accounting upon derecognition to that described above, like IFRS Accounting Standards. [610-20-05-2, 32-2 – 32-4]

Unlike IFRS Accounting Standards, if the subsidiary performs oil- and gas-producing activities, or is not a business and substantially all of the fair value of the assets in the subsidiary is *not* concentrated in non-financial assets, then other US GAAP is applied on losing control, which may result in partial step-up and partial gain recognition. [810-10-40-3A]

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

Any retained non-controlling equity investment in the former subsidiary is remeasured to its fair value at the date on which control is lost. From the date that control is lost, the remaining interest is accounted for as:

- an associate (see chapter 3.5);
- a joint arrangement (see chapter 3.6); or
- a financial asset (see chapter 7.7).

Unlike IFRS Accounting Standards, if a parent loses control of a subsidiary by contributing it to an equity-method investee, then the recognition of any gain or loss generally depends on whether the subsidiary meets the definition of a business (see chapter 2.6).

- If the former subsidiary is a business (other than oil- and gas-producing activities or goods in the scope of the revenue Codification Topic), then the parent recognises a full gain or loss on the loss of control, like IFRS Accounting Standards.
- If the former subsidiary is not a business and substantially all of the fair value of the assets in the subsidiary is concentrated in non-financial assets, then the parent recognises a full gain or loss on the loss of control using the recognition and measurement requirements of the other income Codification Topic (see chapter 4.2), unlike IFRS Accounting Standards.
- If the former subsidiary is neither of the above, then the gain or loss is accounted for using other Codification topics, which may result in differences from IFRS Accounting Standards. [610-20-15-4, 810-10-40-3A, 40-5]

Like IFRS Accounting Standards, any retained non-controlling equity investment in the former subsidiary that is a business is remeasured to its fair value at the date on which control is lost, unless control is lost through a spin-off (see below).

Any retained non-controlling equity investment in a former subsidiary that is not a business and has substantially all of the fair value of its assets concentrated in non-financial assets is treated as non-cash consideration and measured at fair value as part of the transaction price received under the other income Codification Topic. Although IFRS Accounting Standards do not make this distinction, the resulting remeasurement of the retained non-controlling equity investment at fair value is like IFRS Accounting Standards. [610-20-05-2, 32-2 – 32-4]

From the date on which control is lost, the remaining interest is accounted for as:

- an equity-method investee (see chapter 3.5), like IFRS Accounting Standards;
- an equity investment with a readily determinable fair value with changes in fair value recognised in profit or loss (see chapter 7.4), like IFRS Accounting Standards; or
- an equity investment without a readily determinable fair value with changes in fair value recognised in profit or loss, like IFRS Accounting Standards. Alternatively, unlike IFRS Accounting Standards, the entity may elect to use the measurement alternative and subsequently measure the equity investment at cost minus impairment, if any, plus or minus changes in fair value when an entity identifies observable price changes in orderly transactions for the identical or similar security of the same issuer (see chapter 7.7). [321-10-30-1, 35-2]

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IFRS Accounting Standards

Based on facts and circumstances, an entity accounts for two or more transactions or arrangements that result in the loss of control of a subsidiary as a single transaction. Judgement is required in making this determination, and IFRS Accounting Standards provide the following indicators to consider:

- the transactions or arrangements are entered into at the same time or in contemplation of one another;
- the transactions or arrangements form a single arrangement that achieves, or is designed to achieve, an overall commercial effect;
- the occurrence of one transaction or arrangement is dependent on the other transaction(s) or arrangement(s) occurring; and/or
- one or more of the transactions or arrangements considered on their own is not justified economically, but they are justified economically when considered together. [IFRS 10.B97]

A spin-off, in which operations are distributed to owners on a pro rata basis, is accounted for on a fair value basis (see chapter 7.3), with a gain or loss recognised in profit or loss. However, if the spin-off is a common control transaction (i.e. the operations are controlled by the same party before and after the transaction – see chapter 5.13), then there is no specific guidance in IFRS Accounting Standards. In this case, in our view an entity should choose an accounting policy, to be applied consistently, to use fair value or book value (i.e. with no gain or loss recognised). [IFRIC 17.5, 11, 14]

In a non-pro rata spin-off, operations are distributed to owners on a non-pro rata basis. In this case, in our view an entity should choose an accounting policy, to be applied consistently, to use fair value (with a gain or loss recognised in profit or loss) or book value (no gain or loss recognised).

US GAAP

Based on facts and circumstances, an entity accounts for two or more transactions or arrangements that result in the loss of control of a subsidiary as a single transaction. Judgement is required in making this determination, and US GAAP provides the same indicators as IFRS Accounting Standards to consider:

- the transactions or arrangements are entered into at the same time or in contemplation of one another;
- the transactions or arrangements form a single arrangement that achieves, or is designed to achieve, an overall commercial effect;
- the occurrence of one transaction or arrangement is dependent on the other transaction(s) or arrangement(s) occurring; and/or
- one or more of the transactions or arrangements considered on their own is not justified economically, but they are justified economically when considered together. [810-10-40-6]

Unlike IFRS Accounting Standards, under US GAAP spin-offs are accounted for on the basis of book values (with no gain or loss recognised) if there is a pro rata distribution to owners (see chapter 7.3). [845-10-30-10]

Unlike IFRS Accounting Standards, a non-pro rata spin-off, in which operations are distributed to owners on a non-pro rata basis, is required to be accounted for on the basis of fair values (with a gain or loss recognised in profit or loss). [845-10-30-10]

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2.6 Business combinations

(IFRS 3)

Overview

- Business combinations are accounted for under the acquisition method, with limited exceptions.
- A 'business combination' is a transaction or other event in which an acquirer obtains control of one or more businesses.
- The acquirer in a business combination is the combining entity that obtains control of the other combining business or businesses.
- In some cases, the legal acquiree is identified as the acquirer for accounting purposes (reverse acquisition).
- The 'date of acquisition' is the date on which the acquirer obtains control of the acquiree.
- Consideration transferred by the acquirer, which is generally measured at fair value at the date of acquisition, may include assets transferred, liabilities incurred by the acquirer to the previous owners of the acquiree and equity interests issued by the acquirer.
- Contingent consideration transferred is initially recognised at fair value. Contingent consideration classified as a liability or an asset is remeasured to fair value each period until settlement, with changes recognised in profit or loss. Contingent consideration classified as equity is not remeasured.
- Any items that are not part of the business combination transaction are accounted for outside the acquisition accounting.

2.6 Business combinations

(Topic 805)

Overview

- Like IFRS Accounting Standards, business combinations are accounted for under the acquisition method, with limited exceptions.
- Like IFRS Accounting Standards, a 'business combination' is a transaction or other event in which an acquirer obtains control of one or more businesses. However, the US GAAP guidance on control differs from IFRS Accounting Standards.
- Like IFRS Accounting Standards, the acquirer in a business combination is the combining entity that obtains control of the other combining business or businesses.
- Like IFRS Accounting Standards, in some cases the legal acquiree is identified as the acquirer for accounting purposes (reverse acquisition).
- Like IFRS Accounting Standards, the 'date of acquisition' is the date on which the acquirer obtains control of the acquiree.
- Like IFRS Accounting Standards, consideration transferred by the acquirer, which is generally measured at fair value at the date of acquisition, may include assets transferred, liabilities incurred by the acquirer to the previous owners of the acquiree and equity interests issued by the acquirer.
- Like IFRS Accounting Standards, contingent consideration transferred is initially recognised at fair value. Like IFRS Accounting Standards, contingent consideration classified as a liability or an asset is remeasured to fair value each period until settlement, with changes recognised in profit or loss. Contingent consideration classified as equity is not remeasured, like IFRS Accounting Standards. However, the guidance on debt vs equity classification differs from IFRS Accounting Standards.
- Like IFRS Accounting Standards, any items that are not part of the business combination transaction are accounted for outside the acquisition accounting.

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Overview (continued)

- The identifiable assets acquired and liabilities assumed are recognised separately from goodwill at the date of acquisition if they meet the definition of assets and liabilities and are exchanged as part of the business combination.
- The identifiable assets acquired and liabilities assumed as part of a business combination are generally measured at the date of acquisition at their fair values.
- There are limited exceptions to the recognition and/or measurement principles for contingent liabilities, deferred tax assets and liabilities, indemnification assets, employee benefits, leases in which the acquiree is the lessee, reacquired rights, share-based payment awards, non-current assets held for sale and insurance contracts.
- Goodwill is measured as a residual and is recognised as an asset. If the residual is a deficit (bargain purchase gain), then it is recognised in profit or loss after reassessing the values used in the acquisition accounting.
- Adjustments to the acquisition accounting during the 'measurement period' reflect additional information about facts and circumstances that existed at the date of acquisition. Such adjustments are made by retrospective application to the period in which the acquisition occurred and any subsequent periods.
- 'Ordinary' NCI are measured at fair value, or at their proportionate interest in the net assets of the acquiree, at the date of acquisition. 'Other' NCI are generally measured at fair value.
- If a business combination is achieved in stages (step acquisition), then the acquirer's previously held non-controlling equity interest in the acquiree is remeasured to fair value at the date of acquisition, with any resulting gain or loss recognised in profit or loss.

Overview (continued)

- The identifiable assets acquired and liabilities assumed are recognised separately from goodwill at the date of acquisition if they exist, unlike IFRS Accounting Standards, and are exchanged as part of the business combination, like IFRS Accounting Standards. Despite differences in the recognition conditions, we do not expect significant differences from IFRS Accounting Standards in practice.
- Like IFRS Accounting Standards, the identifiable assets acquired and liabilities assumed as part of a business combination are generally measured at the date of acquisition at their fair values.
- Like IFRS Accounting Standards, there are limited exceptions to the recognition and/or measurement principles. However, some of the exceptions differ from IFRS Accounting Standards.
- Like IFRS Accounting Standards, goodwill is measured as a residual and is recognised as an asset. Like IFRS Accounting Standards, if the residual is a deficit (bargain purchase gain), then it is recognised in profit or loss after reassessing the values used in the acquisition accounting.
- Like IFRS Accounting Standards, adjustments to the acquisition accounting during the 'measurement period' reflect additional information about facts and circumstances that existed at the date of acquisition. Unlike IFRS Accounting Standards, such adjustments are made in the current period.
- Unlike IFRS Accounting Standards, the acquirer in a business combination generally measures NCI at fair value at the date of acquisition.
- Like IFRS Accounting Standards, if a business combination is achieved in stages (step acquisition), then the acquirer's previously held non-controlling equity interest in the acquiree is remeasured to fair value at the date of acquisition, with any resulting gain or loss recognised in profit or loss.

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Overview (continued)

- **In general, items recognised in the acquisition accounting are measured and accounted for in accordance with the relevant accounting standard subsequent to the business combination. However, as an exception, there is specific guidance for certain items – e.g. contingent liabilities and indemnification assets.**
- **'Push-down' accounting, whereby fair value adjustments are recognised in the financial statements of the acquiree, is not permitted under IFRS Accounting Standards.**
- **The acquisition of a collection of assets that does not constitute a business is not a business combination. In such cases, the entity generally allocates the cost of acquisition to the assets acquired and liabilities assumed based on their relative fair values at the date of acquisition. No goodwill (or bargain purchase gain) is recognised.**

Scope

The business combinations standard does not apply to:

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

Overview (continued)

- **Like IFRS Accounting Standards, in general, items recognised in the acquisition accounting are measured and accounted for in accordance with the relevant US GAAP subsequent to the business combination. However, like IFRS Accounting Standards, there is specific guidance for certain items, although the guidance differs in some respects from IFRS Accounting Standards.**
- **Unlike IFRS Accounting Standards, 'push-down' accounting, whereby fair value adjustments are recognised in the financial statements of the acquiree, is permitted.**
- **Like IFRS Accounting Standards, the acquisition of a collection of assets that does not constitute a business is not a business combination. Like IFRS Accounting Standards, the entity generally allocates the cost of acquisition to the assets acquired and liabilities assumed based on their relative fair values at the date of acquisition, and no goodwill (or bargain purchase gain) is recognised.**

Scope

The business combinations Codification Topic does not apply to:

- the formation of a joint venture in the financial statements of the joint venture itself, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, US GAAP does not define a joint arrangement other than a joint venture (see chapter 3.6); as a result, this scope exclusion is narrower than under IFRS Accounting Standards;
- the acquisition of an asset or a group of assets that does not meet the definition of a business (see below), like IFRS Accounting Standards;
- a combination of entities or businesses under common control, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, US GAAP includes guidance on the accounting for a combination of entities or businesses under common control (see chapter 5.13);
- financial assets and financial liabilities of a consolidated variable interest entity that is a collateralised financing entity, when the entity chooses to measure both the assets and liabilities using the more observable of the fair value of the financial assets and the fair value of the financial liabilities, unlike IFRS Accounting Standards; and

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The scope of the accounting standard includes business combinations between mutual entities, and business combinations in which separate entities are brought together by contract alone without obtaining an ownership interest. [IFRS 3.33, 43]

A not-for-profit organisation that chooses to apply IFRS Accounting Standards also complies with the accounting for business combinations. [P.9]

Identifying a business combination

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

A 'business' is an integrated set of activities and assets that is capable of being conducted and managed to provide goods or services to customers, generate investment income (e.g. dividends or interest) or generate other income from ordinary activities. [IFRS 3.A]

IFRS Accounting Standards provide a two-step framework for determining whether transactions should be accounted for as asset acquisitions or business combinations. This framework contains an optional concentration test (Step 1), which might be used on a transaction-by-transaction basis to simplify the assessment of whether a transaction is an asset acquisition.

- *Step 1:* Determine whether substantially all of the fair value of the gross assets acquired is concentrated in a single (group of similar) identifiable asset(s). Judgement is required because there is no bright line for 'substantially all'. If the test in Step 1 is met, then the entity may elect to treat the transaction as an asset acquisition. If the test is not met or not applied, then the entity proceeds with Step 2.
- the acquisition by an investment company of an investment in a subsidiary that is required to be measured at FVTPL, which differs from the exception under IFRS Accounting Standards in some respects (see chapter 5.6). [805-10-15-4, 805-50-30-10, 946-810-45-2]

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

Unlike IFRS Accounting Standards, business combinations between not-for-profit organisations and the acquisition of a for-profit business by a non-profit organisation are excluded from the scope of the business combinations Codification Topic and a separate Codification topic applies. [805-10-15-4, 954-805, 958-805]

Identifying a business combination

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

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

Like IFRS Accounting Standards, US GAAP provides a framework and related guidance for determining whether the acquired set is a business and therefore the transaction or event is a business combination. The framework contains an initial screening test (Step 1) that reduces the population of transactions that an entity needs to analyse to determine whether the acquired set is a business (Step 2). Unlike IFRS Accounting Standards, the initial screening test (Step 1) is mandatory.

- *Step 1:* Determine whether substantially all of the fair value of the gross assets acquired is concentrated in a single (group of similar) identifiable asset(s). Judgement is required because there is no bright line for 'substantially all'. If the test in Step 1 is met, then the acquired set is not a business and the entity treats the transaction as an asset acquisition. If the test is not met, then the entity proceeds with Step 2.

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- *Step 2:* Assess whether an input and a substantive process exist that together significantly contribute to the ability to create outputs. The approach used to determine whether a process is substantive depends on whether the set has outputs. If the test in Step 2 is met, then a business has been acquired and the entity accounts for the transaction as a business combination. [IFRS 3.A, B7–B12D, BC21X]

An entity in its development stage can meet the definition of a business. [IFRS 3.B9]

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

Business combinations in the scope of the accounting standard are accounted for under the acquisition method. [IFRS 3.4]

Identifying the acquirer

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

The concept of 'control' is discussed in chapter 2.5.

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

- *Step 2:* Assess whether an input and a substantive process exist that together contribute to the ability to create outputs. If the test in Step 2 is met, then the acquired set is a business and the entity accounts for the transaction as a business combination. [805-10-55-3A, 55-5A – 55-5D]

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

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

Like IFRS Accounting Standards, business combinations in the scope of the Codification Topic are accounted for under the acquisition method. However, the application of the acquisition method under US GAAP differs from IFRS Accounting Standards for certain financial statement elements (see below). [805-10-25-1]

Identifying the acquirer

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

The concept of 'control' is discussed in chapter 2.5.

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

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

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

Determining the date of acquisition

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

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

Consideration transferred and determining what is part of the business combination

General principles

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

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

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

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

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

Determining the date of acquisition

Like IFRS Accounting Standards, the 'date of acquisition' is the date on which the acquirer obtains control of the acquiree. However, the determination of control under US GAAP differs from IFRS Accounting Standards (see chapter 2.5) and differences may arise in practice. [805-10-20]

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

Consideration transferred and determining what is part of the business combination

General principles

Like IFRS Accounting Standards, the acquirer recognises and measures the consideration transferred, the assets acquired and liabilities assumed, NCI and goodwill at the date of acquisition. [805-20-30, 805-30-30]

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

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

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

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

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

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

Restructuring liabilities are recognised as part of the acquisition accounting only if they represent a liability recognised by the acquiree at the date of acquisition (see chapter 3.12). An acquiree's restructuring plan that is conditional on it being acquired is not, immediately before the business combination, a present obligation of the acquiree. [IFRS 3.11]

Pre-existing relationships

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

The settlement of pre-existing relationships is recognised in profit or loss. The measurement of such settlements is based on:

- for a non-contractual relationship, fair value (e.g. a lawsuit); and
- for a contractual relationship, the lesser of the amount by which the pre-existing relationship is off-market from the acquirer's perspective and any cancellation clause that is exercisable by the party to which the relationship is unfavourable. [IFRS 3.B52]

Like IFRS Accounting Standards, contingent consideration that is part of the consideration transferred is classified as equity or a liability in accordance with the guidance on the presentation of financial instruments (see chapter 7.3). However, these requirements differ from IFRS Accounting Standards in certain respects. [805-30-25-6]

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

Like IFRS Accounting Standards, a business combination can occur without the acquirer transferring consideration. Acquisition accounting is applied using the fair value of the acquirer's interest in the acquiree instead of the fair value of the consideration transferred in such business combinations, like IFRS Accounting Standards. [805-30-30-2]

Like IFRS Accounting Standards, the acquirer is required to identify any items that are not part of the business combination transaction and account for them separately from the business combination. [805-10-25-20]

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

Pre-existing relationships

Like IFRS Accounting Standards, the settlement of a pre-existing relationship between the acquirer and the acquiree is an example of a transaction that is not part of the business combination. [805-10-25-20, 55-20]

Like IFRS Accounting Standards, the settlement of pre-existing relationships is recognised in profit or loss. Like IFRS Accounting Standards, the measurement of such settlements is based on:

- for a non-contractual relationship, fair value (e.g. a lawsuit); and
- for a contractual relationship, the lesser of the amount by which the pre-existing relationship is off-market from the acquirer's perspective and any cancellation clause that is exercisable by the party to which the relationship is unfavourable. [805-10-55-21]

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An entity may, as part of settling a pre-existing relationship, reacquire a right that it had previously granted to the acquiree. Such reacquired rights are recognised as intangible assets and are measured based on the remaining contractual term. [IFRS 3.B35]

Payments to employees or former owners of the acquiree

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

Contingent payment arrangements that potentially benefit employees or former owners of an acquiree are evaluated to determine whether they constitute contingent consideration issued in the business combination or are separate transactions. The automatic forfeiture of payments when employment is terminated always leads to the conclusion that the contingent payments represent remuneration for post-combination services. [IFRS 3.B55, IU 01-13, IU 03-24]

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

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

To the extent that the replacement awards' value is attributable to past service, it is included in the consideration transferred; however, the amount included cannot exceed the market-based (i.e. fair-value-based) measure of the acquiree awards at the date of acquisition (see below). To the extent that replacement awards require future service, they are not part of the consideration transferred and instead are treated as post-combination remuneration cost. If they relate to both past and future services, then the market-based measure is allocated between consideration transferred and post-combination remuneration cost. [IFRS 3.B56–B58]

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

Payments to employees or former owners of the acquiree

Like IFRS Accounting Standards, an arrangement that compensates employees or former owners of the acquiree for future services is an example of a transaction that is not part of the business combination. [805-10-25-21]

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

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

Unlike IFRS Accounting Standards, the US GAAP guidance applies to share-based payment awards held by grantees of the acquiree, including both employees and non-employees. Like IFRS Accounting Standards, if the acquirer is obliged to issue share-based payment awards (replacement awards) to grantees of an acquiree in exchange for share-based payment awards issued previously by the acquiree (acquiree awards), then all or a portion of the amount of the acquirer's replacement awards is included in measuring the consideration transferred in the business combination. [805-30-30-9]

Like IFRS Accounting Standards, to the extent that the replacement awards' value is attributable to past vesting, it is included in the consideration transferred; however, the amount included cannot exceed the fair-value-based measure of the acquiree awards at the date of acquisition (see below). Like IFRS Accounting Standards, to the extent that replacement awards require future vesting, they are not part of the consideration transferred and instead are treated as post-combination cost. If they relate to both past and future vesting, then the fair-value-based measure is allocated between consideration transferred and post-combination cost, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, US GAAP contains specific guidance on allocating non-employee replacement awards. [805-30-30-11, 55-7, 55-9A]

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IFRS Accounting Standards

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

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

The market-based measures of both the acquiree awards and the replacement awards are determined at the date of acquisition (see chapter 4.5). [IFRS 3.30]

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

Subsequent changes in the number of replacement awards that are expected to vest due to service and non-market performance conditions are reflected as an adjustment to post-combination remuneration cost, not to the consideration transferred for the business combination. [IFRS 3.B60]

Market conditions and non-vesting conditions are reflected in the market-based measure at the date of acquisition. There is no true-up if the expected and actual outcomes differ because of these conditions for equity-settled transactions. [IFRS 2.21–21A, 3.30]

US GAAP

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

Unlike IFRS Accounting Standards, an entity applies the modification guidance of the share-based payment Codification Topic. [805-30-30-9]

Like IFRS Accounting Standards, the fair-value-based measures of both the acquiree awards and the replacement awards are determined at the date of acquisition (see chapter 4.5). [805-30-30-11]

Like IFRS Accounting Standards, if the fair-value-based measure of the replacement awards is greater than the fair-value-based measure of the acquiree awards (determined at the date of acquisition), then the excess amount is recognised as post-combination remuneration cost by the acquirer. [805-30-30-12, 55-10]

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

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

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For cash-settled transactions, an entity recognises the liability incurred. The liability is remeasured, until settlement date, for subsequent changes in its market-based measure with changes recognised in post-combination expense – even if the amount of the liability that is recognised for services attributed to pre-combination service remains in goodwill. [IFRS 2.33, 3.B61]

Acquisition-related costs

Acquisition-related costs are expensed as they are incurred, except for costs related to the issue of debt or equity instruments (see chapter 7.7). [IFRS 3.53]

Control maintained over assets transferred

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

Identifiable assets acquired and liabilities assumed

General principles and exceptions

The identifiable assets acquired and liabilities assumed as part of a business combination are recognised separately from goodwill at the date of acquisition only if they meet the definition of assets and liabilities. In addition, they must have been exchanged as part of the business combination rather than being the result of separate transactions. [IFRS 3.11–12]

The identifiable assets acquired and liabilities assumed as part of a business combination are measured at the date of acquisition at their fair values, with limited exceptions. [IFRS 3.18]

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

Acquisition-related costs

Like IFRS Accounting Standards, acquisition-related costs are expensed as they are incurred, except for costs related to the issue of debt or equity instruments. However, the accounting for costs related to the issue of debt or equity instruments may differ from IFRS Accounting Standards (see chapter 7.7). [805-10-25-23]

Control maintained over assets transferred

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

Identifiable assets acquired and liabilities assumed

General principles and exceptions

Unlike IFRS Accounting Standards, the identifiable assets acquired and liabilities assumed as part of a business combination are recognised separately from goodwill at the date of acquisition only if they exist. In addition, they must have been exchanged as part of the business combination rather than being the result of separate transactions, like IFRS Accounting Standards. Despite differences in the recognition conditions, we do not expect significant differences from IFRS Accounting Standards in practice. [805-20-25-2 – 25-3]

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

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IFRS Accounting Standards

The following are exceptions to the recognition and measurement principles.

- Exceptions to the recognition principle:
  - Liabilities that would be accounted for under the provisions standard are recognised if a present obligation exists at the date of acquisition under the provisions standard (see chapter 3.12).
  - Liabilities that would be accounted for under the interpretation on levies are recognised if the obligating event that gives rise to a liability to pay the levy has occurred by the date of acquisition (see chapter 3.12).
  - Contingent liabilities are included in the acquisition accounting only to the extent that they represent 'present' obligations. Whether a present obligation exists at the date of acquisition is determined under the provisions standard (see chapter 3.12).
  - Contingent assets are not recognised.
- Exceptions to the recognition and measurement principles:
  - Deferred tax assets and liabilities are recognised and measured in accordance with relevant income tax guidance (see chapter 3.13).
  - Indemnification assets are recognised and measured consistently with the underlying item that has been indemnified, subject to adjustments for collectability.
  - Employee benefits are recognised and measured in accordance with relevant employee benefits guidance (see chapter 4.4).
  - Leases in which the acquiree is the lessee (see below).
- Exceptions to the measurement principle:
  - Reacquired rights are measured without taking into account potential renewals.
  - Share-based payment awards are measured in accordance with relevant share-based payments guidance (see chapter 4.5).
  - Non-current assets (or disposal groups) that are held for sale are measured at fair value less costs to sell (see chapter 5.4). [IFRS 3.22–31]
  - Insurance contracts and any assets for insurance acquisition cash flows are measured in accordance with the relevant insurance contracts guidance (see chapter 8.1). [IFRS 3.22–31A]

US GAAP

The following are exceptions to the recognition and measurement principles.

- Exception to the recognition principle:
  - Unlike IFRS Accounting Standards, there are no exceptions to the recognition principle only.
- Exceptions to the recognition and measurement principles:
  - Deferred tax assets and liabilities, as well as amounts due to or receivable from tax authorities related to prior ('uncertain') tax positions, are recognised and measured in accordance with the relevant income tax Codification Topic (see chapter 3.13), which differs in certain respects from IFRS Accounting Standards.
  - Indemnification assets are recognised and measured consistently with the underlying item that has been indemnified, subject to adjustments for collectability, like IFRS Accounting Standards.
  - Employee benefits are recognised and measured in accordance with relevant guidance on employee remuneration (see chapter 4.4), which differs in certain respects from IFRS Accounting Standards.
  - Leases (see below).
  - Assets and liabilities that arise from contingencies are recognised in the acquisition accounting only if either of the following applies, unlike IFRS Accounting Standards: if fair value is determinable, then the contingency is recognised at its fair value at the date of acquisition; if fair value is not determinable, then it is recognised at its estimated amount if the criteria (probable and reasonably estimable) in the contingencies Codification Topic are met (see chapter 3.12).
  - Contract assets and contract liabilities from contracts with customers are recognised and measured at the date of acquisition under the revenue Codification Topic (see chapter 4.2) as if the acquirer had originated the acquired contract, unlike IFRS Accounting Standards.
- Exceptions to the measurement principle:
  - Reacquired rights are measured without taking into account potential renewals, like IFRS Accounting Standards.
  - Share-based payment awards are measured in accordance with relevant share-based payments guidance (see chapter 4.5), which differs in certain respects from IFRS Accounting Standards.
  - Long-lived assets (or disposal groups) that are held for sale are measured at fair value less costs to sell (see chapter 5.4), like IFRS Accounting Standards.
  - Purchased financial assets with credit deterioration (including beneficial interests meeting certain conditions) are measured in accordance with the relevant financial instruments guidance on credit losses (see chapter 7.8), unlike IFRS Accounting Standards. [805-20-30, 805-740-25-5]

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IFRS Accounting Standards

At the date of acquisition, the acquirer classifies and designates the identifiable assets acquired and liabilities assumed as necessary to apply other accounting standards subsequently. Those classifications or designations are made based on the contractual terms, economic conditions, acquirer's operating or accounting policies and other relevant conditions at the date of acquisition. There is one exception to this principle for leases in which the acquiree is a lessor (see below). [IFRS 3.15–17]

Assets acquired that the acquirer intends not to use, or to use in a way that is different from how other market participants would use them, are nonetheless measured at their acquisition date fair values based on what market participants would do with them – i.e. the specific intentions of the acquirer are ignored for the purpose of determining fair values. [IFRS 3.18]

Intangible assets

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

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

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

Leases

Lease contracts acquired in a business combination are recognised separately from goodwill at the date of acquisition. [IFRS 3.10]

If the acquiree is the *lessor*, then the classification of a lease acquired in a business combination as an operating lease or a finance lease is generally retained. [IFRS 3.17]

US GAAP

Like IFRS Accounting Standards, at the date of acquisition the acquirer classifies and designates the identifiable assets acquired and liabilities assumed as necessary to apply other US GAAP subsequently. Those classifications are made based on the contractual terms, economic conditions, acquirer's operating or accounting policies and other relevant conditions at the date of acquisition, like IFRS Accounting Standards. There are exceptions to this principle for leases (see below), like IFRS Accounting Standards, and contracts written by an entity meeting the specialised insurance industry accounting requirements, unlike IFRS Accounting Standards (see chapter 8.1). [805-20-25-6, 25-8]

Like IFRS Accounting Standards, assets acquired that the acquirer intends not to use, or to use in a way that is different from how other market participants would use them, are nonetheless measured at their acquisition date fair values based on what market participants would do with them – i.e. the specific intentions of the acquirer are ignored for the purpose of determining fair values. [805-20-30-6]

Intangible assets

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

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

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

Leases

Lease contracts acquired in a business combination are recognised separately from goodwill at the date of acquisition. However, the accounting requirements may differ from IFRS Accounting Standards.

Unlike IFRS Accounting Standards, the classification of a lease acquired in a business combination as an operating lease or a finance (direct financing/sales-type) lease is generally retained regardless of whether the acquiree is the lessee or lessor. [805-20-25-8, 842-10-55-11]

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Lease contracts acquired in which the acquiree is the *lessor* are accounted for as follows.

- For an *operating lease*, no separate intangible asset or liability is recognised for the existing lease contract. Instead, the favourable or unfavourable terms of the lease are taken into account in measuring the acquisition date fair value of the underlying asset.
- For a *finance lease*, the acquirer recognises a receivable for the net investment in the finance lease at its acquisition date fair value. In our view, the acquirer should not separately recognise an additional asset or liability related to favourable or unfavourable contracts.

In addition, an intangible asset may be recognised for the relationship that the lessor has with the lessee. [IFRS 3.B42]

If the acquiree is the *lessee*, then for leases to which neither of the recognition exemptions (see chapter 5.1) are applied an acquirer recognises and measures:

- a lease liability at the present value of the remaining lease payments as if the acquired lease were a new lease at the date of acquisition, using a discount rate determined under the leases standard at the date of acquisition; in our view, the rate should take into account the terms of the contract and the characteristics of the lessee as part of the newly enlarged group at the date of acquisition; and
- a right-of-use asset at the same amount as the lease liability, adjusted to reflect any favourable or unfavourable terms of the lease compared with market terms. [IFRS 3.28A–28B]

Under IFRS Accounting Standards, no additional intangible asset can be recognised for the relationship that the lessee has with the lessor.

Non-controlling interests

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

Lease contracts acquired in which the acquiree is the lessor are accounted for as follows.

- For an *operating lease*, unlike IFRS Accounting Standards, a separate intangible asset or liability is recognised for the favourable or unfavourable terms of the lease. Additionally, unlike IFRS Accounting Standards, there is generally a separate intangible asset recognised for the in-place lease value.
- For a *finance (direct financing/sales-type) lease*, like IFRS Accounting Standards, the acquirer recognises a receivable for the net investment in such a lease at its acquisition date fair value. Like IFRS Accounting Standards, the acquirer does not separately recognise an additional asset or liability related to favourable or unfavourable contracts. [805-20-25-12, 30-25]

In addition, like IFRS Accounting Standards, an intangible asset may be recognised for the relationship that the lessor has with the lessee. [805-20-25-10A]

If the acquiree is the *lessee*, then for leases to which the recognition exemption (see chapter 5.1) is not applied, like IFRS Accounting Standards, an acquirer recognises and measures:

- a lease liability at the present value of the remaining lease payments as if the acquired lease were a new lease at the date of acquisition, using a discount rate determined under the leases Codification Topic at the date of acquisition; in our view, the rate should take into account the terms of the contract and the characteristics of the lessee as part of the newly enlarged group at the date of acquisition, like IFRS Accounting Standards; and
- a right-of-use asset at the same amount as the lease liability, adjusted to reflect any favourable or unfavourable terms of the lease compared with market terms. [805-20-30-24]

In addition, unlike IFRS Accounting Standards, an intangible asset may be recognised for the relationship that the lessee has with the lessor. [805-20-25-10A]

Non-controlling interests

Unlike IFRS Accounting Standards, the acquirer in a business combination measures NCI at fair value at the date of acquisition with the exception of share-based payments held as NCI, which are measured using the fair-value-based measurement requirements of the share-based payment Codification Topic. [805-20-30-21]

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

Goodwill or bargain purchase gain

Goodwill

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

Goodwill is measured as a residual, as the excess of (a) over (b).

a. The aggregate of:
   - consideration transferred, which is generally measured at fair value at the date of acquisition;
   - the amount of any NCI in the acquiree; and
   - the acquisition date fair value of any previously held equity interest in the acquiree.
b. The net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. [IFRS 3.32]

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

Bargain purchase gain

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

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

Like IFRS Accounting Standards, if share-based payment awards of the acquiree are not replaced with share-based payment awards of the acquirer, then the fair-value-based measure of the unreplaced acquiree awards that are vested at the date of acquisition is part of NCI in the acquiree. In our view, the fair-value-based measure of the unreplaced acquiree awards that are not vested at the date of acquisition should be allocated between NCI and post-combination remuneration cost. [805-30-30-11, 810-10-20]

Goodwill or bargain purchase gain

Goodwill

Like IFRS Accounting Standards, goodwill arising in a business combination is recognised as an asset. [805-30-30]

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

a. The aggregate of:
   - consideration transferred, which is generally measured at fair value at the date of acquisition;
   - the amount of any NCI in the acquiree; and
   - the acquisition date fair value of any previously held equity interest in the acquiree.
b. The net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. [805-30-30-1]

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

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

Bargain purchase gain

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

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

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

Measurement after the initial accounting for the business combination

The measurement period

A measurement period is allowed for entities to finalise the acquisition accounting. [IFRS 3.45]

Measurement-period adjustments reflect additional information about facts and circumstances that existed at the date of acquisition. [IFRS 3.45]

Adjustments made to the acquisition accounting during the measurement period may affect the recognition and measurement of assets acquired and liabilities assumed, any NCI, consideration transferred and goodwill or any bargain purchase gain, as well as the remeasurement of any pre-existing interest in the acquiree. [IFRS 3.46]

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

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

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

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

Like IFRS Accounting Standards, a bargain purchase gain is recognised in profit or loss after reassessing the values used in the acquisition accounting. [805-30-25-2]

Measurement after the initial accounting for the business combination

The measurement period

Like IFRS Accounting Standards, a measurement period is allowed for entities to finalise the acquisition accounting. [805-10-25-13]

Like IFRS Accounting Standards, measurement-period adjustments reflect additional information about facts and circumstances that existed at the date of acquisition. [805-10-25-13 – 25-15, 30-1]

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

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

Like IFRS Accounting Standards, if the acquirer issues financial statements for a period in which the acquisition accounting is not finalised, then it discloses information about the provisional acquisition accounting. [805-20-50-4A]

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

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

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Subsequent measurement and accounting

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

- Reacquired rights are amortised over their contractual life, not taking into account potential contract renewals.
- When a contingent liability recognised in the acquisition accounting subsequently becomes a provision, it is recognised at the higher of the fair value recognised at the date of acquisition less the cumulative amount of income recognised under the principles of the revenue standard (if appropriate) and the then-current provision amount (see chapter 3.12).
- Indemnification assets are measured on the same basis as the underlying item that has been indemnified, subject to adjustments for collectability and overall contractual limitations.
- Contingent consideration that is classified as equity is not remeasured.
- Contingent consideration that is a liability or an asset is remeasured to fair value, with changes therein recognised in profit or loss. [IFRS 3.55–58]

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

Business combinations achieved in stages

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

Subsequent measurement and accounting

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

- Like IFRS Accounting Standards, reacquired rights are amortised over their contractual life, not taking into account potential contract renewals.
- Unlike IFRS Accounting Standards, US GAAP does not provide specific guidance on the subsequent accounting for a contingent liability recognised at the date of acquisition and directs entities to develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature. In our experience, entities generally apply the guidance applicable to contingencies with adjustments recognised in profit or loss (see chapter 3.12).
- Like IFRS Accounting Standards, indemnification assets are measured on the same basis as the underlying item that has been indemnified, subject to adjustments for collectability and overall contractual limitations.
- Equity-classified contingent consideration is not remeasured, like IFRS Accounting Standards. However, the classification of contingent consideration as equity or a liability may differ from IFRS Accounting Standards (see chapter 7.3).
- Like IFRS Accounting Standards, contingent consideration that is a liability or an asset is remeasured to fair value, with changes therein recognised in profit or loss. However, the classification of contingent consideration as equity or a liability may differ from IFRS Accounting Standards (see chapter 7.3). [805-20-35]

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

Business combinations achieved in stages

Like IFRS Accounting Standards, a 'business combination achieved in stages' (step acquisition) is a business combination in which the acquirer obtains control of an acquiree in which it held a non-controlling equity interest immediately before the date of acquisition. [805-10-25-9 – 25-10]

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In a step acquisition:

- the previously held non-controlling equity interest is remeasured to its fair value at the date of acquisition, with any resulting gain or loss recognised in profit or loss or OCI – depending on whether this equity interest was measured at FVTPL or FVOCI;
- the acquirer derecognises the previously held non-controlling equity interest and recognises 100 percent of the acquiree's identifiable assets acquired and liabilities assumed; and
- any amounts recognised in OCI related to the previously held equity interest are recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest. [IFRS 3.32(a)(iii), 42, BC384, 9.4.1.4, 5.7.5, B5.7.1]

Business combinations achieved without the transfer of consideration

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

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

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

A stapling arrangement is another example of a business combination in which no consideration is transferred. It is a contractual arrangement between two or more entities or their shareholders in which the equity securities of the entities or other similar instruments are 'stapled' together and each of these entities has the same owners. The stapled securities are quoted as a single security – i.e. the equity securities of each entity are not traded independently. For these arrangements, one of the combining entities needs to be identified as the acquirer. [IU 05-14]

In a step acquisition:

- the previously held non-controlling equity interest is remeasured to its fair value at the date of acquisition, with any resulting gain or loss recognised in profit or loss in all cases, unlike IFRS Accounting Standards;
- the acquirer derecognises the previously held non-controlling equity interest and recognises 100 percent of the acquiree's identifiable assets acquired and liabilities assumed, like IFRS Accounting Standards; and
- any amounts recognised in OCI related to the previously held equity interest are recognised in profit or loss, which may differ from IFRS Accounting Standards depending on the nature of the underlying item. [805-10-25-10]

Business combinations achieved without the transfer of consideration

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

Like IFRS Accounting Standards, in calculating goodwill the acquirer substitutes the acquisition date fair value of its interest in the acquiree for the consideration transferred. [805-30-30-3]

If the acquirer obtains control over another entity without holding an equity interest, then the acquiree is likely to be a variable interest entity (see chapter 2.5). In that case, the principles of business combination accounting described in this chapter are applied, and 100 percent of the acquiree's equity is attributed to the NCI, like IFRS Accounting Standards. [805-10-25-5]

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

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Reverse acquisitions

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

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

The accounting acquiree must meet the definition of a business (see above) for the transaction to be accounted for under the acquisition method. [IFRS 3.B19, IU 03-13]

Business combinations between mutual entities

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

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

Income taxes

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

Push-down accounting

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

Reverse acquisitions

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

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

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

Business combinations between mutual entities

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

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

Income taxes

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

Push-down accounting

Unlike IFRS Accounting Standards, 'push-down' accounting, whereby the effect of acquisition accounting of the acquirer is pushed down into the financial statements of the acquiree, is permitted. Push-down accounting may also be applied even if the acquirer is not required to apply the acquisition method in its financial statements (e.g. the acquirer is an investment company). [805-50-25-4 – 25-9, SAB 115]

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Asset acquisitions

The acquisition of a collection of assets that does not constitute a business is not a business combination. In such cases, the acquirer generally allocates the cost of acquisition to the assets acquired and liabilities assumed based on their relative fair values at the date of acquisition. Such transactions do not give rise to goodwill or bargain purchase gain. The initial recognition exemption (see chapter 3.13) applies to temporary differences on assets acquired and liabilities assumed but, in our view, is not applicable to acquired tax losses. [IFRS 3.2, IAS 12.15(b), 24, 34, IU 11-17]

Disclosure of pro forma information

The acquirer discloses:

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

Forthcoming requirements

There are no forthcoming requirements under IFRS Accounting Standards.

Asset acquisitions

Like IFRS Accounting Standards, the acquisition of a collection of assets that does not constitute a business is not a business combination. Like IFRS Accounting Standards, the acquirer generally allocates the cost of acquisition to the assets acquired and liabilities assumed based on their relative fair values at the date of acquisition, and no goodwill or bargain purchase gain is recognised. However, accounting for the income tax effects of an asset acquisition differs from IFRS Accounting Standards (see chapter 3.13). [805-50-05-3]

Disclosure of pro forma information

Unlike IFRS Accounting Standards, public entity acquirers disclose:

- the revenue and earnings of the acquiree since the date of acquisition included in the consolidated income statement for the reporting period – i.e. excluding OCI;
- the revenue and earnings of the combined entity as if the date of acquisition for all business combinations that occurred during the year had been as of the beginning of the comparative annual reporting period; and
- a description of the nature and amount of material, non-recurring pro forma adjustments. [805-10-50-2(h)]

Forthcoming requirements

Amendments to the business combinations Codification Topic are effective for annual periods beginning after 15 December 2026; early adoption is permitted. See appendix.

The amendments change the framework for identifying the accounting acquirer in business combinations when the legal acquiree is a variable interest entity and require entities to consider the general accounting acquirer factors in the business combinations Codification Topic when the transaction is primarily effected by the exchange of equity instruments.

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2.7 Foreign currency translation

(IAS 21, IAS 29, IFRIC 22)

Overview

- An entity measures its assets, liabilities, income and expenses in its functional currency, which is the currency of the primary economic environment in which it operates.
- Transactions that are not denominated, or do not require settlement, in an entity's functional currency are foreign currency transactions, and exchange differences arising on translation are generally recognised in profit or loss.
- The financial statements of foreign operations are translated for consolidation purposes as follows: assets and liabilities are translated at the closing rate; income and expenses are translated at the actual rates or appropriate averages; in our view, equity components (excluding current-year movements, which are translated at the actual rates) should not be retranslated.
- Exchange differences arising on the translation of the financial statements of a foreign operation are recognised in OCI and accumulated in a separate component of equity. The amount attributable to any NCI is allocated to and recognised as part of NCI.
- If the functional currency of a foreign operation is the currency of a hyperinflationary economy, then current purchasing power adjustments are made to its financial statements before translation into a different presentation currency. However, if the presentation currency is not the currency of a hyperinflationary economy, then comparative amounts are not restated.

2.7 Foreign currency translation

(Topic 830, SEC Reg S-X 3-20)

Overview

- Like IFRS Accounting Standards, an entity measures its assets, liabilities, income and expenses in its functional currency, which is the currency of the primary economic environment in which it operates. However, the indicators used to determine the functional currency differ in some respects from IFRS Accounting Standards.
- Like IFRS Accounting Standards, transactions that are not denominated in an entity's functional currency are foreign currency transactions, and exchange differences arising on remeasurement are generally recognised in profit or loss.
- Like IFRS Accounting Standards, the financial statements of foreign operations are translated for consolidation purposes as follows: assets and liabilities are translated at the current exchange rate; income and expenses are translated at actual rates or appropriate averages; equity components (excluding current-year movements, which are translated at the actual rates) are not retranslated.
- Like IFRS Accounting Standards, exchange differences arising on the translation of the financial statements of a foreign operation are recognised in OCI and accumulated in a separate component of equity (accumulated OCI). The amount attributable to any NCI is allocated to and recognised as part of NCI, like IFRS Accounting Standards.
- Unlike IFRS Accounting Standards, the financial statements of a foreign operation in a highly inflationary economy are remeasured as if the parent's reporting currency were its functional currency.

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Overview (continued)

- An entity may present its financial statements in a currency (or currencies) other than its functional currency (presentation currency). An entity that translates its financial statements into a presentation currency other than its functional currency uses the same method as for translating the financial statements of a foreign operation.
- If an entity loses control of a foreign operation, then the cumulative exchange differences relating to that foreign operation are recognised in OCI and are reclassified in their entirety to profit or loss. If control is not lost, then a proportionate amount of the cumulative exchange differences recognised in OCI is reclassified to NCI.
- If an entity retains neither significant influence nor joint control over a foreign operation that was an associate or joint arrangement, then the cumulative exchange differences recognised in OCI are reclassified in their entirety to profit or loss. If either significant influence or joint control is retained, then a proportionate amount of the cumulative exchange differences recognised in OCI is reclassified to profit or loss.
- An entity may present supplementary financial information in a currency other than its presentation currency if certain disclosures are made.

Overview (continued)

- Like IFRS Accounting Standards, an entity may present its financial statements in a currency other than its functional currency (reporting currency). Like IFRS Accounting Standards, an entity that translates its financial statements into a reporting currency other than its functional currency uses the same method as for translating the financial statements of a foreign operation.
- Like IFRS Accounting Standards, if an entity loses control of a subsidiary that is a foreign entity, then the exchange differences recognised in accumulated OCI are reclassified in their entirety to profit or loss. Like IFRS Accounting Standards, if control is not lost, then a proportionate amount of the exchange differences is reclassified to NCI. However, unlike IFRS Accounting Standards, if an entity loses control of a subsidiary *within* a foreign entity, then the exchange differences are reclassified in their entirety to profit or loss only if the foreign entity has been sold or substantially liquidated; otherwise, none of the exchange differences is reclassified to profit or loss.
- If an equity-method investee that is a foreign entity is disposed of in its entirety, then the exchange differences recognised in accumulated OCI are reclassified in their entirety to profit or loss, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, if the equity-method investee is a foreign entity and is not disposed of in its entirety, then a proportionate amount is reclassified to profit or loss, and the remaining amount is generally transferred to the carrying amount of the investee.
- Like IFRS Accounting Standards, an SEC registrant may present supplementary financial information in a currency other than its reporting currency; however, the SEC regulations are more prescriptive than IFRS Accounting Standards.

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Functional and presentation currency

An entity measures its assets, liabilities, equity, income and expenses in its functional currency, which is the currency of the primary economic environment in which it operates. All transactions in currencies other than the functional currency are foreign currency transactions. [IAS 21.IN7, 8, 20]

A 'foreign operation' of an entity is a subsidiary, associate, joint arrangement or branch whose activities are based or conducted in a country or currency other than those of the reporting entity. A single legal entity may comprise multiple foreign operations (e.g. divisions) with different functional currencies in certain circumstances. [IAS 21.8, BC6]

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

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

Primary indicators:

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

Secondary indicators:

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

Functional and reporting currency

Like IFRS Accounting Standards, an entity measures its assets, liabilities, equity, income and expenses in its functional currency, which is the currency of the primary economic environment in which it operates. However, the indicators used to determine the functional currency differ in some respects from IFRS Accounting Standards (see below). Like IFRS Accounting Standards, all transactions in currencies other than the functional currency are foreign currency transactions. [830-10-20, 45-2]

Like IFRS Accounting Standards, a 'foreign entity' is an operation – including a subsidiary, division, branch, equity-method investee or a joint venture – whose functional currency differs from that of the reporting entity. [830-10-20]

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

The US GAAP guidance on functional currency is based on the presumption that reporting entities in the US have the US dollar as their functional currency. Therefore, unlike IFRS Accounting Standards, the guidance is written from the perspective of assessing whether a foreign operation has a functional currency that is different from that of the parent (which is assumed to be the US dollar). [830-10-15-4]

Unlike IFRS Accounting Standards, in determining an entity's functional currency, the following indicators are considered (without distinguishing between primary and secondary).

- Cash flows that are generated by the assets and liabilities of the foreign operation are primarily in the foreign currency and do not directly affect the parent's cash flows.
- Sales prices of the foreign operation's products or services are determined more by local competition or local government regulation than by worldwide competition or international prices and are not generally responsive on a short-term basis to changes in exchange rates.
- There is an active local sales market for the foreign operation's products or services, although there might also be significant amounts of exports.
- The foreign operation uses primarily local labour, material and other costs to produce its products or render its services, even though there might also be imports from other countries.
- The financing is primarily denominated in the foreign currency and cash flows generated by the foreign operation are sufficient to service existing and anticipated financing obligations.

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In determining whether the functional currency of a foreign operation is the same as that of its parent, the following additional indicators are considered:

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

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

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

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

- The foreign operation has a low volume of inter-company transactions and no extensive inter-relationship of operations with the parent. However, the foreign operation may rely on the parent's competitive advantages, such as patents and trademarks.
- The parent's currency would generally be the functional currency if the foreign entity is a holding company or shell company for holding investments, obligations, intangible assets and other assets and liabilities that could readily be carried on the parent's financial statements. [830-10-55-5]

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

Unlike IFRS Accounting Standards, there is no priority given to any of the above indicators if the indicators are mixed and the functional currency is not obvious. Instead, management evaluates all relevant information and exercises its judgement in determining the functional currency that best achieves the objectives of foreign currency translation. Because determination of the functional currency requires judgement, it is possible for an entity to identify different functional currencies under IFRS Accounting Standards and US GAAP. [830-10-45-6, 55-4]

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

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

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

Translation of foreign currency transactions

Each foreign currency transaction is recorded in the entity's functional currency at the spot rate of exchange at the date of the transaction. This is the date on which the transaction first qualifies for recognition under IFRS Accounting Standards. An average of spot exchange rates for a specific period may be a suitable approximate rate for transactions during that period; however, if spot exchange rates fluctuate, then the use of an average rate for a period may be inappropriate. [IAS 21.21–22]

When foreign currency consideration is paid or received in advance of the item to which it relates (e.g. an asset, expense or income), the date of the transaction is generally the date on which the entity initially recognises the asset or liability arising from the payment or receipt of the advance consideration. This date is used to determine the spot exchange rate for translating the related item on its initial recognition. [IFRIC 22.8]

At each subsequent reporting date, monetary items denominated in a foreign currency are translated at the closing rate, which is the spot exchange rate at the reporting date. [IAS 21.23]

Foreign exchange gains and losses are generally recognised in profit or loss. As exceptions, exchange gains and losses related to the following are recognised in OCI:

- monetary items that in substance form part of the net investment in a foreign operation (see below);
- hedging instruments in a qualifying cash flow hedge or hedge of a net investment in a foreign operation (see chapters 7.9 and 7.9B); and
- insurance contracts for which an entity has chosen to disaggregate insurance finance income and expense between profit or loss and OCI (see chapter 8.1). [IAS 21.28, 32, IFRS 17.92]

Unlike IFRS Accounting Standards, US GAAP does not address whether an entity may have more than one reporting currency. However, the SEC Staff has indicated that a foreign private issuer may select any reporting currency that the issuer deems appropriate, like IFRS Accounting Standards. [830-10-20, Reg S-X 210.3-20]

Remeasurement of foreign currency transactions

Like IFRS Accounting Standards, each foreign currency transaction is recorded in the entity's functional currency at the spot rate of exchange at the date the foreign currency transaction is recognised. The use of a weighted-average exchange rate that approximates the spot exchange rates during that period is acceptable under US GAAP. Although the wording differs from IFRS Accounting Standards regarding the use of averages, we would not expect differences in practice. [830-10-55-10 – 55-11, 830-20-30-1]

Like IFRS Accounting Standards, when foreign currency consideration is paid or received in advance of the item to which it relates (e.g. an asset, expense or income), the transaction date is the date on which the entity initially recognises the asset or liability arising from the payment or receipt of the advance consideration. This date is used to determine the spot exchange rate for translating the related item on its initial recognition. [830-20-25-1]

Like IFRS Accounting Standards, at each subsequent reporting date monetary items denominated in a foreign currency are remeasured at the current spot exchange rate at the reporting date. [830-10-45-17, 830-20-35-2]

Like IFRS Accounting Standards, foreign exchange gains and losses are generally recognised in profit or loss. As exceptions, exchange gains and losses related to the following are recognised in OCI:

- monetary items that in substance form part of the net investment in a foreign operation (see below), like IFRS Accounting Standards;
- foreign currency-denominated available-for-sale debt securities (see next paragraph below);
- a derivative that qualifies as a cash flow hedge (see chapters 7.9 and 7.9B), which is narrower than the IFRS Accounting Standards reference to hedging instruments; and
- hedging instruments in a qualifying hedge of a net investment in a foreign operation (see chapters 7.9 and 7.9B), like IFRS Accounting Standards. [830-20-35-1, 35-3]

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For the purpose of recognising foreign exchange differences, monetary assets classified as measured at FVOCI are treated as if they were measured at amortised cost in the foreign currency. Accordingly, the foreign exchange differences arising from changes in amortised cost are recognised in profit or loss and the remainder of the fair value change is recognised in OCI (see chapter 7.7). [IFRS 9.5.7.10, B5.7.2A, IG.E.3.2, IG.E.3.4A]

For a monetary item to form, in substance, part of the net investment in a foreign operation, settlement in cash of the monetary item needs to be neither planned nor likely to occur in the foreseeable future. The entity that has the monetary item receivable from or payable to the foreign operation may be the parent and/or any subsidiaries of the group. It may also be a long-term interest that, in substance, forms part of the entity's net investment in an associate or joint venture. [IAS 21.15, 15A, 32–33, BC25F, 28.14A, 38]

Non-monetary items measured at historical cost in a currency other than the functional currency are not retranslated into the functional currency; they remain at the exchange rate at the date of the transaction. [IAS 21.23]

Non-monetary items measured at fair value in a currency other than the functional currency are translated into the functional currency at the spot exchange rate when the fair value was determined. The resulting exchange differences are recognised in profit or loss or OCI depending on the nature of the item. [IAS 21.23, 30]

Unlike IFRS Accounting Standards, under US GAAP insurance finance income or expenses for insurance or reinsurance entities in the scope of the financial services – insurance Codification Topic (see chapter 8.1) are not presented. However, exchange gains and losses related to changes in the discount rate used to measure traditional and limited-payment long-duration insurance contracts and changes in instrument-specific credit risk of market risk benefits are recognised in OCI.

Unlike IFRS Accounting Standards, for foreign currency-denominated available-for-sale classified debt securities (a category similar to FVOCI), the entire change in fair value not related to the allowance for credit losses is recognised in OCI, unlike IFRS Accounting Standards (see chapter 7.7). [830-20-35-6]

For a monetary item to form, in substance, part of the net investment in a foreign operation, it needs to be a long-term investment in nature (i.e. cash settlement is not planned or anticipated in the foreseeable future) and the entities to the transaction need to be either consolidated, combined or accounted for under the equity method in the reporting entity's financial statements; although the exact wording differs from IFRS Accounting Standards, in general we would not expect significant differences in practice. [830-20-35-3]

Like IFRS Accounting Standards, non-monetary items measured at historical cost in a currency other than the functional currency are not remeasured into the functional currency; they remain at the exchange rate at the date of the transaction. [830-10-45-17 – 45-18]

Like IFRS Accounting Standards, non-monetary items measured at fair value in a currency other than the functional currency are remeasured into the functional currency at the spot exchange rate when the fair value was determined. The resulting exchange differences, as well as other changes in fair value, are recognised in profit or loss or OCI, depending on the nature of the item, like IFRS Accounting Standards. However, US GAAP guidance for items that may be measured at either cost or fair value (e.g. lower of cost and market) differs from IFRS Accounting Standards, which could result in differences in practice. [830-10-55-8, 830-20-35-6]

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Translation of foreign currency financial statements of a foreign operation

The financial statements of foreign operations are translated as follows:

- assets and liabilities are translated at the spot exchange rate at the reporting date;
- items of income and expense are translated at the exchange rates at the dates of the relevant transactions, although appropriate average rates may be used;
- the resulting exchange differences are recognised in OCI and are presented within equity (generally referred to as the 'foreign currency translation reserve' or 'currency translation adjustment'); and
- cash flows are translated at the exchange rates at the dates of the relevant transactions, although appropriate average rates may be used. [IAS 7.26–27, 21.39–40, 52]

In addition, although IFRS Accounting Standards are not explicit on these points, in our view:

- capital transactions (e.g. dividends) should be translated at exchange rates at the dates of the relevant transactions; and
- components of equity should not be retranslated (i.e. each component of equity is translated once, at the exchange rates at the dates of the relevant transactions).

There is no guidance in IFRS Accounting Standards about the exchange rate to be applied when reclassifying gains and losses from OCI to profit or loss. In our view, an entity should choose an accounting policy, to be applied consistently, to translate reclassification adjustments into the presentation currency by applying one of the following approaches.

- *Historical rate approach:* Use the historical exchange rate used to measure the gain or loss when it was originally included in OCI.
- *Current rate approach:* Use the exchange rate at the date on which the gain or loss is reclassified from OCI to profit or loss, with the effect of any difference between this rate and the historical rate being included in retained earnings.

Goodwill and any fair value acquisition accounting adjustments related to the acquisition of a foreign operation (see chapter 2.6) are treated as assets and liabilities of the foreign operation and are translated at the closing rate at each reporting date. [IAS 21.47]

Translation of foreign currency financial statements of a foreign operation

The financial statements of foreign operations are translated as follows:

- assets and liabilities are translated at the closing exchange rate at the reporting date, like IFRS Accounting Standards;
- items of income and expense are translated at the exchange rates at the dates of the relevant transactions, although appropriate weighted-average rates may be used, like IFRS Accounting Standards;
- the resulting exchange differences are recognised in OCI, and are presented within equity, like IFRS Accounting Standards (often referred to as a 'cumulative translation adjustment', which is an element of accumulated OCI);
- cash flows are translated at the exchange rates at the dates of the relevant transactions, although appropriate weighted-average rates may be used, like IFRS Accounting Standards;
- capital transactions (e.g. dividends) are translated at the exchange rates at the dates of the relevant transactions, although appropriate average rates may be used, like IFRS Accounting Standards; and
- components of equity are not retranslated (i.e. each component of equity is translated once at the exchange rates at the dates of the relevant transactions), like IFRS Accounting Standards. [830-30-45-3, 45-6, 45-12, 830-230-45-1]

Like IFRS Accounting Standards, US GAAP does not address the translation of amounts accumulated in OCI or which exchange rates to use when they are reclassified into earnings. In our view, the following approaches may be used, but their applicability is generally more restrictive than under IFRS Accounting Standards.

- *Historical exchange rate method:* Use the historical exchange rate used to measure the gain or loss when it was originally included in accumulated OCI. Like IFRS Accounting Standards, this method is available in all instances.
- *Current exchange rate method:* Use the exchange rate at the date on which the gain or loss is reclassified from accumulated OCI to earnings, with the effect of any difference between this rate and the historical rate being included in retained earnings. Unlike IFRS Accounting Standards, this method is only available, as an alternative accounting policy choice, for amounts related to pension and other post-retirement benefit plans.

Like IFRS Accounting Standards, goodwill and any fair value acquisition accounting adjustments related to the acquisition of a foreign operation (see chapter 2.6) are treated as assets and liabilities of the foreign operation and are translated at the current exchange rate at each reporting date. [830-30-45-11]

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IFRS Accounting Standards

If a foreign operation's reporting date is before that of the parent (see chapter 2.5), then adjustments are made for significant movements in exchange rates up to the parent's reporting date for consolidation purposes. [IAS 21.46]

If there are NCI in a foreign operation that is a subsidiary, then a portion of the foreign currency translation reserve is attributed to NCI. [IAS 21.41]

If the functional currency of a foreign operation is the currency of a hyperinflationary economy, then the foreign operation's financial statements are first restated into the measuring unit that is current at the reporting date, and then translated into the group's presentation currency using the spot exchange rate at the current reporting date. [IAS 21.42–43, 29.8]

If the financial statements of a hyperinflationary foreign operation are translated into the currency of a non-hyperinflationary economy, then the comparative amounts are not adjusted for changes in the price level or exchange rate since the relevant comparative reporting date. In other words, the comparatives are those previously presented. [IAS 21.42(b)]

An entity may use one of the following approaches to account for changes in equity as a result of the adjustments for hyperinflation (the restatement effect) and the translation of the adjusted balances to a presentation currency that is non-hyperinflationary (the translation effect) – to be applied consistently, for periods during which the economy is hyperinflationary – and present:

- the entire amount in OCI (i.e. accumulation in the foreign currency translation reserve); or
- the restatement effect as an adjustment to equity and the translation effect in OCI. [IU 03-20]

The financial statements of a foreign operation can be translated from its functional currency directly into the presentation currency of the consolidated financial statements or by applying the step-by-step method of intermediate consolidation. Although the cumulative exchange differences in respect of all foreign operations recognised in equity will be the same under either method, the attribution of that difference to individual foreign operations will differ. [IAS 21.BC18, IFRIC 16.17]

US GAAP

Unlike IFRS Accounting Standards, if a foreign operation's reporting date is before that of the parent (see chapter 2.5), then adjustments for movements in exchange rates up to the parent's reporting date for consolidation purposes are not made, although disclosures about exchange rate movements subsequent to the reporting date of the foreign operation may be needed. [830-30-45-8, 45-16, 50-2]

Like IFRS Accounting Standards, if there are NCI in a foreign operation that is a subsidiary, then a portion of the cumulative translation adjustment is attributed to NCI. [830-30-45-17]

Unlike IFRS Accounting Standards, the financial statements of a foreign operation whose functional currency is highly inflationary are remeasured for consolidation purposes as if the parent's reporting currency were its functional currency. [830-10-45-11]

Unlike IFRS Accounting Standards, under US GAAP foreign operations are translated under the step-by-step method.

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IFRS Accounting Standards

Translation from functional to presentation currency

If an entity presents its financial statements in a presentation currency that is different from its functional currency, then the translation procedures are the same as those for translating foreign operations (see above). [IAS 21.39]

If an entity's functional currency is hyperinflationary, then the translation procedures are the same as those for translating hyperinflationary foreign operations (see above). [IAS 21.42]

On first application of hyperinflationary accounting, it is unclear whether the entity should restate its comparatives for price changes in prior periods if its presentation currency is that of a non-hyperinflationary economy. In our view, an entity should choose an accounting policy, to be applied consistently, on whether it restates its comparatives in these circumstances. [IAS 21.42, 29.8]

Lack of exchangeability

A currency is exchangeable into another currency when an entity is able to exchange that currency for the other currency at the measurement date and for a specified purpose. When a currency is not exchangeable, an entity is required to estimate a spot exchange rate. In estimating a spot exchange rate, an entity may use:

- an observable exchange rate without adjustment; or
- another estimation technique. [IAS 21.19A, Appendix A]

Disposal of a foreign operation

The treatment of the foreign currency translation reserve on disposal of a foreign operation depends on the type of investee and whether a full or partial disposal has occurred.

US GAAP

Translation from functional to reporting currency

Like IFRS Accounting Standards, if an entity presents its financial statements in a reporting currency that is different from its functional currency, then the translation procedures are the same as those for translating foreign operations (see above). [830-30-45-3, Reg S-X 210.3-20, SEC FRM 6610.1]

Unlike IFRS Accounting Standards, if the currency that would be the entity's functional currency is that of a highly inflationary economy, then that currency can no longer be its functional currency. In this situation, the entity uses its parent's functional currency as its functional currency. [830-10-45-11]

Unlike IFRS Accounting Standards, the prior-year financial statements are not restated following a change in functional currency arising from the identification that the entity's previous functional currency is that of a highly inflationary economy. In such cases, the cumulative translation adjustments of prior periods are not removed from equity. The exchange rate on the date of the change becomes the historical rate for remeasurement of non-monetary assets and liabilities into the new functional currency. [830-10-45-10]

Lack of exchangeability

Unlike IFRS Accounting Standards, US GAAP specifies that if exchangeability between two currencies is temporarily lacking at the transaction date or balance sheet date, the first subsequent rate at which exchanges could be made is used to remeasure foreign currency transactions or to translate foreign currency financial statements. [830-20-30-2, 830-30-45-9]

Unlike IFRS Accounting Standards, US GAAP does not have specific guidance when there is other than temporary lack of exchangeability. In such circumstances, an entity considers the propriety of consolidation, combination, or equity method of accounting for its foreign operations. [830-20-30-2, 830-30-45-9]

Disposal of a foreign operation

Like IFRS Accounting Standards, the treatment of the foreign currency translation reserve on disposal of a foreign operation depends on the type of investee and whether a full or partial disposal has occurred. However, unlike IFRS Accounting Standards, the treatment also depends on whether the disposal involves a 'foreign entity' or a subsidiary/business *within* a foreign entity.

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IFRS Accounting Standards

The cumulative exchange differences related to a foreign operation that have been included in the foreign currency translation reserve are reclassified to profit or loss when the foreign operation is disposed of. A disposal may arise, for example, through sale, liquidation, repayment of share capital or abandonment. [IAS 21.48–49]

If an entity loses control of a subsidiary that is a foreign operation, then the cumulative exchange differences recognised in OCI are reclassified in their entirety to profit or loss. If control is not lost, then a proportionate amount of the cumulative exchange differences recognised in OCI is reclassified to NCI. [IAS 21.48–48A, 48C]

If an entity retains neither significant influence nor joint control over a foreign operation that was an associate or joint arrangement, then the cumulative exchange differences recognised in OCI are reclassified in their entirety to profit or loss. If either significant influence or joint control is retained, then a proportionate amount of the cumulative exchange differences recognised in OCI is reclassified to profit or loss. [IAS 21.48–48A, 48C]

US GAAP

Like IFRS Accounting Standards, the cumulative exchange differences arising on translation of the net investment in a foreign entity and included in the cumulative translation adjustment are reclassified to profit or loss when the foreign entity is sold or on complete or substantially complete liquidation. [830-30-40-1 – 40-3]

Like IFRS Accounting Standards, if an entity loses control of a subsidiary that is a foreign entity, then the exchange differences recognised in accumulated OCI are reclassified in their entirety to profit or loss. Like IFRS Accounting Standards, if control is not lost then a proportionate amount of the exchange differences recognised in accumulated OCI is reclassified to NCI.

Unlike IFRS Accounting Standards, US GAAP distinguishes between disposals of investments *in* and those *within* a foreign entity. Under US GAAP, only changes in a parent's ownership interest *in* a foreign entity result in a reclassification of cumulative exchange differences in OCI. If an entity disposes of a subsidiary *within* a foreign entity, then the cumulative exchange differences are reclassified in their entirety to profit or loss only if the foreign entity has been sold or substantially liquidated; otherwise, none of the cumulative exchange differences are reclassified to profit or loss. [830-30-40-1 – 40-3]

If an entity loses significant influence over a foreign entity that was an equity-method investee, then the exchange differences recognised in accumulated OCI in respect of an equity-method investee are treated as follows.

- If the investee is disposed of in its entirety, then the exchange differences are reclassified in their entirety to profit or loss, like IFRS Accounting Standards.
- If the investee is partially disposed of and significant influence or joint control is not retained, then a proportionate amount of the exchange differences is reclassified to profit or loss, unlike IFRS Accounting Standards. Also, unlike IFRS Accounting Standards, the remaining amount of the exchange differences is reclassified into the carrying amount of the investment unless doing so would reduce the carrying amount below zero, in which case, any excess amount is reclassified to profit or loss. [830-30-40-2 – 40-3, 323-10-35-37 – 35-39]

If the investee is partially disposed of and significant influence or joint control is retained, then a proportionate amount of the exchange differences is reclassified to profit or loss, like IFRS Accounting Standards. [830-30-40-2]

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IFRS Accounting Standards

When a parent loses control of a subsidiary by contributing it to an associate or joint arrangement, the amount of the foreign exchange translation reserve that is reclassified from OCI to profit or loss depends on the accounting policy adopted by the entity to calculate the gain or loss on disposal and can be either the full related amount or a proportionate amount (see also chapter 2.5).

On partial disposal of a subsidiary that includes a foreign operation where control is retained, the entity re-attributes the proportionate share of the cumulative amount of the exchange differences recognised in OCI to the NCI in that foreign operation. In any other partial disposals of a foreign operation that result in a loss of control of the subsidiary, the entity reclassifies to profit or loss the proportionate share of the cumulative amount of the exchange differences recognised in OCI. [IAS 21.48C]

A write-down of the carrying amount of a foreign operation – either because of its own losses or because of an impairment recognised by an investor – is not a partial disposal and therefore does not result in any amount of the foreign currency translation reserve being reclassified to profit or loss. In our view, a major restructuring that reduces the scale of operations of a foreign operation does not in itself trigger the reclassification to profit or loss of any amount of the foreign currency translation reserve, because the operations have not substantively ceased and the parent has not realised its investment in the foreign operation. However, in our view the substantive liquidation of a foreign operation should be treated as a disposal. [IAS 21.49]

An entity may make a loan to a foreign operation that is classified as part of its net investment, such that exchange differences on the loan are recognised in the foreign currency translation reserve. IFRS Accounting Standards are silent about whether repayment of an inter-company loan forming part of the net investment is a partial disposal. In our view, an entity should choose an accounting policy, to be applied consistently, to consider whether repayment of an inter-company loan forming part of the net investment in a foreign operation is considered a partial disposal. We prefer such a repayment not to be considered a partial disposal. [IAS 21.8, 48D, BC25D]

The cumulative exchange differences recorded and therefore subject to reclassification in respect of an individual foreign operation are affected by whether the entity uses a direct or step-by-step method of consolidation (see above). However, if an entity uses the step-by-step method of consolidation, then it may adopt a policy of determining the amount to be reclassified as if it had applied the direct method of consolidation to translate the financial statements of the foreign operation into the functional currency of the ultimate parent. [IFRIC 16.17]

US GAAP

Unlike IFRS Accounting Standards, when a parent loses control of a subsidiary that is a foreign entity by contributing it to an equity-method investee, the full gain or loss on disposal is recognised and the full amount of the related cumulative translation adjustment balance is reclassified from accumulated OCI to profit or loss (see also chapter 2.5). [830-30-40-1 – 40-3]

Like IFRS Accounting Standards, on partial disposal of a subsidiary that is a foreign entity while retaining control of the subsidiary, the entity re-attributes the proportionate share of the cumulative translation adjustment recognised in accumulated OCI to the NCI in that subsidiary. Unlike IFRS Accounting Standards, for a partial disposal of a subsidiary that is a foreign entity resulting in a loss of control, the entity reclassifies the entire amount of accumulated OCI to profit or loss. [830-30-40-2, 810-10-45-23 – 45-24]

Like IFRS Accounting Standards, a major restructuring that reduces the scale of operations of a foreign operation does not in itself trigger the reclassification to profit or loss of any amount of the foreign currency translation reserve, because the parent has not realised its investment in the foreign operation. Like IFRS Accounting Standards, substantially complete liquidation of a foreign operation is treated as a disposal. [830-30-40-1]

A reporting entity may make a loan to a foreign operation that is classified as part of its net investment, such that exchange differences on the loan are recognised in the foreign currency translation reserve. Unlike IFRS Accounting Standards, repayment of an inter-company loan forming part of the net investment in a foreign operation is not considered a partial disposal of the net investment. [830-20-35-4]

Unlike IFRS Accounting Standards, under US GAAP foreign operations are translated under the step-by-step method (see above) and there is no option to determine the amount to be transferred to profit or loss based on the direct method of consolidation.

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Convenience translations

An entity is permitted to present financial information in a currency that is different from its functional currency or presentation currency (a 'convenience translation') as long as:

- the information is identified as being supplementary to the financial statements prepared in accordance with IFRS Accounting Standards;
- the currency in which the supplementary information is presented is disclosed; and
- the entity's functional currency and the method used to translate the financial information are disclosed. [IAS 21.BC14]

Convenience translations

Unlike IFRS Accounting Standards, for SEC registrants whose reporting currency is not the US dollar, a convenience translation may be presented for the most recent annual reporting period and interim period using the exchange rate as at the most recent reporting date or the most recent date practicable, if this is materially different. The rate used should generally be the rate that the issuer would use if dividends were to be paid in US dollars. For non-public entities, US GAAP does not provide any guidance on when it is appropriate to present consolidated financial information in a currency that is different from the parent's reporting currency, unlike IFRS Accounting Standards. [830-10-15-7, SEC FRM 6620.5]

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2.8 Accounting policies, errors and estimates

(IAS 1, IAS 8)

Overview

- 'Accounting policies' are the specific principles, bases, conventions, rules and practices that an entity applies in preparing and presenting financial statements.
- If IFRS Accounting Standards do not cover a particular issue, then management uses its judgement based on a hierarchy of accounting literature.
- Unless an accounting standard specifically permits otherwise, the accounting policies adopted by an entity are applied consistently to all similar items. Accounting policies within a group are consistent for consolidation purposes, including in respect of equity-accounted investees.
- An accounting policy is changed in response to a new or revised accounting standard, or on a voluntary basis if the new policy will result in reliable and more relevant information.
- Generally, accounting policy changes and corrections of material prior-period errors are made by adjusting opening equity and restating comparatives unless this is impracticable.
- Accounting estimates are monetary amounts in the financial statements that are subject to measurement uncertainty. The effects of changes in the measurement techniques or inputs used to develop them are changes in accounting estimates.

2.8 Accounting policies, errors and estimates

(Topic 205, Topic 250)

Overview

- Like IFRS Accounting Standards, 'accounting principles' (policies) are the specific principles, bases, conventions, rules and practices that an entity applies in preparing and presenting financial statements.
- If the Codification does not address an issue directly, then an entity considers other parts of the Codification that might apply by analogy and non-authoritative guidance from other sources; these sources are broader than under IFRS Accounting Standards.
- Like IFRS Accounting Standards, the accounting principles adopted by an entity are applied consistently to all similar items. In our view, accounting policies within a group for consolidation purposes should generally be consistent, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, different accounting policies may be used by equity-method investees.
- Like IFRS Accounting Standards, an accounting principle is changed in response to an Accounting Standards Update, or on a voluntary basis if the new principle is 'preferable'.
- Like IFRS Accounting Standards, accounting principle changes are generally made by adjusting opening equity and comparatives unless this is impracticable. Errors that are material are corrected by restating opening equity and comparatives, like IFRS Accounting Standards; however, unlike IFRS Accounting Standards, there is no impracticability exemption.
- Unlike IFRS Accounting Standards, US GAAP does not define accounting estimates. However, we would not generally expect significant differences in practice.

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Overview (continued)

- **Changes in accounting estimates are accounted for prospectively.**
- **If it is difficult to determine whether a change is a change in accounting policy or a change in estimate, then it is treated as a change in estimate.**
- **If the classification or presentation of items in the financial statements is changed, then comparatives are restated unless this is impracticable.**
- **A statement of financial position as at the beginning of the preceding period is presented when an entity restates comparative information following a change in accounting policy, the correction of an error, or the reclassification of items in the statement of financial position.**

Overview (continued)

- **Like IFRS Accounting Standards, changes in accounting estimates are accounted for prospectively.**
- **Like IFRS Accounting Standards, if it is difficult to determine whether a change is a change in accounting principle or a change in estimate, then it is treated as a change in estimate. However, unlike IFRS Accounting Standards, 'preferability' is required for such changes.**
- **Like IFRS Accounting Standards, if the classification or presentation of items in the financial statements is changed, then comparatives are adjusted.**
- **Unlike IFRS Accounting Standards, a statement of financial position as at the beginning of the earliest comparative period is not required in any circumstances.**

Selection of accounting policies

'Accounting policies' are the specific principles, bases, conventions, rules and practices that an entity applies in preparing and presenting financial statements. [IAS 8.5]

If IFRS Accounting Standards do not cover a particular issue, then an entity considers:

- in the first instance, the guidance and requirements in accounting standards and interpretations dealing with similar and related issues; and then
- the IASB's Conceptual Framework (see chapter 1.2). [IAS 8.11, IU 03-11]

The entity may also consider the most recent pronouncements of other standard-setting bodies and accepted industry practice, to the extent that they do not conflict with the IASB's accounting standards, interpretations and the Conceptual Framework. [IAS 8.12]

The accounting policies adopted by an entity are applied consistently to all similar items. An exception occurs when an accounting standard requires or allows the application of different methods to different categories of items. [IAS 8.13]

Selection of accounting principles

Like IFRS Accounting Standards, 'accounting principles' (policies) are the specific principles, bases, conventions, rules and practices that an entity applies in preparing and presenting financial statements.

If the Codification (see chapter 1.1) does not address an issue directly, then US GAAP requires an entity to first consider other parts of the Codification that might apply by analogy and then consider non-authoritative guidance from other sources. This may include FASB Concepts Statements and IFRS Accounting Standards, but may also include other non-authoritative sources, which is broader than IFRS Accounting Standards. [105-10-05-2]

Like IFRS Accounting Standards, the accounting policies adopted by an entity are applied consistently from period to period for events and transactions of a similar type. [250-10-45-1]

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Accounting policies within a group are consistent for consolidation purposes (see chapter 2.5), including in respect of equity-accounted investees (see chapter 3.5). [IFRS 10.19, B87, IAS 28.35]

Restatement

In our experience, the term 'restatement' is used more broadly than in the context of the correction of an error. Accordingly, the restatement of comparatives does not imply that the previously issued financial statements were in error.

Changes in accounting policy

A change in accounting policy is made when an entity is required to adopt a new or revised accounting standard, or otherwise if a voluntary change will result in reliable and more relevant information. [IAS 8.14]

When a change in accounting policy arises from the adoption of a new, revised or amended accounting standard, an entity follows the specific transitional requirements in that accounting standard. [IAS 8.19]

The financial statements include disclosures regarding the change in accounting policy, including the reasons why applying a voluntary change in accounting policy provides reliable and more relevant information. [IAS 8.28–29]

A change in accounting policy to revalue items of property, plant and equipment (see chapter 3.2) or intangible assets (see chapter 3.3) is accounted for as a revaluation in accordance with the relevant accounting standards. [IAS 8.17]

In other cases, an entity applies a change in accounting policy retrospectively (i.e. as if the new accounting policy had always been applied), including any income tax effect. This is done by adjusting the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented, unless this is impracticable (see below). [IAS 8.22–27]

In our view, accounting policies within a group for consolidation purposes should generally be consistent, like IFRS Accounting Standards (see chapter 2.5). However, unlike IFRS Accounting Standards, different accounting policies may be used by equity-method investees (see chapter 3.5).

Restatement

Unlike IFRS Accounting Standards, in US GAAP the term 'restatement' is generally used in the context of the correction of an error (see below). The term 'retrospective adjustment' is used to refer to other situations in which the comparatives are adjusted.

Changes in accounting principle

Like IFRS Accounting Standards, an accounting principle is changed in response to a new Accounting Standards Update, or on a voluntary basis if the new principle is preferable. Although US GAAP refers to a new accounting principle being 'preferable' for a voluntary change, we would not generally expect significant differences in practice. [250-10-45-2, 45-12]

Like IFRS Accounting Standards, when a change in accounting principle arises from the adoption of a new Accounting Standards Update, an entity follows the specific transitional requirements in that Update. [250-10-45-3]

Like IFRS Accounting Standards, the financial statements include disclosures regarding the nature of and reason for the change, including why the new principle is preferable. However, unlike IFRS Accounting Standards, for a voluntary change domestic SEC registrants need to include as an exhibit in the first Form 10-Q or 10-K filed after the date of the accounting change, a letter from the registrant's independent accountants indicating whether the change is preferable under the circumstances ('preferability letter'). [250-10-50-1, Reg S-K Item 601(a), 601(b)(18)]

Unlike IFRS Accounting Standards, US GAAP does not permit the revaluation of property, plant and equipment (see chapter 3.2) or intangible assets (see chapter 3.3).

Like IFRS Accounting Standards, in other cases, an entity applies a change in accounting principle retrospectively (i.e. as if the new accounting principle had always been applied), including any income tax effect. This is done by adjusting the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented, unless this is impracticable (see below), like IFRS Accounting Standards. [250-10-45-5]

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Errors

'Errors' result from the misapplication of accounting policies, oversight or the misinterpretation of facts and circumstances that exist at the reporting date and were made in a prior period. Examples include mathematical mistakes and fraud.

Material (see chapter 1.2) prior-period errors are corrected by restating comparative information presented in the current-period financial statements, unless this is impracticable (see below). [IAS 8.5, 41–43]

Impracticability of retrospective adjustment

Retrospective application or restatement is done using only information that:

- would have been available in preparing the financial statements for that earlier period; and
- provides evidence of circumstances that existed on the date(s) that the transaction or event occurred. [IAS 8.52]

Other information (e.g. information that uses the benefit of hindsight) is not used. [IAS 8.53]

The financial statements are adjusted as at the beginning of the earliest period from which retrospective adjustment is practicable. [IAS 8.23-24, 43-44]

Errors

US GAAP describes an 'error' as an error in recognition, measurement, presentation or disclosure in financial statements resulting from mathematical mistakes, mistakes in the application of US GAAP or the oversight or misuse of facts that existed when the financial statements were prepared, like IFRS Accounting Standards. [250-10-20]

Like IFRS Accounting Standards, material (see chapter 1.2) prior-period errors are corrected by correcting comparative information. However, unlike IFRS Accounting Standards, under SEC guidance there is a distinction between:

- reissuance (or 'Big R') restatements: if the financial statements of one or more prior periods were materially misstated, then those financial statements are restated and reissued as soon as practicable; and
- revision (or 'Little r') restatements: if the financial statements of one or more prior periods were not materially misstated, but the correction of the error is material to the current period, then the prior-period financial statements are restated by revising the statements the next time they are presented (i.e. as comparatives). If the error is immaterial to the prior-period financial statements as well as the current-period financial statements, an entity may also voluntarily revise the prior-period financial statements the next time they are presented. [250-10-20, 250-10-45-22 – 45-24, SAB Topic 1N Q1]

Unlike IFRS Accounting Standards, there is no impracticability exemption for material errors under US GAAP.

Impracticability of retrospective adjustment

Like IFRS Accounting Standards, retrospective application is done using only information that:

- would have been available in preparing the financial statements for that earlier period; and
- provides evidence of circumstances that existed on the date(s) that the transaction or event occurred. [250-10-45-9C]

Like IFRS Accounting Standards, other information (e.g. information that uses the benefit of hindsight) is not used. [250-10-45-10]

Like IFRS Accounting Standards, the financial statements are adjusted at the beginning of the period from which retrospective adjustment is practicable. [250-10-45-5 – 45-6]

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The impracticability exemption applies in respect of both changes in accounting policy and the correction of errors. [IAS 8.5, 23, 43]

Changes in accounting estimates

Accounting estimates are monetary amounts in the financial statements that are subject to measurement uncertainty. [IAS 8.5]

Developing an accounting estimate includes both:

- selecting a measurement technique – e.g. an estimation technique used to measure a loss allowance for expected credit losses when applying the financial instruments standard; and
- choosing the inputs to be used when applying the chosen measurement technique – e.g. the expected cash outflows for determining a provision for warranty obligations when applying the provisions standard.

The effects of changes in such measurement techniques or inputs are changes in accounting estimates. [IAS 8.32–32B, 34A, IG.Ex5]

Changes in estimates are accounted for in the period in which they occur, or in the current and the future period(s) if they affect more than one period. [IAS 8.36–37]

If it is difficult to determine whether a change is a change in accounting policy or a change in estimate, then the change is treated as a change in estimate and disclosure is made. Similarly, if an objective determination cannot be made of whether a change is a change in estimate or the correction of an error, then in our view it should be accounted for as a change in estimate. [IAS 8.35]

Judgements and estimation

Disclosures are required if judgements made by management in applying accounting policies have a significant effect on the recognition or measurement of items in the financial statements. Additionally, disclosures are required of the key assumptions about the future, and other sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities in the next annual reporting period. [IAS 1.122, 125]

Unlike IFRS Accounting Standards, the impracticability exemption applies only in respect of changes in accounting principle and does not extend to the correction of material errors. [250-10-45-5, 45-23]

Changes in accounting estimates

Unlike IFRS Accounting Standards, US GAAP does not define accounting estimates. However, we would not generally expect significant differences in practice.

Like IFRS Accounting Standards, changes in estimates are accounted for in the period in which they occur, or in the current and the future period(s) if they affect more than one period. [250-10-45-17]

Like IFRS Accounting Standards, if a change in accounting estimate cannot be distinguished from a change in accounting principle (e.g. a change in the method of depreciation), then the change is treated as a change in estimate and disclosure is made. Unlike IFRS Accounting Standards, 'preferability' should be demonstrated. [250-10-45-18 – 45-19]

Judgements and estimation

SEC registrants provide a discussion of critical accounting policies and estimates, which is like the disclosure requirements under IFRS Accounting Standards; however, unlike IFRS Accounting Standards, such disclosure is required as part of MD&A, which is outside the financial statements (see chapter 5.8). Like IFRS Accounting Standards, all entities are required to disclose in their financial statements information about estimates that have a reasonable possibility of changing by a material amount in the near term; however, unlike IFRS Accounting Standards, there is no specific disclosure requirement for non-SEC registrants in respect of significant judgements made in applying accounting policies. Non-public entities disclose the use of estimates and information about significant estimates but this information is generally not as detailed as for SEC registrants or under IFRS Accounting Standards. [Reg S-K, 275-10-50-6 – 50-15A]

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Change in classification or presentation

In some cases, it may be appropriate to change the classification or presentation of items, even though there has been no change in accounting policy, to achieve a more appropriate presentation. In such cases, comparative information is restated unless it is impracticable to do so (see above), and appropriate explanatory disclosures are included in the notes to the financial statements. [IAS 1.41, 45–46]

If the change in classification or presentation relates to a voluntary change in accounting policy, then it should result in more relevant information (see above). [IAS 8.14]

Presentation of a third statement of financial position

A third statement of financial position is presented as at the beginning of the preceding period following a retrospective change in accounting policy, the correction of an error or a reclassification that has a material effect on the information in that statement of financial position. [IAS 1.10(f), 40A]

Other restatements

The consolidated financial statements are not restated on the acquisition or disposal of a subsidiary, except to the extent that the disposal is a discontinued operation (see chapter 5.4). However, in our view the acquirer may elect to adjust comparatives in accounting for a common control transaction (see chapter 5.13).

IFRS Accounting Standards are silent on what might constitute a change in the reporting entity and when it might be appropriate to adjust comparatives. However, neither a business combination accounted for using acquisition accounting (see chapter 2.6) nor the consolidation of a structured entity (see chapter 2.5) results in the adjustment of comparatives.

Change in classification or presentation

Like IFRS Accounting Standards, comparatives are adjusted retrospectively if the classification or presentation of items has changed, and disclosures are included in the notes to the financial statements. However, if the change in classification or presentation results from an error, then the guidance on correction of an error is applied. [205-10-45-3, 50-1]

Like IFRS Accounting Standards, if the change in classification or presentation relates to a voluntary change in accounting principle, then it should be justified as 'preferable' (see above). [250-10-45-2, 45-12]

Presentation of a third statement of financial position

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

Other adjustments to comparative information

Like IFRS Accounting Standards, the consolidated financial statements are not adjusted on the acquisition or disposal of a subsidiary, except to the extent that the disposal is a discontinued operation (see chapter 5.4). However, unlike IFRS Accounting Standards, the acquirer is required to adjust comparatives in accounting for a common control transaction (see chapter 5.13).

Unlike IFRS Accounting Standards, prior-period financial statements are adjusted retrospectively if there is a change in the reporting entity – e.g. consolidated or combined financial statements are presented in place of the financial statements of individual entities. However, neither a business combination accounted for using acquisition accounting (see chapter 2.6) nor the consolidation of a variable interest entity (see chapter 2.5) constitutes a change in the reporting entity, like IFRS Accounting Standards. [250-10-20, 45-21]

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Disclosure about the effects of new accounting standards

When an entity has not applied a new accounting standard that has been issued, but is not yet effective, it discloses this fact and known or reasonably estimable information relevant to assessing the possible impact of the new accounting standard on the entity's financial statements, including:

- the title of the new accounting standard;
- the nature of the impending change;
- the date by which application is required;
- the date from which it plans to apply the accounting standard; and
- either a discussion of the effect that initial application is expected to have on the entity's financial statements or, if the effect is not known or reasonably estimable, a statement to that effect. [IAS 8.30–31]

Disclosure about the effects of new Accounting Standards Updates

Like IFRS Accounting Standards, SEC registrants disclose the expected effects of the forthcoming adoption of an Accounting Standards Update (ASU). Unlike IFRS Accounting Standards, providing this disclosure is not required for other entities but is considered best practice. The disclosure generally includes:

- a brief description of the new ASU, including the date on which adoption is required and the date that the registrant plans to adopt, like IFRS Accounting Standards;
- a discussion of the effect that adopting the ASU is expected to have on the financial statements of the registrant or, if the effect is not known or reasonably estimable, a statement to that effect, like IFRS Accounting Standards; and
- a discussion of the transition methods allowed by the ASU and the method that the registrant expects to use, if it has been determined, unlike IFRS Accounting Standards. [SAB Topic 11M]

In addition, unlike IFRS Accounting Standards, SEC registrants are encouraged to provide a discussion of the potential effects of other significant matters that they believe might result from adopting the ASU – e.g. violation of debt covenant agreements, or planned or intended changes in business practices. [SAB Topic 11M]

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2.9 Events after the reporting date

(IAS 1, IAS 10)

Overview

- **The financial statements are adjusted to reflect events that occur after the reporting date, but before the financial statements are authorised for issue, if those events provide evidence of conditions that existed at the reporting date.**
- **Financial statements are not adjusted for events that are a result of conditions that arose after the reporting date, except when the going concern assumption is no longer appropriate.**
- **The classification of loan liabilities as current or non-current is based on circumstances at the reporting date.**

2.9 Events after the reporting date

(Topic 855, SAB Topic 4.C)

Overview

- **Like IFRS Accounting Standards, the financial statements are adjusted to reflect events that occur after the reporting date if those events provide evidence of conditions that existed at the reporting date. However, unlike IFRS Accounting Standards, the period to consider goes to the date on which the financial statements are issued for public entities and to the date on which the financial statements are available to be issued for certain non-public entities.**
- **Like IFRS Accounting Standards, financial statements are generally not adjusted for events that are a result of conditions that arose after the reporting date. However, unlike IFRS Accounting Standards, there is no exception for when the going concern assumption is no longer appropriate, although disclosures are required. Also unlike IFRS Accounting Standards, SEC registrants adjust the statement of financial position for a share dividend, share split or reverse share split occurring after the reporting date.**
- **The classification of liabilities as current or non-current generally reflects circumstances at the reporting date, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, in some circumstances debt is classified as non-current based on events after the reporting date.**

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Adjusting events

The financial statements are adjusted to reflect events that occur after the reporting date but before the financial statements are authorised for issuance, if those events provide evidence of conditions that existed at the reporting date (adjusting events) or if they indicate that the going concern basis of preparation is inappropriate (see chapter 2.1). [IAS 10.3, 8, 14]

Non-adjusting events

Financial statement amounts are not adjusted for events that are a result of conditions that arose after the reporting date (non-adjusting events). An exception is when events after the reporting date indicate that the financial statements should not be prepared on a going concern basis (see chapter 2.1). [IAS 10.3, 10, 14]

The following is disclosed in respect of material non-adjusting events: the nature of the event and an estimate of its financial effect, or a statement that an estimate cannot be made. [IAS 10.21]

Detailed information about business combinations effected after the reporting date is disclosed. [IFRS 3.59–60, B64–B66]

Recognised events

Like IFRS Accounting Standards, the financial statements are adjusted to reflect events that occur after the reporting date if they provide evidence of conditions that existed at the reporting date (recognised events). However, unlike IFRS Accounting Standards, for public entities, subsequent events are considered up to the date on which the financial statements are issued, which may be later than when the financial statements are authorised for issuance. For non-public entities whose financial statements are not widely distributed, subsequent events are considered up to the date on which the financial statements are available to be issued, unlike IFRS Accounting Standards. Also unlike IFRS Accounting Standards, tax positions with uncertainty (see chapter 3.13) are not adjusted to reflect events that occur after the reporting date even if they provide evidence of conditions that existed at the reporting date. [855-10-25-1 – 25-2, 740-10-25-8, 30-7]

The financial statements are issued as at the date on which they are distributed for general use and reliance in a form and format that complies with US GAAP. 'Issuance' is the earlier of when the financial statements are widely distributed to all shareholders and other financial statement users, and when they are filed with the SEC. The issuance of an earnings release does not constitute issuance. [855-10-20]

Non-recognised events

Like IFRS Accounting Standards, financial statement amounts are not adjusted for events that are a result of new conditions that arose after the reporting date (non-recognised events). However, unlike IFRS Accounting Standards, there is no specific requirement to adjust the financial statements when a subsequent event occurs indicating that the going concern basis of preparation is not appropriate; instead, disclosures are required (see chapter 2.1). [855-10-25-3 – 25-4]

Like IFRS Accounting Standards, non-recognised events may be of such a nature and significance that disclosure is required to keep the financial statements from being misleading. Like IFRS Accounting Standards, for such non-recognised events entities are required to disclose the event and an estimate of its effect, or a statement that such an estimate cannot be made. [855-10-50-2]

Like IFRS Accounting Standards, detailed information about business combinations effected after the reporting date is disclosed. [805-10-50-1 – 50-3]

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Specific application issues

Dividends

Cash dividends declared (i.e. the dividends are authorised and no longer at the discretion of the entity) after the reporting date are non-adjusting events that are not recognised as a liability in the financial statements, but are disclosed in the notes to the financial statements. This is because no obligation exists at the reporting date (see chapter 7.3). [IAS 10.12–13, BC4]

Share dividends, share splits or reverse splits occurring after the reporting date are also non-adjusting events. Their impact on EPS is explained below. [IAS 10.22(f)]

Current vs non-current classification

Generally, the classification of a long-term loan liability as current or non-current is based on an entity's legal rights at the reporting date and reflects circumstances at the reporting date. Refinancings, amendments, waivers etc. that are agreed after the reporting date are not considered in determining the classification of the loan liability, but are disclosed as non-adjusting events if material. A loan liability that is repayable on demand because loan covenants have been breached is classified as current; this is so even if the lender has agreed, after the reporting date but before the financial statements are authorised for issue, not to demand payment as a consequence of the breach. However, the loan liability is classified as non-current if the lender agrees by the reporting date to provide a period of grace ending at least 12 months after the reporting date or it waives its right to demand the payment. See chapter 3.1. [IAS 1.72–76, BC47]

Settlement of a liability classified as non-current after the reporting date is a non-adjusting event and is disclosed in the notes to the financial statements. [IAS 1.75A, 76(d)]

Earnings per share

EPS is restated to include the effect on the number of shares of certain share transactions that occur after the reporting date even though the transactions themselves are non-adjusting events (see chapter 5.3). [IAS 10.22(f), 33.64]

Specific application issues

Dividends

Like IFRS Accounting Standards, cash dividends declared, proposed or approved by shareholders after the reporting date are non-recognised events that are not recognised as a liability in the financial statements because no obligation exists at the reporting date (see chapter 7.3). [TPA 4210.01]

Unlike IFRS Accounting Standards, SEC registrants are required to adjust the statement of financial position for a share dividend, share split or reverse split occurring after the reporting date but before the financial statements are issued. Their impact on EPS is explained below. [SAB Topic 4.C]

Current vs non-current classification

Unlike IFRS Accounting Standards, refinancings, amendments, waivers etc. that occur after the reporting date are considered in determining the classification of debt at the reporting date. Therefore, debt that would otherwise be classified as current is classified as non-current if the intent and ability to refinance is demonstrated by a refinancing or the existence of a financing agreement that was entered into after the reporting date but before the financial statements are issued. Unlike IFRS Accounting Standards, liabilities that are payable on demand at the reporting date because debt covenants have been breached are classified as non-current if the lender agrees through a waiver before the issue of the financial statements, not to demand repayment for more than 12 months (or operating cycle, if it is longer) from the reporting date, unless an entity determines that it is probable that it will breach another covenant related to this debt within 12 months from the reporting date. [470-10-45-1, 45-4 – 45-5, 45-13 – 45-14]

Unlike IFRS Accounting Standards, we believe that the settlement of a liability after the reporting date may be an indication of management's intent at the reporting date, in which case the liability would be classified as current at that date. Like IFRS Accounting Standards, the settlement is disclosed in the notes to the financial statements. [855-10-50-2]

Earnings per share

Like IFRS Accounting Standards, EPS is restated to include the effect on the number of shares of certain share transactions that occur after the reporting date (see chapter 5.3). However, unlike IFRS Accounting Standards, the transactions themselves may also be recognised events (see above). [260-10-55-12, 55-15]

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Disclosure of the date of authorisation for issuance

Disclosure is required in the financial statements of the date on which the financial statements were authorised for issuance and who gave such authorisation. If the shareholders have the power to amend the financial statements after issue, then the entity discloses that fact. [IAS 10.17]

In our view, two different dates of authorisation for issuance of the financial statements ('dual dating') should not be disclosed, because we believe that only a single date of authorisation for issuance of the financial statements complies with IFRS Accounting Standards. [IAS 10.17, IU 05-13]

Discovery of a fraud after the reporting date

A fraud may be discovered after the financial statements have been authorised for issuance. In our view, if information about the fraud could reasonably be expected to have been obtained and taken into account by an entity preparing financial statements when those financial statements were authorised for issuance – e.g. in the case of a fraud within the entity itself – then subsequent discovery of such information is evidence of a prior-period error in those financial statements. [IAS 8.5, 10.9(e)]

In other circumstances, an external fraud may be discovered after the reporting date but before the financial statements are authorised for issuance. In our view, in concluding whether the discovery of the fraud should be treated as an adjusting or a non-adjusting event related to reporting the fair value of financial assets in the scope of the financial instruments standards (see chapter 7.1) in financial statements that have not yet been authorised for issuance, management should first identify whether there is a question of existence, valuation or both.

In our view, if the discovery of a fraud raises issues about the existence of the financial assets involved, then it should be treated as an adjusting event for financial statements that have not yet been authorised for issuance. However, if the fraud raises issues related only to the valuation of financial assets that do exist, then in our view it should be treated as a non-adjusting event for reporting the fair values of financial assets.

In our view, if it is impracticable to separate the existence and the valuation issues, then the entire effect should be treated as an issue related to the existence of assets.

Disclosure of the subsequent-events date

Unlike IFRS Accounting Standards, US GAAP requires the financial statements of non-SEC filers to include disclosure of the date to which subsequent events have been evaluated and whether that is the date on which the financial statements were issued or available to be issued. Unlike IFRS Accounting Standards, such disclosure is not required for SEC filers. Unlike IFRS Accounting Standards, if the shareholders have the power to amend the financial statements, then the financial statements would not be considered as available for issuance until such approvals have been obtained. [855-10-20]

Unlike IFRS Accounting Standards, US GAAP does not specify whether there can be only a single date of issuance. [855-10]

Discovery of a fraud after the reporting date

A fraud may be discovered after the financial statements have been authorised for issuance. Like IFRS Accounting Standards, if information about the fraud could reasonably be expected to have been obtained and taken into account by an entity preparing financial statements when those financial statements were issued or available for issuance, as appropriate (see above), then subsequent discovery of such information is evidence of a prior-period error in those financial statements. [250-10-20]

In other circumstances, a fraud may be discovered after the reporting date but before the financial statements are issued or are available for issuance, as appropriate (see above). Like IFRS Accounting Standards, in concluding whether the discovery of a fraud should be treated as a recognised or a non-recognised event related to reporting the fair value of financial assets in the scope of the financial instruments Codification Topics (see chapter 7.1) in financial statements that have not yet been issued or are not available for issuance, an entity first identifies whether there is a question of existence, valuation or both. [855-10-55-1, 55-2]

Like IFRS Accounting Standards, if the discovery of a fraud raises issues about the existence of the financial assets involved, then it should be treated as a recognised event for financial statements that have not yet been issued or are not available for issuance. However, if the fraud raises issues related only to the valuation of financial assets that do exist, then it should be treated as a non-recognised event for reporting the fair values of financial assets, like IFRS Accounting Standards.

Like IFRS Accounting Standards, if it is impracticable to separate the existence and the valuation issues, then the entire effect should be treated as an issue related to the existence of assets.

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2.10 Hyperinflation

(IAS 21, IAS 29, IFRIC 7)

Overview

- **When an entity's functional currency is hyperinflationary, its financial statements are adjusted to state all items in the measuring unit current at the reporting date.**
- **When an entity's functional currency becomes hyperinflationary, it makes price-level adjustments retrospectively as if the economy had always been hyperinflationary.**
- **When an economy ceases to be hyperinflationary, an entity stops making price-level adjustments for annual periods *ending* on or after the date on which the economy ceases to be hyperinflationary.**

Indicators of hyperinflation

Although it is a matter of judgement as to when restatement for hyperinflation becomes necessary, IFRS Accounting Standards provide guidance on the characteristics of a hyperinflationary economy. These characteristics include, but are not limited to, a cumulative inflation rate over three years approaching or exceeding 100 percent. [IAS 29.3]

2.10 Highly inflationary economies

(Subtopic 255-10, Topic 830)

Overview

- **When a non-US entity that prepares US GAAP financial statements operates in an environment that is highly inflationary, it remeasures its financial statements into a non-highly inflationary currency, unlike IFRS Accounting Standards, or reports price-level adjusted local currency financial statements in certain circumstances, like IFRS Accounting Standards.**
- **Unlike IFRS Accounting Standards, when an economy becomes highly inflationary, an entity remeasures its financial statements prospectively in the reporting period following the three-year period in which the cumulative inflation rate exceeds 100 percent.**
- **Unlike IFRS Accounting Standards, when an economy ceases to be highly inflationary an entity changes its functional currency from the non-highly inflationary reporting currency to the local currency and restates the functional currency accounting bases of non-monetary assets and liabilities in the annual period *following* the three-year period in which the cumulative inflation rate is no longer in excess of 100 percent.**

Indicators of highly inflationary economies

Like IFRS Accounting Standards, a highly inflationary (hyperinflationary) economy is indicated by cumulative inflation of approximately 100 percent or more over a three-year period. Historical inflation rate trends and other relevant economic factors are also considered if the cumulative inflation rate over three years is less than 100 percent, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, if the cumulative inflation rate over three years is higher than 100 percent, then the economy is highly inflationary in all instances. [830-10-45-11 – 45-13]

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Restating for hyperinflation

When an entity's functional currency is hyperinflationary, its financial statements are adjusted to state all items in the measuring unit current at the reporting date. [IAS 29.8]

When an entity identifies the existence of hyperinflation in the economy of its functional currency, it makes price-level adjustments as if the economy had always been hyperinflationary. [IAS 29.8, 34, IFRIC 7.3]

Comparative amounts of an entity whose functional and presentation currency are hyperinflationary are also stated in terms of the measuring unit current at the reporting date. However, comparative amounts are not restated if the presentation currency is non-hyperinflationary. For a discussion of translation into a presentation currency that is non-hyperinflationary, see chapter 2.7. [IAS 29.8, 34]

Additionally, although the changing prices Codification Topic permits the use of price-level adjusted financial statements (discussed below) for certain foreign entities reporting under US GAAP, it does not establish a requirement for price-level adjusted financial statements or define 'highly inflationary'.

Remeasuring for highly inflationary economies

Unlike IFRS Accounting Standards, when a non-US entity that prepares US GAAP financial statements operates in an environment that is highly inflationary, it remeasures its financial statements into a non-highly inflationary currency (see chapter 2.7). [830-10-45-11]

US GAAP also permits a comprehensive application of price-level adjustments in presenting basic foreign currency financial statements of entities operating in countries with highly inflationary economies if the statements are intended for readers in the US. These price-level adjusted financial statements adjust all items in the local, highly inflationary currency to a current measuring unit as of the reporting date, like IFRS Accounting Standards. However, in our experience the application of price-level adjusted financial statements is uncommon in practice and specific guidance under US GAAP is limited. As such, the focus in the remainder of this chapter is remeasuring financial statements into a non-highly inflationary currency under foreign currency Codification Topic only. [255-10-45-2 – 45-4]

Unlike IFRS Accounting Standards, when an entity identifies that the economy of its functional currency is highly inflationary, it remeasures its financial statements prospectively in the new functional currency in the reporting period following the three-year period in which the cumulative inflation rate exceeds 100 percent. [830-10-45-11 – 45-12, 55-24 – 55-25]

Unlike IFRS Accounting Standards, remeasurement of the financial statements is applied prospectively – i.e. there is no such restatement requirement for comparative amounts. [830-10-45-7]

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IFRS Accounting Standards

In adjusting for hyperinflation, a general price index is applied to all non-monetary items in the financial statements (including components of owners' equity). Monetary items in the closing statement of financial position, which are defined as money held and items to be received or paid in money, are not adjusted because they are already expressed in purchasing power at that date. The gain or loss on the entity's net monetary position – reflecting the change in purchasing power of monetary items – is recognised in profit or loss and disclosed separately. [IAS 29.9, 11–12, 28]

Non-monetary items are adjusted from the date of acquisition or contribution. However, if an asset has been revalued, then it is adjusted only from the date of the valuation; if the item is stated at fair value at the reporting date, then no adjustment is necessary. Income and expenses recognised in profit or loss are updated to reflect changes in the price index from the date on which they are initially recognised in the financial statements. Restated retained earnings are derived after all other amounts in the restated statement of financial position and statement of profit or loss and OCI have been calculated. [IAS 29.14–15, 18, 24, 26]

IFRS Accounting Standards require the use of a general price index that reflects changes in general purchasing power. Although it is not specifically mentioned in the accounting standard, in our view the consumer price index (CPI) is the most appropriate index to use because it is a broad-based measurement across all consumers in an economy. Some jurisdictions have multiple price indices published and further analysis and judgement may be required to determine an appropriate index that reliably reflects changes in general purchasing power. [IAS 29.37]

The financial statements of a foreign operation whose functional currency is hyperinflationary are adjusted before being translated and included in the investor's consolidated financial statements (see chapter 2.7). [IAS 21.42–43]

US GAAP

Unlike IFRS Accounting Standards, at the application date the opening balances of non-monetary items are remeasured in the new functional currency, which we believe should be the functional currency of the entity's immediate parent, based on the amounts reported in the group financial statements at the immediately preceding reporting date. Subsequently, non-monetary items are accounted for as if they had always been assets and liabilities in the new functional currency. Monetary items are treated in the same manner as any other foreign currency monetary items (see chapter 2.7). Subsequently, monetary items are remeasured into the new functional currency using current exchange rates. Differences arising from the remeasurement of monetary items are recognised in profit or loss. [830-10-45-10, 45-17]

Unlike IFRS Accounting Standards, adjustments with a price index are not applicable in remeasuring the financial statements in the new functional currency.

Unlike IFRS Accounting Standards, use of a general price index is not applicable in remeasuring the financial statements in the new functional currency.

Unlike IFRS Accounting Standards, the financial statements of a foreign operation in a highly inflationary economy are remeasured for consolidation purposes as if the parent's reporting currency were its functional currency (see chapter 2.7). [830-10-45-11]

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Ceasing to be hyperinflationary

When an economy ceases to be hyperinflationary, an entity stops preparing its financial statements in accordance with the standard on financial reporting in hyperinflationary economies for reporting periods *ending* on or after the date on which the economy ceases to be hyperinflationary. Cessation of hyperinflationary accounting is applied prospectively. Judgement is required in determining when the economy ceases to be hyperinflationary. [IAS 29.38]

Ceasing to be highly inflationary

Unlike IFRS Accounting Standards, when an economy ceases to be highly inflationary, an entity changes its functional currency from the non-highly inflationary reporting currency to the local currency and restates the functional currency accounting bases of non-monetary assets and liabilities in the reporting period following the three-year period in which the cumulative inflation rate is no longer in excess of 100 percent. Judgement is required in determining when the economy ceases to be highly inflationary, like IFRS Accounting Standards. [830-10-45-12 – 45-13, 45-15, 55-24 – 55-26]

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3 Statement of financial position

3.1 General

(IAS 1)

Overview

- Generally, an entity presents its statement of financial position classified between current and non-current assets and liabilities. An unclassified statement of financial position based on the order of liquidity is acceptable only if it provides reliable and more relevant information.
- Although IFRS Accounting Standards require certain line items to be presented in the statement of financial position, there is no prescribed format.
- A loan liability that is payable on demand because certain covenants are breached is classified as current even if the lender has agreed, after the reporting date but before the financial statements are authorised for issue, not to demand repayment.
- There is no specific guidance for a loan arrangement subject to a subjective acceleration clause. Classification is based on whether the entity has a right to defer settlement for at least 12 months after the reporting date.

3.1 General

(Topic 210, Reg S-X Rule 5-02, Subtopic 470-10)

Overview

- Unlike IFRS Accounting Standards, US GAAP does not require the presentation of a classified statement of financial position, except for commercial and industrial SEC registrants. For other entities, there is no restriction on when an unclassified statement of financial position based on the order of liquidity can be presented, unlike IFRS Accounting Standards.
- Unlike IFRS Accounting Standards, SEC regulations prescribe the format and certain minimum line item presentation for SEC registrants. For non-SEC registrants, there is limited guidance on the presentation of the statement of financial position, like IFRS Accounting Standards.
- Generally, obligations that are payable on demand are classified as current, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, a liability is not classified as current when the debtor demonstrates its intent and ability to refinance the obligation on a long-term basis after the reporting date but before the financial statements are issued (available to be issued for certain non-public entities), or when the lender has waived after the reporting date its right to demand repayment for more than 12 months from the reporting date.
- Unlike IFRS Accounting Standards, there is specific guidance when an otherwise long-term debt agreement includes a subjective acceleration clause. Classification is based on the likelihood that the lender will choose to accelerate repayment of the liability, which may result in differences from IFRS Accounting Standards.

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Format of the statement of financial position

IFRS Accounting Standards generally require an entity to present a classified statement of financial position, which distinguishes current from non-current assets and liabilities. However, entities may present assets and liabilities broadly in order of liquidity if such a presentation provides information that is reliable and more relevant. [IAS 1.60]

The accounting standard lists line items to be presented in the statement of financial position. An entity presents additional line items (including by disaggregating the line items listed in the accounting standard), headings and subtotals when such presentation is relevant to an understanding of the entity's financial position. Additional items may be presented because of their size or nature or to distinguish them from other items with differing timing, liquidity or function within the entity. An entity can aggregate immaterial line items listed in the accounting standard. [IAS 1.29–31, 54–55, BC38A–BC38E]

When additional subtotals are presented, those subtotals:

- comprise line items made up of amounts recognised and measured in accordance with IFRS Accounting Standards;
- are presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable;
- are consistent from period to period; and
- are displayed with no more prominence than other subtotals and totals presented in the statement of financial position. [IAS 1.55A, BC38G]

Current vs non-current classification

Assets

An asset is classified as 'current' if it meets any of the following conditions:

- it is expected to be realised in, or is held for sale or consumption in, the entity's normal operating cycle;
- it is primarily held for trading purposes;
- it is expected to be realised within 12 months after the reporting date; or
- it is cash or a cash equivalent (see chapter 2.3) that is not restricted from being exchanged or used to settle a liability for at least 12 months after the reporting date. [IAS 1.66]

Format of the statement of financial position

Unlike IFRS Accounting Standards, US GAAP does not require the presentation of a classified statement of financial position, except for commercial and industrial SEC registrants. Other entities can elect to present assets and liabilities in order of liquidity without demonstrating that such a presentation provides information that is reliable and more relevant than a classified statement of financial position, unlike IFRS Accounting Standards. However, prevalent practice under US GAAP is to present a classified statement of financial position, like IFRS Accounting Standards. [210-10-05-4, Reg S-X Rule 5-02]

Unlike IFRS Accounting Standards, there are limited requirements for specific line items and no requirements for headings and subtotals to be presented under US GAAP; therefore, differences from IFRS Accounting Standards may arise in practice. However, SEC regulations prescribe the presentation and certain minimum line item disclosures for SEC registrants in general and by industry, which include the following and may differ from IFRS Accounting Standards:

- general instructions for financial statements;
- commercial and industrial companies;
- registered investment companies (see chapter 5.6);
- insurance companies;
- employee stock purchase, savings and similar plans;
- certain brokers and dealers; and
- bank holding companies. [Reg S-X Art 3, 5, 6, 6A, 7, 9, Reg S-X 210.17a-5]

Like IFRS Accounting Standards, each line item should only include homogenous classes of items.

Current vs non-current classification

Assets

Under US GAAP, 'current assets' are those assets that are:

- reasonably expected to be realised in cash or sold or consumed in the course of the entity's operating cycle, like IFRS Accounting Standards;
- items classified as trading securities, like IFRS Accounting Standards;
- expected to be realised, sold or consumed within 12 months after the reporting date, which is like IFRS Accounting Standards except that it excludes an asset that is to be used to settle a non-current liability; or
- cash available for current operations or cash equivalents, like IFRS Accounting Standards. [210-10-20, 210-10-45-1 – 45-4]

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There is no specific guidance in IFRS Accounting Standards on the classification of cash and claims to cash that are restricted in relation to withdrawal or use for other than current operations, designated for expenditure in the acquisition or construction of non-current assets or segregated for the liquidation of long-term debts. The above general classification principles apply.

Liabilities

A liability is classified as 'current' if it meets any of the following conditions:

- it is expected to be settled in the entity's normal operating cycle;
- it is primarily held for trading purposes;
- it is due to be settled within 12 months after the reporting date; or
- it is not subject to the entity's right at the reporting date to defer settlement of the liability for at least 12 months after the reporting date. [IAS 1.69]

The terms of a liability (e.g. the liability component of a convertible instrument) that could, at the option of the counterparty, result in its settlement by the issue of an entity's own equity instruments, affect classification of the liability as current or non-current if the conversion options are recognised as a liability under the financial instruments standard. If the conversion options are recognised as equity under the financial instruments standard, then they do not affect the current or non-current classification of the liability. [IAS 1.69(d), 72A–72B, 75A, 76A–76B]

A loan liability is classified as current if the entity does not have the right to defer its settlement for at least 12 months after the reporting date. The right to defer settlement must have substance and exist at the reporting date. [IAS 1.69(d), 72A]

Unlike IFRS Accounting Standards, cash and claims to cash that are restricted in relation to withdrawal or use for other than current operations, designated for expenditure in the acquisition or construction of non-current assets or segregated for the liquidation of long-term debts are classified as non-current. This also includes funds that are clearly to be used in the near future for similar purposes, even though they are not actually set aside in special accounts. [210-10-45-4]

Liabilities

Under US GAAP 'current liabilities' generally include all of the following, like the outcome under IFRS Accounting Standards except as indicated:

- debts that arise from operations directly related to the operating cycle, such as accruals for wages, salaries, commissions, rentals, royalties and income and other taxes;
- collections received in advance of the delivery of goods or performance of services, which may differ from IFRS Accounting Standards;
- liabilities whose regular and ordinary liquidation is expected to occur within a relatively short period of time, usually 12 months;
- amounts required to be expended within 12 months under 'sinking fund' provisions;
- obligations that, by their terms, are due on demand or will be due on demand within 12 months (or the operating cycle, if longer) of the reporting date, even though liquidation may not be expected within that period; or
- long-term obligations that are or will be callable by the lender, like IFRS Accounting Standards except that there are certain exceptions (see below). [210-10-45-5 – 45-12, 470-10-45]

Unlike IFRS Accounting Standards, US GAAP has no specific guidance addressing the classification of convertible instruments as current or non-current and the general guidance applies. The classification analysis is not dependent on whether the conversion option meets the definition of a liability or equity. Instead, classification depends solely on the instrument's features. For example, a currently convertible debt in which the issuer is required to settle the debt's principal amount in cash on conversion, but is allowed to settle the conversion spread (i.e. the excess of conversion value over the debt principal amount) in either cash or shares, would be classified as current because the holder can immediately convert and require the issuer to pay cash for the principal amount. [210-10-20, 470-10-45]

Unlike IFRS Accounting Standards, a liability is classified as non-current if the entity has the ability and intent to defer settlement for at least 12 months after the reporting date. [470-10-45-14]

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IFRS Accounting Standards

The existence of an entity's right to defer settlement of a liability for at least 12 months after the reporting date may be subject to compliance with covenants. Only covenants with which an entity must comply on or before the reporting date are considered when assessing classification of liabilities arising from loan arrangements. [IAS 1.72B]

A loan liability that is due within 12 months or is payable on demand because loan covenants have been breached is classified as current even if the lender has agreed, after the reporting date but before the financial statements are authorised for issue, not to demand repayment as a result of the breach. However, if by the reporting date the lender agrees to provide a period of grace ending at least 12 months after the reporting date, then the liability is classified as non-current. [IAS 1.74–76, BC47]

A loan liability that is not due to be settled within 12 months may include terms that enable the lender to call the loan at any time without cause. In our view, such a liability is classified as current because the presence of such terms means the entity does not have a right to defer settlement for at least 12 months after the reporting date. [IAS 1.69(d)]

The current portion of long-term debt is classified as current even if an agreement to refinance or reschedule payments on a long-term basis is completed after the reporting date but before the financial statements are authorised for issue. However, if at the reporting date an entity has the right to refinance or roll over an obligation for at least 12 months after the reporting date under an existing loan facility, then it classifies the obligation as non-current even if the loan would otherwise be current (even if the entity does not intend or expect to roll over that liability for at least 12 months after the reporting date). [IAS 1.72–73]

Usually, a liability is classified as current or non-current based on whether it is due to be settled within 12 months after the reporting date. However, if a liability is part of the working capital used in the entity's normal operating cycle, then it is classified as current even if it is due to be settled more than 12 months after the reporting date. [IAS 1.69(a)–(b)]

US GAAP

The ability of an entity to defer settlement of a liability for at least 12 months from the reporting date may be subject to compliance with covenants. Like IFRS Accounting Standards, only covenants with which an entity must comply on or before the reporting date are considered when assessing classification of the liability. However, unlike IFRS Accounting Standards, when an entity has breached a covenant at the reporting date and obtained a waiver, the entity must consider covenant compliance for 12 months from the reporting date (see chapter 2.9). [470-10-45-11]

Unlike IFRS Accounting Standards, a liability that is due within 12 months or is payable on demand because debt covenants have been breached is not classified as current if, before the financial statements are issued (available to be issued for certain non-public entities), the lender has waived or subsequently lost the right to demand repayment for more than 12 months from the reporting date or, for long-term obligations containing a grace period within which the breach may be remedied, it is probable that the breach will be remedied within that grace period. [470-10-45]

Like IFRS Accounting Standards, the current liability classification includes obligations that, by their terms, are due on demand or will be due on demand within 12 months (or operating cycle, if longer) from the reporting date, even though liquidation may not be expected within that period. [470-10-45-10]

Unlike IFRS Accounting Standards, the current portion of long-term debt is classified as non-current if an agreement to refinance or reschedule payments on a long-term basis is completed after the reporting date but before the financial statements are issued (available to be issued for certain non-public entities). Further, unlike IFRS Accounting Standards, if at the reporting date an entity has the ability and intent to refinance or roll over an obligation for at least 12 months after the reporting date under an existing loan facility, then it classifies the obligation as non-current even if the loan would otherwise be current. [470-10-45-1 – 45-21, 55-1 – 55-36]

Like IFRS Accounting Standards, if a liability is part of the working capital used in the entity's operating cycle, then it is classified as current even if it is due to be settled more than 12 months after the reporting date. [210-10-45]

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An otherwise long-term loan arrangement may include a subjective acceleration clause – i.e. a clause that allows the lender to accelerate the scheduled maturity of the loan under conditions that are not objectively determinable (e.g. if the debtor 'fails to maintain satisfactory operations').

There is no specific guidance for a loan arrangement subject to a subjective acceleration clause in IFRS Accounting Standards. Although subjective acceleration clauses may require greater judgement, in our view objective and subjective covenant tests should be dealt with consistently; both need to be assessed to determine whether the entity has a right to defer settlement for at least 12 months after the reporting date. However, more judgement may be needed to determine whether a subjective clause has been breached at the reporting date. [IAS 1.74–75]

Assets and liabilities

If a line item in the statement of financial position includes a combination of assets that are expected to be realised or a combination of liabilities that are expected to be settled both before and more than 12 months after the reporting date, then an entity discloses the amount expected to be realised or settled after more than 12 months. [IAS 1.61]

All assets and liabilities that do not meet the definition of current assets or liabilities are classified as non-current. [IAS 1.66, 69]

Non-current assets and assets of disposal groups classified as held-for-sale or held-for-distribution (see chapter 5.4) are classified as current in the statement of financial position. In our view, liabilities of such disposal groups should be classified as current in the statement of financial position because they are expected to be realised within 12 months after the date of classification as held-for-sale or held-for-distribution. Assets and liabilities classified as held-for-sale or held-for-distribution cannot be offset, unless the offsetting requirements explained below apply. [IFRS 5.3, BC9–BC10, IAS 1.32–33, 66]

The current portion of a non-current financial asset or liability is classified as a current asset or liability. [IAS 1.68, 71]

An otherwise long-term debt agreement may include a subjective acceleration clause – i.e. a clause that allows the lender to accelerate the scheduled maturity of the debt under conditions that are not objectively determinable (e.g. if the debtor 'fails to maintain satisfactory operations').

Unlike IFRS Accounting Standards, there are specific requirements relating to subjective acceleration clauses, and classification is based on the likelihood that the lender will choose to accelerate repayment of the liability.

- If the likelihood of acceleration is 'remote', then the debtor is neither required to classify the debt as a current liability nor required to disclose the existence of the subjective acceleration clause.
- If the likelihood of acceleration is 'reasonably possible', then the debtor evaluates the facts and circumstances to determine the proper classification of the debt and the appropriate disclosures.
- If the likelihood of acceleration is 'probable', then the debt is classified as current and the debtor discloses the nature and terms of the subjective acceleration clause, the amount that may be due within 12 months of the reporting date, and the debt's due date assuming acceleration. [470-10-20, 10-45]

Assets and liabilities

Unlike IFRS Accounting Standards, if a line item in the statement of financial position includes a combination of assets that are expected to be realised or a combination of liabilities that are expected to be settled both before and more than 12 months after the reporting date, then disclosure of that split is not required. [210-10-45]

Like IFRS Accounting Standards, all assets and liabilities that do not meet the definition of current assets or liabilities are classified as non-current. [210-10-20]

Like IFRS Accounting Standards, non-current assets as well as assets and liabilities of disposal groups classified as held-for-sale (see chapter 5.4) are required to be segregated in the statement of financial position. Although in general we would expect such assets and liabilities to be classified as current following the general classification principles, there is no such requirement in US GAAP, which may give rise to differences from IFRS Accounting Standards in practice. Like IFRS Accounting Standards, the segregated assets and segregated liabilities cannot be offset. Unlike IFRS Accounting Standards, there is no held-for-distribution classification. [360-10-45-14 – 45-15]

Like IFRS Accounting Standards, the current portion of a non-current financial asset or liability is classified as a current asset or liability. [210-10-45]

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Deferred tax assets and liabilities are always classified as non-current (see chapter 3.13). [IAS 1.56]

There is no requirement to classify post-employment benefit obligations and assets into current and non-current portions, and in our experience this is not typically done. [IAS 19.133]

Offsetting

A financial asset and a financial liability are offset and reported net only if the entity has a legally enforceable right to set off and it intends to settle either simultaneously or on a net basis (see chapter 7.10). [IAS 32.42]

Specific offsetting requirements exist for current and deferred tax assets and liabilities (see chapter 3.13), and plan assets and obligations in a defined benefit plan (see chapter 4.4). Non-financial assets and non-financial liabilities cannot be offset under IFRS Accounting Standards. [IAS 1.32–33]

Like IFRS Accounting Standards, deferred tax assets and liabilities are classified as non-current (see chapter 3.13). [740-10-45-4]

Unlike IFRS Accounting Standards, a net post-retirement benefit obligation is classified as current or non-current if the entity prepares a classified statement of financial position. The current portion of the obligation is the amount of benefits expected to be paid within 12 months of the reporting date that is in excess of the plan assets. The remaining amount of the obligation is classified as non-current. If a net post-retirement benefit asset exists, then it is classified as non-current. [715-20-45-2 – 45-3]

Offsetting

Like IFRS Accounting Standards, the offsetting of financial assets and financial liabilities is permitted only if there is a legally enforceable right to set off and the intention is to settle the amounts net. Additionally, unlike IFRS Accounting Standards, US GAAP permits the offsetting of positions under a master netting agreement (see chapter 7.10), and also provides for offsetting by entities that follow certain specialised industry guidance. [210-20-05, 20-45]

Like IFRS Accounting Standards, specific offsetting requirements exist for deferred tax assets and liabilities and plan assets and obligations in a defined benefit plan (see chapters 3.13 and 4.4). Like IFRS Accounting Standards, non-financial assets and non-financial liabilities cannot be offset. Unlike IFRS Accounting Standards, US GAAP specifically requires offsetting for other specific arrangements.

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3.2 Property, plant and equipment

(IAS 16, IFRIC 1)

Overview

- Property, plant and equipment is recognised initially at cost.
- 'Cost' includes all expenditure that is directly attributable to bringing the asset to the location and working condition for its intended use.
- 'Cost' includes the estimated cost of dismantling and removing the asset and restoring the site.
- Changes to an existing decommissioning or restoration obligation are generally adjusted against the cost of the related property, plant and equipment. Decommissioning or restoration costs related to the production of inventory are included in the cost of inventory.
- Property, plant and equipment is depreciated over its expected useful life.

3.2 Property, plant and equipment

(Subtopic 360-10, Subtopic 410-20, Subtopic 610-20, Subtopic 908-720)

Overview

- Like IFRS Accounting Standards, property, plant and equipment is recognised initially at cost.
- Like IFRS Accounting Standards, 'cost' includes all expenditure that is directly attributable to bringing the asset to the location and working condition for its intended use.
- Like IFRS Accounting Standards, 'cost' includes the estimated cost of dismantling and removing the asset and certain costs of restoring the site. However, unlike IFRS Accounting Standards, to the extent that such costs relate to environmental remediation as a result of improper use of an asset, generally they are not capitalised.
- Like IFRS Accounting Standards, changes to an existing decommissioning or restoration obligation are generally adjusted against the cost of the related property, plant and equipment. Unlike IFRS Accounting Standards, this includes changes in an obligation related to the production of inventory.
- Like IFRS Accounting Standards, property, plant and equipment is depreciated over its expected useful life.

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Overview (continued)

- Estimates of useful life and residual value, and the method of depreciation, are reviewed as a minimum at each annual reporting date. Any changes are accounted for prospectively as a change in estimate.

- If an item of property, plant and equipment comprises individual components for which different depreciation methods or rates are appropriate, then each component is depreciated separately.

- Property, plant and equipment may be revalued to fair value, as an accounting policy choice, if fair value can be measured reliably. All items in the same class are revalued at the same time and the revaluations are kept up to date.

- When property, plant and equipment is disposed of or no future economic benefits are expected from its use or disposal, a gain or loss is recognised. If the asset is disposed of as part of a sale-and-leaseback transaction, then the requirements in the leases standard apply (see chapter 5.1).

- Compensation for the loss or impairment of property, plant and equipment is recognised in profit or loss when it becomes receivable.

Overview (continued)

- US GAAP does not specifically require an entity to review depreciation estimates, such as useful lives or methods of depreciation, on an annual basis. We believe that an entity should periodically assess useful life and salvage value estimates for long-lived assets, regardless of whether impairment indicators exist under the property, plant and equipment Codification Topic, to ensure that the existing policies and methods continue to be appropriate. In general, we would not expect significant differences between IFRS Accounting Standards and US GAAP in practice. Like IFRS Accounting Standards, any changes are accounted for prospectively as a change in estimate.

- Unlike IFRS Accounting Standards, component accounting is permitted but not required. When component accounting is used, its application may differ from IFRS Accounting Standards.

- Unlike IFRS Accounting Standards, the revaluation of property, plant and equipment is not permitted.

- Like IFRS Accounting Standards, when property, plant and equipment is disposed of or permanently withdrawn from use, a gain or loss is recognised. Like IFRS Accounting Standards, if the asset is disposed of as part of a sale-leaseback transaction, then the requirements in the leases Codification Topic apply (see chapter 5.1).

- Unlike IFRS Accounting Standards, compensation for the loss or impairment of property, plant and equipment, to the extent of losses and expenses recognised, is recognised in profit or loss when receipt is likely to occur. Compensation in excess of that amount is recognised only when it is receivable, like IFRS Accounting Standards.

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IFRS Accounting Standards

Definition

'Property, plant and equipment' comprises tangible assets that are held by an entity for use in the production or supply of goods or services, for rental to others or for administrative purposes, that are expected to be used for more than one period. Property, plant and equipment also includes bearer plants (see chapter 3.9). [IAS 16.6]

Initial recognition

Property, plant and equipment is recognised initially at cost. [IAS 16.15]

Sometimes a customer transfers property, plant and equipment to an entity that will use the contributed assets to connect the customer to a network or provide it with ongoing services. If the entity obtains control of the contributed assets, then the assets are recognised initially following the guidance on non-cash consideration in the revenue standard (see chapter 4.2).

Directly attributable expenditure

'Cost' includes all expenditure that is directly attributable to bringing the asset to the location and condition necessary for its intended use, which means capable of operating in the manner intended by management. In our view, the costs incurred need not be external or incremental. [IAS 16.16–17]

The cost of an item of property, plant and equipment may include costs incurred relating to leases of assets that are used to construct, add to, replace part of or service an item of property, plant and equipment (e.g. depreciation of right-of-use assets). [IAS 16.10]

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset (see chapter 4.6). [IAS 23.8–9]

US GAAP

Definition

Like IFRS Accounting Standards, 'property, plant and equipment' comprises tangible assets that are held by an entity for use in the production or supply of goods or services, for rental to others or for administrative purposes, that are expected to be used for more than one period. US GAAP does not use the term 'bearer plants', but the property, plant and equipment accounting model generally applies to such assets. [360-10-05-3, 905-360]

Initial recognition

Like IFRS Accounting Standards, property, plant and equipment is recognised initially at cost. [360-10-30-1]

Sometimes a customer transfers property, plant and equipment to an entity that will use the contributed assets to connect the customer to a network or provide it with ongoing services. Like IFRS Accounting Standards, if the entity obtains control of the contributed assets, then the assets are recognised initially following the guidance on non-cash consideration in the revenue Codification Topic, which differs from IFRS Accounting Standards in some respects (see chapter 4.2).

Directly attributable expenditure

Like IFRS Accounting Standards, 'cost' includes all expenditure that is directly attributable to bringing the asset to the location and condition necessary for its intended use, which means capable of operating in the manner intended by management. Like IFRS Accounting Standards, the costs incurred need not be external or incremental. [360-10-30-1]

Like IFRS Accounting Standards, the cost of an item of property, plant and equipment may include costs incurred relating to leases of assets that are used to construct, add to, replace part of or service an item of property, plant and equipment (e.g. depreciation of right-of-use assets).

Like IFRS Accounting Standards, interest (borrowing costs) that is directly attributable to the acquisition, construction or production of a qualifying asset forms part of the cost of that asset. However, the specific requirements differ from IFRS Accounting Standards in certain respects (see chapter 4.6). [360-10-30-1]

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The following are not included in the cost of an item of property, plant and equipment:
- training costs;
- when an item of property, plant and equipment is constructed by an entity, abnormal amounts of wasted material, labour and other resources;
- start-up and pre-operating costs unless those costs are necessary to bring the asset to its working condition; and
- losses incurred before the asset reaches its planned performance level.

[IAS 16.19–20, 22]

Incidental income from operations (including testing) to bring an item of property, plant and equipment to the location and condition necessary for its intended use is not part of the directly attributable cost of the asset and is recognised in profit or loss. [IAS 16.17, 20A, 21]

Income from other incidental operations is also recognised in profit or loss. [IAS 16.21]

Decommissioning or restoration

The cost of property, plant and equipment includes the estimated cost of dismantling and removing the asset and restoring the site (decommissioning or restoration) to the extent that such cost is recognised as a provision (see chapter 3.12). [IAS 16.16(c)]

Decommissioning costs comprise liabilities incurred during the period of use for purposes other than producing inventory. Decommissioning or restoration costs related to the production of inventory are included in the cost of inventory. [IAS 16.16(c), 18, IFRIC 1.5(a)]

Like IFRS Accounting Standards, the following are not activities necessary to bring the asset to the condition and location necessary for its intended use and would not be included in the cost of an item of property, plant and equipment:
- training costs;
- when an item of property, plant and equipment is constructed by an entity, abnormal amounts of wasted material, labour and other resources;
- start-up and pre-operating costs unless those costs are necessary to bring the asset to its working condition; and
- losses incurred before the asset reaches its planned performance level.

[360-10-30-1 – 30-2]

Like IFRS Accounting Standards, incidental income from operations (including testing) to bring an item of property, plant and equipment to the location and condition necessary for its intended use is generally not part of the directly attributable cost of the asset and is recognised in profit or loss. [970-340-25-12]

However, unlike IFRS Accounting Standards there is specific guidance under US GAAP for entities that have productive activities relating to real estate. Those entities recognise income in excess of expenses from incidental operations as a reduction in the cost of the asset, unless the asset is an amenity. Incidental income or loss from operations related to an amenity before it is substantially completed and available for use is included as a common cost of the property and therefore is a reduction of (or an addition to) the cost of the asset.

Like IFRS Accounting Standards, income and expenses from other incidental operations are recognised in profit or loss. [970-340-25-11 – 25-12]

Asset retirement obligation

Like IFRS Accounting Standards, the cost of property, plant and equipment includes the estimated cost of dismantling and removing the asset and restoring the site to the extent that such cost is recognised as an asset retirement obligation. Unlike IFRS Accounting Standards, to the extent that such costs are environmental remediation obligations resulting from improper use of an asset, generally they are recognised in profit or loss. For further discussion, see chapter 3.12. [410-20-35-8]

Like IFRS Accounting Standards, asset retirement obligations include liabilities incurred during the period of use. However, unlike IFRS Accounting Standards, asset retirement obligations incurred as a consequence of the production of inventory in a particular period are not part of the cost of inventory, but are added to the carrying amount of the item of property, plant and equipment. [410-20-35-1]

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IFRS Accounting Standards

If an entity uses the cost model for the subsequent measurement of property, plant and equipment, then any changes to an existing decommissioning or restoration obligation (other than changes related to the unwinding of the discount) are added to or deducted from the cost of the related asset, and are depreciated prospectively over the asset's useful life. However, the amount deducted from the cost of the asset cannot exceed its carrying amount; any excess is recognised immediately in profit or loss. [IFRIC 1.5]

The remeasurement of a decommissioning or restoration obligation includes the effect of changes in interest rates (see chapter 3.12). [IFRIC 1.3]

Under the revaluation model, changes in a liability for decommissioning or restoration (other than changes related to the unwinding of the discount) are recognised in the same way as a revaluation (see below), unless the change would reduce the depreciated cost of the asset to below zero. [IFRIC 1.6]

Deferred payment

If payment is deferred beyond normal credit terms, then the cost of the asset is the cash price equivalent (i.e. current cash price) at the date of recognition, which may be different from the cash flows discounted using a market rate of interest. [IAS 16.23]

Depreciation

Subsequent to initial recognition, property, plant and equipment is depreciated on a systematic basis over its useful life, which is reviewed at least at each annual reporting date. A change in the useful life is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [IAS 16.50–51]

US GAAP

Like IFRS Accounting Standards, any changes to an existing decommissioning or restoration obligation (other than changes related to the unwinding of any discount) are added to or deducted from the cost of the related asset if initially the obligation was recognised as an increase to the cost of the asset, and are depreciated prospectively over the asset's useful life. However, the amount deducted from the cost of the asset cannot exceed its carrying amount; any excess is recognised immediately in profit or loss, like IFRS Accounting Standards. [410-20-35-8]

Unlike IFRS Accounting Standards, the remeasurement of an asset retirement obligation includes the effect of changes in interest rates only in respect of increases in estimates of future cash flows (see chapter 3.12). If the estimated future cash flows do not change but the settlement date changes, then in our view the entity may choose an accounting policy, to be applied consistently, to remeasure the liability for changes in interest rates, like IFRS Accounting Standards. [410-20-35-1, 35-8]

Unlike IFRS Accounting Standards, entities are not permitted to use the revaluation model under US GAAP.

Deferred payment

If payment is deferred, then the purchase price is recognised at the fair value of the consideration given, which may be measured as the present value of the future payments discounted using a market rate of interest or in some cases the fair value of the asset received; we would not generally expect significant differences in measurement in practice. [835-30-25-7 – 25-10]

Depreciation

Like IFRS Accounting Standards, subsequent to initial recognition property, plant and equipment is depreciated on a systematic basis over its useful life. US GAAP does not specifically require an entity to review useful lives on an annual basis. We believe that an entity should periodically assess the useful life of property, plant and equipment, regardless of whether impairment indicators exist under the property, plant and equipment topic, to ensure that it continues to be appropriate. In general, we would not expect significant differences between IFRS Accounting Standards and US GAAP in practice. Like IFRS Accounting Standards, a change in useful life is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [360-10-35-3 – 35-4]

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IFRS Accounting Standards

In determining the useful life of non-removable leasehold improvements, a lessee considers whether it expects to use them beyond the lease term. If not, then their useful life will generally be restricted to the lease term of the related lease. [IU 11-19]

The depreciation charge for each period is recognised as an expense in profit or loss, unless it is included in the carrying amount of another asset (e.g. inventory). [IAS 16.48]

An asset's depreciable amount is its cost or revalued amount, less its residual value. 'Residual value' is the amount that an entity could receive from disposal of the asset at the reporting date if the asset were already of the age and in the condition that it will be in when the entity expects to dispose of it. Residual value does not include expected future inflation or expected increases or decreases in the ultimate disposal value. The residual value of an asset is reviewed at least at each annual reporting date; changes in the residual value are accounted for prospectively as a change in accounting estimate (see chapter 2.8). [IAS 16.6, 51]

No specific method of depreciation is required to be used, and suitable methods include the straight-line method, the diminishing (or reducing) balance method and the sum-of-the-units (or units-of-production) method. In our view, the financing costs of an asset or inflation adjustments should not impact the selection of a depreciation method – i.e. the annuity method, under which the depreciation charge is adjusted to reflect the time value of money, is not acceptable. The method of depreciation reflects the pattern in which the benefits associated with the asset are consumed; the depreciation method applied is reviewed at least at each annual reporting date. A change in the depreciation method is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [IAS 16.60–62, IU 11-04]

US GAAP

The useful life of non-removable leasehold improvements is expressly restricted to the lease term unless the lease either transfers title to the underlying asset or the lessee is reasonably certain to exercise an option to purchase the underlying asset. However, we do not expect significant differences from IFRS Accounting Standards in practice. [842-20-35-12]

Like IFRS Accounting Standards, the depreciation charge for each period is recognised as an expense in profit or loss, unless it is included in the carrying amount of another asset (e.g. inventory). [360-10-35-3]

Like IFRS Accounting Standards, an asset's depreciable amount is its cost less its salvage value (residual value). US GAAP does not define 'salvage value' for depreciable assets, or prescribe a method for measuring salvage value. Instead, US GAAP only requires the cost of an asset, less salvage if any, to be allocated over its estimated useful life in a systematic and rational manner. We believe salvage value is the estimated value expected to be recovered by the entity at the end of an asset's estimated useful life and should reflect all costs necessary to realise the salvage value, such as disposal costs. This amount may differ from its estimated fair value at the end of the estimated useful life (e.g. if the entity does not plan to sell the asset to realise that residual fair value). Although this is similar to the definition under IFRS Accounting Standards, differences may arise in practice. Like IFRS Accounting Standards, changes in the salvage value are accounted for prospectively as a change in accounting estimate (see chapter 2.8). [360-10-35-4]

Like IFRS Accounting Standards, no specific method of depreciation is required to be used, and suitable methods include the straight-line method, the diminishing (or reducing) balance method and the sum-of-the-units (or units-of-production) method. The annuity method is not acceptable, like IFRS Accounting Standards. Additionally, US GAAP specifies that certain tax depreciation approaches are not acceptable if the number of years specified by the tax code does not fall within a reasonable range of the asset's useful life. Like IFRS Accounting Standards, the method of depreciation reflects the pattern in which the benefits associated with the asset are consumed.

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The use of a revenue-based method of depreciation is prohibited. [IAS 16.62A]

Depreciation of an asset begins when it is available or ready for use – i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. In our view, depreciation of a right-of-use asset should begin from the lease commencement date – i.e. the date on which a lessor makes the underlying asset available for use by a lessee. [IAS 16.55]

Component accounting

If an item of property, plant and equipment comprises individual components for which different depreciation methods or rates are appropriate, then each component is depreciated separately. A separate component may be either a physical component or a non-physical component that represents a major inspection or overhaul. [IAS 16.43–47]

Routine maintenance costs are expensed as they are incurred. Major inspection or overhaul costs are accounted for as a separate component of the item of property, plant and equipment if that component is used over more than one period. In our view, the cost of a major inspection or overhaul includes internal as well as external costs, and there is no requirement for the costs to be incremental. [IAS 16.12, 14]

US GAAP does not specifically require an entity to review methods of depreciation on an annual basis. We believe that an entity should periodically assess them for long-lived assets, regardless of whether impairment indicators exist under the property, plant and equipment topic, to ensure that they continue to be appropriate. In general, we would not expect significant differences between IFRS Accounting Standards and US GAAP in practice. Like IFRS Accounting Standards, a change in the depreciation method is accounted for prospectively as a change in accounting estimate (see chapter 2.8). However, unlike IFRS Accounting Standards, because an accounting principle (policy) is also involved, the change needs to be justified as preferable and the disclosure requirements for a change in accounting principle apply. [250-10-45-2, 50-1, 360-10-35-7, 35-9 – 35-11]

Unlike IFRS Accounting Standards, the use of a revenue-based method of depreciation is not prohibited. However, in our experience such a method is not typically used in practice. [360-10-35-2, 35-7, 35-9]

Like IFRS Accounting Standards, depreciation of an asset begins when it is available for use – i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Like IFRS Accounting Standards, amortisation of a right-of-use asset begins from the lease commencement date – i.e. the date on which a lessor makes the underlying asset available for use by a lessee. [360-10-35-4, 842-20-25-5(a), 25-6(a)]

Component accounting

Unlike IFRS Accounting Standards, there is neither a requirement for, nor a prohibition from, accounting for separate components of an asset. Therefore, differences from IFRS Accounting Standards may arise in practice.

Like IFRS Accounting Standards, routine maintenance costs are expensed as they are incurred. In our experience, entities apply industry guidance by analogy to account for planned major maintenance using one of the following methods.

- *Direct expense method:* all maintenance costs are expensed in the period in which they are incurred, unlike IFRS Accounting Standards.
- *Built-in overhaul method:* planned major maintenance costs (which may include internal as well as external costs) are accounted for as a separate component of the asset, like IFRS Accounting Standards.

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If the component is a physical component, then the initial carrying amount of the component is determined with reference to its cost. [IAS 16.15]

The remaining carrying amount of a component that is replaced by a new component is derecognised. [IAS 16.13]

Subsequent expenditure

Expenditure incurred subsequent to the initial recognition of property, plant and equipment is capitalised only when it is probable that future economic benefits associated with the item will flow to the entity, or when it replaces a component that is accounted for separately. Expenditure associated with the day-to-day servicing of assets is expensed as it is incurred. [IAS 16.7, 12]

The costs of relocating or reorganising part or all of an entity's operations are not included in the carrying amount of an item of property, plant and equipment. [IAS 16.20]

Revaluations

An entity may elect to apply the revaluation model to account for property, plant and equipment if its fair value can be measured reliably (see chapter 2.4). Any surplus arising on revaluation is recognised in OCI except to the extent that the surplus reverses a previous revaluation deficit on the same asset recognised in profit or loss, in which case the credit to that extent is recognised in profit or loss. Any deficit on revaluation is recognised in profit or loss except to the extent that it reverses a previous revaluation surplus on the same asset, in which case the debit to that extent is recognised in OCI. Therefore, revaluation increases and decreases cannot be offset, even within a class of assets. [IAS 16.31, 36, 39–40]

- *Deferral method:* although no component of the asset is attributed to planned major maintenance on initial recognition, costs (which may include internal as well as external costs) incurred for each major maintenance are capitalised and amortised over the period to the next planned major maintenance, unlike IFRS Accounting Standards. [360-10-25-5, 45-1, 908-360-30-2 – 30-3, 908-720-25-3]

If an entity uses a component approach, then the initial carrying amount of the component is normally determined using the estimated relative fair value of the components. Although this wording differs from IFRS Accounting Standards, we would not generally expect significant differences in practice.

Like IFRS Accounting Standards, if an entity uses a component approach, then the carrying amount of the component that is replaced by a new component would generally be derecognised. However, unlike IFRS Accounting Standards, because the component approach is not required, entities may use the composite depreciation method whereby the cost of a new component is capitalised without derecognising the replaced component.

Subsequent expenditure

Like IFRS Accounting Standards, expenditure incurred subsequent to the initial recognition of property, plant and equipment is capitalised only when it is probable that future economic benefits associated with the item will flow to the entity. However, unlike IFRS Accounting Standards, component accounting is not required and replacement components may be recognised without derecognising the replaced component. Like IFRS Accounting Standards, expenditure associated with the day-to-day servicing of assets is expensed as it is incurred. [TQA 2210.15]

The costs of relocating or reorganising property, plant and equipment, including part or all of an entity's operations, are generally expensed as they are incurred, like IFRS Accounting Standards. [CON 6.149]

Revaluations

Unlike IFRS Accounting Standards, entities are not permitted to use the revaluation model under US GAAP. [ARB 43.9B.1]

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If an asset is revalued, then all property, plant and equipment of the same class is revalued at the same time and these revaluations are kept up to date. A 'class of assets' is a grouping of items that have a similar nature and use in an entity's operations. [IAS 16.31, 36–38]

The revaluation surplus may be transferred directly to retained earnings as the surplus is realised. 'Realisation' of the surplus may occur either by the use (and depreciation) of the asset or its disposal (see below). [IAS 16.41]

If an entity changes its accounting policy from cost to fair value, then the effect of the change is recognised as a revaluation; the opening balance of equity is not adjusted and comparatives are not restated (see chapter 2.8). [IAS 8.17]

Compensation received

Compensation for insurance recoveries, including the loss or impairment of property, plant and equipment, is recognised in profit or loss when it becomes receivable. The loss or impairment is recognised in profit or loss as an expense when it occurs. [IAS 16.65–66]

An entity may be entitled to compensation from a supplier for the late delivery of an item of property, plant and equipment (often referred to as 'liquidated damages'). In determining the appropriate accounting for the compensation, an entity needs to consider its economic substance, in particular whether it is an incentive to deliver on time or coverage for actual losses incurred.

- In our view, if the compensation is an incentive to deliver an asset on time (i.e. similar to a penalty for late delivery or a rebate for early delivery), then it should be deducted from the cost of the asset.
- In limited circumstances, if the compensation is intended to cover actual revenues lost or actual costs incurred because of the late delivery (i.e. there is a direct link between the actual economic damage caused by the delay and the compensation amount), then we believe that the compensation should be recognised as income or a reduction of the related expense in profit or loss.

Compensation received

Unlike IFRS Accounting Standards, compensation for the loss or impairment of property, plant and equipment, to the extent of losses and expenses recognised in the financial statements, is recognised in profit or loss when receipt is probable (likely to occur). Compensation in excess of such amount is treated as a gain contingency (see chapter 3.12) and is not recognised until it is receivable, like IFRS Accounting Standards. The loss or impairment is recognised in profit or loss as an expense when it occurs, like IFRS Accounting Standards. [360-10-45-4, 450-30-25-2]

Unlike IFRS Accounting Standards, contractually specified liquidated damages for the late delivery of property, plant and equipment are recognised as a reduction of its capitalised cost, regardless of whether the compensation is an incentive to deliver the asset on time or coverage for actual losses incurred. [TQA 2210.28]

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Retirements, disposals and changes in use

When an item of property, plant and equipment is disposed of or no future economic benefits are expected from its use or disposal, a gain or loss is recognised for the difference between:

- any *net* proceeds received, which is the transaction price determined under the revenue standard (see chapter 4.2), less, in our view, all directly attributable incremental costs of disposal; and
- the carrying amount of the asset. [IAS 16.71–72]

Any attributable revaluation surplus may be transferred to retained earnings, but is not recognised in profit or loss. [IAS 16.41]

If an item of property, plant and equipment is disposed of as part of a sale-and-leaseback transaction, then an entity applies the requirements in the leases standard (see chapter 5.1). Under those requirements, a seller-lessee derecognises the underlying asset only if the transfer leg satisfies the requirements of the revenue standard to be accounted for as a sale of the asset. [IFRS 16.100]

Assets that are rented out and subsequently sold on a routine basis are transferred to inventories at their carrying amount when they cease to be rented and become held for sale. Proceeds from the sale are recognised as revenue under the revenue standard. [IAS 16.68A]

An entity continues to recognise depreciation even when an asset is idle, unless the asset is fully depreciated or is classified as held-for-sale (see chapter 5.4). [IAS 16.55]

Retirements, disposals and changes in use

Like IFRS Accounting Standards, when an item of property, plant and equipment is disposed of or permanently withdrawn from use, a gain or loss is recognised. The gain or loss is determined as the difference between:

- the consideration received, which is the transaction price determined under the revenue Codification Topic (see chapter 4.2); and
- the carrying amount of the asset. [360-10-40-3A, 40-5, 610-20-32-2]

Unlike IFRS Accounting Standards, the revaluation model is not permitted and therefore no revaluation surplus exists.

Like IFRS Accounting Standards, if an item of property, plant and equipment is disposed of as part of a sale-leaseback transaction, then an entity applies the requirements in the leases Codification Topic (see chapter 5.1). Under those requirements, like IFRS Accounting Standards, a seller-lessee derecognises the underlying asset only if the transfer leg satisfies the requirements of the revenue Codification Topic to be accounted for as a sale of the asset. [842-40-25-1, 606-10-25-1 – 25-8, 25-30]

Unlike IFRS Accounting Standards, US GAAP has no explicit guidance on accounting for assets that are rented out and subsequently sold on a routine basis, and practice may vary. Proceeds from the sale would be accounted for in a manner that is consistent with the accounting for the asset.

Like IFRS Accounting Standards, an entity continues to recognise depreciation even when an asset is idle, unless the asset is fully depreciated or is classified as held-for-sale (see chapter 5.4). [360-10-35-49]

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3.3 Intangible assets and goodwill

(IAS 38, SIC-32)

Overview

- **An 'intangible asset' is an identifiable non-monetary asset without physical substance.**
- **An intangible asset is 'identifiable' if it is separable or arises from contractual or other legal rights.**
- **In general, intangible assets are recognised initially at cost.**
- **The initial measurement of an intangible asset depends on whether it has been acquired separately or as part of a business combination, or was internally generated.**
- **Goodwill is recognised only in a business combination and is measured as a residual.**
- **Acquired goodwill and other intangible assets with indefinite useful lives are not amortised, but instead are subject to impairment testing at least annually.**
- **Intangible assets with finite useful lives are amortised over their expected useful lives.**

3.3 Intangible assets and goodwill

(Topic 350, Subtopic 610-20, Subtopic 720-15, Subtopic 720-35, Topic 730, Subtopic 985-20)

Overview

- **Like IFRS Accounting Standards, an 'intangible asset' is an asset, not including a financial asset, without physical substance.**
- **Like IFRS Accounting Standards, an intangible asset is 'identifiable' if it is separable or arises from contractual or other legal rights.**
- **Intangible assets are recognised at cost, which is established under the relevant Codification topic/subtopic and may differ from IFRS Accounting Standards.**
- **Like IFRS Accounting Standards, the initial measurement of an intangible asset depends on whether it has been acquired separately or as part of a business combination, or was internally generated. However, there are differences from IFRS Accounting Standards in the detailed requirements.**
- **Like IFRS Accounting Standards, goodwill is recognised only in a business combination and is measured as a residual.**
- **Like IFRS Accounting Standards, acquired goodwill and other intangible assets with indefinite useful lives are not amortised, but instead are subject to impairment testing at least annually. However, the impairment test differs from IFRS Accounting Standards.**
- **Like IFRS Accounting Standards, intangible assets with finite useful lives are amortised over their expected useful lives.**

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Overview (continued)

- **Subsequent expenditure on an intangible asset is capitalised only if the definition of an intangible asset and the recognition criteria are met.**
- **Intangible assets may be revalued to fair value only if there is an active market.**
- **Internal research expenditure is expensed as it is incurred. Internal development expenditure is capitalised if specific criteria are met. These capitalisation criteria are applied to all internally developed intangible assets.**
- **In-process R&D acquired in a business combination is accounted for under specific guidance.**
- **Advertising and promotional expenditure is expensed as it is incurred.**
- **Expenditure related to the following is expensed as it is incurred: internally generated goodwill, customer lists, start-up costs, training costs, and relocation or reorganisation.**

Definition

An 'intangible asset' is an identifiable non-monetary asset without physical substance. To meet the definition of an intangible asset, an item lacks physical substance and is:

- identifiable;
- non-monetary; and
- controlled by the entity and expected to provide future economic benefits to the entity – i.e. meets the definition of an asset. [IAS 38.8–17]

Overview (continued)

- **Subsequent expenditure on an intangible asset is not capitalised unless it can be demonstrated that the expenditure increases the utility of the asset, which is broadly like IFRS Accounting Standards.**
- **Unlike IFRS Accounting Standards, the revaluation of intangible assets is not permitted.**
- **Unlike IFRS Accounting Standards, internal R&D expenditure is expensed as it is incurred. Special capitalisation criteria apply to software developed for internal use, software developed for sale to third parties and motion picture film costs, which differ from the general criteria under IFRS Accounting Standards.**
- **In-process R&D acquired in either a business combination or an asset acquisition is accounted for under specific guidance, like IFRS Accounting Standards. However, that guidance differs in some respects.**
- **Advertising and promotional expenditure is generally expensed as it is incurred, like IFRS Accounting Standards, or deferred until the advertisement is shown, unlike IFRS Accounting Standards.**
- **Like IFRS Accounting Standards, expenditure related to the following is expensed as it is incurred: internally generated goodwill, customer lists, start-up costs, training costs, and relocation or reorganisation.**

Definition

Under US GAAP, an 'intangible asset' is an asset (not including a financial asset) that lacks physical substance. Although this definition differs from IFRS Accounting Standards, we would not generally expect significant differences in practice. [350-10-20]

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An intangible asset is 'identifiable' if it:

- is separable: i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged either individually or together with a related contract, asset or liability; or
- arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations. [IAS 38.12]

Holdings of a cryptocurrency (i.e. digital or virtual currency that is recorded in a distributed ledger and is not issued by a jurisdictional authority or other party) meet the definition of an intangible asset. If cryptocurrencies are held for sale in the ordinary course of business, then the entity applies the inventories standard (see chapter 3.8). [IU 06-19]

Initial recognition and measurement

An intangible asset is recognised when:

- it is probable that future economic benefits that are attributable to the asset will flow to the entity; and
- the cost of the asset can be measured reliably. [IAS 38.21]

If an intangible asset is acquired in a business combination, then these recognition criteria are assumed to be met. If an intangible asset is acquired in a separate acquisition (i.e. outside a business combination), then the 'probability' criterion is assumed to be met and the 'reliable measurement' criterion is usually met. [IAS 38.25–26, 33]

An intangible asset is recognised initially at cost. [IAS 38.24]

The cost of an intangible asset acquired in a separate acquisition is the cash paid or the fair value of any other consideration given plus transaction costs. It includes the directly attributable expenditure in preparing the asset for its intended use. The principles discussed in respect of property, plant and equipment (see chapter 3.2) apply equally to the recognition of intangible assets. [IAS 38.8, 27–28]

Like IFRS Accounting Standards, an intangible asset is 'identifiable' if it:

- is separable: i.e. capable of being separated or divided and sold, transferred, licensed, rented or exchanged either individually or together with a related contract, asset or liability, regardless of whether there is an intent to do so; or
- arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations. [805-20-20, 25-10]

Like IFRS Accounting Standards, we believe that holdings of a cryptocurrency (i.e. digital or virtual currency that is recorded in a distributed ledger and is not issued by a jurisdictional authority or other party) will often meet the definition of an intangible asset. Unlike IFRS Accounting Standards, cryptocurrencies cannot meet the definition of inventory, because inventory under US GAAP includes only tangible property (see chapter 3.8).

Initial recognition and measurement

An identifiable intangible asset is recognised when it is acquired either individually or with a group of other assets, unless another specific Codification topic applies (see below). Unlike IFRS Accounting Standards, there are no general criteria that apply to all intangible assets. [350-30-25-1]

An intangible asset acquired in a business combination is recognised when it meets the contractual-legal criterion or the separability criterion. If an intangible asset is acquired in a separate acquisition (i.e. outside a business combination), then it is recognised regardless of the contractual-legal and separability criteria. Although the wording of US GAAP differs from IFRS Accounting Standards, we would not generally expect significant differences in practice. [350-30-25-4]

Intangible assets are recognised at cost, which is established under the relevant Codification topic/subtopic and, therefore, may differ from IFRS Accounting Standards.

Like IFRS Accounting Standards, the cost of an intangible asset acquired in a separate acquisition is the cash paid or the fair value of any other consideration given plus transaction costs. Unlike IFRS Accounting Standards, there is no overall principle related to costs incurred in preparing an intangible asset for its intended use, and the nature of the costs capitalised vs expensed as they are incurred depends on the nature of the intangible asset. [805-50-30-1 – 30-2]

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If payment is deferred beyond normal credit terms, then the cost of the asset is the cash price equivalent (i.e. current cash price) at the date of recognition, which may be different from the cash flows discounted using a market rate of interest. [IAS 38.32]

If payment is deferred, then cost is recognised at the fair value of the consideration given, which may be measured as the present value of the future payments discounted using a market rate of interest or in some cases the fair value of the asset received; we would not generally expect significant differences in measurement in practice. [835-30-25-7 – 25-10]

A contract to acquire an intangible asset in a separate acquisition may include variable payments. IFRS Accounting Standards are silent on whether the estimated fair value of these payments should be included in the cost of the intangible asset on initial recognition and on how to account for them subsequently. When determining the appropriate accounting for variable payments, an entity applies judgement and carefully considers specific facts and circumstances. In our view, variable payments that are based on period activity or usage of the asset (e.g. sales- or usage-based royalties) should generally be expensed when they are incurred. We believe that other variable payments relating to the cost of the acquired intangible asset and future economic benefits (e.g. development-based milestones) may be capitalised under the intangible assets standard or expensed as they are incurred. In our view, an entity should choose an accounting policy based on an acceptable approach, to be applied consistently, to account for these other variable payments.

Like IFRS Accounting Standards, US GAAP is silent on some aspects of the accounting for variable payments in a separate acquisition of an intangible asset. Like IFRS Accounting Standards, an entity applies judgement and carefully considers specific facts and circumstances in determining the appropriate accounting. Relevant factors to consider are the form of the variable payments and whether they are in the scope of a specific Codification topic/subtopic, which may differ from IFRS Accounting Standards.

The cost of an internally generated intangible asset includes the directly attributable expenditure of creating, producing and preparing the asset for its intended use that is incurred from the date when the asset first meets the recognition criteria. Expenditure on training activities, identified inefficiencies and initial operating losses is expensed as it is incurred. [IAS 38.27–30, 65–67]

Unlike IFRS Accounting Standards, internally developed intangible assets are recognised only if a specific Codification subtopic requires their recognition – e.g. software developed for internal use, software developed for sale to third parties, and motion picture films. Such assets are initially recognised by accumulating costs incurred after the capitalisation criteria are met; however, the capitalisation criteria differ for each subtopic and they differ from IFRS Accounting Standards (see below). Like IFRS Accounting Standards, expenditure on training activities, clearly identified inefficiencies and initial operating losses is expensed as it is incurred. [350-30-30-1, 350-40-25, 926-20-25]

Borrowing costs are capitalised as part of the cost of an internally generated intangible asset if it is a qualifying asset (see chapter 4.6). [IAS 23.7–9, 38.65–66]

Like IFRS Accounting Standards, borrowing (i.e. interest) costs are generally capitalised as part of the cost of an internally generated intangible asset if it is a qualifying asset recognised under a specific Codification topic (see chapter 4.6). [350-40-30-1, 985-20-25-5]

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The cost of an intangible asset acquired in a business combination is its fair value. [IFRS 3.18, IAS 38.33]

An intangible asset acquired for defensive purposes rather than for active use may also meet the above recognition criteria.

Research and development

'Research' is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding. 'Development' is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use. Development does not include the maintenance or enhancement of ongoing operations. [IAS 38.8]

Research costs are generally expensed as they are incurred. [IAS 38.54]

If an internally generated intangible asset arises from the development phase of a project, then directly attributable expenditure is capitalised from the date on which the entity is able to demonstrate:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete the intangible asset and use or sell it;
- its ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- its ability to measure reliably the expenditure attributable to the intangible asset during its development. [IAS 38.57]

Like IFRS Accounting Standards, intangible assets acquired in a business combination are initially recognised at fair value. [805-20-30-1]

Like IFRS Accounting Standards, an intangible asset acquired for defensive purposes rather than for active use may also meet the above recognition criteria. [350-30-25-5A]

Research and development

'Research' is a planned search or critical investigation aimed at the discovery of new knowledge with the hope that such knowledge will be useful in developing a new product or service or a new process or technique or in bringing about a significant improvement to an existing product, service, process or technique. 'Development' is the translation of research findings or other knowledge into a plan or design for a new product, service, process or technique, whether intended for sale or for use. Because the precise language under US GAAP differs from IFRS Accounting Standards, it is possible that differences may arise in practice. [730-10-20]

Like IFRS Accounting Standards, research costs are generally expensed as they are incurred. [730-10-25-1]

Unlike IFRS Accounting Standards, with the exception of certain computer software and direct-response advertising costs associated with acquiring or renewing insurance contracts, all other internally generated development costs are expensed as they are incurred. [350-40-25, 730-10-25-1, 25-3, 944-30-25-1AA, 985-20-25]

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In-process R&D acquired in a business combination is recognised initially at fair value. Subsequent to initial recognition, the intangible asset is accounted for following the general principles outlined in this chapter. [IAS 38.33–34]

In-process R&D acquired in a separate acquisition is recognised and initially measured at cost. In-process R&D acquired with a group of assets that does not constitute a business is recognised and measured based on its relative fair value in relation to the cost of the group of assets as a whole. [IFRS 3.2(b), IAS 38.8, 24, 26]

Expenditure on internally generated intangible assets such as brands, mastheads, publishing titles, customer lists and similar items is not capitalised. [IAS 38.63]

There is no specific guidance in IFRS Accounting Standards on R&D activities that are funded by other parties.

Like IFRS Accounting Standards, in-process R&D acquired in a business combination is recognised initially at fair value. Unlike IFRS Accounting Standards, subsequent to initial recognition the intangible asset is classified as indefinite-lived (regardless of whether it has an alternative future use) until the completion or abandonment of the associated R&D efforts, and is subject to annual impairment testing during the period over which these assets are considered indefinite-lived. All costs incurred to complete the project are expensed as they are incurred, unlike IFRS Accounting Standards. [350-30-35-17A, 805-20-30-1]

In-process R&D acquired in a separate acquisition or with a group of assets that does not constitute a business is recognised as an asset only if it has an alternative future use, in which case it is initially measured at cost or based on its relative fair value in relation to the cost of the group of assets as a whole, like IFRS Accounting Standards. In-process R&D acquired outside a business combination that does not have an alternative future use is measured at cost or based on its relative fair value in relation to the cost of the group of assets as a whole, and expensed at the time of acquisition, unlike IFRS Accounting Standards. [730-10-25-2(c)]

Like IFRS Accounting Standards, expenditure on internally generated intangible assets such as brands, mastheads, publishing titles, customer lists and similar items is not capitalised. [350-20-25-3, 805-20-25-4]

Unlike IFRS Accounting Standards, there is specific guidance for arrangements under which the R&D activities of an entity are funded by other parties, which may give rise to differences in practice. The R&D costs are accounted for following the general principles outlined above (generally expensed as they are incurred). To the extent that the entity has an obligation to repay the funding party, regardless of the outcome of the R&D activities, it recognises a liability; a repayment obligation may be explicit or implicit. Factors that lead to a presumption that the entity doing the research will pay back the funding party include:

- an indicated intent to repay;
- severe economic consequences for non-payment;
- a significant related party relationship; or
- the project is essentially complete when the arrangement is entered into; the apparent absence of an ability to repay the funding party does not overcome this presumption. [730-10-25-1, 730-20-25]

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Software developed for sale

There is no specific guidance in IFRS Accounting Standards on software developed for sale. The costs of such software are accounted for following the general principles for internally generated intangible assets. [IAS 38.57]

Internal-use software

There is no specific guidance in IFRS Accounting Standards on the development of internal-use software. The costs of such software are accounted for under the general principles for internally generated intangible assets or, in the case of purchased software, following the general requirements for intangible assets. [IAS 38.57]

Software developed for sale

Unlike IFRS Accounting Standards, there is specific guidance on software developed to be sold. The costs incurred in creating a computer software product to be sold, leased or otherwise marketed as a separate product or as part of a product or process are R&D costs that are expensed as they are incurred until technological feasibility has been established for the product. 'Technological feasibility' is established on completion of a detailed programme and product design or, in the absence of a detailed programme design, completion of a working model whose consistency with the product design has been confirmed through testing. Thereafter, software development costs incurred up to the point of general release of the product to customers are capitalised and reported subsequently at the lower of amortised cost and net realisable value. Although the technological feasibility capitalisation threshold is similar to the general recognition principles for internally generated intangible assets under IFRS Accounting Standards, because the precise language under US GAAP differs from IFRS Accounting Standards, differences may arise in practice. [985-20-25-1 – 25-3, 35-4]

Internal-use software

Unlike IFRS Accounting Standards, there is specific guidance on the development of internal-use software. The costs incurred for such software that is acquired, internally developed or modified solely to meet the entity's internal needs are capitalised depending on the stage of development. The stages of software development are the preliminary project stage, application development stage and post-implementation/operation stage. Costs incurred during the preliminary project stage and the post-implementation/operation stage are expensed as they are incurred. [350-40-25-1 – 25-2, 25-6]

Software development and implementation costs for upgrades and enhancements, including specified upgrades and enhancements to licensed internal-use software, are capitalised or expensed on the same basis as if those costs were incurred to develop and implement new software. If an entity cannot separate internal costs of maintenance from those of minor upgrades or enhancements, then all such costs are expensed as they are incurred. [350-40-25-8 – 25-10]

Costs incurred in the application development stage that are capitalised include only:

- the external direct costs of materials and services consumed in developing or obtaining internal-use software;
- payroll and payroll-related costs for employees who are directly associated with and who devote time to the internal-use software project; and
- interest (borrowing costs) incurred during development (see chapter 4.6). [350-40-30-1]

See forthcoming requirements.

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Website development costs

Costs associated with websites developed for advertising or promotional purposes are expensed as they are incurred. In respect of other websites, costs incurred during the planning stage (pre-development) are expensed when they are incurred; costs incurred during the application and infrastructure development stage, the graphical design stage and the content development stage are capitalised if the criteria for capitalising development costs are met (see above). The costs of developing content for advertising or promotional purposes are expensed as they are incurred. [SIC-32.8–9]

Cloud computing

An entity entering into a cloud computing arrangement assesses whether it receives a software asset or a service over the contract term. It receives a software asset if:

- the arrangement contains a software lease under the guidance in the leases standard (see chapter 5.1); or
- it otherwise obtains control of the software under the guidance in the intangible assets standard (see above). [IU 03-19]

Training and data conversion/migration costs are not software development costs, and therefore are expensed as they are incurred even if that is during the application development stage. [350-40-25-4 – 25-5, 55-4]

General administrative and overhead costs are expensed as they are incurred. [350-40-30-3]

The application development stage will often commence sooner than the date on which the criteria for capitalising development costs under IFRS Accounting Standards are met. Therefore, both the timing of commencing capitalisation and the amounts capitalised are likely to differ from IFRS Accounting Standards.

Capitalised internal-use software costs are generally amortised on a straight-line basis. The costs are also assessed for impairment under the long-lived assets impairment guidance (see chapter 3.10). [350-40-35-1, 35-4]

Website development costs

Unlike IFRS Accounting Standards, US GAAP provides guidance that applies broadly to the development of websites.

- Costs incurred during the planning stage are expensed as they are incurred, like IFRS Accounting Standards.
- Costs incurred during the website application and infrastructure development and graphics development stages follow the internal-use software guidance (see above), which differs from the general capitalisation criteria for internally developed intangible assets under IFRS Accounting Standards. In addition, there is detailed guidance on the activities that are deemed to be within the application and infrastructure and graphics development stages.
- Costs incurred in loading content and the related data conversion costs are expensed as they are incurred, but the costs of developing content follow other applicable guidance depending on the nature of the content. Therefore, differences from IFRS Accounting Standards may arise in practice. [350-50-25-2, 25-14]

Cloud computing

Like IFRS Accounting Standards, an entity first assesses whether it receives a software licence asset under the cloud computing arrangement. If so, it then applies the guidance on internal-use software to the software licence. If not, then the cloud computing arrangement is a service contract. [350-40-15-4A, 15-4C]

Unlike IFRS Accounting Standards, there is no question about whether the cloud computing arrangement contains a software lease because intangible assets cannot be leased (i.e. are outside the scope of the leases Codification Topic). [842-10-15-1]

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Cloud computing arrangements generally do not meet the definition of a lease. In our experience, they usually also do not give rise to an intangible asset, except in some limited circumstances. In our view, features of a cloud computing arrangement that may indicate that the entity obtains control of a software intangible asset include:

- the right to take possession of the software and run it on the entity's own or a third party's computer infrastructure; or
- exclusive rights to use the software or ownership of the intellectual property for customised software (i.e. the vendor cannot make the software available to other customers).

If an entity determines that a cloud computing arrangement is a service contract, then it recognises the related expenditure when it receives the service – i.e. over the contract term. [IU 03-19]

The accounting for implementation costs incurred in a cloud computing arrangement depends on whether an entity receives a software intangible asset or enters into a service contract.

- If an entity acquires a software intangible asset, then it accounts for the related implementation costs applying the general requirements for intangible assets, including capitalisation of the directly attributable costs of preparing the asset for its intended use (see above).
- If an entity determines that a cloud computing arrangement is a service contract, then these requirements do not apply, and a different analysis is performed to determine whether any implementation costs should be capitalised.

In a cloud computing arrangement that is a service contract, up-front implementation costs are often required to be expensed when the related implementation service is performed. In our view, these costs can be recognised over a longer period in the following limited circumstances:

- when the implementation service is not distinct from the service of receiving access to the software, because the related expense is then recognised over the period during which the supplier provides access to the software; or
- when the cost gives rise to a separate intangible asset meeting the intangible asset definition (which might be the case when a new interface between an entity's existing software and the cloud software is created). [IAS 38.69–70, IU 03-21]

Unlike IFRS Accounting Standards, the internal-use software Codification Subtopic includes explicit guidance that a cloud computing arrangement contains a software licence if:

- the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty; and
- it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software.

In practice, this guidance results in similar conclusions to IFRS Accounting Standards.

Like IFRS Accounting Standards, an entity accounts for a cloud computing arrangement that is a service contract in the same manner it would any other service contract. This means that the entity recognises the cloud computing arrangement fees over the period it receives the service.

Unlike IFRS Accounting Standards, an entity capitalises implementation costs incurred in a cloud computing arrangement that is a service contract if those same costs would also be capitalised when developing or implementing internally developed or licensed internal-use software (see above). [350-40-25-18, 30-5]

Like IFRS Accounting Standards, some implementation costs may give rise to a separate internal-use software asset (e.g. a software interface that will reside in the entity's IT environment, or for which it owns the software IP). However, unlike IFRS Accounting Standards, an entity implementing a cloud computing arrangement that is a service contract does not consider whether an implementation service, such as to configure the cloud software to the entity's needs, is distinct from the service of receiving access to the cloud software. Such evaluation has no effect on the entity's accounting for the implementation costs. [350-40-25-18, 30-5]

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In our view, if a cloud computing arrangement includes more than one service and those services are received over different periods, then an entity may need to allocate the total consideration to each service to recognise the expense when each service is received. We believe that this allocation should be based on the relative stand-alone price of each service.

Goodwill

Goodwill arising in a business combination is capitalised (see chapter 2.6). [IFRS 3.32]

Goodwill may include an amount that is attributable to NCI if an entity elects to initially measure such interests at fair value (see chapter 2.6). [IFRS 3.19]

Items that are expensed as they are incurred

Expenditure associated with the following costs is expensed as it is incurred, regardless of whether the general criteria for asset recognition appear to be met:

- internally generated goodwill;
- start-up costs, unless they qualify for recognition as part of the cost of property, plant and equipment (see chapter 3.2);
- training activities;
- advertising and promotional activities (see below); and
- relocating or reorganising part or all of an entity. [IAS 38.48, 69]

Expenditure on advertising and promotional activities is recognised as an expense when the benefit of those goods or services is available to the entity. This requirement does not prevent the recognition of an asset for prepaid expenses, but a prepayment is recognised only for payments made in advance of the receipt of the corresponding goods or services. [IAS 38.69–70, IU 09-17]

Emissions and green schemes

There is no specific guidance in IFRS Accounting Standards on the accounting for emissions allowances. In our view, a participant in a mandatory 'cap-and-trade' scheme should choose an accounting policy, to be applied consistently, to account for emissions allowances regardless of whether they are bought or received from a government, based on one of the following approaches:

- as intangible assets, therefore applying the general principles in this chapter; or
- as inventories (see chapter 3.8).

Like IFRS Accounting Standards, if a cloud computing arrangement includes more than one element, then an entity allocates the consideration to each element on a relative stand-alone price basis. [350-40-30-4]

Goodwill

Like IFRS Accounting Standards, goodwill arising in a business combination is capitalised (see chapter 2.6). [805-30-30-1]

Unlike IFRS Accounting Standards, goodwill always includes an amount that is attributable to NCI because NCI are initially measured at fair value (see chapter 2.6). [805-20-30-1]

Items that are expensed as they are incurred

Like IFRS Accounting Standards, expenditure associated with the following costs is expensed as it is incurred, regardless of whether the general criteria for asset recognition appear to be met:

- internally generated goodwill;
- start-up costs, unless they qualify for recognition as part of the cost of property, plant and equipment (see chapter 3.2);
- training activities; and
- relocating or reorganising part or all of an entity. [350-20-25-3, 350-40-25-4, 25-6, 720-15-15-4(f), 25-1]

Unlike IFRS Accounting Standards, direct-response advertising expenditure is capitalised if certain criteria are met. Advertising production costs may be expensed as they are incurred or capitalised until the first time that the advertisement is shown, at which time the amount is expensed, unlike IFRS Accounting Standards; other advertising and promotional activities are expensed as they are incurred, like IFRS Accounting Standards. [720-35-25-1]

Emissions and green schemes

There is no specific guidance in US GAAP on the accounting for emissions allowances and practice varies, so differences from IFRS Accounting Standards may arise in practice.

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If an entity receives emissions allowances from a government, then it may apply the guidance for government grants. A non-monetary government grant may be recognised either at fair value or at a nominal amount (see chapter 4.3). [IAS 20.23]

An entity may voluntarily purchase carbon credits to offset the impact of its emissions (e.g. credits that represent a reduction of emissions achieved through a certified offsetting project like the planting of trees). There is no specific guidance in IFRS Accounting Standards on these transactions; therefore, an entity may need to apply judgement based on the specific facts and circumstances to determine the appropriate accounting treatment.

Crypto assets

There is no specific guidance in IFRS Accounting Standards on crypto assets. For assets accounted for as intangible assets, the general principles in this chapter apply.

Under the general principles, crypto intangible assets are measured at cost, unless there is an active market and the entity elects to apply the revaluation model (see below).

An entity may have many interchangeable intangible assets, acquired at different times and costs (e.g. interchangeable emissions allowances and cryptocurrencies). IFRS Accounting Standards are silent on how an entity should determine the carrying amount of such assets (e.g. to calculate a gain or loss on disposal). If it is not feasible to identify and track specific units sold or transferred, then in our view an entity should apply the guidance for determining cost formulas for inventories by analogy (see chapter 3.8). We believe that a reasonable cost allocation method may be used (i.e. average cost or first-in, first-out). An entity should apply the elected accounting policy consistently.

Crypto assets

Unlike IFRS Accounting Standards, there is specific guidance on crypto assets, which applies to all digital assets that:

- meet the US GAAP definition of an intangible asset;
- do not provide the asset holder with enforceable rights to or claims on underlying goods, services or any other asset(s);
- reside or are created on a distributed ledger (i.e. blockchain or similar technology);
- are secured through cryptography;
- are fungible; and
- are not created or issued by the reporting entity or its related parties. [350-60-15-1]

Unlike IFRS Accounting Standards, all digital assets meeting these criteria ('in-scope crypto intangible assets') are measured at fair value each reporting period, with fair value changes recorded in net income. [350-60-35-1]

Unlike IFRS Accounting Standards, US GAAP specifies that the carrying amount of in-scope crypto intangible assets is fair value. For out-of-scope crypto intangible assets, we believe an entity elects a reasonable and rational approach for determining the carrying amount or cost basis, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, we believe this does not include an average cost approach (unless the entity is an investment company in the scope of the investment companies Codification Topic), because that may result in offsetting a loss in one cryptocurrency unit with a gain in another. [350-30-35-21, 35-24]

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Amortisation

Acquired goodwill is not amortised, but instead is subject to impairment testing at least annually (see chapter 3.10). [IAS 36.10]

The useful life of intangible assets other than goodwill is either finite or indefinite. Intangible assets with indefinite useful lives are not amortised, but instead are subject to impairment testing at least annually (see chapter 3.10). [IAS 36.10, 38.89, 107–110]

An intangible asset has an 'indefinite' useful life if, based on an analysis of all relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity. [IAS 38.88–90]

An intangible asset with a finite life is amortised on a systematic basis over its useful life. [IAS 38.97]

There is no specific guidance on the amortisation of defensive intangible assets (see above) and the general principles apply. Accordingly, such assets are amortised over their useful lives and tested for impairment within the relevant CGU (see chapter 3.10).

A change in useful life is accounted for prospectively as a change in accounting estimate (see chapter 2.8). The amortisable amount of an intangible asset with a finite useful life is determined after deducting its residual value. The residual value of an intangible asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were of the age and in the condition expected at the end of its useful life. [IAS 38.8, 101, 104]

Amortisation

Like IFRS Accounting Standards, acquired goodwill is not amortised, but instead is subject to impairment testing at least annually; the method of impairment testing differs in certain respects from IFRS Accounting Standards (see chapter 3.10). [350-20-35-3]

Like IFRS Accounting Standards, the useful life of intangible assets other than goodwill is either finite or indefinite. Like IFRS Accounting Standards, intangible assets with indefinite useful lives are not amortised, but instead are subject to impairment testing at least annually; the method of impairment testing differs in certain respects from IFRS Accounting Standards (see chapter 3.10). [350-30-35-1]

Like IFRS Accounting Standards, an intangible asset has an 'indefinite' useful life if, based on an analysis of all relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity. However, because the specific criteria for considering whether an intangible asset is indefinite-lived under IFRS Accounting Standards and US GAAP differ (see below), differences may arise in practice. [350-30-35-4]

Like IFRS Accounting Standards, an intangible asset with a finite life is amortised on a systematic basis over its useful life. However, in some situations, US GAAP specifies the amortisation method (e.g. proportionate to revenues), unlike IFRS Accounting Standards. [350-30-35-6]

Defensive intangible assets are amortised over their useful lives, which is the period over which the assets contribute directly or indirectly to the entity's cash flows, and tested for impairment within the asset group – e.g. the entity's other assets supported by the defensive intangible assets. Because IFRS Accounting Standards have no explicit guidance on the accounting for defensive intangible assets, differences may arise in practice. [350-30-35-5A, 35-14]

Like IFRS Accounting Standards, a change in useful life is accounted for prospectively as a change in accounting estimate (see chapter 2.8). Like IFRS Accounting Standards, the amortisable amount of an intangible asset with a finite useful life is determined after deducting its residual value. Residual value is the estimated fair value of an intangible asset at the end of its useful life to an entity, less any disposal costs; although this wording differs from IFRS Accounting Standards, we would not generally expect significant differences in practice. [350-30-35-8 – 35-10, 35-13, 35-17]

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The residual value of an intangible asset with a finite useful life is assumed to be zero unless a third party has committed to buy the asset at the end of its useful life or there is an active market from which a residual value can be obtained and it is probable that such a market will exist at the end of the asset's useful life. [IAS 38.100]

The residual value of an intangible asset is reviewed at least at each annual reporting date. A change in the asset's residual value is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [IAS 38.102]

The useful life of an intangible asset is based on an analysis of all relevant factors, including:

- the expected use of the asset by the entity;
- whether the useful life of the asset is dependent on the useful life of other assets of the entity;
- typical product life cycles for the asset;
- the term of any agreements and other legal or contractual restrictions on the use of the asset (see below);
- technological, commercial and other types of obsolescence;
- the stability of the industry, changes in market demand and expected actions by competitors; and
- the level of maintenance expenditure required to obtain the expected future economic benefits from the asset. [IAS 38.90]

If control of an intangible asset is based on legal rights that have been granted for a finite period, then the useful life cannot exceed that period unless:

- the legal rights are renewable; and
- there is evidence to support the conclusion that they will be renewed without significant cost. [IAS 38.94]

An entity reviews the classification in each annual reporting period to decide whether the assessment made about the useful life of an intangible asset as indefinite or finite is still appropriate. Any such change is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [IAS 38.109]

Like IFRS Accounting Standards, the residual value of an intangible asset with a finite useful life is assumed to be zero unless a third party has committed to buy the asset at the end of its useful life or there is an exchange transaction in an existing market and that market is expected to exist at the end of the asset's useful life. [350-30-35-8]

The residual value of an intangible asset is reviewed each reporting period, which is more frequent than IFRS Accounting Standards for an entity preparing interim reports. Like IFRS Accounting Standards, a change in the asset's residual value is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [350-30-35-8 – 35-9]

The useful life of an intangible asset is based on an analysis of all relevant factors, including:

- the expected use of the asset by the entity;
- the expected useful life of another asset or group of assets to which the intangible asset may relate;
- legal, regulatory or contractual requirements that may limit the life;
- the entity's own historical experience in renewing or extending similar arrangements, consistent with the intended use of the asset by the entity, regardless of whether those arrangements have explicit renewal or extension terms. In the absence of historical experience, the entity considers the assumptions that market participants would use about renewal or extension terms, consistent with the highest and best use of the asset by market participants, adjusted for entity-specific factors;
- the effects of obsolescence, demand, competition or other economic factors; and
- the level of maintenance expenditure required to obtain the expected future cash flows from the asset. [350-30-35-3]

These factors are broadly consistent with the requirements of IFRS Accounting Standards.

An entity reviews the classification each reporting period to decide whether the assessment made about the useful life of an intangible asset as indefinite or finite is still appropriate; this is more frequent than IFRS Accounting Standards for an entity preparing interim reports. If there is a change in the assessment of the useful life of an intangible asset from indefinite to finite or vice versa, then that change is accounted for prospectively as a change in accounting estimate, like IFRS Accounting Standards (see chapter 2.8). [350-30-35-9 – 35-10, 35-13, 35-16 – 35-17]

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The method of amortisation, which is reviewed at each annual reporting date, reflects the pattern of consumption of the economic benefits. If the pattern in which the asset's economic benefits are consumed cannot be determined reliably, then the straight-line method is used. [IAS 38.97, 104]

An entity is permitted to use a revenue-based method of amortisation only when:
- it can demonstrate that revenue and the consumption of the economic benefits of the intangible asset are 'highly correlated'; or
- the intangible asset is expressed as a measure of revenue. [IAS 38.98A, 98C]

The 'highly correlated' test is a high threshold to be met before applying such an approach. In our view, an entity cannot simply assume that the consumption of economic benefits is based on revenue; it should be able to demonstrate the high correlation.

A change in the method of amortisation is accounted for prospectively as a change in accounting estimate (see chapter 2.8). There is no explicit requirement for the change in estimate to be justified by its preferability in the same way as a voluntary change in accounting policy. [IAS 38.104]

The amortisation of intangible assets with finite lives begins when the intangible asset is available for use – i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management – which may be before the asset is brought into use. [IAS 38.97]

Amortisation ceases at the earlier of the date when the asset is classified as held-for-sale (see chapter 5.4) or is derecognised. [IAS 38.97]

Subsequent expenditure

Subsequent expenditure to add to, replace part of or service an intangible asset is recognised as part of the cost of the intangible asset if an entity can demonstrate that the items meet:
- the definition of an intangible asset (see above); and
- the general recognition criteria for intangible assets (see above). [IAS 38.18]

Unlike IFRS Accounting Standards, there is no requirement to review the method of amortisation at each annual reporting date; rather, it is reviewed whenever events or changes in circumstances indicate that the current estimate is no longer appropriate. Like IFRS Accounting Standards, the method of amortisation reflects the pattern of consumption of the economic benefits. Like IFRS Accounting Standards, if that pattern cannot be determined reliably, then the straight-line method is used. [350-30-35-6, 35-9]

Unlike IFRS Accounting Standards, US GAAP does not place explicit restrictions on a revenue-based method of amortisation; however, in practice, such an approach is generally not appropriate because it would not reflect the pattern of consumption of the economic benefits. As an exception, for software developed with an intent to sell or license, amortisation on the basis of revenues is used such that the annual amortisation charge is the greater of the amounts determined on the following bases:
- the ratio that current gross revenue for a product bears to the total current and anticipated future gross revenues for that product; and
- straight-line amortisation over the remaining estimated economic life of the product, including the current period. [350-30-35-6, 985-20-35-1]

Like IFRS Accounting Standards, a change in the method of amortisation is accounted for prospectively as a change in accounting estimate. However, unlike IFRS Accounting Standards, there is an explicit requirement that the change be justified by its 'preferability' (see chapter 2.8). [250-10-45-18]

Like IFRS Accounting Standards, the amortisation of intangible assets with finite lives begins when the intangible asset is available for use, which may be before the asset is brought into use. [350-30-35-2]

Like IFRS Accounting Standards, amortisation ceases at the earlier of the date when the asset is classified as held-for-sale (see chapter 5.4) or is derecognised. [350-30-35-6, 35-9]

Subsequent expenditure

Under US GAAP, expenditure that is incurred subsequent to the completion or acquisition of an intangible asset is not capitalised unless it can be demonstrated that the expenditure increases the utility of the asset. Although this wording differs from IFRS Accounting Standards, we would not generally expect significant differences in practice. [350-30-25-1 – 25-3, TQA 2260.03]

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The general recognition criteria for internally generated intangible assets are applied to subsequent expenditure on in-process R&D projects acquired separately or in a business combination. Therefore, capitalisation after initial recognition is limited to development costs that meet the recognition criteria (see above). [IAS 38.42, 54–62]

Revaluations

Intangible assets may be revalued to fair value only when there is an active market, which requires a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis (see chapter 2.4). [IAS 38.75]

If an intangible asset is revalued, then fair value is measured in accordance with the fair value measurement standard (see chapter 2.4).

If an intangible asset is revalued, then all intangible assets in that class are revalued to the extent that there is an active market for such assets, and the revaluations are kept up to date. [IAS 38.72]

Most of the issues related to the accounting for revaluations of intangible assets are similar to those in respect of property, plant and equipment (see chapter 3.2). [IAS 8.16–17, 38.80, 87]

Retirements and disposals

When an operation to which goodwill relates is disposed of, goodwill allocated to that operation via CGUs is included in calculating the gain or loss on disposal. [IAS 36.86]

The amount of goodwill included in the carrying amount of the operation being disposed of is based on the relative values of the operation to be disposed of and the portion of the CGU that will be retained, unless the entity can demonstrate that another allocation method is preferable. [IAS 36.86]

Unlike IFRS Accounting Standards, subsequent in-process R&D expenditure is generally expensed as incurred unless it qualifies for capitalisation under transaction-specific guidance such as for internal-use software (see above). [350-40-35-1, 35-9]

Revaluations

Unlike IFRS Accounting Standards, entities are not permitted to use the revaluation model under US GAAP. [ARB 43.9B.1]

Retirements and disposals

Like IFRS Accounting Standards, when a portion of a reporting unit is disposed of, goodwill of that reporting unit is included in the carrying amount of the portion of the reporting unit in calculating the gain or loss on disposal. However, unlike IFRS Accounting Standards, this requirement applies only if the reporting unit meets the definition of a business (see chapter 2.6), and differences may arise between a reporting unit and a CGU under IFRS Accounting Standards (see chapter 3.10). [350-20-40-1 – 40-2]

Unlike IFRS Accounting Standards, the amount of goodwill included in the carrying amount of the operation being disposed of is based on the relative fair values of the business to be disposed of and the portion of the reporting unit that will be retained; an exception arises only if a prior acquisition has not yet been integrated into the reporting unit, unlike IFRS Accounting Standards. If the operation being disposed of does not constitute a business, then goodwill is not included in the carrying amount of the operation being disposed of, unlike IFRS Accounting Standards. Additionally, differences may arise because of a difference between a reporting unit under US GAAP and a CGU under IFRS Accounting Standards (see chapter 3.10). [350-20-40-1 – 40-7]

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When an intangible asset is disposed of or when no further economic benefits are expected from its use, it is derecognised. If an intangible asset is disposed of as part of a sale-and-leaseback transaction, then the requirements in the leases standard apply (see chapter 5.1).

The gain or loss on derecognition is the difference between:
- any net proceeds received, which are based on the transaction price determined under the revenue standard (see chapter 4.2); and
- the carrying amount of the asset. [IAS 38.113, 116]

Any attributable revaluation surplus may be transferred to retained earnings, but is not recognised in profit or loss. [IAS 38.87]

If an entity recognises the cost of replacing part of an intangible asset, then it derecognises the carrying amount of the replaced part. [IAS 38.115]

Amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully amortised or is classified as held-for-sale (see chapter 5.4). [IAS 38.117]

Forthcoming requirements

There are no forthcoming requirements under IFRS Accounting Standards.

There is no specific guidance in IFRS Accounting Standards on the development of internal-use software. The costs of such software are accounted for under the general principles for internally generated intangible assets. [IAS 38.57]

Like IFRS Accounting Standards, when an intangible asset is disposed of or when no further economic benefits are expected from its use, it is derecognised. Unlike IFRS Accounting Standards, intangible assets are not in the scope of the leases Codification Topic.

Like IFRS Accounting Standards, when an intangible asset is derecognised, a gain or loss is recognised. The gain or loss is determined as the difference between:
- the consideration received, which is the transaction price determined under the revenue Codification Topic (see chapter 4.2); and
- the carrying amount of the asset. [350-10-40-1, 610-20-32-2]

Unlike IFRS Accounting Standards, the revaluation model is not permitted and therefore no revaluation surplus exists.

Unlike IFRS Accounting Standards, component accounting is not required under US GAAP; therefore, it is possible for a replacement part to be capitalised without derecognising the part replaced, so differences from IFRS Accounting Standards may arise in practice.

Like IFRS Accounting Standards, amortisation of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully amortised or is classified as held-for-sale (see chapter 5.4). [350-30-35-10]

Forthcoming requirements

Amendments to the intangibles Codification Topic related to internal-use software are effective for annual periods beginning after 15 December 2027; early adoption is permitted (see appendix).

Unlike IFRS Accounting Standards, there is specific guidance on the development of internal-use software. The amendments are intended to modernise that guidance – adapting it to the agile (i.e. iterative and flexible) basis used to develop software – and will change the cost capitalisation threshold by:
- eliminating the accounting consideration of software project development stages; cost capitalisation would begin when (1) management has authorised and committed to funding the project and (2) it is 'probable' the project will be completed and the software used to perform its intended function (the 'probable-to-complete' threshold); and
- enhancing the guidance around the 'probable-to-complete' threshold and providing new examples to illustrate its application.

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3.4 Investment property

(IAS 40)

Overview

- 'Investment property' is property (land or building) held by the owner or lessee to earn rental income or for capital appreciation, or both.
- A portion of a dual-use property is classified as investment property only if the portion could be sold or leased out under a finance lease. Otherwise, the entire property is classified as investment property only if the portion of the property held for own use is insignificant.
- If a lessor provides ancillary services, and such services are a relatively insignificant component of the arrangement as a whole, then the property is classified as investment property.
- Investment property is initially measured at cost.
- Subsequent to initial recognition, all investment property is measured under either the fair value model (subject to limited exceptions) or the cost model. If the fair value model is chosen, then changes in fair value are recognised in profit or loss.
- Disclosure of the fair value of all investment property is required, regardless of the measurement model used.
- Subsequent expenditure is capitalised only if it is probable that it will give rise to future economic benefits.
- Transfers to or from investment property can be made only when there has been a change in the use of the property.

3.4 Investment property

(Topic 360)

Overview

- Unlike IFRS Accounting Standards, there is no specific definition of 'investment property'; such property is accounted for as property, plant and equipment unless it meets the criteria to be classified as held-for-sale.
- Unlike IFRS Accounting Standards, there is no guidance on how to classify dual-use property. Instead, the entire property is accounted for as property, plant and equipment.
- Unlike IFRS Accounting Standards, ancillary services provided by a lessor do not affect the treatment of a property as property, plant and equipment.
- Like IFRS Accounting Standards, investment property is initially measured at cost as property, plant and equipment.
- Unlike IFRS Accounting Standards, subsequent to initial recognition all investment property is measured using the cost model as property, plant and equipment.
- Unlike IFRS Accounting Standards, there is no requirement to disclose the fair value of investment property.
- Similar to IFRS Accounting Standards, subsequent expenditure is generally capitalised if it is probable that it will give rise to future economic benefits.
- Unlike IFRS Accounting Standards, investment property is accounted for as property, plant and equipment, and there are no transfers to or from an 'investment property' category.

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Definition and classification

The investment property standard is not a specialised industry standard. Therefore, determining whether a property is an investment property depends on the use of the property rather than the type of entity that holds the property. 'Investment property' is property that is held to earn rental income or for capital appreciation, or both, rather than for:

- use in the production or supply of goods or services or for administrative purposes; or
- sale in the ordinary course of business. [IAS 40.2, 5]

In determining the classification of a property in consolidated financial statements, the definition is assessed from the point of view of the group as a single reporting entity. [IAS 40.15]

A lessee applies the investment property standard to account for a right-of-use asset if the underlying asset would otherwise meet the definition of investment property. [IAS 40.2, 5, IFRS 16.48, 56]

Property often has dual purposes whereby part of the property is used for an entity's own activities and part of the property is held for earning rentals or for capital appreciation. A portion of a dual-use property is classified as an investment property only if the portion could be sold or leased out separately under a finance lease. If this is not the case, then the entire property is classified as investment property only if the portion of the property held for own use is 'insignificant'. [IAS 40.10]

If an owner or lessee provides ancillary services to tenants, then determining whether the property is investment property is based on whether the services provided are a 'relatively insignificant component of the arrangement as a whole'. Judgement is required in assessing whether the definition of investment property is met and requires an entity to develop criteria that are consistently applied in making that assessment. [IAS 40.11–14]

Definition and classification

Unlike IFRS Accounting Standards, there is no specific guidance under US GAAP on accounting for investment property. Real estate (property) that meets the IFRS Accounting Standards definition of investment property is accounted for as:

- property, plant and equipment if it is to be held and used (see chapter 3.2); or
- held-for-sale if the criteria are met (see chapter 5.4).

Special requirements exist for investment companies, which are outside the scope of this publication except in relation to consolidation (see chapter 5.6). Investments in real estate held by entities that follow specialised industry accounting practices for investment companies are measured at FVTPL.

The discussion that follows assumes that the property is accounted for as property, plant and equipment.

Unlike IFRS Accounting Standards, there is no guidance on the classification of investment property from an entity vs a group point of view. However, this is less relevant because the property is accounted for as property, plant and equipment (see chapter 3.2).

Unlike IFRS Accounting Standards, a lessee accounts for a right-of-use asset as property, plant and equipment (see chapter 5.1).

Unlike IFRS Accounting Standards, because there is no concept of investment property, the whole property is accounted for as property, plant and equipment.

Unlike IFRS Accounting Standards, an analysis of ancillary services is not relevant to the identification of investment property because such property is accounted for as property, plant and equipment. However, the owner of a property that provides ancillary services would identify the nature of the services and determine whether they should be accounted for separately (see chapter 4.2).

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Property under development or construction for future use as investment property is accounted for under the requirements of the investment property standard, using the measurement model elected for investment property. [IAS 40.8(e), 65]

If land is held for an undetermined future use, then it is classified as investment property because it is considered to be held for capital appreciation. [IAS 40.8(b)]

Initial measurement

An owned investment property is initially measured at cost unless it is:

- transferred from another category in the statement of financial position (see below);
- received as a government grant (see chapter 4.3);
- acquired in a share-based payment arrangement granted by the acquiring entity (see chapter 4.5); or
- acquired in a business combination (see chapter 2.6). [IAS 40.14A, 20]

The cost of owned investment property includes the directly attributable expenditure of preparing the asset for its intended use. The principles discussed in respect of property, plant and equipment (see chapter 3.2) apply equally to the initial recognition of investment property. [IAS 40.20–23]

An investment property held by a lessee as a right-of-use-asset is measured initially at cost in accordance with the leases standard (see chapter 5.1). [IAS 40.29A, IFRS 16.23–25]

Subsequent measurement

Subsequent to initial recognition, an entity chooses an accounting policy, to be applied consistently, to either:

- measure all investment property using the fair value model, subject to limited exceptions; or
- measure all investment property using the cost model. [IAS 40.30, 32A]

Unlike IFRS Accounting Standards, all investment property is accounted for as property, plant and equipment (see chapter 3.2), regardless of the stage of completion.

Unlike IFRS Accounting Standards, all investment property is accounted for as property, plant and equipment (see chapter 3.2), regardless of whether it is held for an undetermined future use.

Initial measurement

Like IFRS Accounting Standards, investment property is initially measured at cost. Unlike IFRS Accounting Standards, the treatment of transfers to or from the investment property category is not relevant. [360-10-30-1]

Like IFRS Accounting Standards, the cost of investment property includes the directly attributable expenditure of preparing the asset for its intended use. Because investment property is accounted for as property, plant and equipment under US GAAP, the principles discussed in respect of attributing cost to property, plant and equipment also apply to the cost of investment property; however, the determination of cost differs in certain respects from IFRS Accounting Standards (see chapter 3.2). [360-10-30-1 – 30-2]

Like IFRS Accounting Standards, property held by a lessee as a right-of-use-asset is measured initially at cost in accordance with the leases Codification Topic (see chapter 5.1).

Subsequent measurement

Unlike IFRS Accounting Standards, investment property is accounted for using the principles for property, plant and equipment. Accordingly, all investment property is measured using the cost model.

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The investment property standard implies a preference for measuring investment property at fair value, noting that it would be very difficult to justify a voluntary change in accounting policy from the fair value model to the cost model (see chapter 2.8). In our view, a change in accounting policy from the fair value model to the cost model attributed solely to changes in market conditions is not justifiable. [IAS 40.31]

Disclosure of the fair value of investment property is required regardless of the basis of measurement. [IAS 40.79(e)]

Fair value model

If an entity chooses to measure investment property using the fair value model, then it measures the property at fair value at each reporting date, with changes in fair value recognised in profit or loss. [IAS 40.33–35]

If a lessee uses the fair value model to measure an investment property that is held as a right-of-use asset, then it measures the right-of-use asset and not the underlying property at fair value. [IAS 40.40A, IFRS 16.34]

In exceptional cases, there will be clear evidence on initial recognition of a particular investment property that its fair value cannot be measured reliably on a continuing basis. In such cases, the property in question is measured using the cost model, except that the residual value is deemed to be zero in all cases. [IAS 40.53]

However, if the fair value of an investment property under construction cannot be determined reliably but the entity expects the fair value of the completed property to be reliably measurable, then the investment property under construction is accounted for using the cost model until the earlier of the date that the fair value of the property can be measured reliably and the date that the construction is completed. [IAS 40.53–53B]

Cost model

If an entity chooses to measure owned investment property using the cost model, then it accounts for the property using the cost model for property, plant and equipment – i.e. at cost less accumulated depreciation (see chapter 3.2) and less any accumulated impairment losses (see chapter 3.10). However, the property continues to be classified as investment property in the statement of financial position. [IAS 40.56]

Unlike IFRS Accounting Standards, there is no requirement to disclose the fair value of investment property.

Fair value model

Unlike IFRS Accounting Standards, entities are not permitted to measure property, plant and equipment at fair value under US GAAP. [ARB 43.9B.1]

Cost model

Unlike IFRS Accounting Standards, a cost model is used for all investment property. Like IFRS Accounting Standards, the cost model used is the one used for other property, plant and equipment, with assets measured at cost less accumulated depreciation (see chapter 3.2) and less any accumulated impairment losses (see chapter 3.10). However, there are certain differences in the application of the cost model and impairment testing, and therefore differences from IFRS Accounting Standards may arise in practice. [360-10-35-20]

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An entity that chooses the cost model for subsequent measurement accounts for an investment property that is held as a right-of-use asset in accordance with the leases standard (see chapter 5.1), unless it is held for sale. [IAS 40.56(b), IFRS 16.30–33]

Subsequent expenditure

Expenditure incurred subsequent to the completion or acquisition of an investment property is capitalised only if it meets the general asset recognition criteria – i.e. it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably. Parts of investment property acquired through replacement are capitalised and included in the carrying amount of the property if the general asset recognition criteria are met; the carrying amount of the part replaced is derecognised. Expenditure related to the day-to-day servicing of the property is expensed as it is incurred. [IAS 40.16–19]

Transfers to or from investment property

Timing of transfers

Although an entity's business model plays a key role in the initial classification of property, the subsequent reclassification of property is based on an actual change in use rather than on changes in an entity's intentions. [IAS 40.57–58]

To reclassify inventories to investment property, the change in use is generally evidenced by the inception of an operating lease to another party. [IAS 40.57(d)]

In some cases, a property (or a part of a property) classified as inventory (see chapter 3.8) is leased out temporarily while the entity searches for a buyer. In our view, the inception of such an operating lease, by itself, does not require the entity to transfer the property to investment property provided that the property continues to be held for sale in the ordinary course of business.

Subsequent expenditure

Like IFRS Accounting Standards, expenditure incurred subsequent to the completion or acquisition of an investment property is generally capitalised if it meets the general asset recognition criteria – i.e. it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably. However, because US GAAP does not include a requirement for component depreciation of property, plant and equipment and permits the costs of planned major maintenance to be expensed as they are incurred, parts of investment property acquired through replacement may not necessarily be capitalised and included in the carrying amount of the property if the general asset recognition criteria are met. In addition, if they are, the carrying amount of the part replaced is not necessarily derecognised, unlike IFRS Accounting Standards (see chapter 3.2). Expenditure related to the day-to-day servicing of the property is expensed as it is incurred, like IFRS Accounting Standards. [970-340-25-17]

Transfers to or from investment property

Timing of transfers

Unlike IFRS Accounting Standards, investment property is accounted for as property, plant and equipment, and therefore there are no transfers to or from the 'investment property' category. However, property, including investment property, is transferred between the held-and-used and the held-for-sale classifications under US GAAP when the relevant criteria are met (see chapter 5.4). [360-10-45-6, 45-10]

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An entity may no longer have the intention or the ability to develop property classified as inventory for sale in the ordinary course of business as originally planned due to fluctuations in property and capital markets. Depending on the facts and circumstances, it may be appropriate to reclassify a property originally classified as inventory to investment property if there is a change in the business model of the entity that evidences a change in the use of the property.

A reclassification of an investment property to inventory, property, plant and equipment or right-of-use asset is performed only if an entity's use of the property has changed. For example, the commencement of construction for sale or own use would usually mean that the property is no longer available for rent to third parties. Therefore, a change in use occurs on commencement of redevelopment and reclassification is appropriate at that point. [IAS 40.57, BC26]

Measurement of transfers

If an entity chooses to measure investment property using the cost model, then transfers to and from investment property do not alter the carrying amount of the property. Revaluations recognised for owner-occupied property measured at fair value (see chapter 3.2) are not reversed when the property is transferred to investment property. [IAS 40.59]

If an entity chooses to measure investment property using the fair value model, then investment property transferred from another category in the statement of financial position is recognised at fair value on transfer. The treatment of the gain or loss on revaluation at the date of transfer depends on whether the property was previously held for own use. [IAS 40.61–65]

If the property was previously held for own use, then it is accounted for as property, plant and equipment if it is owned, and as a right-of-use asset if it is held by a lessee, up to the date of the change in use. Any difference at the date of the change in use between the carrying amount of the property and its fair value is recognised as a revaluation in accordance with the property, plant and equipment standard (see chapter 3.2). [IAS 40.61]

If the property is inventory that is being transferred to investment property, then the gain or loss on revaluation, based on the asset's carrying amount at the date of transfer, is recognised in profit or loss. [IAS 40.63–64]

Measurement of transfers

Unlike IFRS Accounting Standards, the issue of the measurement of transfers to and from the investment property category is not applicable because investment property is accounted for under the general principles for property, plant and equipment. Transfers between the held-and-used and the held-for-sale classifications are accounted for under the guidance for assets held for sale (see chapter 5.4).

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When a property is transferred from investment property measured at fair value (whether to own-use properties or to inventories), the transfer is accounted for at fair value. The fair value at the date of transfer is then deemed to be the property's cost for subsequent accounting. Any difference between the carrying amount of the property before transfer and its fair value on the date of transfer is recognised in profit or loss in the same way as any other change in the fair value of investment property. [IAS 40.60]

Redevelopment

When an entity redevelops an existing investment property, the property is not transferred out of investment property during redevelopment. This means that an investment property undergoing redevelopment continues to be measured under the cost model or at fair value (depending on the entity's accounting policy). [IAS 40.58]

Disposals

Unless the transaction is a sale and leaseback (see chapter 5.1), the gain or loss on the disposal of investment property that is sold is recognised for the difference between:

- the net disposal proceeds, which is the transaction price determined under the revenue standard (see chapter 4.2) less, in our view, all directly attributable incremental costs of disposal; and
- the carrying amount of the property. [IAS 40.69-70]

The date of disposal of an investment property is the date on which the recipient obtains control of the asset under the guidance in the revenue standard on the satisfaction of performance obligations under contracts with customers (see chapter 4.2). [IAS 40.67]

Redevelopment

Unlike IFRS Accounting Standards, the issue of the redevelopment of investment property is not applicable because investment property is accounted for under the general principles for property, plant and equipment (see chapter 3.2).

Disposals

Unless the transaction is a sale-leaseback (see chapter 5.1), like IFRS Accounting Standards, when an investment property is sold, a gain or loss is recognised. The gain or loss is determined as the difference between:

- the consideration received, which is the transaction price determined under the revenue Codification Topic (see chapter 4.2); and
- the carrying amount of the property. [360-10-40-3A, 40-5, 610-20-32-2]

Like IFRS Accounting Standards, the date of disposal of a non-financial asset is the date on which the recipient obtains control of the asset under the guidance in the revenue Codification Topic (see chapter 4.2). Additionally, the requirements apply to the transfer of an entity that is an in-substance non-financial asset, unlike IFRS Accounting Standards. [610-20-25-1, 25-5, 32-3, 32-6]

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3.5 Associates and the equity method

(IAS 28)

Overview

- The definition of an associate is based on 'significant influence', which is the power to participate in the financial and operating policies of an entity, but is not control or joint control of those policies.
- There is a rebuttable presumption of significant influence if an entity holds 20 percent or more of the voting rights of another entity in which it does not have control.
- In determining applicability of the equity method, there are no special requirements for partnerships and similar entities.
- Potential voting rights that are currently exercisable are considered in assessing significant influence.
- Venture capital organisations, mutual funds, unit trusts and similar entities may elect to account for investments in associates and joint ventures at fair value, on an investment-by-investment basis. In addition, investment entities measure their investments in associates and joint ventures at fair value.
- Other associates and joint ventures are accounted for under the equity method (equity-accounted investees).
- Equity accounting is not applied to investees that are classified as held-for-sale.

3.5 Equity-method investees

(Subtopic 272-10, Topic 323, Subtopic 610-20, Topic 808, Topic 970)

Overview

- Like IFRS Accounting Standards, 'significant influence' is the ability to significantly influence the operating and financial policies of an investee, but is not control over the investee. The term 'equity-method investee' is used to describe what would be an associate under IFRS Accounting Standards.
- Like IFRS Accounting Standards, there is a rebuttable presumption of significant influence if an entity holds 20 percent or more of the voting rights of another corporate entity in which it does not have a controlling financial interest.
- Unlike IFRS Accounting Standards, for partnerships and similar entities the equity method is applicable unless the investor has virtually no influence over the investee's operating and financial policies.
- Unlike IFRS Accounting Standards, potential voting rights are not considered in assessing significant influence.
- Unlike IFRS Accounting Standards, an entity may elect to account for equity-method investees at fair value regardless of whether it is a venture capital or similar organisation. Additionally, investment companies generally account for investments at fair value, like IFRS Accounting Standards, and as a result generally do not apply equity-method accounting (see chapter 5.6).
- Like IFRS Accounting Standards, corporate joint ventures are accounted for under the equity method. However, certain aspects of the application of the equity method differ from IFRS Accounting Standards.
- Unlike IFRS Accounting Standards, equity accounting continues to be applied to equity-method investees that meet the criteria to be classified as held-for-sale.

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Overview (continued)

- In applying the equity method, an investee's accounting policies should be consistent with those of the investor.
- The annual reporting date of an equity-accounted investee may not differ from the investor's by more than three months, and should be consistent from period to period. Adjustments are made for the effects of significant events and transactions between the two dates.
- When an equity-accounted investee incurs losses, the carrying amount of the investor's interest is reduced but not to below zero. Further losses are recognised by the investor only to the extent that the investor has an obligation to fund losses or has made payments on behalf of the investee.
- An investor applies the financial instruments standard to long-term interests in an associate or joint venture that are not accounted for under the equity method. The investor does so before applying the loss absorption and impairment requirements of the investments in associates and joint ventures standard.
- Unrealised profits or losses on transactions with equity-accounted investees are eliminated to the extent of the investor's interest in the investee.
- In our view, if an entity sells or contributes a controlling interest in a subsidiary in exchange for an interest in an equity-accounted investee, then the entity may choose either to recognise the gain or loss in full or to eliminate the gain or loss to the extent of the investor's retained interest in the former subsidiary.

Overview (continued)

- Unlike IFRS Accounting Standards, in applying the equity method, an investee's accounting policies generally need not be consistent with those of the investor.
- Like IFRS Accounting Standards, the annual reporting date of an equity-method investee may not differ from the investor's by more than three months. However, unlike IFRS Accounting Standards, adjustments are not generally made for the effects of significant events and transactions between the two dates; instead, disclosure is provided.
- Like IFRS Accounting Standards, when an equity-method investee incurs losses, the carrying amount of the investor's interest is reduced but not to below zero. Like IFRS Accounting Standards, further losses are generally recognised by the investor only to the extent that the investor has an obligation to fund losses. However, unlike IFRS Accounting Standards, further losses are also recognised if the investee is expected to return to profitability imminently, or if a subsequent further investment in the investee is in substance the funding of such losses.
- Like IFRS Accounting Standards, an investor applies the financial instruments Codification Topics to long-term interests in an associate or joint venture that are not accounted for under the equity method. Unlike IFRS Accounting Standards, the investor does so after applying the loss absorption and impairment requirements for equity-method investees.
- Unrealised profits or losses on asset sale transactions with equity-method investees are generally eliminated to the extent of the investor's interest in the investee, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, the full gain or loss is recognised if the transaction is the transfer of a business or certain non-financial or in-substance non-financial assets.
- Unlike IFRS Accounting Standards, if an entity contributes non-financial and in-substance non-financial assets in exchange for an interest in an equity-method investee, then the entity generally recognises any gain or loss in full.

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Overview (continued)

- **The carrying amount of an equity-accounted investee is written down if it is impaired.**
- **On the loss of significant influence or joint control, the fair value of any retained investment is taken into account to calculate the gain or loss on the transaction, as if the investment were fully disposed of; this gain or loss is recognised in profit or loss. Amounts recognised in OCI are reclassified to profit or loss or remain within equity as required by other accounting standards.**
- **When an investment becomes an equity-accounted investee, in our view the investor may either remeasure the previously held interest to FVTPL, or add the newly incurred additional cost to the cost of the previously held investment.**
- **In our view, an increase in holding should be accounted for under an 'allocation' approach, whereby only the incremental investment is measured at fair value.**
- **In our view, a decrease in holding (while continuing to apply equity accounting) results in the recognition of a gain or loss in profit or loss. In our view, the retained interest should not be remeasured.**

Associates

An 'associate' is an entity over which an investor has significant influence. 'Significant influence' is the power to participate in the financial and operating policy decisions of the investee, but is not control over the investee (see chapter 2.5). The assessment of 'significant influence' focuses on the *ability* to exercise significant influence and not whether it is actually exercised. [IAS 28.3]

Overview (continued)

- **Unlike IFRS Accounting Standards, the carrying amount of an equity-method investee is written down only if there is an impairment of the carrying amount that is considered to be 'other than temporary'.**
- **Unlike IFRS Accounting Standards, when equity accounting ceases and the investee becomes an investment, the investor remeasures the retained investment either at fair value or using the measurement alternative (see chapter 7.7).**
- **Unlike IFRS Accounting Standards, there is specific guidance on the accounting when an investment becomes an equity-method investee. The current basis of the investor's previously held interest in the investee is remeasured either at fair value or using the measurement alternative (see chapter 7.7).**
- **An increase in holding is accounted for under the 'step-by-step' method, whereby the existing equity-method interest remains at its existing carrying amount, like IFRS Accounting Standards.**
- **A decrease in holding (while continuing to apply equity accounting) results in the recognition of a gain or loss in profit or loss, like IFRS Accounting Standards. The retained interest is not remeasured, like IFRS Accounting Standards.**

Equity-method investees

Like IFRS Accounting Standards, for a corporate investee, an equity-method investee is an entity over whose operating and financial policies the investor has significant influence, but not control. Unlike IFRS Accounting Standards, for a partnership or similar investee, an equity-method investee is an entity over which the investor has more than virtually no influence over its operating and financial policies. [323-10-15-6, 323-30-25-1, S99-1]

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Significant influence is presumed to exist when an investor holds 20 percent or more of the voting rights of another entity in which it does not have control. Conversely, it is presumed that significant influence does not exist with a holding of less than 20 percent. These presumptions may be overcome in circumstances in which an ability, or lack of ability, to exercise significant influence can be demonstrated clearly. [IAS 28.5]

In determining whether an entity has significant influence over another entity, the focus is on the *ability* to exercise significant influence. It does not matter whether significant influence actually is exercised. IFRS Accounting Standards do not include specific guidance on assessing significant influence when the investor attempts to exercise significant influence, but is unable to do so effectively; instead, the general principles apply. [IAS 28.6–8]

In assessing whether voting rights give rise to significant influence, it is necessary to consider both direct holdings and holdings of the investor's subsidiaries (see chapter 2.5). In our view, holdings of the investor's joint ventures and other associates should not be included in this evaluation. [IAS 28.5]

In assessing significant influence, the impact of potential voting rights that are currently exercisable are considered. All potential voting rights are taken into account, whether they are held by the entity or by other parties. Such potential voting rights may take many forms, including call options, warrants, debt or equity instruments that are convertible into ordinary shares, and other similar instruments that have the potential, if they are exercised or converted, to give the holder voting power. Only those rights that either would give the entity voting power or that would reduce another party's voting rights are considered. Management's intentions with respect to the exercise of potential voting rights are ignored in assessing significant influence. The exercise price of potential voting rights, and the financial capability of the holder to exercise them, are also ignored. [IAS 28.7–8]

Like IFRS Accounting Standards, an investor owning 20 percent or more of the voting rights of a corporate investee in which it does not have a controlling financial interest is presumed to have the ability to exercise significant influence over that investee, and an investment of less than 20 percent is presumed not to give the ability to exercise significant influence. Like IFRS Accounting Standards, these presumptions may be overcome in circumstances in which an ability, or lack of ability, to exercise significant influence can be demonstrated clearly. Unlike IFRS Accounting Standards, for partnerships and similar entities, virtually no influence over the operating and financial policies is generally deemed to exist for an investment of less than 3 to 5 percent. [323-10-15-8 – 15-11, 323-30-S99-1]

Like IFRS Accounting Standards, in determining whether an entity has significant influence over another entity, the focus is on the *ability* to exercise significant influence, and it does not matter whether significant influence actually is exercised. However, unlike IFRS Accounting Standards, US GAAP includes specific guidance that if the investor attempts to exercise influence, but is unable to do so effectively, then that may indicate that the investor does not have the ability to exercise significant influence. [323-10-15-10]

Like IFRS Accounting Standards, when assessing whether voting rights give rise to significant influence, it is necessary to consider both direct holdings and holdings of the investor's subsidiaries (see chapter 2.5). Holdings of the investor's equity-method investees are not included in this evaluation, like IFRS Accounting Standards. [323-10-15-8]

Unlike IFRS Accounting Standards, potential voting rights are not considered in assessing significant influence. [323-10-15-9]

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IFRS Accounting Standards do not contain specific guidance on interests in an investee that are not equity instruments but are similar in substance to equity instruments.

There is no specific guidance on assessing significant influence in a partnership or similar entities; the above general principles apply. If an investor obtains significant influence through means other than ordinary shares, then it may not be appropriate to apply the equity method. To determine the appropriate accounting, an entity considers whether an instrument that gives rise to significant influence provides access to the returns associated with the underlying ownership interest.

Venture capital organisations

The investments in associates and joint ventures standard contains an optional exemption from the requirement to apply equity accounting for such investments held by, or indirectly held through, an entity that is a venture capital organisation, mutual fund, unit trust or similar entity, including investment-linked insurance funds. Such entities may elect to measure investments in those investees at FVTPL in accordance with the financial instruments standard (see chapters 7.4–7.8). This election is available on an investment-by-investment basis on initial recognition of the associate or joint venture. [IAS 28.18]

In assessing whether an investor's interest in an investee gives rise to significant influence, the rights conveyed by interests considered to be 'in-substance common stock' are also considered, along with investments in other securities of the investee (e.g. preferred shares, options, warrants and convertible bonds), some of which may be considered potential voting rights under IFRS Accounting Standards. An interest is in-substance common stock if the interest is substantially similar to an investment in the investee's common shares. Characteristics common to in-substance common stock are subordination and risks and rewards substantially similar to an investment in common shares. An investment interest is not considered in-substance common stock if the investee is expected to transfer substantive value to the investor and the common shareholders do not participate in a similar manner. If the investor has significant influence, then the equity method is applied based on both the interest in common shares and the in-substance common stock. Generally, we would not generally expect significant differences in practice. [323-10-15-13]

Unlike IFRS Accounting Standards, non-controlling general partners, limited partnership interests and investors in limited liability companies (LLCs) that maintain specific ownership accounts similar to a partnership capital structure apply the equity method unless their investment gives them virtually no influence over the operating and financial policies of the investee. An investor is presumed to have more than virtually no influence when its ownership threshold is 3 to 5 percent or higher. [323-30-S99-1]

Investment companies and the fair value option

As discussed below, investment companies are generally precluded from applying the equity method of accounting, unlike IFRS Accounting Standards, which contain an optional exemption. [323-10-15-4(d), 946-323-45-1 – 45-2]

Entities that are not investment companies are permitted to elect fair value measurement for an investment that would otherwise be accounted for under the equity method, like IFRS Accounting Standards. Like IFRS Accounting Standards, the election is made on a contract-by-contract basis. However, unlike IFRS Accounting Standards, if the fair value option is applied to an investment that would otherwise be accounted for under the equity method of accounting, then it is applied to all of the investor's financial interests in the same entity (equity and debt, including guarantees) that are eligible items. [825-10-25-7(b)]

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A venture capital or similar organisation that qualifies as an investment entity for the purpose of applying the exception from consolidation measures its investments in associates and joint ventures at FVTPL (see chapter 5.6). [IFRS 10.B85L(b)]

The equity method

The discussion in this section applies to associates and joint ventures (see chapter 3.6) accounted for under the equity method (together, 'equity-accounted investees').

An investment is accounted for under the equity method from the date on which it becomes an associate or joint venture. [IAS 28.32]

Under the equity method:

- the investment is stated as one line item at cost plus the investor's share of post-acquisition retained profits and other changes in net assets;
- cost includes the goodwill arising on the acquisition;
- the investor's share of the post-tax profit or loss of the associate, adjusted for the effects of fair value adjustments recognised on initial recognition, is presented as a single line item in profit or loss;
- the investor's share of OCI of the associate (e.g. foreign currency translation differences and changes in a cash flow hedging reserve) is recognised in OCI; and
- distributions received from the associate generally reduce the investment's carrying amount in the statement of financial position. [IAS 1.82, 28.3, 10]

Accounting periods and policies

The investee's financial statements used for the purpose of applying the equity method are drawn up for the same accounting period as that of the investor, unless this is impracticable. [IAS 28.33]

In general, investment companies are required to account for their investments at FVTPL, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, an exception arises if an operating company provides services to the investment company (see chapter 5.6). [946-323-45-1 – 45-2]

The equity method

The discussion in this section applies to all equity-method investees other than those measured at fair value under the fair value option (see above). [323-10-35-3, 15-5]

Like IFRS Accounting Standards, an investment in an equity-method investee is accounted for under the equity method from the date on which the investor obtains significant influence (more than virtually no influence in the case of partnerships and similar entities) over the operating and financial policies of the investee. [323-10-35-4, 35-33]

Like IFRS Accounting Standards, under the equity method:

- the investment is stated as one line item at cost plus the investor's share of post-acquisition retained profits and other changes in net assets;
- cost includes the goodwill arising on the acquisition;
- the investor's share of the post-tax profit or loss of the equity-method investee, adjusted for the effects of fair value adjustments recognised on initial recognition, is presented as a single line item in profit or loss;
- the investor's share of OCI of the equity-method investee (e.g. foreign currency translation differences and changes in the cash flow hedging component of accumulated OCI) is recognised in OCI; and
- distributions received from the equity-method investee generally reduce the investment's carrying amount in the statement of financial position. [323-10-35-4, 35-13, 35-17 – 35-18, 35-34, 45-1]

Accounting periods and policies

Unlike IFRS Accounting Standards, an equity-method investee's financial statements used for the purpose of applying the equity method may be drawn up for an accounting period that is different from that of the investor, if the investee's statements are not sufficiently timely; the lag in reporting needs to be consistent every year. [323-10-35-6]

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The difference between the annual reporting date and the date of the financial statements of an investee may not exceed three months, and should be consistent from period to period. If different reporting periods are used for the purpose of applying the equity method, then adjustments are made for the effects of any significant events or transactions that occur between the two reporting dates. [IAS 28.34]

For the purpose of applying the equity method, the financial information of the investee is prepared on the basis of IFRS Accounting Standards. The investor's accounting policies are applied. [IAS 28.35]

If a non-investment entity investor has an interest in an equity-accounted investee that is an investment entity (see chapter 5.6) and has subsidiaries, then it may retain the fair value accounting applied by its investment entity equity-accounted investee to the subsidiaries. This election is available on an investment-by-investment basis. [IAS 28.36A, BC46A–BC46G]

Instruments to which the equity method applies

If an investor holds one or more than one instrument issued by the investee over which it has significant influence or joint control, then it needs to determine which accounting standard applies to each instrument that is not an ordinary share, because some instruments (e.g. loans or trade receivables) may be in the scope of the financial instruments standard. If the determination is not straightforward (e.g. for preference shares), then in our view the investor should assess whether the instrument currently gives access to the returns associated with an underlying ownership interest consistent with the principle for evaluating instruments containing potential voting rights.

- If the instrument gives current access, then we believe that it should be accounted for under the equity method.
- If the instrument does not give current access, then we believe that it should be accounted for under the financial instruments standard.

Initial carrying amount of an associate

The initial carrying amount of an investment in an equity-accounted investee comprises the purchase price and other costs that are directly attributable to the acquisition of the investment. In our view, costs directly attributable to the acquisition of an investment in an equity-accounted investee do not normally include costs incurred after the acquisition is completed, except for the costs related to the acquisition of additional interests. [IU 07-09]

Like IFRS Accounting Standards, a difference between the annual reporting date of the investor and the investee (lag period) may not exceed three months, and should be consistent from period to period. However, unlike IFRS Accounting Standards, adjustments are not generally made for the effects of any significant events or transactions that occur between the two reporting dates, although disclosure is required. [323-10-35-6, 810-10-45-12]

For the purpose of applying the equity method, the financial information of the investee is prepared on the basis of US GAAP. However, unlike IFRS Accounting Standards, in applying the equity method, the investor generally does not conform the investee's accounting policies to its own except for entities with oil- and gas-producing activities. [TQA 2220-03]

If a non-investment company investor has an interest in an investee that is an investment company (see chapter 5.6) and has subsidiaries, then it retains the fair value accounting applied by its investment company investee and its subsidiaries. Unlike IFRS Accounting Standards, this is not an accounting policy choice. [323-946-15-1]

Instruments to which the equity method applies

Unlike IFRS Accounting Standards, US GAAP requires the equity method to be applied to both common stock and in-substance common stock. An investment constitutes in-substance common stock only if it has all of the following characteristics that are substantially similar to common stock:

- it is subordinated;
- it provides the investor with the risks and rewards of ownership; and
- its terms do not oblige the investee to transfer substantive value to the investor that is not available to common shareholders. [323-10-15-13]

Initial carrying amount of an equity-method investee

Like IFRS Accounting Standards, the initial carrying amount of an investment in an equity-method investee comprises the purchase price and other costs that are directly attributable to the acquisition of the investment. Costs directly attributable to the acquisition of an investment in an equity-method investee do not normally include costs incurred after the acquisition is completed, except for the costs related to the acquisition of additional interests. [323-10-30-2, 805-50-30-1]

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In our view, costs that are directly attributable to a probable future acquisition of an investment accounted for under the equity method should be recognised as a prepayment (asset) in the statement of financial position. The costs should be included in the initial carrying amount at the date of acquisition, or recognised in profit or loss if the acquisition is no longer expected to be completed.

There is no specific guidance on the treatment of contingent consideration in acquiring an investment in an equity-accounted investee. In our view, contingent consideration arising from the acquisition of an equity-accounted investee should be treated in the same way as contingent consideration arising on the acquisition of a subsidiary (see chapter 2.6) – i.e. it should be recognised initially at fair value as part of the cost of acquisition. [IFRS 3.39–40, 58, IAS 28.26]

On the date of acquisition of an equity-accounted investee, fair values are determined for the investee's identifiable assets and liabilities as if the transaction were the acquisition of a subsidiary.

Any difference between the investor's share of the fair values of the acquired net assets and the cost of acquisition is goodwill. Any excess of the investor's share of the fair values of the acquired net assets over cost is included in the investor's share of the investee's profit or loss in the period in which the investment is acquired. Goodwill arising on the acquisition of an equity-accounted investee is not subject to mandatory annual impairment testing. Instead, the entire investment is assessed for impairment under certain circumstances (see below). [IAS 28.32, 42]

Like IFRS Accounting Standards, costs that are directly attributable to a probable future acquisition of an investment accounted for under the equity method should be recognised as a prepayment (asset) in the statement of financial position. The costs should be included in the initial carrying amount at the date of acquisition, or recognised in profit or loss if the acquisition is no longer expected to be completed, like IFRS Accounting Standards. [SAB Topic 5.A]

Unlike IFRS Accounting Standards, contingent consideration is not recognised as part of the cost of acquisition on initial recognition except to the extent that the acquisition is a bargain purchase, or if it has to be recognised under other US GAAP (e.g. it is a derivative). Otherwise, unlike IFRS Accounting Standards, the contingent consideration is recognised as an adjustment to the carrying amount of the investment once it is resolved. [323-10-25-2A – 30-2A]

Like IFRS Accounting Standards, on the date of acquisition of an equity-method investee, fair values are determined for the investee's identifiable assets and liabilities as if the transaction were the acquisition of a subsidiary.

Like IFRS Accounting Standards, any difference between the investor's share of the fair values of the acquired net assets and the cost of acquisition is goodwill if the investee is a business. Unlike IFRS Accounting Standards, US GAAP does not address how to account for any excess of the investor's share of the fair values of the acquired net assets over cost. In our view, an investor should generally allocate the excess to the non-financial assets acquired such that the initial carrying amount of the equity-method investment equals its cost. Like IFRS Accounting Standards, goodwill arising on the acquisition of an equity-method investee (equity-method goodwill) is not subject to mandatory annual impairment testing. Instead, like IFRS Accounting Standards, the entire investment is assessed for impairment under certain circumstances, which differs in some respects from IFRS Accounting Standards (see below). [323-10-35-13, 350-20-35-59]

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Percentage attributable to the investor

In some cases, the economic interests of an investor will not equal its shareholding (voting interest). In these cases, in our view the investor should account for its economic interest in the profits and net assets of the investee, which would include instruments that are similar in substance to equity instruments. [IAS 28.3, 10, 13, 37]

Indirect holdings

Shareholdings of the parent and all subsidiaries are considered in applying the equity method. Shareholdings of other equity-accounted investees are not considered. [IAS 28.27]

Interest in an entity held via an equity-accounted investee

An investor's equity-accounted investee may have non-wholly owned subsidiaries. NCI in the investee's subsidiary are not reflected in the investor's consolidated financial statements. The investor's interest or entitlement is determined only after the investee's NCI holders have been attributed their interest in the investee. [IAS 28.27]

Percentage attributable to the investor

Like IFRS Accounting Standards, the investor generally only applies the equity method based on its investment in common shares and in-substance common stock of the investee. However, the nature of the interests in the investee should be taken into account – for example:

- if an investee has outstanding preferred stock and the preferred shareholders are entitled to dividends (even though they are not earned) before the declaration of common stock dividends, or as a preference on liquidation, then the dividends should be deducted from investee earnings, or added to investee losses, before determining the investor's share of the investee's earnings and losses, like IFRS Accounting Standards; and
- if an investor holds interests other than common or in-substance common stock, or if there are complex earnings allocation provisions at the investee, then it may be appropriate to use the hypothetical liquidation at book value (HLBV) method. Under this method, an investor determines its share of an investee's earnings or losses for a period by calculating, at each reporting date, the amount that it would receive (or be obliged to pay) if the investee were to liquidate all of its assets at their recorded amounts and distribute the resulting cash to creditors and investors in accordance with their respective priorities, which may differ from the result obtained under IFRS Accounting Standards. [323-10-15-3, 30-1, 35-16]

Indirect holdings

Like IFRS Accounting Standards, shareholdings of the parent and all subsidiaries are taken into account in applying the equity method. Also like IFRS Accounting Standards, shareholdings of other equity-method investees are not considered. [323-10-15-8]

Interest in an entity held via an equity-method investee

An investor's equity-method investee may have non-wholly owned subsidiaries. Like IFRS Accounting Standards, NCI in the investee's subsidiary are not reflected in the investor's consolidated financial statements. The investor's interest or entitlement is determined only after the investee's NCI holders have been attributed their interest in the investee, like IFRS Accounting Standards. [323-10-35-5]

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The equity-accounted investee may sell or purchase NCI in its subsidiaries and account for these transactions as equity transactions in its consolidated financial statements (see chapter 2.5). In our view, there are two possible approaches for the investor to account for such transactions, and the investor should choose an accounting policy, to be applied consistently to all transactions with NCI at the associate level.

- Under the first approach, such transactions are not considered as equity transactions from the investor's perspective, because the NCI of the equity-accounted investee do not meet the definition of NCI at the investor's level. Therefore, the transaction is a transaction with third parties from the perspective of the investor and is accounted for accordingly (e.g. any dilution gain or loss is recognised in profit or loss).
- Under the second approach, such transactions are reflected directly in equity at the investor level, based on the fact that this reflects the post-acquisition change in the net assets of the investee (see above).

Potential voting rights

Potential voting rights are not taken into account in applying the equity method, unless in substance they give access to the returns associated with an ownership interest. [IAS 28.12–13]

Equity-settled share-based payment issued by an equity-accounted investee

When an equity-settled share-based payment is issued by an equity-accounted investee to its own employees, in our view the investor should record its share of the associate's share-based remuneration expense as part of its share of the investee's profit or loss. However, in our view the investor should not account for a share in the credit to shareholders' equity recognised by the investee. Instead, the offsetting credit entry should reduce the investment in the investee because equity instruments of the investee that have been granted to third parties represent a dilution of the investor's interest in the investee.

The equity-method investee may sell or purchase NCI in its subsidiaries and account for these transactions as equity transactions in its consolidated financial statements (see chapter 2.5). Unlike IFRS Accounting Standards, the investor is not required to immediately adjust its investment with a corresponding offset to profit or loss or equity, but may do so as an accounting policy choice. Unlike IFRS Accounting Standards, the investor may also elect to recognise the new basis difference that has arisen as an additional periodic adjustment to the investor's share of the investee's profit or loss in its subsequent application of the equity method. [323-10-35-5]

Potential voting rights

Like IFRS Accounting Standards, potential voting rights are not taken into account in applying the equity method. Instead, the investor applies the equity method based on its investments in common shares and in-substance common stock, like IFRS Accounting Standards. [323-10-15-9]

Equity-settled share-based payment issued by an equity-method investee

When an equity-settled share-based payment is issued by an equity-method investee to its own employees, the investor records its share of the investee's share-based remuneration expense as part of its share of the investee's profit or loss, like IFRS Accounting Standards. In our view, it then should use the HLBV method or the basis adjustment method to determine the impact of any remaining dilution gain or loss. Under the basis adjustment method, the investor amortises the difference between the carrying amount of its investment and its share of the investee's underlying net assets (including the effect of dilution resulting from the transaction) over time as an adjustment to equity-method income or loss. Under either method, the offsetting entry is an adjustment to the investment in the equity-method investee. [323-10-35-6, 40-1, 55-19 – 55-26]

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Losses

The investor's share of losses of an equity-accounted investee is recognised until the carrying amount of the investor's equity interest in the investee is reduced to zero. For the purposes of this calculation, the equity interest in the investee includes the carrying amount of the investment under the equity method and other long-term interests that in substance form part of the net investment. [IAS 28.38]

After the investor's interest is reduced to zero, a liability is recognised only to the extent that the investor has an obligation to fund the investee's operations, or has made payments on behalf of the investee. [IAS 28.39]

An investor applies the financial instruments standard to long-term interests in an associate or joint venture that are not accounted for under the equity method (see above). The investor does so before applying the loss absorption and impairment requirements (see below) of the investments in associates and joint ventures standard. [IAS 28.14A]

Transactions with equity-accounted investees and elimination of balances

Unrealised profits on transactions with an equity-accounted investee are eliminated to the extent of the investor's interest in the investee. Unrealised losses in a downstream transaction are not eliminated to the extent that they provide evidence of a reduction in the net realisable value or an impairment loss of the underlying asset. If an upstream transaction provides evidence of a reduction in the net realisable value of the assets to be purchased, then the investor recognises its share of those losses. [IAS 28.26, 28–29]

Losses

Like IFRS Accounting Standards, the investor's share of losses is recognised until the equity investment (including interests considered to be in-substance common stock), plus other interests in the investee (e.g. long-term loans and advances, preferred shares and debt securities), is reduced to zero. [323-10-35-19]

After the investment has been reduced to zero, equity-method losses continue to be recognised, with the investor recognising a liability to the extent:

- of an obligation to fund the investee's losses or other commitments to provide additional financial support, like IFRS Accounting Standards;
- that it has made payments on behalf of the investee, like IFRS Accounting Standards;
- that the imminent return to profitable operations by the investee appears to be assured, unlike IFRS Accounting Standards;
- of an equity investment that (1) does not result in the ownership interest increasing from one of significant influence to one of control; and (2) is in substance the funding of prior losses, unlike IFRS Accounting Standards; or
- of loans or investments in other securities of the investee. Because US GAAP contains more specific guidance than IFRS Accounting Standards in this regard, differences may arise in practice. [323-10-25-2, 35-21, 35-24, 35-29]

Like IFRS Accounting Standards, an investor applies the financial instruments Codification Topics to interests in an equity-method investee that are not accounted for under the equity method (see above). Unlike IFRS Accounting Standards, the investor does so after applying the loss absorption and impairment requirements (see below) of the equity method Codification Topic. [323-10-35-24 – 35-25]

Transactions with equity-method investees and elimination of balances

Unrealised profits from asset sale transactions with equity-method investees are generally eliminated only to the extent of the investor's ownership percentage in the equity-method investee, like IFRS Accounting Standards. Unrealised losses are eliminated in the same way, except to the extent that the underlying asset is impaired, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, the full gain or loss is recognised if the transaction is the transfer of a business or certain non-financial or in-substance non-financial assets (see below). [323-10-35-7 – 35-11, 610-20-32-2 – 32-5, 810-10-40-5]

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Balances such as receivables or payables and deposits or loans to or from equity-accounted investees are not eliminated when applying the equity method. [IAS 28.28]

An investor may enter into a downstream transaction with an equity-accounted investee for which its share of the gain arising from the transaction exceeds its interest in the investee. In our view, there are two possible accounting approaches for such an excess, and an entity should choose an accounting policy, to be applied consistently to all downstream transactions with equity-accounted investees.

- Under the first approach, once the investor's interest in the investee has been reduced to zero, any remaining portion of the investor's share of the gain is not eliminated, because the resulting credit in the statement of financial position does not meet the definition of a liability. Therefore, it is possible that the investor's share of the gain may not be fully eliminated in the investor's financial statements. If the investee earns a profit in subsequent periods, then the investor recognises its share of such profits only after adjusting for the excess gain that was not eliminated previously.
- Under the second approach, the investor eliminates in full its share of the gain. The amount of the elimination in excess of the carrying amount of the investor's interest in the investee is presented as deferred income. If the investee earns a profit in subsequent periods and the carrying amount of the investment in the investee becomes positive, then the investor changes its presentation of the deferred income so that it is offset against the investment in the investee in the usual way.

Distributions in excess of carrying amount

There is no specific guidance on the accounting for distributions in excess of the investee's carrying amount in the investor's financial statements when applying the equity method. In our view, an entity has the same accounting policy choice as in accounting for a downstream transaction with an equity-accounted investee for which its share of the gain arising from the transaction exceeds its interest in the investee (see above).

Like IFRS Accounting Standards, balances such as receivables or payables and deposits or loans to or from equity-method investees are not eliminated when applying the equity method. [323-10-35-8]

An investor may enter into a downstream asset sale with an equity-method investee for which its share of the gain arising from the transaction exceeds its interest in the investee. Unlike IFRS Accounting Standards, rather than a policy choice, the investor eliminates in full its share of the gain unless the transaction is the transfer of a business or certain non-financial or in-substance non-financial assets (see below). The amount of the elimination in excess of the carrying amount of the investor's interest in the investee is presented as deferred income, like the second approach under IFRS Accounting Standards. If the investee earns a profit in subsequent periods and the carrying amount of the investment in the investee becomes positive, then the investor changes its presentation of the deferred income so that it is offset against the investment in the investee in the usual way, like the second approach under IFRS Accounting Standards. [323-10-35-11]

Distributions in excess of carrying amount

When an equity-method investee enters into a refinancing transaction with a third party, after repayment of the existing financing it is not uncommon for the investee to distribute the remaining proceeds from a refinancing transaction to its investors. Unlike IFRS Accounting Standards, if the cash distribution to an equity-method investor is in excess of the investor's carrying amount of the investment, then the SEC staff has indicated that the excess may be recognised as a gain provided that the investor is not obliged to provide financial support to the investee or others. [2008 AICPA Conf]

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Sale or contribution of a subsidiary to an equity-accounted investee

When an entity sells or contributes a controlling interest in a subsidiary in exchange for an interest in an equity-accounted investee, in our view it should choose an accounting policy, to be applied consistently, to either recognise the gain or loss in full or eliminate the gain or loss to the extent of its retained interest in the former subsidiary.

Contribution of a non-monetary asset to equity-accounted investee

If an entity contributes a non-monetary asset to an equity-accounted investee in exchange for an equity interest in the investee, then the entity recognises a gain or loss following the guidance on upstream and downstream transactions (see above). However, no gain or loss is recognised if the transaction lacks commercial substance. [IAS 28.30, IU 01-18]

Equity-accounted investees classified as held-for-sale

Equity accounting is not applied to an investment, or portion of an investment, in an associate or joint venture that meets the criteria to be classified as held-for-sale. These investments are measured at the lower of their carrying amount and fair value less costs to sell (see chapter 5.4). For any retained portion of the investment that has not been classified as held-for-sale, the entity applies the equity method until disposal of the portion classified as held-for-sale. After disposal, any retained interest in the investment is accounted for as an associate or financial asset (see chapter 7.1), as appropriate. [IAS 28.20]

Impairment

Fair value adjustments and goodwill recognised on acquisitions of equity-accounted investees are not recognised separately. Goodwill recognised on the acquisition of an equity-accounted investee is not subject to an annual impairment test. Instead, after applying equity accounting, the net investment in the equity-accounted investee (i.e. the equity-accounted investment and other long-term interests accounted for under the financial instruments standard; see above) is tested for impairment when there is an indication of a possible impairment. The guidance in the investments in associates and joint ventures standard is used to determine whether it is necessary to perform an impairment test for investments in equity-accounted investees. If there is objective evidence that the net investment in the equity-accounted investee is impaired, then the impairment test is performed applying the principles in the impairment standard (see chapter 3.10). [IAS 28.40–42]

Contribution of a business to an equity-method investee

Unlike IFRS Accounting Standards, if a parent loses control of a subsidiary by contributing it to an equity-method investee, then the recognition of any gain or loss generally depends on the nature of the subsidiary. The parent recognises the full gain or loss if the former subsidiary is a business (other than oil- and gas-producing activities), or a group of non-financial or in-substance non-financial assets. [810-10-40-3A, 40-5]

Contribution of a non-financial asset to equity-method investee

Unlike IFRS Accounting Standards, when non-financial or in-substance non-financial assets are contributed in exchange for an equity-method investment, the investor generally recognises its investment at fair value; no portion of the gain or loss is eliminated if the investee is a non-customer. [610-20-32-2 – 32-5, 718-10-30-2 – 30-3, 810-10-40-5, 860-20-30-1]

Equity-method investees classified as held-for-sale

Unlike IFRS Accounting Standards, equity accounting continues to be applied to equity-method investees that meet the criteria to be classified as held-for-sale. Unlike IFRS Accounting Standards, an equity-method investee is not classified as held-for-sale unless the definition of a discontinued operation is also met (see chapter 5.4). [205-20-45]

Impairment

Like IFRS Accounting Standards, fair value adjustments and goodwill recognised on acquisitions of equity-method investees are not recognised separately, and an equity-method investment may be impaired even if the investee has accounted for impairment losses of its own underlying assets. However, unlike IFRS Accounting Standards, impairments of investments in equity-method investees are generally recognised only if the impairments are 'other than temporary'. Evidence of a loss in value might include, but would not necessarily be limited to, an absence of an ability to recover the carrying amount of the investment or inability of the investee to sustain an earnings capacity that would justify the carrying amount of the investment. A current fair value of an investment that is less than its carrying amount may indicate a loss in value of the investment; however, a decline in the quoted market price below the carrying amount or the existence of operating losses is not necessarily indicative of a loss in value that is 'other than temporary'. [323-10-35-32]

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After applying the equity method, any impairment loss on an investment in an equity-accounted investee is *not* allocated to the underlying assets that make up the carrying amount of the investment, including goodwill. In addition, any such impairment loss is reversed if the recoverable amount increases subsequently. The requirements of the impairment standard are applied to the entire carrying amount of an investment in an equity-accounted investee without 'looking through' the investment to the investor's carrying amount of individual assets within the investee. [IAS 28.42]

Accounting for a disposal

When an investment that is accounted for under the equity method is sold, the difference between the proceeds from the disposal and the carrying amount of the investment (including the carrying amount of any related goodwill) is recognised in profit or loss as a gain or loss on disposal. [IAS 28.22]

Changes in the status of equity-accounted investees

Investment becomes an equity-accounted investee

There is no specific guidance on the accounting when an investment becomes an equity-accounted investee. In our view, to determine the first equity-accounted carrying amount (i.e. the cost of the investment in the equity-accounted investee), an entity should choose an accounting policy, to be applied consistently, based on one of the following approaches.

- Under the *fair value approach*, the cost of the investment is determined as the sum of the fair value of the initial interest at the date of obtaining significant influence or joint control plus the consideration paid for any additional interest.
- Under the *accumulated cost approach*, the cost of the investment is determined as the sum of the consideration paid for the initial interest plus the consideration paid for any additional interest. [IAS 28.10, 26, 32, IFRS 3.42, IU 07-09, IU 01-19]

A previously held investment in equity instruments has been measured at fair value with changes in fair value recognised in either profit or loss or OCI (see chapter 7.4). Reclassification of fair value gains or losses recognised in OCI to profit or loss is prohibited (see chapter 7.7). As a result, when an equity investment becomes an equity-accounted investee under the *fair value approach*, any fair value gains or losses recognised in OCI may be transferred to retained earnings or remain in OCI. [IFRS 9.4.1.4, 5.7.5, B5.7.1]

Like IFRS Accounting Standards, an investor does not perform a separate impairment test on the investee's underlying assets. Instead, the entire equity-method investment is subject to an other-than-temporary impairment model, which is different from the impairment model under IFRS Accounting Standards. Unlike IFRS Accounting Standards, an impairment cannot be reversed subsequently. However, the impairment loss creates a basis difference between the investor's carrying amount and the investor's share of the investee's net book value, which is allocated to the investor's underlying share of the investee's assets that make up the investment, including equity-method goodwill, unlike IFRS Accounting Standards. [323-10-35-32A]

Accounting for a disposal

Like IFRS Accounting Standards, when an investment that is accounted for under the equity method is sold, the difference between the proceeds from the disposal and the carrying amount of the investment (including the carrying amount of any related goodwill) is recognised in profit or loss as a gain or loss on disposal. [323-10-35-35]

Changes in the status of equity-method investees

Investment becomes an equity-method investee

Unlike IFRS Accounting Standards, there is specific guidance on the accounting when an investment becomes an equity-method investee. The current basis of the investor's previously held interest in the investee is remeasured either at fair value or using the measurement alternative (see chapter 7.7). In applying the measurement alternative, the investor considers observable transactions that result in applying equity accounting when measuring its previously held interest – i.e. an investor that currently applies the measurement alternative, but will apply the equity method because an observable transaction has resulted in obtaining significant influence, recognises a fair value adjustment. [323-10-35-33]

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In our view, under the *accumulated cost approach*, any difference resulting from the change in measurement between the fair value of the initial investment on the date of obtaining significant influence or joint control and the consideration paid for the initial investment should be recognised in profit or loss. This applies regardless of whether the entity had elected before the step acquisition to present changes in fair value in profit or loss or OCI (see above). [IU 01-19]

Acquisition of additional interests

In our view, an existing interest should not be remeasured if an acquisition of additional interests does not change the classification as an associate or as a joint venture. We believe that reserves, such as the cumulative foreign currency translation reserve, should not be reclassified to profit or loss or transferred to retained earnings. [IAS 28.24]

There is no specific guidance on the accounting for an additional interest while continuing to apply equity accounting. In our view, an entity should apply an 'allocation' approach similar to that applied when an interest is acquired in a new equity-accounted investee, whereby goodwill is calculated on the incremental interest acquired as a residual after valuing the incremental share of identifiable net assets at fair value. This results in identifiable net assets being valued on a mixed measurement basis.

Decrease in interest held

In our view, a retained interest should not be remeasured if the decrease does not change the classification as an associate or as a joint venture. [IAS 28.24]

If an entity's ownership interest in an equity-accounted investee is reduced, but the entity continues to apply equity accounting, then in our view the difference between the proceeds from the sale and the cost of the investment sold should be recognised in profit or loss.

Acquisition of additional interests

An existing interest is not remeasured if an acquisition of additional interests does not change the classification of an equity-method investee, like IFRS Accounting Standards. Similarly, reserves are not reclassified to profit or loss, like IFRS Accounting Standards. [323-10-35-33]

An increase in holding is accounted for under the 'step-by-step' method, whereby the existing equity-method interest remains at its existing carrying amount, like IFRS Accounting Standards. [323-10-35-33]

Decrease in interest held

When an investor's holding in an equity-method investee decreases, but the investor maintains significant influence, the investor does not remeasure its retained interest, like IFRS Accounting Standards. [323-10-35-35]

When an investor's holding in an equity-method investee decreases, but the investor maintains significant influence, the partial disposal of the investor's ownership interest in an associate (while maintaining significant influence) is recognised in profit or loss for the difference between the proceeds from the sale and the cost of the investment sold, like IFRS Accounting Standards. [323-10-35-35, 610-20-15-2, 32-2 – 32-6]

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If an entity's ownership interest in an equity-accounted investee is reduced, but the entity continues to apply equity accounting, then it also reclassifies to profit or loss any equity-accounted gain or loss previously recognised in OCI in proportion to the reduction in the ownership interest. This reclassification applies only if that gain or loss would be reclassified to profit or loss on disposal of the related asset or liability – e.g. a foreign currency translation reserve. Otherwise, the portion of reserves remains within equity – e.g. revaluation reserve or fair value reserve (equity instruments). [IAS 28.25]

IFRS Accounting Standards are silent on how to determine the cost of the investment sold and the portion of reserves that is reclassified or remains within equity. In our view, the guidance on cost formulas for inventories (see chapter 3.8) should be applied to determine the cost of financial assets sold when the financial assets are part of a homogeneous portfolio. Therefore, an entity should choose an accounting policy, to be applied consistently, to use any reasonable cost allocation method – e.g. weighted-average cost or first-in, first-out – in determining the cost of the investment sold. We believe that the portion of reserves reclassified or remaining within equity should be calculated consistently with the gain or loss of the partial disposal.

A decrease in interest (while the investment continues to be classified as an associate or joint venture) can also result from a dilution. A dilution of an interest in an equity-accounted investee may occur, for example, when the investee issues shares to other parties. The gain or loss on the dilution of an interest in an equity-accounted investee is recognised in profit or loss.

Loss of significant influence or joint control

The equity method continues to apply until significant influence or joint control ceases, or until the investment is classified as held-for-sale. [IAS 28.9, 22]

In the case of a partial disposal, depending on the level of influence still held by the investor, the remaining investment is accounted for:

- as an associate or joint venture; or
- as a financial asset (see chapter 7.4). [IAS 28.22]

Like IFRS Accounting Standards, if an entity's ownership interest in an equity-accounted investee is reduced, but the entity continues to apply equity accounting, then it also reclassifies to profit or loss any equity-accounted gain or loss previously recognised in accumulated OCI in proportion to the reduction in the ownership interest. Unlike IFRS Accounting Standards, all accumulated OCI items are reclassified to profit or loss; none is transferred to retained earnings. [830-30-40-2]

Like IFRS Accounting Standards, US GAAP is silent on how to determine the cost of the investment sold and the portion that is reclassified or remains within equity. A common approach in practice is average cost, but the first-in first-out and specific identification methods are also acceptable, like IFRS Accounting Standards. In our view, the portion of reserves reclassified or remaining within equity should be calculated consistently with the gain or loss of the partial disposal, like IFRS Accounting Standards.

Like IFRS Accounting Standards, the investor accounts for the issuance of shares by the equity-method investee that reduces the investor's ownership percentage in the same manner as if the investor had sold a proportionate share of its investment, with a dilution gain or loss recognised in profit or loss. [323-10-40-1]

Loss of significant influence

Like IFRS Accounting Standards, the equity method continues to apply until significant influence ceases, or until the investment is classified as held-for-sale. [323-10-35-36, 205-10-45-1C]

Like IFRS Accounting Standards, in the case of a partial disposal, depending on the level of influence still held by the investor, the remaining investment is accounted for:

- as an equity-method investee; or
- as an investment (see chapter 7.4). [323-10-35-36]

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If an investment in an associate becomes an investment in a joint venture or vice versa, then the equity method continues to be applied and the entity does not remeasure the retained interest. [IAS 28.24]

When equity accounting ceases, an investor recognises a gain or loss in profit or loss calculated as the difference between:

- the sum of:
  - the fair value of any proceeds from the interests disposed of;
  - the fair value of any retained investment; and
  - the amount reclassified from OCI; and
- the carrying amount of the investment at the date on which significant influence or joint control is lost. [IAS 28.22–23]

Amounts recognised in OCI in relation to the investee are accounted for on the same basis as would be required if the investee had disposed directly of the related assets and liabilities. Some amounts are reclassified to profit or loss and some are not. [IAS 28.23]

Gain of control of existing associate or joint venture

When an investor obtains control over an existing associate or joint venture that meets the definition of a business, it applies the guidance for a business combination achieved in stages (see chapter 2.6). [IFRS 3.41–42]

IFRS Accounting Standards do not provide specific guidance for cases in which an investor obtains control over an existing associate or joint venture (i.e. a previously held equity interest) that does not meet the definition of a business. In our view, an entity should choose an accounting policy, to be applied consistently, to remeasure the previously held interest to fair value or to account for it at cost. [IFRS 3.2(b)]

Unlike IFRS Accounting Standards, when equity accounting ceases and the investee becomes an investment, the investor remeasures the retained investment either at fair value or using the measurement alternative (see chapter 7.7). In applying the measurement alternative, the investor considers observable transactions that result in discontinuing equity accounting when measuring its retained investment – i.e. an investor that currently applies the equity method, but will apply the measurement alternative because an observable transaction has resulted in losing significant influence, recognises a fair value adjustment. [323-10-35-36]

Unlike IFRS Accounting Standards, an investor's proportionate share of an investee's equity adjustments in accumulated OCI is offset against the carrying amount of the investment when significant influence is lost. To the extent that the offset results in a carrying amount of the investment that is less than zero, any additional amount is recognised in profit or loss, unlike IFRS Accounting Standards. [323-10-35-39]

Gain of control of existing associate or joint venture

Like IFRS Accounting Standards, when an investor obtains control over an existing associate or joint venture that meets the definition of a business, it applies the guidance for a business combination achieved in stages (see chapter 2.6). [805-10-25-9]

When an investor obtains control over an existing associate or joint venture that does not meet the definition of a business, the existing interest is not generally remeasured, which may differ from the accounting policy elected under IFRS Accounting Standards. However, there is diversity in practice because some entities remeasure the previously held investment at fair value. [805-50-30-1, 810-10-30-4]

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3.6 Joint arrangements

(IFRS 11)

Overview

- **A 'joint arrangement' is an arrangement over which two or more parties have joint control. There are two types of joint arrangements: a joint operation and a joint venture.**
- **In a 'joint operation', the parties to the arrangement have rights to the assets and obligations for the liabilities related to the arrangement. A joint arrangement not structured through a separate vehicle is a joint operation.**
- **In a 'joint venture', the parties to the arrangement have rights to the net assets of the arrangement.**
- **A joint arrangement structured through a separate vehicle may be either a joint operation or a joint venture. Classification depends on the legal form of the vehicle, contractual terms and other facts and circumstances.**
- **Generally, a joint venturer accounts for its interest in a joint venture under the equity method.**
- **In relation to its involvement in a joint operation, a joint operator recognises its assets, liabilities and transactions, including its share in those arising jointly. The joint operator accounts for each item in accordance with the relevant accounting standard.**

Identifying and classifying joint arrangements

A 'joint arrangement' is an arrangement over which two or more parties have *joint control*, which is the contractually agreed sharing of control – i.e. unanimous consent is required for decisions about the relevant activities. [IFRS 11.4, 7]

3.6 Ventures carried on jointly

(Topic 323, Subtopic 805-60, Topic 808, Topic 970)

Overview

- **Unlike IFRS Accounting Standards, there is no definition of a 'joint arrangement', and the accounting depends on the type of venture being carried on jointly.**
- **Unlike IFRS Accounting Standards, there is no concept of a 'joint operation', and the accounting depends on the type of venture being carried on.**
- **Unlike IFRS Accounting Standards, a 'joint venture' is a joint activity carried on through a separate entity (e.g. a corporation or partnership), and there is some diversity in practice when interpreting the definition.**
- **Unlike IFRS Accounting Standards, a jointly controlled activity conducted with the use of a legal entity might be a joint venture or simply an equity-method investee (see chapter 3.5).**
- **Like IFRS Accounting Standards, investors in a corporate joint venture generally account for the investment under the equity method.**
- **Unlike IFRS Accounting Standards, for operations conducted without a legal entity, the accounting depends on the type of venture being carried on.**

Ventures carried on jointly

Unlike IFRS Accounting Standards, there is no definition of a 'joint arrangement', and the accounting depends on the type of venture being carried on jointly. Unlike IFRS Accounting Standards, these ventures carried on jointly do not require joint control.

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Joint arrangements are classified either as:

- a *joint operation*, whereby the jointly controlling parties, known as the 'joint operators', have rights to the assets and obligations for the liabilities of the arrangement; or
- a *joint venture*, whereby the jointly controlling parties, known as the 'joint venturers', have rights to the net assets of the arrangement. [IFRS 11.14–16]

Joint arrangements are classified based on a four-test approach (see below). The joint arrangements standard does not contain guidance on collaborative arrangements without joint control; a contract with a collaborator or a partner is in the scope of the revenue standard (see chapter 4.2) if the counterparty meets the definition of a customer for part or all of the arrangement. [IFRS 11.B33, 15.6]

Test 1: Structure. A joint arrangement not structured through a separate vehicle is classified as a joint operation. A joint arrangement structured through a separate vehicle can be either a joint venture or a joint operation. [IFRS 11.B16, B19, IU 03-15]

Test 2: Legal form. If the joint arrangement is structured through a separate vehicle, then the legal form of the separate vehicle is considered as the next step. If the legal form of the separate vehicle does not confer separation between the parties and the separate vehicle – i.e. the assets and liabilities placed in the separate vehicle are the parties' assets and liabilities – then the joint arrangement is a joint operation. [IFRS 11.B22, B24]

Test 3: Contractual terms. If, in spite of the structure and legal form indicating that the arrangement is a joint venture, the contractual terms specify that the parties have rights to the assets and obligations for the liabilities of the arrangement, then the arrangement is a joint operation. [IFRS 11.B26–B27]

Test 4: Other facts and circumstances. The test at this step of the analysis is to identify whether, in spite of the legal form and contractual terms indicating that the arrangement is a joint venture, other facts and circumstances:

- give the parties rights to *substantially all* of the economic benefits of the arrangement (asset test); and
- cause the arrangement to depend on the parties on a *continuous* basis for settling its liabilities (liability test). [IFRS 11.B29–B32, IU 03-15, 05-14]

If so, then the arrangement is a joint operation. [IFRS 11.B30]

Unlike IFRS Accounting Standards, a 'joint venture' is a joint activity carried on through a separate entity (e.g. a corporation or partnership), and there is some diversity in practice when interpreting the definition. [Master Glossary]

Unlike IFRS Accounting Standards, US GAAP does not include the concept of a joint operation. US GAAP has guidance on collaborative arrangements and undivided interests, neither of which require joint *control*.

- A 'collaborative arrangement' is a contractual arrangement that involves a joint operating activity between two or more parties who are active participants in the activity and are exposed to the significant risks and rewards dependent on the commercial success of the activity.
- An 'undivided interest' is an ownership arrangement in which two or more parties jointly own real estate, and title is held proportionately to each party's interest. [Master Glossary, 808-10-20]

Certain transactions between collaborative partners are presented as revenue under the revenue Codification Topic (see chapter 4.2) when the collaborative partner is a customer, like IFRS Accounting Standards. A distinct good or service is the unit of account for evaluating whether a transaction is with a customer. Transactions with a collaborative partner that are not in the scope of the revenue Codification Topic cannot be presented together with revenue from contracts with customers, like IFRS Accounting Standards. [808-10-45-3]

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Accounting for joint arrangements

There are two types of joint arrangement, which determines the accounting.

A joint controller in a joint venture accounts for its interest under the equity method, unless one of the exemptions in the investments in associates and joint ventures standard applies (see chapter 3.5). [IFRS 11.24]

A joint controller in a joint operation recognises its assets, liabilities and transactions, including its share of those incurred jointly. These assets, liabilities and transactions are accounted for in accordance with the relevant accounting standards. The joint operator does not additionally account for its shareholding in the separate vehicle. [IFRS 11.20–21, 26(a), IU 03-15, 03-19]

Contributions to and transactions with joint arrangements

A joint operator recognises gains and losses from a sale or contribution of assets to a joint operation only to the extent of the other parties' interests in the joint operation. The full amount of any loss is recognised immediately by the joint operator to the extent that these transactions provide evidence of impairment of any assets to be sold or contributed. [IFRS 11.22, B34–B35]

When a joint operator purchases assets from a joint operation, it does not recognise its share of the gains or losses until those assets have been sold to a third party. The joint operator's share of any losses is recognised immediately, to the extent that these transactions provide evidence of impairment of those assets. [IFRS 11.22, B36–B37]

Transactions with a joint venture are subject to the same requirements as transactions with an associate (see chapter 3.5).

Accounting for ventures carried on jointly

Unlike IFRS Accounting Standards, there is specific guidance for each type of venture carried on jointly; there are no broad categories of arrangement.

The equity method is required for joint ventures conducted in a legal entity, with the exception of unincorporated entities if specialised industry practices (e.g. construction and extractive industries) permit the use of proportionate consolidation, unlike IFRS Accounting Standards. [810-10-45-14]

Unlike IFRS Accounting Standards, jointly controlled assets that comprise an undivided interest in real estate are accounted for as equity-method investees. There is no specific guidance on how to account for an undivided interest in non-real estate assets; in our experience, the investor classifies its share of the asset on its statement of financial position based on the nature of the asset (e.g. property) and recognises in the income statement the individual components of its results of operations (e.g. depreciation), like IFRS Accounting Standards. [970-323-25-12]

Contributions to and transactions with joint ventures

When an investor contributes assets to an entity that is jointly controlled, it recognises the full gain or loss on the assets and liabilities transferred if they constitute a business or a non-financial asset (unless they are goods or services in the scope of the revenue Codification Topic or oil- and gas-producing activities), unlike IFRS Accounting Standards. If the assets and liabilities transferred do not constitute a business or a non-financial asset, then a gain or loss is recognised only to the extent of the other parties' interests in the entity, like IFRS Accounting Standards. [323-10-30-2, 35-7]

When an investor purchases assets from an entity that is jointly controlled, it does not recognise its share of the gains or losses until those assets have been sold to a third party, like IFRS Accounting Standards. [323-10-35-7]

Like IFRS Accounting Standards, transactions with a joint venture are subject to the same requirements as transactions with an equity-method investee (see chapter 3.5).

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Acquisition of an interest in a joint operation

If a joint operator acquires an interest in a joint operation that constitutes a business, then it applies the relevant principles for business combinations accounting (see chapter 2.6). This includes recognising goodwill, recognising deferred taxes from the initial recognition of the identifiable assets acquired and liabilities assumed, and recognising acquisition-related costs in profit or loss. However, the principles for business combinations accounting do not apply if the formation of the joint operation coincides with the formation of the business. [IFRS 11.21A, B33A–B33B]

These principles apply to the acquisition of both the initial interest and additional interests of the joint operation in respect of the acquired interest. However, when an additional interest is acquired (without obtaining control), previously held interests in the joint operation are not remeasured. Previously held interests are also not remeasured when an entity that participates in a joint operation, but does not have joint control, subsequently obtains joint control. [IFRS 11.21A, B33C–B33CA]

If the joint operation does not constitute a business, then a cost-based approach is used and any existing assets are generally not remeasured. [IFRS 3.2(b), IU 01-16]

Accounting by joint ventures for contributions received

If assets comprising a business are contributed on formation of the joint venture, then in our view the joint venture should choose an accounting policy, to be applied consistently, to recognise such contributions either in accordance with the business combinations standard (see chapter 2.6) or based on book values.

If assets comprising a business are contributed subsequent to the formation of the joint venture, then the joint venture applies the business combinations standard (see chapter 2.6). [IFRS 3.2(a)]

Acquisition of joint control in assets

Unlike IFRS Accounting Standards, an undivided interest in real estate that is subject to joint control is accounted for as an equity-method investee. The acquisition of such an interest is accounted for in the same way as acquiring significant influence (see chapter 3.5), which differs in some respects from acquisition accounting.

Accounting by joint ventures for contributions received

Unlike IFRS Accounting Standards, a new basis of accounting and recognition of the joint venture's assets, liabilities and non-controlling interest at fair value (with exceptions) is required at the formation date. The joint venture generally applies the business combinations Codification Topic (see chapter 2.6) to recognise and measure these assets. [805-60-30-1]

Like IFRS Accounting Standards, if assets comprising a business are contributed subsequent to the formation of the joint venture, then the joint venture applies the business combinations Codification Topic (see chapter 2.6).

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If assets not comprising a business are contributed to a joint venture in exchange for equity instruments (on formation or subsequent to formation of the joint venture), then the joint venture applies the share-based payments standard and measures the contributed assets at fair value (see chapter 4.5). [IFRS 2.5]

IFRS Accounting Standards are silent on how a joint venture itself should account for other contributions received.

Unlike IFRS Accounting Standards, if assets not comprising a business are contributed on formation of the joint venture in exchange for equity instruments, then a new basis of accounting and recognition of the joint venture's assets, liabilities and non-controlling interest at fair value (with exceptions) is required at the formation date. The joint venture generally applies the business combinations Codification Topic (see chapter 2.6) to recognise and measure these assets. If assets not comprising a business are contributed to a joint venture subsequent to formation in exchange for equity instruments, then the joint venture may apply the guidance for share-based payments with non-employees, which differs from IFRS Accounting Standards (see chapter 4.5). However, other views may be acceptable depending on the facts and circumstances. [805-60-25-11]

Like IFRS Accounting Standards, US GAAP is silent on how a joint venture itself should account for other contributions received, which may result in differences in practice.

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3.8 Inventories

(IAS 2)

Overview

- Inventories are generally measured at the lower of cost and net realisable value.
- 'Cost' includes all direct expenditure to get inventory ready for sale, including attributable overheads.
- Decommissioning and restoration costs incurred through the production of inventory are included in the cost of that inventory.
- The cost of inventory is generally determined using the first-in, first-out (FIFO) or weighted-average cost method. The use of the last-in, first-out (LIFO) method is prohibited.
- Other cost formulas, such as the standard cost or retail methods, may be used if the results approximate actual cost.
- The same cost formula is applied to all inventories having a similar nature and use to the entity.
- The cost of inventory is generally recognised as an expense when the inventory is sold.

3.8 Inventories

(Topic 330)

Overview

- Unlike IFRS Accounting Standards, inventories whose cost is based on the LIFO or retail inventory methods are measured at the lower of cost and market. Other inventories are measured at the lower of cost and net realisable value, like IFRS Accounting Standards.
- Like IFRS Accounting Standards, 'cost' includes all direct expenditure to get inventory ready for sale, including attributable overheads.
- Unlike IFRS Accounting Standards, asset retirement obligations (decommissioning costs) incurred through the production of inventory are added to the carrying amount of the related item of property, plant and equipment.
- Unlike IFRS Accounting Standards, the cost of inventory may be determined using the LIFO method in addition to the FIFO or weighted-average cost method.
- Like IFRS Accounting Standards, the standard cost method may be used if the results approximate actual cost. The retail inventory method may be used as an approximation of cost, but there are differences from IFRS Accounting Standards in the detailed application.
- Unlike IFRS Accounting Standards, the same cost formula need not be applied to all inventories having a similar nature and use to the entity.
- Like IFRS Accounting Standards, the cost of inventory is generally recognised as an expense when the inventory is sold.

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Overview (continued)

- **Inventories are written down to net realisable value when net realisable value is less than cost.**
- **'Net realisable value' is the estimated selling price less the estimated costs of completion and sale.**
- **If the net realisable value of an item that has been written down subsequently increases, then the write-down is reversed.**

Overview (continued)

- **Unlike IFRS Accounting Standards, inventories whose cost is based on the LIFO or retail inventory methods are written down to market value when market value is less than cost. Other inventories are written down to net realisable value when net realisable value is less than cost, like IFRS Accounting Standards.**
- **Like IFRS Accounting Standards, 'net realisable value' is the estimated selling price less the estimated costs of completion and sale. Unlike IFRS Accounting Standards, 'market value' is current replacement cost limited by net realisable value (ceiling) and net realisable value less a normal profit margin (floor).**
- **Unlike IFRS Accounting Standards, a write-down of inventory to net realisable value (or market) is not reversed for subsequent recoveries in value unless it relates to changes in exchange rates.**

Scope exclusions

The inventories standard applies to all inventories, except:

- financial instruments (see chapter 7.1); and
- biological assets related to agricultural activity and agricultural produce before the point of harvest (see chapter 3.9). [IAS 2.2]

The inventories standard does not apply to the measurement of inventories held by:

- producers of agricultural and forest products and mineral ores that are measured at net realisable value in accordance with well-established practices in those industries; and
- commodity broker-traders who measure their inventories at fair value less costs to sell. [IAS 2.3]

The inventories standard generally applies to agricultural produce from the point of harvest (see chapter 3.9). [IAS 41.3]

Scope exclusions

Like IFRS Accounting Standards, the inventories Codification Topic applies to all inventories, except:

- financial instruments (see chapter 7.1); and
- inventories of agricultural producers and co-operatives from the point of harvest (see chapter 3.9). [825, 905-330]

The inventories Codification Topic does not apply to the measurement of:

- inventories of agricultural producers; development costs of land, trees and vines, intermediate-life plants and animals; product deliveries to co-operatives by members; and accounting by co-operatives for products received from members; instead, guidance in a separate Codification topic applies, which differs from IFRS Accounting Standards in certain respects (see chapter 3.9); and
- commodities, whether held by a broker-dealer or by another entity; there is no specific guidance on accounting for commodity inventories and differences from IFRS Accounting Standards may arise in practice.

Unlike IFRS Accounting Standards, the inventories Codification Topic does not apply to agricultural produce from the point of harvest unless the scope criteria of the Codification Topic for agricultural producers and co-operatives are not met (see chapter 3.9). [905-330-35-3 – 35-4]

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Inventories exempt from the measurement aspects of the inventories standard are still required to comply with the presentation and disclosure requirements. [IAS 2.4–5]

Definition

'Inventories' are assets:

- held for sale in the ordinary course of business (finished goods);
- in the process of production for sale (work in progress); or
- in the form of materials or supplies to be consumed in the production process or in the rendering of services (raw materials). [IAS 2.6]

Inventory may include intangible assets that are produced for resale – e.g. software. [IAS 2.8, 38.2–3]

Inventory includes properties that have been purchased or are being developed for resale in the ordinary course of business. [IAS 2.8, 40.5, 9]

If an entity incurs costs under a contract with a customer and those costs do not give rise to inventories or assets in the scope of another accounting standard, then the entity considers whether those costs represent 'costs to fulfil a contract' under the revenue standard (see chapter 4.2). [IAS 2.2, 8]

Financial assets held for resale are not accounted for as inventories (see chapter 7.4). [IAS 2.2(b)]

Assets held for resale, but not in the ordinary course of the entity's business, are not inventories. [IAS 2.6]

Items of property, plant and equipment that an entity holds for rental to others and then routinely sells in the course of its ordinary activities are reclassified to inventories when they cease to be rented and become held for sale. [IAS 16.68A]

Like IFRS Accounting Standards, the general presentation and disclosure requirements for inventories apply to inventories within the scope of other Codification topics/subtopics. However, unlike IFRS Accounting Standards, incremental disclosures are required by certain Codification topics/subtopics. [905-330 – 985-330]

Definition

Like IFRS Accounting Standards, 'inventories' are assets:

- held for sale in the ordinary course of business (finished goods);
- in the process of production for such sale (work in progress); or
- to be consumed in the production of goods or services to be available for sale (raw materials). [330-10-20]

Unlike IFRS Accounting Standards, inventory does not include intangible assets. Differences from IFRS Accounting Standards may also arise in practice for software inventory – e.g. software inventory includes only the costs incurred for duplicating, documenting and producing materials from the product masters and for physically packaging them for sale. [330-10-20, 985-330-25-1]

Like IFRS Accounting Standards, inventory includes properties that have been purchased or are being developed for resale in the ordinary course of business. [330-10-20]

Like IFRS Accounting Standards, if an entity incurs costs under a contract with a customer and those costs do not give rise to inventories or fall in the scope of another Codification topic, then the entity considers whether those costs represent 'costs to fulfil a contract' under the revenue Codification Topic (see chapter 4.2). [340-40-25]

Like IFRS Accounting Standards, financial assets held for resale are not accounted for as inventories (see chapter 7.4).

Like IFRS Accounting Standards, assets held for resale, but not in the ordinary course of business, are not inventories.

Unlike IFRS Accounting Standards, US GAAP has no explicit guidance on accounting for assets that are rented out and then subsequently sold on a routine basis, and practice may vary. Proceeds from the sale would be accounted for in a manner consistent with the nature of the asset.

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Recognition and derecognition

The inventories standard does not include specific guidance on the timing of recognition of purchased inventories. In our experience, entities generally refer to the revenue recognition requirements – i.e. inventory is recognised on the date on which the entity obtains control of it (see chapter 4.2). [IFRS 15.31, 38]

The carrying amount of inventories is generally recognised as an expense when the inventories are sold. [IAS 2.34–35]

Measurement

Inventory is measured at the lower of cost and net realisable value (see below). [IAS 2.9]

Net realisable value write-downs are normally determined on an individual item basis. However, in some cases it may be appropriate to group together similar products. [IAS 2.29]

Cost

'Cost' includes purchase costs, production or conversion costs and other costs incurred in bringing inventory to its present location and condition. [IAS 2.10]

Purchase costs

'Purchase costs' include the purchase price, transport and handling costs, taxes that are not recoverable from the taxing authority and other costs directly attributable to the purchase. Cash, trade or volume discounts and rebates are deducted from the cost of purchase. [IAS 2.11, IU 08-02, 11-04]

Recognition and derecognition

Like IFRS Accounting Standards, the inventories Codification Topic does not include specific guidance on the timing of recognition of purchased inventories. In our experience, entities under US GAAP generally recognise inventory on the date on which legal ownership is established, which may give rise to differences from IFRS Accounting Standards in practice.

Like IFRS Accounting Standards, the carrying amount of inventories is generally recognised as an expense when the inventories are sold. [330-10-30-9 – 30-10]

Measurement

Unlike IFRS Accounting Standards, inventories whose cost is based on the LIFO or retail inventory methods are measured at the lower of cost and market. Other inventories are measured at the lower of cost and net realisable value, like IFRS Accounting Standards. [330-10-35-1A – 35-1C]

Like IFRS Accounting Standards, net realisable value (or market value) write-downs are normally applied separately to each item of inventory, although it may be appropriate to use a group or category of inventory in some cases. [330-10-35-9 – 35-10]

Cost

Like IFRS Accounting Standards, 'cost' includes purchase costs, production or conversion costs and other costs incurred in bringing inventory to its present location and condition. [330-10-30-1]

Purchase costs

Like IFRS Accounting Standards, 'purchase costs' include the purchase price, transport and handling costs, taxes that are not recoverable from the taxing authority and other costs directly attributable to the purchase. Cash, trade or volume discounts and rebates are deducted from the cost of purchase, like IFRS Accounting Standards. [330-10-30-1, 35-22, 705-20]

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IFRS Accounting Standards provide limited guidance on amounts received from vendors. Amounts that represent a reduction in the prices of the manufacturer's products or services (e.g. trade discounts, rebates and other similar items) are deducted from the cost of purchase. [IAS 2.11]

Costs of production or conversion

'Costs of production or conversion' include all direct costs such as labour, material and direct overheads, and an allocation of fixed and variable production overheads. 'Labour costs' include wage taxes, post-employment benefit costs and share-based payment costs associated with labour that is directly involved in the production process. The costs do not need to be external or incremental. [IAS 2.12]

The allocation of fixed production overheads is based on the normal capacity of production facilities. Unallocated overheads are recognised as an expense in the period in which they are incurred. Abnormal amounts of waste and spoilage are recognised in profit or loss. [IAS 2.13, 16]

Decommissioning and restoration costs incurred as a consequence of the production of inventory in a particular period are part of the cost of that inventory. Accordingly, the effect of any changes to an existing obligation for decommissioning and restoration costs related to items that have been sold is recognised in profit or loss. [IAS 16.16(c), 18, IFRIC 1.4]

Other costs

Transport costs that are necessary to get purchased inventory to its present location or condition form part of the cost of inventory. [IAS 2.10–11]

Selling and advertising costs are not included in the cost of inventory. [IAS 2.15–16]

Unlike IFRS Accounting Standards, US GAAP has specific guidance on amounts received from vendors. Such amounts generally reduce the prices of the manufacturer's products or services (e.g. trade discounts, rebates and other similar items) and are presented as a reduction in inventory cost. However, the amounts do not reduce inventory and related costs if the payment is:

- for a distinct good or service;
- a reimbursement of costs incurred by the customer to sell the vendor's products provided that the cash consideration is specific, incremental and identifiable; or
- consideration for a sales incentive offered to customers by manufacturers that meet certain criteria. [705-20]

Costs of production or conversion

Like IFRS Accounting Standards, 'costs of production or conversion' include all direct costs such as labour, material and direct overheads, and an allocation of fixed and variable production overheads. 'Labour costs' include wage taxes, pension and post-employment benefit costs, and share-based payment costs associated with labour that is involved directly in the production process, like IFRS Accounting Standards. Also like IFRS Accounting Standards, the costs do not need to be external or incremental. [330-10-30-3, 30-8]

Like IFRS Accounting Standards, the allocation of fixed production overheads is based on the normal capacity of production facilities. Like IFRS Accounting Standards, unallocated overheads are recognised as an expense in the period in which they are incurred. Abnormal amounts of waste and spoilage are recognised in profit or loss, like IFRS Accounting Standards. [330-10-30-3, 30-7]

Unlike IFRS Accounting Standards, asset retirement obligations (decommissioning costs) incurred as a consequence of the production of inventory in a particular period are not part of the cost of inventory, but are added to the carrying amount of the related property, plant and equipment. The subsequent depreciation of that cost is included in production overheads in future periods over the asset's estimated remaining useful life (see chapter 3.2). [410-20-35-8]

Other costs

Like IFRS Accounting Standards, transport costs that are necessary to get purchased inventory to its present location or condition form part of the cost of inventory. [330-10-30-1]

Like IFRS Accounting Standards, selling and advertising costs are not included in the cost of inventory. [330-10-30-1, 30-8]

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IFRS Accounting Standards

Packaging costs incurred to prepare inventory for sale are included in the cost of inventory. [IAS 2.15]

Storage and holding costs are generally expensed as they are incurred, unless storage is necessary before a further stage in the production process, the inventory is produced as a discrete project or the inventory requires a maturation process to bring it to a saleable condition. [IAS 2.16(b)]

A production process may result in more than one output being produced. If the cost of the individual products cannot be identified, then the total production costs are allocated between the products on a rational and consistent basis. [IAS 2.14]

Borrowing costs are capitalised on inventory that is a qualifying asset (see chapter 4.6). [IAS 2.17, 23.4–5, 7, BC6]

A basis adjustment resulting from fair value hedging is an adjustment to the cost basis of inventory. A basis adjustment resulting from cash flow hedging is also an adjustment to the initial carrying amount of inventory (see chapter 7.9). [IFRS 9.6.5.9, 11(d)]

The accounting for the costs of distributing and transporting goods to customers depends on whether transportation of goods represents a separate performance obligation.

- If yes, then the entity applies the guidance in the revenue standard (see chapter 4.2).
- If no, then the entity considers whether the costs are necessary to get the inventory to its present location or condition for sale.
  - If yes, then the entity includes such costs in the cost of inventory.
  - If no, then the entity recognises such costs as an expense when they are incurred. [IAS 2.10–11, 15]

US GAAP

Like IFRS Accounting Standards, packaging costs incurred to prepare inventory for sale are included. [330-10-30-1]

Unlike IFRS Accounting Standards, US GAAP does not contain specific guidance on storage and holding costs, which may give rise to differences from IFRS Accounting Standards in practice.

Like IFRS Accounting Standards, if a production process results in more than one output being produced and the cost of the individual products cannot be identified, then the total production costs are allocated between the products on a rational and consistent basis. [330-10-30-3]

Like IFRS Accounting Standards, interest (borrowing costs) is capitalised on inventory that is a qualifying asset. However, the specific requirements differ from IFRS Accounting Standards in certain respects (see chapter 4.6). [835-20-15-5]

Like IFRS Accounting Standards, a basis adjustment resulting from fair value hedging is an adjustment to the cost basis of inventory. However, unlike IFRS Accounting Standards, the amount recognised in accumulated OCI is reclassified to profit or loss in the period in which the inventory is sold, rather than adjusting the initial carrying amount (see chapter 7.9). [330-10-35-7A]

Unlike IFRS Accounting Standards, an entity chooses an accounting policy, to be applied consistently, to account for shipping and handling activities undertaken after the customer has obtained control of the related goods using one of the following approaches.

- *Fulfilment activity:* The costs are accrued when revenue is recognised, instead of when the activities occur, unlike IFRS Accounting Standards.
- *Performance obligation:* The entity accounts for the activities as a separate performance obligation, applying the guidance in the revenue Codification Topic (see chapter 4.2), like IFRS Accounting Standards.

If the distribution activities occur before the customer has obtained control of the related goods (i.e. they are not a performance obligation or eligible for the accounting policy choice), then they are evaluated as fulfilment costs related to the entity's asset.

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Agricultural produce harvested from biological assets

Agricultural produce that an entity has harvested from its biological assets is measured at fair value less costs to sell at the point of harvest. This amount becomes deemed cost of the produce for the purpose of applying the inventories standard (see chapter 3.9). [IAS 2.20]

Cost formulas

If items of inventory are not interchangeable or comprise goods or services produced for specific projects, then cost is determined on an individual item (specific identification) basis. If there are many interchangeable items, then the cost formula used is FIFO or weighted-average cost. The LIFO method is prohibited. [IAS 2.23, 25, BC9]

The same type of cost formula need not be used for all inventories. However, the same cost formula is applied to all inventories with a similar nature and use to the entity, even if they are held by different group entities or in different countries. [IAS 2.25–26]

The standard cost method may be used for convenience if the results approximate actual cost. No specific disclosures are required if this method is chosen. [IAS 2.21]

Under the retail method the cost of inventory is determined by reducing the retail value of the inventory by a gross margin percentage. The retail method may be used if the result approximates the actual costs. The retail amount is reviewed regularly, in our view at least at each reporting date, to determine that it approximates cost. Adjustments are made when inventory has been marked down to below its selling price. [IAS 2.21–22]

In our view, changing the cost formula from, for example, FIFO to weighted-average should be accounted for as a change in accounting policy (see chapter 2.8). [IAS 2.25, 36(a)]

Agricultural produce harvested from biological assets

Unlike IFRS Accounting Standards, growing crops are accounted for at the lower of cost and net realisable value (see chapter 3.9). Also unlike IFRS Accounting Standards, at harvest and until sale, crops are reported at fair value less costs of disposal (see chapter 3.9). [905-330-35-1 – 35-2]

Cost formulas

Like IFRS Accounting Standards, the specific identification basis is used to determine cost if items of inventory are not interchangeable. Like IFRS Accounting Standards, FIFO or weighted-average cost may be used when there are many interchangeable items. Unlike IFRS Accounting Standards, the LIFO method is also permitted. [330-10-30-9 – 30-11]

Unlike IFRS Accounting Standards, the same cost formula need not be applied to all inventories having a similar nature and use to the entity. Also unlike IFRS Accounting Standards, inventories that are held by different group entities or in different countries may be costed using different formulas. [330-10-30-13, TQA 1400.23]

Like IFRS Accounting Standards, the standard cost method may be used for convenience if the results approximate actual cost. Unlike IFRS Accounting Standards, specific disclosure is required of the fact that standard costs approximate the costs that would have been calculated under a particular cost formula. [330-10-30-12]

Like IFRS Accounting Standards, under the retail inventory method the cost of inventory is determined by reducing the retail value of the inventory by a gross margin percentage. Unlike IFRS Accounting Standards, in our experience permanent markdowns are recognised as a direct reduction of the carrying amount of inventory under the retail inventory method. Unlike IFRS Accounting Standards, in practice there is no requirement to periodically assess the retail inventory amount to the amount determined under a cost formula. [330-10-30-13]

A change in cost formula is required to be accounted for as a change in accounting policy, like IFRS Accounting Standards (see chapter 2.8). [250-10-55-3]

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Net realisable value

'Net realisable value' is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. [IAS 2.6, 28]

In our view, the estimated costs of completion include future borrowing costs if those form part of the cost of the inventory.

The estimated costs necessary to make the sale include directly attributable marketing and distribution costs, and are not limited to those that are incremental. [IAS 2.6, IU 06-21]

The estimated selling price takes into account the intended use of the items. [IAS 2.31]

Changes in exchange rates may require a net realisable value write-down.

If an entity has a contract to sell inventory for less than the cost of fulfilling its obligations under the contract, then it has an onerous contract and a provision may be necessary if the write-down to net realisable value is insufficient to absorb the loss (see chapter 3.12). [IAS 2.31]

Any write-down to net realisable value is recognised as an expense, but IFRS Accounting Standards do not specify in which line item the write-down is included. In our view, write-downs of inventory as well as any reversals should be presented in cost of sales. [IAS 2.34]

Reversals of previous write-downs are recognised in profit or loss in the period in which the reversal occurs. [IAS 2.34]

Net realisable value (or market value)

Like IFRS Accounting Standards, 'net realisable value' is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. [330-10-20]

'Market value' is equal to current replacement cost except that:

- it cannot exceed net realisable value (ceiling), which, like IFRS Accounting Standards, is the estimated selling price less the estimated costs of completion and sale; and
- it cannot be less than net realisable value less a normal profit margin (floor), unlike IFRS Accounting Standards. [330-10-20]

Like IFRS Accounting Standards, the reasonably predictable costs of completion include future borrowing costs if those form part of the cost of the inventory]. [835-20-15-5]

Like IFRS Accounting Standards, the costs necessary to make the sale include directly attributable distribution costs but, unlike IFRS Accounting Standards, may exclude marketing costs. Unlike IFRS Accounting Standards, there is no specific guidance on whether costs necessary to make the sale can be limited to those that are incremental, and differences may arise in practice. [330-10-30-7 – 30-8]

Like IFRS Accounting Standards, the estimated selling price takes into account the intended use of the items, although this would generally be the price in the ordinary course of business. [330-10-35-2 – 35-5]

Like IFRS Accounting Standards, changes in exchange rates may require a write-down to net realisable value (or market value). [830-10-55-8]

Unlike IFRS Accounting Standards, US GAAP does not permit recognising provisions for onerous contracts for the sale of inventory unless required by specific guidance (see chapter 3.12). However, a loss on a firm purchase commitment is recognised, like IFRS Accounting Standards. The loss is measured in the same manner as inventory write-downs under US GAAP. [605-35-25-45, 330-10-35-17]

Any write-down to net realisable value (or market value) is normally included in cost of goods sold, like IFRS Accounting Standards. [330-10-50-1]

Unlike IFRS Accounting Standards, reversals of previous write-downs are not permitted, unless they relate to changes in exchange rates. [330-10-35-14, 835-10-50-8]

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3.9 Biological assets

(IAS 41)

Overview

- **Biological assets are measured at fair value less costs to sell unless it is not possible to measure fair value reliably, in which case they are measured at cost. Gains and losses from changes in fair value less costs to sell are recognised in profit or loss.**

- **Agricultural produce harvested from a biological asset is measured at fair value less costs to sell at the point of harvest. After harvest, the inventories standard generally applies.**

Definition and scope

'Biological assets' are living animals or plants that are capable of biological transformation or harvest into either agricultural produce that is generally accounted for as inventory (see chapter 3.8) or other biological assets. Determining whether an asset is a biological asset or inventory sometimes depends on the purpose for which the asset is held. [IAS 41.5]

Biological assets and agricultural produce are in the scope of the agriculture standard if they relate to agricultural activity. Animals or plants that are not subject to a process of management of biological transformation are not in the scope of the agriculture standard. [IAS 41.1, 6]

Bearer plants are accounted for in accordance with the property, plant and equipment standard (see chapter 3.2), rather than under the agriculture standard. Therefore, the cost model is permitted as an accounting policy choice. However, any produce growing on bearer plants is accounted for under the agriculture standard. [IAS 41.1(a), 2(b)]

3.9 Agriculture

(Topic 905, AICPA Agricultural Producers and Agricultural Cooperatives Guide)

Overview

- **Unlike IFRS Accounting Standards, growing crops and animals being developed for sale are classified as inventory and are measured on a cost basis. Also unlike IFRS Accounting Standards, other livestock such as production animals (dairy cattle, sheep and breeding stock) are accounted for as property, plant and equipment and are measured on a cost basis.**

- **Unlike IFRS Accounting Standards, no reclassification or remeasurement occurs at the point of harvest. Unlike IFRS Accounting Standards, harvested crops and animals held for sale are measured at net realisable value if certain criteria are met, or continue to be measured on a cost basis.**

Definition and scope

US GAAP has a Codification Topic applicable only to agricultural producers and co-operatives, and does not use the term 'biological assets'. Crops are segregated into 'growing crops' and 'harvested crops'. Animals are segregated into 'developing animals,' 'animals available and held for sale', and 'production animals' (e.g. dairy cattle). [905-330-05-2]

Unlike IFRS Accounting Standards, animals and plants not held by agricultural producers or co-operatives are not in the scope of the Codification Topic. [905-10-05-1]

Direct and indirect development costs of groves, orchards and vineyards are required to be capitalised during the development period and depreciated over the estimated useful life of the particular asset, which may result in the same outcome as under IFRS Accounting Standards when the cost model is elected. Unlike IFRS Accounting Standards, such assets are not permitted to be revalued. Unlike IFRS Accounting Standards, produce growing on bearer plants is not accounted for separately until the point of harvest. [905-330-35-4, 905-360-25-3, 360-35, ARB 43, Ch 9B.1]

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A 'bearer plant' is a living plant that is:
- used in the production or supply of agricultural produce;
- expected to bear produce for more than one period; and
- has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales. [IAS 41.5]

Land is not a biological asset in the scope of the agriculture standard, even if it is used in the production of such assets. Such land is accounted for as property, plant and equipment or investment property (see chapters 3.2 and 3.4). [IAS 41.2(a)]

Measurement

Biological assets are measured at fair value (see chapter 2.4) less costs to sell. If the fair value of a biological asset cannot be measured reliably at the date of initial recognition, then the asset is stated at cost less any accumulated depreciation and less any accumulated impairment losses. There is a presumption under IFRS Accounting Standards that fair value can be measured reliably for a biological asset. This presumption can be rebutted only on initial recognition when quoted market prices are not available and alternative fair value measurements are determined to be clearly unreliable. In our view, the level of uncertainty required to conclude that a fair value measurement is clearly unreliable is a high threshold. [IAS 41.30, IU 06-17]

If fair value subsequently becomes reliably measurable, then the asset is measured at fair value less costs to sell. Once a biological asset has been measured at fair value less costs to sell, it continues to be measured on that basis until disposal. Changes in fair value less costs to sell are recognised in profit or loss. [IAS 41.12, 26, 30–31]

An entity that incurs costs related to the biological transformation of biological assets chooses an accounting policy, to be applied consistently to each group of biological assets, to either capitalise the subsequent expenditure or expense it when it is incurred. [IAS 41. B61–B62, IU 09-19]

US GAAP does not use the term 'bearer plant'. However, there is specific guidance on accounting for groves, orchards and vineyards, which would generally meet the definition of bearer plants under IFRS Accounting Standards. [905-360-20]

Although land used for agriculture is subject to the Codification Topic for agricultural producers and co-operatives, these requirements are generally the same as for property, plant and equipment (see chapter 3.2). Therefore, differences from IFRS Accounting Standards in practice are not expected for land used in the production of biological assets. [905-360-05-2]

Measurement

Unlike IFRS Accounting Standards, 'growing crops' and 'animals being developed for sale' (which are what would be described as 'biological assets' under IFRS Accounting Standards) are classified as inventory and are therefore measured on a cost basis under the inventory Codification Topic (see chapter 3.8). [905-330-35-1 – 35-2]

Unlike IFRS Accounting Standards, 'other livestock' such as production animals (dairy cattle, sheep and breeding stock), which would also be described as biological assets under IFRS Accounting Standards, are accounted for as property, plant and equipment and the historical costs are depreciated over the animals' useful lives. Animals with short productive lives, such as poultry, may be classified as inventory, unlike IFRS Accounting Standards. [905-360-30-4 – 30-5, 905-330-25-3]

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Agricultural produce

'Agricultural produce' (i.e. the harvested produce of biological assets) before the point of harvest is part of the biological asset from which it will be harvested. Therefore, agricultural produce is not accounted for separately from the biological asset from which it will be harvested, except for produce growing on bearer plants, which is accounted for separately. Agricultural produce after the point of harvest is accounted for under the inventories standard (see chapter 3.8), unless another accounting standard applies. [IAS 41.3, 5C, B42]

Agricultural produce is measured at fair value less costs to sell at the point of harvest. This amount becomes deemed cost for the purposes of subsequent accounting under the inventories standard (see chapter 3.8). Gains or losses arising on initial recognition of agricultural produce are recognised in profit or loss in the period in which they arise. Such gains or losses may arise as a result of harvesting. [IAS 41.13, 28–29, 32]

After harvest, agricultural produce is treated as inventory (see chapter 3.8), even if the harvested produce requires additional biological transformation or harvest (e.g. fermentation). [IAS 41.3]

Agricultural produce

Unlike IFRS Accounting Standards, no reclassification or remeasurement occurs at the point of harvest. Unlike IFRS Accounting Standards, crops need to be available for immediate delivery to be treated as 'harvested' – i.e. there should be no additional biological transformation expected. There may be instances in which additional costs such as costs of special tillage, chopping or burning are required after harvest of a particular crop to overcome a physical or noxious condition; however, those costs are estimated and accrued as costs of the harvested crop, which is not considered an additional biological transformation as it is in IFRS Accounting Standards. [905-330-30-2]

Unlike IFRS Accounting Standards, 'harvested crops' and 'animals held for sale' (which would be described as 'agricultural produce' under IFRS Accounting Standards) are measured at net realisable value, with changes recognised in profit or loss, only when the harvested crop or animal held for sale:

- has a reliable, readily determinable and realisable market value;
- has relatively insignificant and predictable costs of disposal; and
- is available for immediate delivery. [905-330-35-3]

Harvested crops and animals held for sale for which these criteria are not met are measured in accordance with the inventory Codification Topic (see chapter 3.8), unlike IFRS Accounting Standards. [905-330-35-3]

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3.10 Impairment of non-financial assets

(IAS 36, IFRS 13, IFRIC 10)

Overview

- The impairment standard covers the impairment of a variety of non-financial assets, including: property, plant and equipment, right-of-use assets, intangible assets and goodwill, investment property and biological assets measured at cost less accumulated depreciation, and investments in subsidiaries and equity-accounted investees.
- Impairment testing is required when there is an indication of impairment.
- Annual impairment testing is required for goodwill and intangible assets that either are not yet available for use or have an indefinite useful life. This impairment test may be performed at any time during the year provided that it is performed at the same time each year.
- Depending on the specific asset and circumstances, assets are tested for impairment as an individual asset, as part of a CGU or as part of a group of CGUs. A CGU is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or groups of assets.

3.10 Impairment of non-financial assets

(Topic 350, Topic 360)

Overview

- Like IFRS Accounting Standards, the impairment Codification Topics deal with the impairment of a variety of non-financial long-lived assets, including: property, plant and equipment, intangible assets and goodwill. However, unlike IFRS Accounting Standards, different topics/subtopics address the impairment of biological assets and investments in equity-method investees.
- Like IFRS Accounting Standards, impairment testing is required when there is an indicator of impairment.
- Like IFRS Accounting Standards, annual impairment testing is required for goodwill and intangible assets that have an indefinite useful life. Like IFRS Accounting Standards, the goodwill impairment test may be performed at any time during the year provided that it is performed at the same time each year. Unlike IFRS Accounting Standards, the annual impairment test for indefinite-lived intangible assets is not required to be performed at the same time each year.
- Unlike IFRS Accounting Standards, depending on the specific asset and circumstances, assets are tested for impairment as an individual asset, as part of an asset group or at the reporting unit level.
  - An asset group is the lowest level for which there are identifiable cash flows (i.e. both cash inflows and cash outflows) that are largely independent of the net cash flows of other groups of assets, which may differ from a CGU under IFRS Accounting Standards.
  - A reporting unit is an operating segment or one level below an operating segment if certain conditions are met, unlike IFRS Accounting Standards.

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Overview (continued)

- Whenever possible, an impairment test is performed for an individual asset. Otherwise, assets are tested for impairment at the CGU level.

- Goodwill is allocated to CGUs or groups of CGUs that are expected to benefit from the synergies of the business combination from which it arose. The allocation is based on the level at which goodwill is monitored internally, restricted by the size of the entity's operating segments before aggregation.

- The carrying amount of goodwill is grossed up for impairment testing if it arose in a transaction in which NCI were measured initially based on their proportionate share of identifiable net assets.

- An impairment loss is recognised if an asset's or CGU's carrying amount exceeds its recoverable amount. 'Recoverable amount' is the higher of fair value less costs of disposal and value in use (which is always based on the net present value of future cash flows). The impairment loss is measured as the difference between the carrying amount of the asset, or CGU, and its recoverable amount.

Overview (continued)

- Unlike IFRS Accounting Standards, impairment tests for long-lived assets subject to depreciation or amortisation are applied to asset groups; an asset group may or may not be a CGU under IFRS Accounting Standards. Unlike IFRS Accounting Standards, certain long-lived depreciable or amortisable assets have a separate impairment test (e.g. capitalised software intended for sale). Unlike IFRS Accounting Standards, an indefinite-lived intangible asset is generally tested as an individual asset.

- Unlike IFRS Accounting Standards, goodwill is allocated to reporting units that are expected to benefit from the synergies of the business combination from which it arose.

- Unlike IFRS Accounting Standards, the carrying amount of goodwill is not grossed up for impairment testing because NCI are measured at fair value in the acquisition accounting.

- Unlike IFRS Accounting Standards, an impairment loss is triggered for long-lived assets only if the asset's, or asset group's, carrying amount exceeds its recoverable amount (i.e. the carrying amount is greater than the undiscounted cash flows of the asset or asset group). If the carrying amount is not recoverable, then the impairment loss is the difference between the carrying amount of the asset (asset group) and the fair value of the asset (asset group), unlike IFRS Accounting Standards.

- Unlike IFRS Accounting Standards, goodwill is impaired if the reporting unit's fair value is less than its carrying amount. Unlike IFRS Accounting Standards, the amount of the impairment is measured as the difference between the reporting unit's fair value and its carrying amount.

- Unlike IFRS Accounting Standards, an indefinite-lived identifiable intangible asset is impaired if its fair value is less than its carrying amount.

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Overview (continued)

- **Estimates of future cash flows used in the value in use calculation are specific to the entity, and need not be the same as those of market participants. Conversely, estimates of future cash flows used to estimate fair value less costs of disposal are consistent with those of a market participant. All cash flows used to estimate the recoverable amount are discounted to a present value. The discount rate used in the value in use calculation reflects the market's assessment of the risks specific to the asset or CGU.**
- **An impairment loss for a CGU is allocated first to any goodwill and then pro rata to other assets in the CGU that are in the scope of the impairment standard.**
- **An impairment loss is generally recognised in profit or loss. An exception relates to assets revalued through OCI.**
- **If there is an indication of reversal of impairment for an asset other than goodwill and the recoverable amount of the impaired asset or CGU increases subsequently, then the impairment loss is generally reversed. A reversal of an impairment loss is generally recognised in profit or loss. An exception relates to assets revalued through OCI.**
- **An impairment loss for goodwill is never reversed.**

Overview (continued)

- **Like IFRS Accounting Standards, estimates of future cash flows used to assess the recoverability of long-lived assets (asset groups) are specific to the entity. However, unlike IFRS Accounting Standards, the cash flows used to determine recoverability (before calculating an impairment loss) are not discounted. Unlike IFRS Accounting Standards, if a long-lived asset (asset group) is impaired, then the amount of the impairment loss is always measured with reference to assumptions that a market participant would make.**
- **Unlike IFRS Accounting Standards, an impairment loss for an asset group is allocated pro rata to the long-lived assets in the asset group based on the relative carrying amounts of those assets. Goodwill and indefinite-lived intangible assets are tested after the asset group has been tested for impairment and separately, unlike IFRS Accounting Standards.**
- **Unlike IFRS Accounting Standards, impairment losses are always recognised directly in profit or loss and the revaluation of property, plant and equipment and intangible assets is not permitted.**
- **Unlike IFRS Accounting Standards, reversals of impairments are prohibited.**
- **Like IFRS Accounting Standards, an impairment loss for goodwill is never reversed.**

Scope

The impairment standard deals with the impairment of all assets except for:

- investment property measured at fair value (see chapter 3.4);
- financial assets (see chapters 7.7 and 7.8);
- inventories (see chapter 3.8);
- deferred tax assets (see chapter 3.13);
- contract assets (see chapter 7.8) and contract costs to obtain or fulfil a contract with customers (see chapter 4.2);
- assets arising from employee benefit plans (see chapter 4.4);

Scope

Like IFRS Accounting Standards, the impairment Codification Topics deal with the impairment of all assets, except for:

- financial assets (see chapter 7.6);
- inventories (see chapter 3.8);
- deferred tax assets (see chapter 3.13);
- contract assets and contract costs to obtain or fulfil a contract (see chapter 4.2);
- assets arising from employee benefit plans (see chapter 4.4);
- deferred acquisition costs and intangible assets arising from an insurer's contractual rights under insurance contracts (see chapter 8.1); and

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- insurance contracts that are assets and any assets for insurance acquisition cash flows as defined in the insurance contracts standard (see chapter 8.1);
- non-current assets (disposal groups) classified as held-for-sale (see chapter 5.4); and
- biological assets that are measured at fair value less costs to sell (see chapter 3.9). [IAS 36.2–5]

The impairment testing of equity-accounted investees is discussed in chapter 3.5.

A reference to the impairment testing of an asset in the rest of this chapter refers to an asset in the scope of the impairment standard.

Summary of approach

The following is a summary of certain aspects of impairment testing under IFRS Accounting Standards, which are explained in more detail below.

- Goodwill is tested for impairment annually, as are indefinite-lived intangible assets and intangible assets not yet available for use, or more frequently if there is an indication of impairment.
- Other assets are tested for impairment when there is an indication of impairment.
- Whenever possible, an asset is tested for impairment on a stand-alone basis; otherwise, assets are tested at the CGU level.
- An asset is impaired when its carrying amount exceeds its recoverable amount. Recoverable amount is determined for an individual asset unless that asset does not generate cash inflows that are largely independent of those from other assets or group of assets. If this is the case, then recoverable amount is determined for CGUs.
- Corporate assets that contribute to more than one CGU are allocated to CGUs and are tested as part of the testing of individual CGUs if there is an indication of impairment. If allocation is not possible, then the CGUs to which corporate assets relate are tested together if there is an indication of impairment.
- Goodwill is allocated to CGUs and tested for impairment at least annually, either as part of the testing of individual CGUs if there is an indication of impairment, or as a separate test if there is no indication of impairment.
- An 'impairment loss' is the excess of an asset's (CGU's) carrying amount over its recoverable amount.

- other intangible assets for which specific guidance is applicable (e.g. capitalised software intended for sale). [350-20-35, 350-30-35, 360-10-35-16]

Unlike IFRS Accounting Standards, the impairment Codification Topics:

- exclude all assets that would be biological assets under IFRS Accounting Standards, which are covered by industry-specific guidance; and
- include long-lived assets (disposal groups) classified as held-for-sale (see chapter 5.4). [360-10-35-37]

The impairment testing of equity-method investees, which differs from IFRS Accounting Standards, is discussed in chapter 3.5.

A reference to the impairment testing of an asset in the rest of this chapter refers to an asset in the scope of the impairment Codification Topics.

Summary of approach

The following is a summary of certain aspects of impairment testing under US GAAP, which are explained in more detail and contrasted with IFRS Accounting Standards below.

- Goodwill is tested for impairment annually, as are indefinite-lived intangible assets and intangible assets not yet available for use, or more frequently if there is an indicator of impairment.
- Other long-lived assets are tested for impairment when there is an indicator of impairment.
- Long-lived assets are generally tested for impairment in asset groups, which are defined as the lowest level of assets that generate identifiable cash flows that are largely independent of the cash flows from the other asset groups.
- Intangible assets with an indefinite life are generally tested for impairment at the individual asset level.
- Goodwill is allocated to reporting units and tested at that level.
- Corporate (enterprise) assets are not allocated to asset groups in testing long-lived assets for impairment; instead, they may result in additional asset groups being identified. However, such assets may be allocated to reporting units when goodwill is tested for impairment.
- A long-lived asset (asset group) is impaired if its carrying amount exceeds its recoverable amount, which is based on estimated undiscounted future cash flows from operation and eventual disposal. If an asset (asset group) is impaired, then the amount of the impairment is calculated with reference to the fair value of that asset (asset group).

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- 'Recoverable amount' is the higher of value in use (which reflects entity-specific future cash flows) and fair value less costs of disposal (which reflects market participant assumptions – see chapter 2.4).

Asset groupings

Impairment tests are applied to the individual asset if the asset generates cash inflows that are largely independent of those from other assets or groups of assets. When this is not possible, assets are tested for impairment in groupings called CGUs. [IAS 36.66]

A CGU is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or groups of assets. [IAS 36.6, IU 03-07]

IFRS Accounting Standards do not have a category of asset groupings other than CGUs (or group of CGUs).

If an active market exists for the output from an asset or a group of assets and the output could be sold on that active market, then that asset or group of assets is a separate CGU even if the output is sold only to other units of the same entity. In assessing its ability to sell the output on an active market, an entity considers all existing factors that may impact it. In our view, in determining whether there is no genuine ability to sell the output on the active market, an entity should consider only substantial restrictions (e.g. legal restrictions prohibiting sales outside the entity or significant effort to develop required infrastructure). [IAS 36.70–71]

- Goodwill is impaired if the carrying amount of the reporting unit to which it is allocated exceeds the fair value of the reporting unit. An impairment loss is the excess of the reporting unit's carrying amount over its fair value.
- An indefinite-lived intangible asset is impaired if its carrying amount exceeds its fair value.
- Entities are permitted to assess qualitative factors to evaluate whether it is more likely than not that goodwill or indefinite-lived intangible assets are impaired. If, based on this qualitative assessment, an entity determines that it is not more likely than not that the fair value of a reporting unit (for goodwill) or an identifiable indefinite-lived intangible is less than its carrying amount, then a quantitative test is not required.

Asset groupings

Unlike IFRS Accounting Standards, impairment tests for long-lived assets subject to depreciation or amortisation are applied to asset groups (see below); an asset group may or may not be a CGU under IFRS Accounting Standards. Unlike IFRS Accounting Standards, indefinite-lived intangible assets are tested at the individual asset level unless they are operated as and comprise a single asset and as such are essentially inseparable from one another; goodwill is tested for impairment at the reporting unit level. [350-20-35-41, 350-30-35-21, 360-10-35-23 – 35-25]

Unlike IFRS Accounting Standards, an asset group is the lowest level for which there are identifiable cash flows (i.e. both cash inflows and cash outflows) that are largely independent of the net cash flows of other groups of assets. [360-10-35-23]

In addition to asset groups, US GAAP defines a reporting unit as an operating segment (see chapter 5.2) or one level below an operating segment if certain criteria are met (see below). [350-20-20]

Unlike IFRS Accounting Standards, even if an active market exists for the output from a group of assets, that group of assets is not a separate asset group unless cash flows are generated predominantly from transactions with external parties. However, to the extent that revenues are dependent, it might be appropriate to conclude that the asset group is at a higher level. [360-10-35-23]

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Corporate assets are assets other than goodwill that contribute to the future cash flows of more than one CGU. If possible, corporate assets are allocated to CGUs on a reasonable and consistent basis. [IAS 36.6, 100–102]

For impairment testing purposes, goodwill is allocated to those CGUs or groups of CGUs that are expected to benefit from the synergies of the business combination even if no other assets or liabilities of the acquiree are assigned to that CGU. The goodwill allocation is determined as at the date of acquisition. [IAS 36.80]

Each CGU or group of CGUs to which goodwill is allocated:

- represents the lowest level within the entity for which information about goodwill is available and monitored for internal management purposes; but
- cannot be larger than an operating segment before aggregation, determined in accordance with the operating segments standard (see chapter 5.2). [IAS 36.80]

When to test for impairment

An entity assesses at each reporting date whether there is an indication that an asset may be impaired. [IAS 36.9]

In testing long-lived assets for impairment, corporate (enterprise) assets are assets that lack identifiable cash flows that are largely independent of the cash flows of other asset groups, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, enterprise assets are not allocated to the underlying asset groups that they support; instead, an additional higher-level asset group is identified (which may be at the entity level), which is tested for impairment after the related lower-level asset groups have been tested. [350-20-35-39, 360-10-35-24 – 35-25]

In testing goodwill for impairment, corporate assets (and liabilities) are not defined but are generally understood to be items such as environmental liabilities that relate to the operations of one or more reporting units. Corporate items are allocated to the related reporting units if they will be considered in determining the reporting units' fair value, like IFRS Accounting Standards. [350-20-35-39 – 35-40]

Although goodwill is allocated to reporting units, which may differ from CGUs under IFRS Accounting Standards, the allocation is done on the same basis as IFRS Accounting Standards. Like IFRS Accounting Standards, for impairment testing purposes, goodwill is allocated to those reporting units that are expected to benefit from the synergies of the business combination even if no other assets or liabilities of the acquiree are assigned to those reporting units. Like IFRS Accounting Standards, the allocation is determined as at the date of acquisition. [350-20-35-41]

The groupings to which goodwill is allocated may differ from IFRS Accounting Standards. Goodwill is allocated to reporting units, which are:

- operating segments (see chapter 5.2); or
- one level below the operating segment level (component level), if it constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of that component. [350-20-35-33 – 35-38]

When to test for impairment

Like IFRS Accounting Standards, an entity assesses the recoverability of a depreciable or amortisable long-lived asset when there is an indication that an asset's (asset group's) carrying amount may no longer be recoverable. [360-10-35-21]

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Impairment testing is required both:

- for any asset when there is an indication of a possible impairment at the reporting date; and
- annually for the following assets, regardless of whether there is an indication of a possible impairment:
  - intangible assets with an indefinite useful life and intangible assets not yet available for use (see chapter 3.3); and
  - CGUs to which goodwill has been allocated. [IAS 36.9–10]

The annual impairment test for goodwill, indefinite-lived intangible assets and intangible assets not yet available for use may be performed at any time during the annual reporting period, but is performed at the same time each year. [IAS 36.10, 96]

If the goodwill relates to a business combination that occurred during the current reporting period, then the CGUs to which goodwill has been allocated are generally tested for impairment before the reporting date. [IAS 36.10, 84, 96]

Qualitative assessment

There is no formal qualitative assessment that can substitute for calculating the recoverable amount (i.e. the quantitative test) as part of the annual testing of goodwill, indefinite-lived intangible assets and intangible assets not yet available for use. However, when testing goodwill and indefinite-lived intangible assets, an entity may rely on its previous calculation of recoverable amount (see conditions below).

The accounting standard explicitly acknowledges that an entity need not re-estimate the recoverable amount if previous calculations show that the asset's recoverable amount is significantly greater than its carrying amount and no events have occurred that would eliminate that difference. [IAS 36.15, 24, 99]

Impairment testing is required both:

- for any asset when there is an indication of a possible impairment during the reporting period, which is a broader requirement than under IFRS Accounting Standards; and
- annually for the following assets, regardless of whether there is an indication of a possible impairment:
  - intangible assets with an indefinite useful life and intangible assets not yet available for use (see chapter 3.3), like IFRS Accounting Standards; and
  - reporting units to which goodwill has been allocated, which is like IFRS Accounting Standards except that reporting units and CGUs are often at different levels. [350-20-35-28, 350-30-35-17A, 35-18, 360-10-35-21]

Like IFRS Accounting Standards, the annual impairment test for goodwill may be performed at any time during the annual reporting period, but is performed at the same time each year. Unlike IFRS Accounting Standards, the annual impairment test for indefinite-lived intangible assets is not required to be performed at the same time each year. [350-20-35-28]

Unlike IFRS Accounting Standards, there is no specific requirement for goodwill arising from a business combination that occurred during the current reporting period to be tested for impairment before the reporting date. However, there is a requirement to test for impairment if a triggering event occurs, and a reporting unit is tested at least annually (at the same time each year). [350-20-35-28]

Qualitative assessment

Unlike IFRS Accounting Standards, for each reporting unit (or indefinite-lived intangible asset), an entity may elect to perform an initial qualitative assessment before proceeding with the quantitative test. If an entity concludes, based on a qualitative assessment, that it is *not* more likely than not that a reporting unit (or indefinite-lived intangible asset) is impaired, then the entity is not required to perform the quantitative test for that reporting unit (or indefinite-lived intangible asset). [350-20-35-30, 350-30-35-18A]

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Quantitative test

An asset or CGU is impaired if its carrying amount exceeds its recoverable amount. The recoverable amount of an asset or a CGU is the higher of its fair value less costs of disposal and its value in use. [IAS 36.6, 8]

If a CGU rather than an individual asset is tested for impairment (see above), then goodwill is included in that impairment test to the extent that goodwill was allocated to that CGU. [IAS 36.90]

If an indication of impairment exists in respect of a CGU that is smaller than the group of CGUs identified as relevant for goodwill impairment testing (and that includes the smaller CGU), then that smaller CGU is tested for impairment first. If it is determined that there is an impairment loss for that smaller CGU, then this impairment loss is recognised in the carrying amounts of the individual assets making up the smaller CGU, as appropriate. Only then is the larger CGU (or group of CGUs) tested for impairment (based on the revised carrying amounts for assets in the smaller CGU). [IAS 36.97]

Goodwill is impaired if the carrying amount of the CGU(s) to which it is allocated exceeds the recoverable amount of the CGU(s). [IAS 36.90]

For the impairment testing of goodwill and indefinite-lived intangible assets at the CGU level, an entity may rely on its previous calculation of recoverable amount if:

- the assets and liabilities making up the relevant CGU have not changed significantly since the last determination of recoverable amount;
- the last determination of recoverable amount resulted in carrying amount being exceeded by a substantial margin; and
- management assesses, based on an analysis of the facts and circumstances, that the likelihood of an impairment loss is remote. [IAS 36.24, 99]

Quantitative test

Like IFRS Accounting Standards, an asset or asset group is impaired if its carrying amount exceeds its recoverable amount. However, the term 'recoverable amount' means the undiscounted future cash flows that are directly associated with and that are expected to arise as a direct result of the use and eventual disposition of the asset or asset group, unlike IFRS Accounting Standards. For the impairment of goodwill related to a reporting unit, 'recoverable amount' is the fair value of the reporting unit, unlike IFRS Accounting Standards. [350-20-35-4, 360-10-35-17]

Unlike IFRS Accounting Standards, goodwill is tested for impairment at the reporting unit level. [350-20-35]

Like IFRS Accounting Standards, if an indicator of impairment exists in respect of an asset group, then the asset group is first tested for impairment and any impairment loss is recognised as described above. However, as noted above, the determination of whether there is an impairment loss and if so how much of a loss differs from IFRS Accounting Standards. Additionally, indefinite-lived intangible assets are tested for impairment before goodwill is tested for impairment at the reporting unit level, unlike IFRS Accounting Standards. [350-20-35-31, 360-10-35-27]

Unlike IFRS Accounting Standards, goodwill is impaired if the carrying amount of the reporting unit to which it is allocated exceeds the fair value of the reporting unit. [350-20-35-2 – 35-3D]

Unlike IFRS Accounting Standards, an entity is not permitted to carry forward its previous calculation of the fair value of a reporting unit or an indefinite-lived intangible asset; however, the previous fair value calculation may be considered in the optional qualitative assessment (see above). [350-20-35-3C, 350-30-35-18B]

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Corporate assets (see above) are allocated to CGUs on a reasonable and consistent basis. If it is impracticable to allocate a portion of a corporate asset to a CGU on such a basis, then two levels of impairment testing are carried out.

- First, the individual CGU is tested without any portion of the corporate asset ('bottom-up' test), and any impairment loss is recognised.
- Second, the minimum collection of CGUs to which the corporate asset can be allocated reasonably and consistently is tested, including the corporate asset ('top-down' test). [IAS 36.102]

Fair value less costs of disposal

The fair value element of fair value less costs of disposal is measured in accordance with the fair value measurement standard (see chapter 2.4).

Costs of disposal are incremental costs directly attributable to the disposal of an asset or CGU. Finance costs and income taxes are excluded, as are costs already recognised as a liability. [IAS 36.6, 28]

Value in use

'Value in use' represents the discounted expected future net cash flows from the continuing use and ultimate disposal of an asset or CGU. [IAS 36.6, 31]

Cash flows

The value in use calculation is based on cash flow projections approved by management. These cash flow forecasts should cover a maximum of five years unless a longer period can be justified. Thereafter, the cash flow projections are extrapolated over the useful life of the asset or CGU using a steady or declining growth rate that is consistent with that of the product, industry or country, unless there is clear evidence to support another basis. [IAS 36.33, 35]

The cash flows used in the calculation are those specific to the entity – i.e. they incorporate the entity's own assumptions about its future. [IAS 36.33]

Cash flows include cash inflows from continuing use, cash outflows necessary to generate the cash inflows including attributable overheads, and net cash flows from the ultimate disposal of the asset or CGU. [IAS 36.39, 41]

Unlike IFRS Accounting Standards, there is no concept of 'bottom-up' and 'top-down' impairment testing under US GAAP. The determination of the unit of account relative to corporate (enterprise) assets differs from IFRS Accounting Standards (see above), as does the method of testing discussed in this section.

Fair value

The fair value measurement Codification Topic applies to all fair value measurements, including the impairment of long-lived assets, goodwill and other indefinite-lived intangible assets (see chapter 2.4).

Unlike IFRS Accounting Standards, costs to sell are not included in determining whether assets held for use are impaired. [360-10-35-17]

Recoverable amount

Unlike IFRS Accounting Standards, the concept of 'value in use' is not used in US GAAP. Instead, the 'recoverable amount' of a depreciable or amortisable asset (asset group) is the sum of the undiscounted cash flows that are expected to result from the use and eventual disposition of the asset or asset group. The discussion in this section relates to the cash flows used in this test. [350-20-35, 360-10-35-17]

Cash flows

Cash flows estimates used are those consistent with management's internal budget assumptions and information communicated to others, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, US GAAP specifies that cash flows should be projected for the remaining useful life of the primary asset of the group – i.e. it does not limit the period for which cash flow forecasts may be used. [360-10-35-29 – 35-35]

Like IFRS Accounting Standards, the cash flows used to test the recoverability of depreciable and amortisable assets are those specific to the entity. [360-10-35-30]

Like IFRS Accounting Standards, cash flows include only the future cash flows that are directly associated with, and that are expected to arise as a direct result of, the use and eventual disposal of the asset (asset group). The cash flows include attributable overheads, like IFRS Accounting Standards. [360-10-35-29 – 35-35]

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IFRS Accounting Standards

In general, estimates of future cash flows do not include cash outflows that will be required to settle obligations that have been recognised as liabilities, and these liabilities are not deducted from the carrying amount of the CGU. However, such cash outflows are included if a recognised liability needs to be considered in determining the recoverable amount of a CGU – e.g. when a buyer would be required to assume the liability on disposal of the CGU. Such a liability is included in the carrying amount of the CGU to ensure consistency. In our view, lease liabilities should be treated in this way by a lessee, i.e. it should assess whether a buyer would be required to assume the lease liability on disposal of the CGU. [IAS 36.29, 43, 78, IU 05-16]

Inflows from assets that generate inflows that are largely independent of the cash inflows from the asset or CGU under review are also excluded. [IAS 36.43]

IFRS Accounting Standards do not provide specific guidance on cash flows related to environmental exit costs and the general principles apply (see above). If the disposal of a CGU would require the buyer to assume a liability (e.g. a decommissioning liability), then the carrying amount of the liability is deducted both from the CGU's carrying amount and from its value in use. [IAS 36.78, IU 05-16]

Cash flows exclude amounts from financing activities. [IAS 36.50]

Cash flow estimates reflect the asset in its current condition. Therefore, they exclude future capital expenditure that will improve or enhance the asset's performance, or restructurings to which the entity is not yet committed and the expected benefits related to restructuring. [IAS 36.44–47]

Expenditure that is necessary to maintain the performance of an asset is included in the cash flow estimates. [IAS 36.49]

US GAAP

Like IFRS Accounting Standards, cash flows of an asset group exclude the principal amount of any liabilities included in the asset group when that principal amount is not included in the carrying amount of the asset group. However, there are specific requirements for environmental exit costs (see below).

Cash flows (not just inflows) from assets that generate cash flows that are largely independent of the cash flows from the asset or asset group under review are also excluded, like IFRS Accounting Standards. [360-10-35-23]

Unlike IFRS Accounting Standards, for environmental exit costs that have not been recognised as a liability, whether they are included in the undiscounted expected future cash flows used to test a long-lived asset for recoverability depends on management's intent with respect to the asset. For environmental exit costs that have been recognised as a liability, the carrying amount of the asset (asset group) being tested for impairment includes the amount capitalised to the asset, and the estimated future cash flows to settle the liability are excluded from the undiscounted future cash flows used to test the asset for recoverability, like IFRS Accounting Standards. [360-10-35-18, 55-7 – 55-18]

Like IFRS Accounting Standards, the estimates of future cash flows used to test recoverability exclude interest that will be recognised as an expense as it is incurred. [360-10-35-29]

Like IFRS Accounting Standards, estimates of future cash flows used to test recoverability reflect the asset in its current condition. Therefore, like IFRS Accounting Standards, they exclude future capital expenditure that will improve or enhance the asset's service potential. [360-10-35-33]

Like IFRS Accounting Standards, only capital expenditure that is necessary to maintain the current service potential of an asset is included in cash flow estimates used to test recoverability. This would include expenditure necessary to reinvest in production capacity during the useful life of the primary asset of the asset group. [360-10-35-33]

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If a CGU consists of assets with different useful lives, including indefinite-lived intangible assets or goodwill when appropriate, all of which are essential to its ongoing operation, then the replacement of assets and components with shorter lives is considered to be part of the day-to-day servicing of the unit. These servicing costs are included when estimating the cash flows of the CGU. [IAS 36.49]

If an asset is not ready for use and requires future expenditure to prepare it for use, then these expected cash outflows are included in the estimated cash flows. [IAS 36.42]

If a CGU sells or purchases goods or services from another operation within the same consolidated group, and the goods or services could be sold in an active market, then the market price for the goods or services is used when estimating the cash inflows. Additionally, if an active market exists for the output from a group of assets, then that group of assets is a separate CGU even if the output is sold only to other divisions of the same entity (see above). [IAS 36.70]

If the cash flows of an asset or CGU are generated in a foreign currency, then the cash flows used in the calculation are in that foreign currency. If a CGU is a foreign operation, then any impairment loss is calculated in the foreign currency (the CGU's functional currency) and is then translated into the entity's presentation currency using the principles in chapter 2.7. [IAS 21.25, 36.54]

Discount rate

The discount rate is based on a market-related rate that reflects the current market assessment of risks specific to the asset at the current date. Therefore, although the cash flows in the value in use calculation are entity-specific, the discount rate is not. An entity typically estimates an appropriate rate using the WACC formula as a starting point and may adjust the WACC to develop a market participant discount rate. [IAS 36.55–56, A16–A18, BCZ53]

Estimates of future cash flows used to test recoverability for an asset group are based on the primary asset of the group (i.e. the most significant component of the asset group generating cash flows), like IFRS Accounting Standards. Therefore, like IFRS Accounting Standards, the replacement of assets with shorter lives is included when estimating the cash flows. However, unlike IFRS Accounting Standards, a primary asset cannot be an indefinite-lived intangible asset or goodwill. [360-10-35-31]

Like IFRS Accounting Standards, for assets that are under development, cash outflows expected in preparing the asset for use are included in cash flow estimates used to test recoverability. [360-10-35-35]

Unlike IFRS Accounting Standards, there is no specific guidance on estimating cash flows if an asset group sells goods or services to another operation within the same consolidated group, and the goods or services could be sold in an active market, and differences from IFRS Accounting Standards may arise in practice.

If the cash flows of an asset or asset group are generated in a foreign currency, then the cash flows used in the calculation are translated into the entity's functional currency for the purpose of assessing recoverability. If it is concluded that the asset or asset group is impaired, then any impairment loss is calculated in the foreign currency (the entity's functional currency) and is then translated into the entity's presentation currency using the principles in chapter 2.7, like IFRS Accounting Standards. [360-10-35-29 – 35-35]

Discount rate

Unlike IFRS Accounting Standards, the cash flows used to assess the recoverability of depreciable and amortisable assets are not discounted. If the undiscounted recoverability test is failed, then the cash flows used to measure fair value and calculate the amount of the impairment loss are discounted using a market participant discount rate. [360-10-35-17]

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Income tax considerations in impairment testing

Fair value less costs of disposal

When fair value is determined using a discounted cash flow technique, the assumptions used for the cash flows and discount rates reflect market participants' views (see chapter 2.4). In our experience, it is common for market participants to determine the fair value less costs of disposal using post-tax assumptions (i.e. post-tax cash flows and post-tax discount rate). [IFRS 13.B14, IAS 36.6]

Value in use

The impairment standard *prima facie* requires an entity to use pre-tax cash flows and a pre-tax discount rate to determine value in use. However, it also requires the discount rate in a value in use calculation to be based on a market participant's view (see above). Typically, the WACC formula is used as a starting point to estimate such a discount rate. WACC is a post-tax discount rate, which is why in our experience value in use calculations are predominantly performed on a post-tax basis. [IAS 36.50(b), 55, A15–A21]

When value in use is determined using post-tax cash flows and a post-tax discount rate, the pre-tax discount rate needs to be calculated to comply with the disclosure requirements of the impairment standard. In practice, an iterative method is used and the pre-tax discount rate is changed until the discounted pre-tax cash flows equate to the value in use already known from the post-tax calculation. [IAS 36.134(d)(v)]

Carrying amount and deferred tax liability recognised in a business combination

When temporary differences arise in a business combination, deferred taxes are recognised with a corresponding entry to goodwill (see chapter 3.13). In our view, a day one impairment loss cannot arise simply as a result of recognising a deferred tax liability in a business combination. For impairment testing purposes only, we believe that the following are possible approaches to avoid this anomaly:

- reduce the carrying amount of goodwill by the amount of the deferred tax liability recognised in the business combination; or
- reduce the carrying amount of the CGU by the amount of the deferred tax liability recognised in the business combination.

Income tax considerations in impairment testing

Fair value

Like IFRS Accounting Standards, because a market participant would consider tax implications in pricing the asset or asset group, the fair value measurement when measuring an impairment loss is generally on a post-tax basis.

Value in use

Unlike IFRS Accounting Standards, the concept of 'value in use' is not used in US GAAP.

Carrying amount and deferred tax liability recognised in a business combination

Like IFRS Accounting Standards, when temporary differences arise in a business combination, deferred taxes are recognised with a corresponding entry to goodwill (see chapter 3.13). Unlike IFRS Accounting Standards, the carrying amount of the reporting unit is always reduced by the amount of the deferred tax liability recognised in the business combination. [350-20-35-7]

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Adjusting the carrying amount of goodwill or the CGU by the deferred tax liability recognised in the business combination to avoid the day one impairment loss may create some complexity in subsequent periods. This is because, in our view, goodwill should be adjusted for the amount of the deferred tax liability based on temporary differences initially recognised in the business combination but not reversed at the date of the impairment test. If an impairment loss is identified in a subsequent period, then we believe that it should be allocated first to reduce the unadjusted carrying amount of goodwill – i.e. before any adjustment for the amount of the deferred tax liability. [IAS 36.104]

Non-controlling interests

If NCI were initially measured based on their proportionate interest in the identifiable net assets of the subsidiary, then the carrying amount of goodwill allocated to such a CGU or group of CGUs is grossed up to include the unrecognised goodwill attributable to the NCI. For impairment testing purposes, it is this adjusted carrying amount that is compared with the recoverable amount. This gross-up is not required if NCI were initially measured at fair value. [IAS 36.C4]

The impairment standard illustrates the gross-up of the carrying amount of goodwill allocated to a CGU or group of CGUs on the same basis as profit or loss is allocated to the parent and the NCI. However, in our view the accounting standard does not preclude using another rational basis of gross-up – e.g. one that takes into account any control premium paid in the acquisition. [IAS 36.C4, IE62–IE65]

If a non-wholly owned CGU is impaired, then any impairment losses are allocated between the amount attributable to the parent and to NCI. The impairment standard refers to allocating the impairment loss on the same basis as profit or loss is allocated to the parent and the NCI (i.e. a mechanical allocation). However, in our view the accounting standard does not preclude using another rational basis of allocation – e.g. one that takes account of any control premium paid in the acquisition. [IAS 36.C6]

If a non-wholly owned CGU is impaired, then to the extent that the goodwill impairment loss is allocated to NCI that were initially measured at their proportionate interest in the identifiable net assets of the subsidiary, that impairment is not recognised in the financial statements. [IAS 36.C6, C8, IE66–IE68]

Unlike IFRS Accounting Standards, goodwill is separated into two components to facilitate the accounting for basis differences associated with the goodwill. The first component of goodwill equals the lesser of financial statement goodwill and tax-deductible goodwill, including any carryover-tax-deductible goodwill of the acquiree. The second component of goodwill is the remainder of any goodwill for financial statement purposes or tax purposes. Unlike IFRS Accounting Standards, if an impairment loss is identified in a subsequent period and an entity has second component financial statement goodwill, we believe there are two acceptable methods that can be applied: (1) the impairment loss is allocated first to the second component financial statement goodwill to the extent possible and then any remaining loss to the first component goodwill or (2) the impairment loss is allocated on a pro rata basis to the reporting unit's first component and second component financial statement goodwill.

Non-controlling interests

Unlike IFRS Accounting Standards, the carrying amount of goodwill is not grossed up for impairment testing because NCI are measured at fair value in the acquisition accounting (see chapter 2.6). [350-20-35-57A]

If a non-wholly owned reporting unit is impaired, then any impairment losses are allocated between the amount attributable to the parent and to the NCI on a rational basis, which may give rise to differences from IFRS Accounting Standards in practice. [350-20-35-57A]

Because NCI are measured at fair value in the acquisition accounting (see chapter 2.6), the allocation of impairment losses to NCI measured on a different basis is not relevant.

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Recognition and measurement of an impairment loss

An impairment loss is recognised to the extent that the carrying amount of an asset or a CGU exceeds its recoverable amount. [IAS 36.6, 59]

Impairment losses are generally recognised in profit or loss. However, assets that are measured at a revalued amount under another accounting standard are first revalued applying the principles in the relevant accounting standard. Any impairment loss is calculated on the basis of the revalued carrying amount. Any impairment loss is charged directly to the revaluation reserve in OCI to the extent that it reverses a previous revaluation surplus related to the same asset. Any excess is recognised in profit or loss. [IAS 36.60]

Any impairment loss is allocated first by writing down the goodwill that is allocated to the CGU and then pro rata to the CGU's other assets (including intangible assets) in the scope of the impairment standard on the basis of their carrying amount. However, no asset is written down to below its known recoverable amount. A liability for any remaining amount of the impairment loss is recognised only if it is required by another accounting standard. [IAS 36.104–108]

Recognition and measurement of an impairment loss

Unlike IFRS Accounting Standards, an impairment loss is recognised for a depreciable or amortisable asset (asset group) only if the carrying amount of the asset (asset group) exceeds its recoverable amount, which is the undiscounted entity-specific future cash flows of the asset (asset group). If the asset is not recoverable, then an asset's (asset group's) impairment is calculated with reference to the fair value of that asset (asset group) in comparison to its carrying amount. [360-10-35-17]

Unlike IFRS Accounting Standards, goodwill is impaired if the carrying amount of the reporting unit to which it is allocated exceeds the fair value of the reporting unit. An impairment loss is the excess of the reporting unit's carrying amount over its fair value, which may differ from the amount calculated under IFRS Accounting Standards. [350-20-35-2]

Unlike IFRS Accounting Standards, an impairment loss for an indefinite-lived intangible asset is recognised if the fair value of the asset is less than the asset's carrying amount. [350-30-35-19]

Unlike IFRS Accounting Standards, the revaluation of property, plant and equipment and intangible assets is not permitted. Therefore, impairment losses are always recognised in profit or loss. [350-20-45-2 – 45-3, 360-10-45-4]

Unlike IFRS Accounting Standards, any impairment loss is allocated on a pro rata basis to those depreciable and amortisable assets in the asset group that are in the scope of the Codification Subtopic. Indefinite-lived intangible assets and goodwill are tested separately for impairment and no impairment loss from testing those assets is allocated to the depreciable and amortisable assets. [360-10-35-17, 35-28]

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Reversal of impairment

At each reporting date, an entity assesses whether there is an indication that an impairment loss recognised in prior periods for an asset other than goodwill has reversed. If there is such an indication and the recoverable amount of the impaired asset or CGU increases subsequently, then the impairment loss is generally reversed. [IAS 36.110, 117]

An impairment loss is not reversed when the increase in recoverable amount is caused only by the passage of time – i.e. unwinding of the discount used in calculating value in use. [IAS 36.116]

An impairment loss for goodwill is never reversed, including an impairment loss recognised in a previous interim period. [IAS 36.122, 124, IFRIC 10.8]

The maximum amount of a reversal is the lower of:

- the amount necessary to bring the carrying amount of the asset to its recoverable amount (if this is determinable); and
- the amount necessary to restore the assets of the CGU to their pre-impairment carrying amounts, less subsequent depreciation or amortisation that would have been recognised. [IAS 36.117, 123]

A reversal of an impairment loss is generally recognised in profit or loss. A reversal of an impairment loss on a revalued asset is recognised in profit or loss to the extent that it reverses an impairment loss on the same asset that was previously recognised as an expense in profit or loss. Any additional increase in the carrying amount of the asset is treated as a revaluation increase. [IAS 36.119]

Reversal of impairment

Unlike IFRS Accounting Standards, an impairment loss may not be reversed if the fair value of the impaired asset or asset group increases subsequently. [350-20-35-13, 350-30-35-14, 360-10-35-20]

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3.12 Provisions, contingent assets and liabilities

(IAS 37, IFRIC 1, IFRIC 5, IFRIC 6, IFRIC 21)

Overview

- A provision is recognised for a legal or constructive obligation arising from a past event, if there is a probable outflow of resources and the amount can be estimated reliably. 'Probable' in this context means more likely than not.
- A 'constructive obligation' arises when an entity's actions create valid expectations of third parties that it will accept and discharge certain responsibilities.
- A provision is measured at the 'best estimate' of the expenditure to be incurred.
- If there is a large population of items, then the obligation is generally measured at its expected value.
- If there is a single item, then the obligation is generally measured at its individual most likely outcome. If there is a continuous range of equally possible outcomes for a single event, then the obligation is measured at the mid-point in the range.
- If the possible outcomes of a single obligation are mostly higher (lower) than the single most likely outcome, then the obligation is measured at an amount higher (lower) than the single most likely outcome.

3.12 Contingencies and other 'provisions'

(Topic 450, Topic 410, Topic 420, Topic 460, Topic 710, Topic 712, Topic 720, SAB Topic 5Y)

Overview

- A loss contingency is recognised if it is probable that a liability has been incurred and the amount is reasonably estimable. 'Probable' in this context means likely to occur, which is a higher recognition threshold than IFRS Accounting Standards. Recognised loss contingencies are referred to as 'provisions' in this chapter.
- Under the legal doctrine of promissory estoppel, a constructive obligation may arise when an entity's actions create reasonable expectations of third parties that it will accept and discharge certain responsibilities, which is narrower than the concept under IFRS Accounting Standards. In addition, unlike IFRS Accounting Standards, constructive obligations are recognised only if this is required by a specific Codification topic/subtopic.
- A provision is measured using a 'reasonable estimate', which differs in some respects from IFRS Accounting Standards. In addition, some obligations that would be deemed a provision under IFRS Accounting Standards are measured at fair value, unlike IFRS Accounting Standards.
- Unlike IFRS Accounting Standards, US GAAP does not provide specific measurement guidance for provisions related to a large population of items.
- Unlike IFRS Accounting Standards, if no amount within a range is a better estimate than any other, then the obligation is measured at the low end of the range.
- Unlike IFRS Accounting Standards, an obligation is measured at the single most likely outcome even if the possible outcomes are mostly higher or lower than that amount.

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Overview (continued)

- Provisions are discounted if the effect of discounting is material.
- A provision is not recognised for costs that need to be incurred to operate in the future or for expected future operating losses.
- A provision for restructuring costs is not recognised until there is a formal plan and details of the restructuring have been communicated to those affected by the plan.
- IFRS Accounting Standards do not specifically address provisions for contract termination costs.
- Provisions are not recognised for repairs or maintenance of own assets or for self-insurance before an obligation is incurred.
- A provision is recognised for a contract that is onerous.
- 'Contingent liabilities' are present obligations with uncertainties about either the probability of outflows of resources or the amount of the outflows, and possible obligations whose existence is uncertain.
- Contingent liabilities are not recognised except for those that represent present obligations in a business combination.

Overview (continued)

- Provisions are not discounted except in limited cases, in which case the specific requirements may differ from IFRS Accounting Standards.
- Like IFRS Accounting Standards, a provision is not recognised for future operating losses.
- Like IFRS Accounting Standards, a provision for restructuring costs is not generally recognised until there is a formal plan and details of the restructuring have been communicated to those affected by the plan, although certain benefits are subject to specific recognition requirements that differ from IFRS Accounting Standards.
- Unlike IFRS Accounting Standards, a liability for contract termination costs is recognised only when the contract has been terminated pursuant to its terms or the entity has permanently ceased using the rights granted under the contract.
- Like IFRS Accounting Standards, provisions are not recognised for repairs or maintenance of own assets or for self-insurance before an obligation is incurred.
- Unlike IFRS Accounting Standards, there is no general requirement to recognise a loss for onerous contracts.
- Unlike IFRS Accounting Standards, 'loss contingencies' are uncertain obligations, both recognised and unrecognised.
- Unlike IFRS Accounting Standards, loss contingencies may be either recognised or unrecognised. Unlike IFRS Accounting Standards, loss contingencies are recognised in a business combination only when the acquisition date fair value is determinable within the measurement period, or if the contingency is likely to occur and the amount is reasonably estimable.

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Overview (continued)

- **Details of contingent liabilities are disclosed in the notes to the financial statements unless the probability of an outflow is remote.**
- **'Contingent assets' are possible assets whose existence is uncertain.**
- **IFRS Accounting Standards set a high threshold for contingent assets, which are not recognised in the statement of financial position until their realisation is virtually certain, at which point the assets are no longer considered contingent. If an inflow of economic benefits is probable (more likely than not), then details are disclosed in the notes.**
- **A reimbursement right is recognised as a separate asset when recovery is virtually certain, capped at the amount of the related provision. Any gain in excess of this amount is recognised only when it is realised.**

Overview (continued)

- **Like IFRS Accounting Standards, information on contingencies is generally disclosed in the notes to the financial statements unless the probability of an outflow is remote; however, IFRS Accounting Standards require more detailed disclosures about contingencies than US GAAP. Unlike IFRS Accounting Standards, certain loss contingencies are disclosed even if the likelihood of an outflow is remote.**
- **A 'gain contingency' is an item whose existence will be confirmed by the occurrence or non-occurrence of uncertain future events, like IFRS Accounting Standards.**
- **Like IFRS Accounting Standards, US GAAP sets a high threshold for gain contingencies. However, unlike IFRS Accounting Standards, they are not recognised until they are realised or realisable. Unlike IFRS Accounting Standards, there is no specific probability threshold for disclosing gain contingencies and disclosures should avoid misleading information about the likelihood of realisation.**
- **Unlike IFRS Accounting Standards, a reimbursement right is recognised when recovery is likely to occur (which is a lower threshold than 'virtually certain' under IFRS Accounting Standards) to the extent of any related loss or cost incurred. Unlike IFRS Accounting Standards, any gain in excess of this amount is recognised when it is realised or realisable. Like IFRS Accounting Standards, the reimbursement is recognised as a separate asset.**

Unlike IFRS Accounting Standards, the term 'loss contingency' under US GAAP refers to both recognised and unrecognised uncertain obligations. US GAAP does not have separate terms to describe loss contingencies that meet the recognition criteria vs those that do not. However, the term 'contingent liability' is often used in practice to describe a recognised loss contingency, unlike IFRS Accounting Standards (except for present obligations assumed in a business combination – see chapter 2.6). [450-20-20]

Loss contingencies that are recognised for US GAAP purposes are referred to as 'provisions' throughout this chapter for ease of comparison.

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Scope

This chapter deals with all provisions other than those resulting from non-onerous executory contracts or those addressed by a specific accounting standard – e.g.:

- restructurings recognised as liabilities in a business combination (see chapter 2.6);
- financial instruments including guarantees (see chapter 7.1);
- income taxes, including income tax uncertainties (see chapter 3.13);
- obligations for employee benefits (see chapter 4.4);
- liabilities for share-based payments (see chapter 4.5);
- liabilities for insurance contracts (see chapter 8.1); and
- liabilities for leases, unless a lease becomes onerous before the lease commencement date or a lease to which an entity applies one of the recognition exemptions becomes onerous (see chapter 5.1). [IAS 37.1–2, 5]

The provisions dealt with in this chapter are in the scope of the provisions standard.

Definition and recognition

A 'provision' is a liability of uncertain timing or amount. A provision is recognised when:

- there is a legal or constructive obligation arising from past events, or when it is more likely than not that a legal or constructive obligation has arisen from a past event;
- it is more likely than not that there will be an outflow of benefits; and
- the amount can be estimated reliably. [IAS 37.10, 14–16, 23]

Possible new legislation gives rise to a legal obligation when it is virtually certain to be enacted. However, in many cases it is not possible to be virtually certain that the legislation will be enacted before actual enactment. [IAS 37.22]

Scope

Like IFRS Accounting Standards, this chapter deals with all provisions (referred to as 'contingencies' under US GAAP) other than those resulting from non-onerous executory contracts or those addressed by specific requirements, such as:

- restructurings recognised as liabilities in a business combination (see chapter 2.6);
- financial instruments, including guarantees (see chapter 7.1);
- deferred tax and income tax uncertainties (see chapter 3.13);
- obligations for employee benefits (see chapter 4.4);
- liabilities for share-based payments (see chapter 4.5);
- liabilities for insurance contract obligations written by insurance entities (see chapter 8.1); and
- liabilities for leases, unless a lease becomes onerous before the lease commencement date or a lease to which an entity applies the recognition exemption becomes onerous (see chapter 5.1).

Unlike IFRS Accounting Standards, there are different Codification topics that address different types of provisions. As a consequence, the comparison between IFRS Accounting Standards and US GAAP differs depending on the type of provision.

Definition and recognition

Unlike IFRS Accounting Standards, a 'contingency' is an existing condition, situation or circumstance involving uncertainty that can result in a possible gain or loss, depending on future events. Unlike IFRS Accounting Standards, a loss contingency (provision) is recognised when:

- it is probable that a liability has been incurred; 'probable' is defined as likely to occur, which is a higher threshold than 'more likely than not' under IFRS Accounting Standards; and
- the amount is reasonably estimable. [450-10-20, 450-20-25-2]

Unlike IFRS Accounting Standards, legal obligations arising from legislation are recognised only when the legislation is enacted. [410-20-55-1, 450-10-55-4]

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A constructive obligation arises when an entity, by past practice or sufficiently specific communication to affected parties, has created a valid expectation in other parties that it will carry out an action. A management or board decision alone (e.g. to restructure) does not give rise to a constructive obligation; see below for decommissioning, and chapter 4.4 for termination benefits. [IAS 37.10, 75]

Under the doctrine of promissory estoppel, a constructive obligation may arise when an entity has created a reasonable expectation in other parties that it will carry out an action; this test is narrower than a constructive obligation under IFRS Accounting Standards and depends on the facts and circumstances, including the laws and regulations of a particular jurisdiction. Like IFRS Accounting Standards, a management or board decision alone does not give rise to a constructive obligation. However, unlike IFRS Accounting Standards, constructive obligations are recognised only if recognition is required by a specific Codification topic/subtopic; see below for asset retirement obligations, and chapter 4.4 for termination benefits. [410-20-15-2, 710-10-25-2]

Many entities make public statements about their 'net-zero' or similar climate-related commitments. When an entity makes a commitment to be net zero – e.g. by 2050 – this usually means that by 2050 it plans to reduce its greenhouse gas emissions to as close to zero as possible and offset its remaining emissions. On its own, setting and announcing a climate-related target does not automatically trigger a liability. An entity considers the nature of its commitment and how it will fulfil it. The commitment needs to create a present obligation at the reporting date as a result of a past event (e.g. 'damage done') for a liability to exist at the reporting date. Other recognition criteria also need to be met to recognise a liability. [IU 03-24]

Under the general loss contingency recognition guidance, a provision is recognised when it is probable that a liability has been incurred, and the amount is reasonably estimable. We would not generally expect significant differences in practice from the outcome under IFRS Accounting Standards. [450-20-25-2]

An entity may be subject to penalties only if obligating events are detected.

- In our view, if an entity is obliged to self-report obligating events, then the detection risk (i.e. the possibility that the event will not be detected) should not be considered when measuring the obligation. Examples of events that generally require self-reporting include, but are not limited to, taxes (see chapter 3.13 for income tax exposures) and, in some countries, environmental contamination.
- When self-reporting is not required and there is uncertainty about the amount of an obligation in respect of a past event, then we believe that it may be appropriate to consider detection risk in measuring the provision (i.e. the possibility that the event will not be detected). [IFRIC 23.8]

An entity may be subject to penalties only if obligating events are detected. In our view, an entity should not consider the detection risk (i.e. the possibility that the event will not be detected) in determining whether an obligation has been incurred. If an obligation has been incurred, then the entity applies requirements in the relevant Codification topic/subtopic. If there is uncertainty about whether an obligation has been incurred, then the Contingencies Codification Topic applies and it may be appropriate to consider detection risk in measuring the provision. This different approach may result in different outcomes from IFRS Accounting Standards.

An entity may be involved in a dispute, in which the existence of a liability is uncertain, and be required to make a payment pending resolution of the case or may choose to do so to avoid interest charges – e.g. in a dispute with a tax authority about an uncertain levy in the scope of the provisions standard. Such a payment meets the definition of an asset (see chapter 1.2). [CF 4.3, IU 01-19]

Like IFRS Accounting Standards, if a payment is made before the resolution of a dispute, then the payment in advance may be an asset provided that the entity has determined that an unfavourable outcome and loss is not estimable or probable.

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If the existence of an obligation depends on the future actions of the entity, then a provision is not recognised until the obligation is unavoidable. [IAS 37.19]

Generally, a provision cannot be recognised for costs that need to be incurred to operate in the future (e.g. as part of an entity's transition to net-zero operations) or for expected future operating losses, with the exception of qualifying restructuring costs and onerous contracts (see below). [IAS 37.18, 63, 66, IU 03-24]

A provision for restructuring costs is not recognised until there is a formal plan and details of the restructuring have been communicated to those affected by the plan. [IAS 37.71–72]

A 'contingent liability' is an obligation of sufficient uncertainty that it does not qualify for recognition as a provision, unless it is acquired in a business combination. The uncertainty may arise due to any of the following reasons.

- It is a *possible* obligation (i.e. one whose existence will be confirmed by the occurrence or non-occurrence of uncertain future events not wholly within the control of the entity). For example, if an entity is jointly and severally liable for an obligation, then the portion of the obligation that is expected to be met by other parties is an example of a possible obligation.
- It is a *present* obligation, but it is not more likely than not that there will be an outflow of resources embodying economic benefits, so that the probability of an outflow is 50 percent or less. An example is a claim against an entity if the entity concludes that it is liable but that it is likely to defend the case successfully.
- It is a *present* obligation, but its amount cannot be estimated reliably. These cases are expected to be extremely rare. [IAS 37.10, 29]

Like IFRS Accounting Standards, if the existence of an obligation depends on the future actions of the entity, then a provision is not generally recognised until the obligation is unavoidable, except for guarantees (see chapter 7.1). However, some Codification topics/subtopics have different recognition requirements, which may result in differences from IFRS Accounting Standards. [450-20-25-2, 460-10-25-3]

Like IFRS Accounting Standards, a provision cannot be recognised for future expenses and operating losses unless a specific Codification topic/subtopic requires recognition – e.g. for qualifying restructuring costs (see below). [420-10-25-3, 450-20-25-3]

A provision for restructuring costs to terminate employees is not generally recognised until there is a formal plan and details of the restructuring have been communicated to those affected by the plan, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, a provision is recognised only as employees accept the offer (for benefits to be paid under a non-retirement post-employment plan) or when a loss is probable (contractual termination benefits). [420-10-25-1 – 25-2, 25-4, 712-10-25-1 – 25-2]

Unlike IFRS Accounting Standards, the term 'loss contingencies' under US GAAP refers to both recognised and unrecognised uncertain obligations. US GAAP does not have separate terms to describe loss contingencies that meet the recognition criteria and those that do not.

Although both IFRS Accounting Standards and US GAAP use the term 'probable' as a recognition threshold, under US GAAP 'probable' is defined as likely to occur, which is a higher recognition threshold than the more-likely-than-not (above 50 percent) threshold used under IFRS Accounting Standards. [450-20-20]

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Contingent liabilities are not recognised in the statement of financial position unless they were assumed in a business combination. A contingent liability assumed in a business combination is recognised if it is a present obligation that arises from past events and its fair value can be measured reliably (see chapter 2.6). [IFRS 3.23, IAS 37.27]

If a present obligation relates to a past event, the possibility of an outflow is probable (i.e. more likely than not) and a reliable estimate can be made, then the obligation is not a contingent liability, but instead is a liability for which a provision is required. [IAS 37.14]

The expectation that an outflow related to an obligation will be reimbursed – e.g. that an environmental obligation will be covered by an insurance policy – does not affect the assessment of the probability of an outflow for the obligation. [IAS 37.53]

A 'contingent asset' is a possible asset that arises from past events and whose existence will be confirmed by the occurrence or non-occurrence of uncertain future events not wholly within the control of the entity. [IAS 37.10]

IFRS Accounting Standards set a high threshold for contingent assets, which are not recognised in the statement of financial position until their realisation is virtually certain, at which point the assets are no longer considered contingent. For a discussion of the recognition of a reimbursement right, see below. [IAS 37.31, 33, 35]

Measurement

The amount recognised as a provision is the best estimate of the expenditure to be incurred. [IAS 37.36]

If the provision is being made for a large population of items, such as for product warranties, then the provision is measured at its expected value, which considers all possible outcomes weighted based on their probabilities. [IAS 37.39]

Items that are not probable to result in an outflow of resources are not recognised, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, there are exceptions for certain guarantees that are recognised at fair value. A loss contingency assumed in a business combination is recognised when either fair value is determinable within the measurement period or it is probable that an obligation exists at the date of acquisition and the amount can be reasonably estimated (see chapter 2.6); this different approach may give rise to differences from IFRS Accounting Standards in practice. [450-20-25-2, 460-10-25-1 – 25-4, 805-20-25-19 – 25-20]

Like IFRS Accounting Standards, if a possible obligation relates to a past event, the possibility of an outflow is probable, which unlike IFRS Accounting Standards means likely to occur, and a reasonable estimate can be made, then the obligation is recognised as a liability. [450-20-25-2]

Like IFRS Accounting Standards, the expectation that an obligation will be reimbursed does not affect the assessment of the probability of an outflow for the obligation. [450-20-25-2]

A 'gain contingency' is an item whose existence will be confirmed by the occurrence or non-occurrence of uncertain future events, like IFRS Accounting Standards. [450-20-20]

Like IFRS Accounting Standards, US GAAP sets a high threshold for the recognition of gain contingencies. However, unlike IFRS Accounting Standards, they are not recognised until they are realised or realisable. Although the wording differs from IFRS Accounting Standards regarding the threshold, we would not generally expect significant differences in practice. For a discussion of the recognition of a reimbursement right, see below. [410-30-35-8, 450-20-55-17A, 450-30-25-1]

Measurement

Unlike IFRS Accounting Standards, the amount recognised as a provision depends on the specific Codification topic/subtopic that applies. In some cases, US GAAP requires a provision to be measured at fair value (e.g. asset retirement obligations or decommissioning, and one-time termination benefits); in other cases, it is the reasonably estimated amount, the best estimate or the expected value. [410-20-30-1, 410-30-30-1, 420-10-30-1, 450-20-30-1]

Unlike IFRS Accounting Standards, US GAAP does not provide specific measurement guidance for provisions related to a large population of items. Therefore, differences from IFRS Accounting Standards may arise in practice. [450-20-30-1]

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If there is a continuous range of possible outcomes in which each value is as likely as any other, then the provision is measured at the mid-point of the range. [IAS 37.39]

If a single obligation is being measured and the possible outcomes are mostly higher (lower) than the single most likely outcome, then the amount provided for will be higher (lower) than the single most likely outcome. [IAS 37.40]

In our view, when a provision is measured at its best estimate, which is less than the amount that could be payable, the difference between the two amounts is *not* a contingent liability, and there is no requirement to disclose the possible additional obligation. [IAS 1.125, 37.85(b)]

IFRS Accounting Standards do not provide much guidance on the types of costs to be included in the measurement of a provision. In our view, anticipated *incremental* costs that are related directly to the settlement of a provision should be included in the measurement of the provision to the extent that a third party who assumes the liability would require compensation. This is likely to be the case if the incremental costs are probable and can be estimated reliably. Therefore, we believe that costs that are not incremental should not be included in the measurement of a provision, even if there is a reasonable basis for allocating a portion of these costs to the settlement of the provision. [IAS 37.18, 36–37]

If the effect is material, then the estimate of a provision is discounted at a pre-tax rate that reflects the time value of money and the risks specific to the liability, even if the timing of the outflows is not fixed or determinable. Risk is reflected by adjusting either the cash flows or the discount rate. In our view, the rate of return on assets set aside to fund an obligation should not be used to discount the provision. [IAS 37.45, 47]

Unlike IFRS Accounting Standards, if no amount within a range is a better estimate than any other, then the low end of the range is provided for when the probable criterion is met. [450-20-30-1]

Unlike IFRS Accounting Standards, if the reasonable estimate of a loss is a range, and one amount within the range is considered a better estimate than any other amount, then that amount is provided for. [450-20-30-1]

Unlike IFRS Accounting Standards, both the amount of any recognised loss and possible additional exposure above that amount are described under US GAAP as 'loss contingencies'. Unlike IFRS Accounting Standards, an entity provides either disclosure of the potential range of loss or a statement that an estimate cannot be made. [450-20-20, 50-4]

There is guidance on the measurement of certain provisions – e.g. environmental remediation liabilities, asset retirement obligations and involuntary redundancy. For provisions that are subject to the general guidance on the recognition of loss contingencies, the *incremental* amount is provided for, like IFRS Accounting Standards. [410, 420]

Unlike IFRS Accounting Standards, provisions are generally not discounted. However, certain obligations (e.g. environmental remediation liabilities) are discounted if the amount and timing of payments is fixed or reliably determinable; such liabilities are generally discounted using a risk-adjusted rate, which may differ from IFRS Accounting Standards. Obligations that are required to be measured at fair value (e.g. asset retirement obligations and one-time termination benefits) may be measured as discounted future cash flows, like IFRS Accounting Standards. Like IFRS Accounting Standards, the return on assets set aside to fund an obligation is not used to discount the provision. [410-20-30-1, 410-30-35-12, 420-10-30-2, 450-20-S99-1]

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Provisions are remeasured at each reporting date based on the best estimate of the expenditure to be incurred, and for changes in interest rates. [IAS 37.36, 59, IFRIC 1.4]

Future events are reflected in measuring a provision if there is sufficient objective evidence that they will occur. For example, a technological development that would make decommissioning less expensive is considered if there is evidence that the new technology will be available. [IAS 37.48–49]

Gains from the expected disposal of assets are not considered in measuring a provision. [IAS 37.51]

Reimbursements

Reimbursements (e.g. insurance recoveries, indemnities or warranty claims) are recognised as a separate asset when recovery is virtually certain. The amount recognised is limited to the amount of the related provision. Any gain in excess of this amount is recognised only when it is realised. Changes in the amount of a reimbursement right are recognised in profit or loss. For the presentation of a reimbursement and the related expense in the statement of profit or loss, see chapter 4.1. [IAS 37.53]

Specific application guidance

Restructuring

A 'restructuring' is a programme planned and controlled by management that significantly changes the scope of the business or the manner in which it is conducted. [IAS 37.10]

Like IFRS Accounting Standards, provisions are remeasured at each reporting date. However, the amounts may be different depending on whether measurement is based on current reasonable estimates of the settlement amount or fair value, which depends on which Codification topic/subtopic applies. Further differences from IFRS Accounting Standards may arise because some topics/subtopics that require provisions to be discounted require an adjustment for changes in interest rates, whereas others prohibit adjustments for changes in interest rates (e.g. termination benefits). [410-20-35-3, 410-30-35-1 – 35-5, 420-10-35-1]

For provisions measured at fair value, the provision reflects assumptions that market participants would make about the outcome of the uncertainty related to amount and timing, including uncertainty related to advances in technology and the effects on cash flows (see chapter 2.4). Therefore, differences from IFRS Accounting Standards may arise in practice.

Like IFRS Accounting Standards, gains from the expected disposal of assets are not considered in measuring a provision. [450-30-25-1]

Reimbursements

Unlike IFRS Accounting Standards, a reimbursement (e.g. an insurance recovery, indemnity or warranty claim) is recognised up to the amount of the related loss or cost incurred when it is probable ('likely to occur', which is a lower threshold than 'virtually certain' under IFRS Accounting Standards) and can be reasonably estimated. Any gain in excess of this amount is recognised when it is realised (like IFRS Accounting Standards) or realisable (unlike IFRS Accounting Standards). Like IFRS Accounting Standards, the reimbursement is recognised as a separate asset and changes in measurement are recognised in profit or loss. For the presentation of a reimbursement and the related loss or costs in the income statement, see chapter 4.1. [210-20-45-1, 410-30-35-8, 450-20-55-17A, 450-30-25-1]

Specific application guidance

Exit activities (restructuring)

The term 'exit activities' encompasses what would be a 'restructuring' under IFRS Accounting Standards, but may be broader. The US GAAP requirements apply broadly to exit activities that do not necessarily involve a newly acquired business or the disposal of a business. [420-10-15-3]

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IFRS Accounting Standards

A constructive obligation for a restructuring arises only when:

- there is a formal plan for the restructuring specifying:
  - the business or part of a business concerned;
  - the principal locations affected;
  - the location, function and approximate number of employees whose services will be terminated;
  - the expenditure to be incurred; and
  - when the plan will be implemented; and
- the entity has raised a valid expectation in those affected that it will carry out the plan by either:
  - starting to implement the plan; or
  - announcing its main features to those affected by it. [IAS 37.72]

Implementation of the plan should begin as soon as possible and be completed in a timeframe that makes significant changes unlikely. [IAS 37.74]

For a discussion of accounting for employee termination payments, see chapter 4.4.

IFRS Accounting Standards do not specifically address provisions for contract termination costs. In our view, the costs of cancelling or terminating a contract should not be recognised until the contract is actually terminated, unless the contract becomes onerous.

Restructuring provisions include only incremental costs associated directly with the restructuring. [IAS 37.80]

IFRS Accounting Standards prohibit the recognition of a provision for costs associated with ongoing activities. [IAS 37.80(b), 81]

US GAAP

Unlike IFRS Accounting Standards, US GAAP divides restructuring into three types of cost:

- termination benefits;
- costs to terminate a contract; and
- costs to consolidate facilities or relocate employees. [420-10-05-2]

US GAAP contains separate criteria for the recognition of each type of cost (see below).

Unlike IFRS Accounting Standards, US GAAP has different requirements for the recognition of an employee termination payment depending on whether it is a one-time benefit, an ongoing benefit arrangement, or pursuant to a plan or a contract. For a discussion of accounting for employee termination payments, see chapter 4.4.

Like IFRS Accounting Standards, a provision for costs to terminate a contract before the end of its term is recognised only when the contract is terminated. Unlike IFRS Accounting Standards, a provision for an onerous contract (i.e. for costs the entity will continue to incur under a contract for its remaining term without economic benefit) is recognised when the entity permanently ceases using the rights granted under the contract, which is likely to be later than IFRS Accounting Standards. When the provision is recognised, it is measured at fair value, which may differ from IFRS Accounting Standards. [420-10-25-11 – 25-13, 30-7]

Unlike IFRS Accounting Standards, restructuring costs other than employee termination benefits and contract termination costs are recognised at fair value when the liability is incurred, which is generally in the period in which the goods or services (e.g. relocation services) are received. [420-10-25-15, 30-10]

Like IFRS Accounting Standards, a provision cannot be recognised for costs associated with ongoing activities. [420-10-25-3]

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Warranties

A constructive obligation generally arises from an established practice of repairing or replacing faulty or defective goods that are returned (even if the entity is not legally obliged to do so). The obligating event is the sale of goods that turn out to be defective or faulty, unless the warranty is a service-type warranty and is therefore accounted for as a separate performance obligation (see chapter 4.2). Some warranties (e.g. warranties issued by a third party for goods sold by a manufacturer, dealer or retailer) are in the scope of the insurance contracts standard (see chapter 8.1). [IAS 37.IE.C.Ex1, IFRS 17.3, 7(a)]

A warranty provision is measured based on the probability of the goods requiring repair or replacement, and the best estimate of the costs to be incurred, in respect of defective products sold on or before the reporting date. [IAS 37.IE.C.Ex1]

Self-insurance

Entities may elect not to insure against some risks, or to obtain insurance that covers only a certain portion of incurred losses; this is sometimes referred to as 'self-insurance'. A provision is not recognised for future losses or costs associated with self-insurance. However, a provision is recognised for costs related to loss events (insured or not) that occur before the reporting date. [IAS 37.14, 18, IFRS 17.B27(c)]

Environmental liabilities

Although there is no formal distinction between environmental and decommissioning provisions under IFRS Accounting Standards, in general environmental provisions exclude provisions related to damage incurred in installing an asset (see decommissioning provisions below).

A provision is recognised for environmental obligations when:

- there is either a legal or constructive obligation to restore a site;
- the damage has already occurred;
- it is probable that a restoration cost will be incurred; and
- the costs can be reliably estimated. [IAS 37.14]

Warranties

Like IFRS Accounting Standards, an entity may have an established practice of repairing or replacing faulty or defective goods that are returned (even if the entity is not legally obliged to do so – e.g. an 'implied warranty' for goods returned outside the warranty period). Like IFRS Accounting Standards, an entity accrues for losses that are estimable and probable if the warranty is an assurance-type warranty, or accounts for the warranty as a separate performance obligation under the revenue Codification Topic (see chapter 4.2) if it is a service-type warranty. Unlike IFRS Accounting Standards, warranty obligations incurred in connection with the sale of goods or services are not in the scope of the insurance Codification Topic. [450-20-55-2. 460-10-25-5]

Like IFRS Accounting Standards, a warranty provision is measured using estimates of future outflows associated with the obligation. Although this is described as a 'reasonable estimate' under US GAAP, for warranty obligations this will generally represent the estimated cost of settling the warranty claim, like IFRS Accounting Standards. [460-10-25-5 – 25-6]

Self-insurance

Like IFRS Accounting Standards, a provision is not recognised for future losses or costs associated with self-insurance. However, a provision is recognised for costs related to loss events (insured or not) that occur before the reporting date, like IFRS Accounting Standards. [450-20-25-2]

Environmental liabilities

Unlike IFRS Accounting Standards, there is a distinction between obligations that arise from the 'improper' vs the 'normal' operation of an asset. Environmental obligations relate to environmental remediation and environmental contamination that arises from the 'improper' operation of an asset. Environmental remediation liabilities that arise from the 'normal' operation of an asset are asset retirement (decommissioning) obligations (see below). [410-20-15-2 – 15-3, 410-30-15-3]

A provision is recognised for environmental obligations when:

- there is a legal obligation to restore a site, like IFRS Accounting Standards;
- the damage has already occurred, like IFRS Accounting Standards;
- it is probable that a restoration cost will be incurred; however, unlike IFRS Accounting Standards, 'probable' means likely; and
- the costs can be reasonably estimated, like IFRS Accounting Standards. [410-30-25-1, 25-3 – 25-4, 25-7]

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Future changes in environmental legislation give rise to a legal obligation only once they are virtually certain of being enacted. [IAS 37.22]

A provision is measured at the best estimate of the future clean-up costs. It reflects the amount that the entity would be required to pay to settle the obligation that has been incurred at the reporting date. [IAS 37.36]

Anticipated cost savings arising from future improvements in technology are considered in measuring the provision only if their existence is reasonably certain. [IAS 37.49]

Environmental provisions are discounted if the effect of discounting is material. [IAS 37.45]

If an obligation to restore the environment arises on the initial recognition of the asset, then the amount is included in the cost of the related asset and is not recognised immediately in profit or loss (see chapter 3.2). [IAS 16.16(c)]

Decommissioning

Decommissioning obligations are obligations to make good environmental or other damage incurred in installing an asset – e.g. an obligation to dismantle an oil rig.

The decommissioning obligation is recognised immediately because the damage arises from a past event, which is the installation of the asset. [IAS 37.14]

Uncertainty over the timing of the obligation would not generally preclude recognition, with the uncertainty being considered in the best estimate measurement. [IAS 37.39]

Unlike IFRS Accounting Standards, changes in environmental legislation are not taken into account until they are enacted. [410-30-35-4]

A provision is measured using a reasonable estimate of the future clean-up costs. As discussed above, a reasonable estimate may be a particular amount within a range that is better than any other estimate or, if no amount is better, the low end of that range; this approach may result in an amount that differs from the amount provided for under IFRS Accounting Standards. [410-30-25-9]

Anticipated cost savings arising from future improvements in technology are considered in measuring the provision only if it is probable that the improvements will be formally accepted, which may result in differences from IFRS Accounting Standards. [410-30-35-5]

Unlike IFRS Accounting Standards, environmental liabilities are discounted only if the amount and timing of the cash outflows is fixed or reliably determinable. In practice, such provisions are not typically discounted, unlike IFRS Accounting Standards. [410-30-35-12]

Unlike IFRS Accounting Standards, an obligation related to environment damage is usually recognised immediately in profit or loss. [410-30-25-16]

Asset retirement obligation

Asset retirement obligations arise from the acquisition, construction or development of an asset, and include environmental remediation liabilities that relate to the 'normal' operation of the asset. [410-20-15-2 – 15-3]

Like IFRS Accounting Standards, environmental obligations or other damage liabilities incurred when installing an asset are recognised immediately because the damage arises from a past event, which is the installation of the asset. However, the obligation associated with normal use is measured at fair value as an asset retirement obligation and the amount associated with other damage is measured as an environmental obligation under different guidance (see above), which may give rise to differences from IFRS Accounting Standards in practice. [410-20-15-2 – 15-3, 25-4]

Unlike IFRS Accounting Standards, US GAAP provides that in some circumstances significant uncertainty about the timing of settlement results in a conclusion that the retirement obligation should not yet be recognised. [410-20-25-10]

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The obligation is discounted at a pre-tax rate that reflects the time value of money and the risks specific to the liability, unless the future cash flows are adjusted for these risks. The discount rate used would not generally include an adjustment for an entity's own credit risk. [IAS 37.47]

If an obligation to restore the environment or dismantle an asset arises on the initial recognition of the asset, then the amount is included in the cost of the related asset and is not recognised immediately in profit or loss (see chapter 3.2). [IAS 16.16(c)]

The effect of any changes to an existing obligation is added to or deducted from the cost of the related asset and depreciated prospectively over the asset's remaining useful life (see chapter 3.2). Changes in the obligation include changes that arise from changes in the discount rate. [IFRIC 1.4–5]

If an obligation to dismantle or decommission an asset or restore the environment arises after the initial recognition of the asset, then a provision is recognised when the obligation arises. In our view, the estimated cost should be recognised as an adjustment to the cost of the asset and depreciated prospectively over the remaining useful life of the asset, assuming that the liability was not created through use of the item – e.g. production of inventory (see chapter 3.2). [IAS 37.14]

However, decommissioning and restoration costs incurred as a consequence of the production of inventory in a particular period are part of the cost of that inventory. The effect of any changes to an existing obligation for decommissioning and restoration costs related to items that have been sold is recognised in profit or loss (see chapter 3.8). [IAS 16.16(c), 18]

A provision reflects only damage incurred at the reporting date; a provision is not recognised for expected future damage. [IAS 37.18–19]

Environmental and similar funds

Sometimes funds are established to finance environmental or other remediation costs. A fund may be set up to meet the decommissioning costs of a single contributor or several contributors.

Unlike IFRS Accounting Standards, an asset retirement obligation is measured by discounting the expected cash flows using an interest rate that equates to a risk-free interest rate adjusted for the effect of the entity's credit standing (a credit-adjusted risk-free rate). [410-20-55-15]

Like IFRS Accounting Standards, if an obligation to dismantle an asset arises on the initial recognition of the asset, then the amount is included in the cost of the related asset and is not recognised immediately in profit or loss (see chapter 3.2). [410-20-25-5]

Like IFRS Accounting Standards, the effect of any changes to an existing obligation is added to or deducted from the cost of the related asset and depreciated prospectively over the asset's remaining useful life if the initial recognition of the obligation resulted in an addition to the asset's cost (see chapter 3.2). However, unlike IFRS Accounting Standards, if the estimated amount of cash flows changes, then the original discount rate is used for decreases in estimated cash flows, but a current rate is used for increases in estimated cash flows; this results in a 'layering' of cash flows, with different discount rates associated with each layer. [410-20-35-1 – 35-8]

Like IFRS Accounting Standards, if an obligation to dismantle or decommission an asset or restore the environment arises after the initial recognition of the asset, then a provision is recognised when the obligation arises. Like IFRS Accounting Standards, the estimated cost is recognised as an adjustment to the cost of the asset and depreciated prospectively over the asset's remaining useful life if it relates to the obligation to dismantle or decommission the asset (see chapter 3.2). [410-20-25-4 – 25-5, 35-1 – 35-2]

Unlike IFRS Accounting Standards, asset retirement obligations incurred as a consequence of the production of inventory in a particular period are added to the carrying amount of the related asset; the subsequent depreciation of that cost is included in production overheads over the asset's estimated remaining useful life. [410-20-25-5]

Like IFRS Accounting Standards, a provision reflects only the damage incurred at the reporting date; a provision is not recognised for an expected future damage. [410-20-25-1]

Environmental and similar funds

Sometimes funds are established to finance environmental or other remediation costs. A fund may be set up to meet the decommissioning costs of a single contributor or several contributors. [410-30-45-1]

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If the operator continues to bear the primary obligation for the decommissioning, then it continues to recognise a provision for its obligation and does not net its obligation with potential recoveries from the fund. [IFRIC 5.7]

If the fund is a subsidiary, joint arrangement or associate of the operator, then it is consolidated, accounted for based on the operator's rights and obligation to individual assets and liabilities or equity accounted, as appropriate (see chapters 2.5, 3.5 and 3.6). Otherwise, the contributor recognises the right to receive compensation from the fund as a reimbursement right. The reimbursement right is measured at the lower of:

- the amount of the decommissioning obligation recognised; and
- the contributor's share of the fair value of the net assets of the fund attributable to the contributors. [IFRIC 5.8–9]

Changes in the carrying amount of the reimbursement right other than from contributions to and payments from the fund are recognised in profit or loss in the period in which they occur. An obligation to make additional contributions is treated as a provision or contingent liability, as applicable. A residual interest in a fund that exceeds the right to reimbursement, such as a contractual right to distributions when decommissioning has been completed, may be an equity instrument (see chapter 7.1). [IFRIC 5.5, 9–10]

Waste electrical and electronic equipment

In the EU, the costs of disposing of waste electrical and electronic equipment are borne by the producers. An entity has an obligation to contribute to waste management costs for historical household equipment (equipment sold to private households, generally before 13 August 2005) based on its share of the market in the measurement period. The measurement period is specified in national law, which may vary from country to country. It is an entity's participation in the market in the measurement period that is the past event that triggers the recognition of an obligation to meet waste management costs. [IFRIC 6.9]

Obligation to acquire or replace assets

Generally, a legal or constructive obligation is recognised as a liability (provision) if the recognition criteria are met. However, a legal or contractual obligation to acquire or replace assets is recognised as a liability only to the extent of the performance of the obligation – i.e. the extent to which the costs of acquiring and replacing the asset have been incurred. [IAS 37.IE.C.Ex6]

Like IFRS Accounting Standards, if an entity continues to be the primary obligor for a liability, then it continues to recognise a provision for the obligation and does not net its obligation with potential recoveries from the fund. [410-30-45-2]

Unlike IFRS Accounting Standards, US GAAP does not provide explicit guidance on the accounting for a fund established to finance environmental obligations. If the fund is a subsidiary, equity-method investee or joint activity of the entity, then the guidance in chapters 2.5, 3.5 and 3.6 applies, which is different in certain respects from IFRS Accounting Standards. Otherwise, the entity (contributor) recognises the right to receive compensation from the fund as a reimbursement right (see above), which may give rise to differences from IFRS Accounting Standards in practice. [410-30-35-8]

Changes in the carrying amount of a reimbursement right (other than for cash payments and receipts to or from the fund) are recognised in profit or loss in the period in which they occur, like IFRS Accounting Standards. An obligation to make additional contributions is accounted for based on the specific guidance for that type of structure, which may differ from IFRS Accounting Standards. A residual interest in a fund needs to meet the definition of a security (see chapter 7.1) to be accounted for as such, and therefore differences from IFRS Accounting Standards may arise in practice. [410-30-35-8]

Waste electrical and electronic equipment

Like IFRS Accounting Standards, the past event that triggers recognition of an obligation for historical household waste electrical and electronic equipment in the EU is participation in the market in the measurement period. [720-40-25-1]

Obligation to acquire or replace assets

Like IFRS Accounting Standards, a legal or contractual obligation to acquire or replace assets is recognised as a liability only to the extent that the costs of acquiring and replacing the asset have been incurred. [908-360-25-2]

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Repairs and maintenance

A provision is not recognised for repairs and maintenance of own assets. These costs are generally expensed as they are incurred. [IAS 37.IE.C.Ex11]

The prohibition on recognising a provision for future repairs and maintenance applies even if there is a legal requirement to undertake the specified repairs and maintenance activities. [IAS 37.IE.C.Ex11B]

Onerous contracts

An 'onerous contract' is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under the contract. In assessing whether a contract is onerous, an entity considers:

- the unavoidable costs of meeting the contractual obligations, which is the lower of the net costs of fulfilling the contract or the cost of terminating it; and
- the economic benefits expected to be received. [IAS 37.10]

The present value of the obligation under an onerous contract is recognised as a provision. Before the onerous contract provision is calculated, all assets dedicated to the contract are tested for impairment (see chapter 3.10). [IAS 37.66, 69]

In determining whether the contract is onerous, an entity considers the costs that relate directly to the contract, including:

- the incremental costs of fulfilling the contract (e.g. direct labour and materials); and
- an allocation of other costs that relate directly to fulfilling the contract (e.g. an allocation of the depreciation charge for property, plant and equipment used in fulfilling the contract). [IAS 37.68A]

The expected economic benefits equal the net present value of the future inflows related to the contract. In our view, these generally should include future inflows from:

- expected renewals of an existing contract;
- expected future sales under a framework agreement; and
- contracts which are required to be combined under the revenue standard (see chapter 4.2).

Repairs and maintenance

Like IFRS Accounting Standards, a provision is not recognised for repairs and maintenance of own assets. These costs are generally expensed as they are incurred, like IFRS Accounting Standards.

Like IFRS Accounting Standards, the prohibition on recognising a provision for future repairs and maintenance applies even if there is a legal requirement to undertake the specified repairs and maintenance activities. [360-10-25-5]

Onerous contracts

Unlike IFRS Accounting Standards, there is no general requirement to recognise a loss for onerous contracts – i.e. executory contracts that are anticipated to result in a loss. Instead, the specific recognition and measurement requirements of the relevant Codification topics/subtopics apply, which may differ from IFRS Accounting Standards. In addition, the related assets dedicated to the contract are likely to require testing for impairment (see chapter 3.10), which differs in some respects from IFRS Accounting Standards.

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In addition, we believe that the following expected future inflows from the same customer may be included in the onerous contract assessment:

- inflows for goods or services which are covered by the terms in the existing contract but are conditional on events within the entity's control (e.g. achieving performance milestones); and
- inflows for goods or services which relate to or are dependent on the goods or services in the existing contract.

We believe that inflows for goods or services which are conditional on the outcome of a competitive tender cannot be included in the onerous contract assessment because the outcome of the tender is outside of the entity's control.

In our view, if a contract includes future inflows falling in the scope of multiple accounting standards (e.g. revenue from contracts with customers, financing income and lease income) then all inflows under the contract should be considered in assessing whether the contract is onerous.

Software modification costs

When an external event (e.g. the introduction of a new currency) requires an entity to modify its software to continue operating, the entity does not have a present obligation to modify the software. In our view, a provision is not recognised because the entity is able to avoid the expenditure by its future actions. However, an entity should consider whether the costs incurred qualify for capitalisation as either an intangible or a tangible asset. [IAS 37.19, IE.C.Ex11]

Legal claims

In our view, the relevant past event for a legal claim is the event that gives rise to the claim, rather than receipt of the claim itself.

However, the mere existence of a present obligation as a result of a past event is not a sufficient basis on which to recognise a provision. In addition, the entity needs to consider whether it is probable that the obligating event will result in an outflow of resources. In our view, the assertion of a claim is not determinative evidence that a present obligation exists. Instead, the receipt of a claim will require assessment of whether there is a present obligation, taking account of all available evidence, including the opinion of experts, for example. [IAS 37.16, 23]

Software modification costs

Like IFRS Accounting Standards, when an external event requires an entity to modify its software to continue operating, the entity does not have a present obligation to modify the software because it is able to avoid the expenditure by its future actions. Instead, when the costs are incurred the entity considers whether they qualify for capitalisation, like IFRS Accounting Standards. [350-40-25]

Legal claims

Like IFRS Accounting Standards, the 'existing condition' for the evaluation of a legal claim is the event that gives rise to the claim, rather than receipt of the claim itself. [450-20-20, 55-14]

Like IFRS Accounting Standards, the mere existence of an existing condition is not a sufficient basis on which to recognise a provision. In addition, the entity needs to consider whether it is probable (likely to occur, which is a higher threshold than IFRS Accounting Standards) that a liability has been incurred and the amount of the loss can be reasonably estimated. [450-20-25-2]

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There is no specific guidance in IFRS Accounting Standards on whether a provision for legal claims should include the expected legal costs of defending the claim. In our view, any such costs that are incremental should be provided for only if a past obligating event for the underlying claim exists.

Levies

A 'levy' is an outflow of resources embodying economic benefits from an entity imposed by a government in accordance with legislation. Income taxes in the scope of the income taxes standard, fines and penalties and payments to a government for purchases of assets or services are not in the scope of the interpretation on levies. [IFRIC 21.4–5]

Under IFRS Accounting Standards, the obligating event that gives rise to a liability is the activity that triggers the payment of the levy in accordance with legislation. An entity does not recognise a liability at an earlier date even if it has no realistic opportunity to avoid performing the activity that triggers the levy. [IFRIC 21.8–10]

Income tax exposures

Obligations for possible income tax exposures are uncertain income tax treatments in the scope of a specific interpretation, and not provisions in the scope of the provisions standard (see chapter 3.13). [IAS 37.1(c), 5, IFRIC 23.4]

Interest and penalties related to income tax exposures are not explicitly included in the scope of the income tax standard. To determine the appropriate accounting, an entity first considers whether the interest or penalty is itself an income tax (see chapter 3.13). If it is, then the entity applies the income tax standard. If it is not, then it applies the provisions standard to that amount. This is not an accounting policy choice – i.e. an entity needs to apply judgement based on the specific facts and circumstances. [IU 09-17]

Unlike IFRS Accounting Standards, the legal costs associated with defending a claim may be either accrued or expensed as they are incurred as an accounting policy choice. [450-20-S99-2]

Levies

Unlike IFRS Accounting Standards, there is no general guidance on accounting for levies (i.e. non-income-based taxes) that covers all industries. Unlike IFRS Accounting Standards, fees paid to the US federal government by manufacturers and importers of branded prescription drugs are generally recognised on a pro rata basis throughout the year. In our experience, real estate entities also typically recognise property taxes on a pro rata basis throughout the year, which may differ from IFRS Accounting Standards. Further, we would expect potential differences from IFRS Accounting Standards in the accounting for taxes and levies (that are not income taxes) in other industries. [720-30-25-7, 720-50-25-1]

Income tax exposures

Like IFRS Accounting Standards, income tax uncertainties are subject to the Codification Topic on accounting for income taxes (see chapter 3.13).

Entities are required to accrue interest on the underpayment of taxes related to unrecognised tax positions and accrue penalties if minimum statutory thresholds to avoid penalties are not met for the tax position. Unlike IFRS Accounting Standards, these amounts may be classified as either income taxes or interest expense in the income statement. [740-10-25-56 – 25-57, 45-25]

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Disclosure

Contingent liabilities are disclosed unless an outflow of resources is only remote. An entity discloses a brief description of the nature of each class of contingent liabilities and, when it is practicable, an estimate of the financial effect, an indication of uncertainties relating to the amount and timing of the outflow and any possible reimbursement. [IAS 37.86, 91]

If crystallisation of a contingent liability would affect an entity's ability to continue as a going concern, then additional disclosures are required (see chapter 2.1). [IAS 1.25]

In the extremely rare case that disclosure could seriously prejudice the entity's position in a dispute with another party, the entity need only disclose the general nature of the dispute and the reasons for not disclosing the information. [IAS 37.92]

Contingent assets are disclosed when an inflow of economic benefits is considered probable (i.e. more likely than not to occur). The disclosure includes the nature and, when it is practicable, the estimated financial effects of the contingent asset. [IAS 37.89–91]

Disclosure

Like IFRS Accounting Standards, loss contingencies are generally disclosed unless an outflow is remote. However, unlike IFRS Accounting Standards, certain loss contingencies are disclosed even if the likelihood of an outflow is remote (e.g. guarantees). The disclosures required under US GAAP are broader than those required by IFRS Accounting Standards and include the risks and uncertainties related to the nature of the entity's operations. However, disclosures about loss contingencies are less detailed than those under IFRS Accounting Standards. [450-20-50-1 – 50-10, 460-10-50-2]

Like IFRS Accounting Standards, if there is substantial doubt about the entity's ability to continue as a going concern, then additional disclosures are required (see chapter 2.1). [205-40-50-12 – 50-14]

Unlike IFRS Accounting Standards, US GAAP does not provide an exception to the disclosure requirements for sensitive information.

Unlike IFRS Accounting Standards, there is no specific probability threshold for disclosing gain contingencies. Adequate disclosure needs to be made of contingencies that might result in gains, with appropriate caution to avoid misleading information about the likelihood of realisation. [450-30-50-1]

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3.13 Income taxes

(IAS 12, IFRIC 23, SIC-25)

Overview

- 'Income taxes' are taxes based on taxable profits, and taxes that are payable by a subsidiary, associate or joint arrangement on distribution to the reporting entity (e.g. withholding taxes).
- The total income tax expense (income) recognised in a period is the sum of current tax plus the change in deferred tax assets and liabilities during the period, excluding tax recognised outside profit or loss – i.e. in OCI or directly in equity, or arising from a business combination.
- 'Current tax' is the amount of income taxes payable (recoverable) in respect of the taxable profit (loss) for a period.
- 'Deferred tax' is generally recognised for the estimated future tax effects of temporary differences, unused tax losses carried forward and unused tax credits carried forward.
- A deferred tax liability is not recognised if it arises from the initial recognition of goodwill.
- A deferred tax asset or liability is not recognised if it arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, it affects neither accounting profit nor taxable profit and does not give rise to equal taxable and deductible temporary differences.

3.13 Income taxes

(Topic 740, Subtopic 830-740)

Overview

- 'Income taxes' are all domestic and foreign federal, state and local (including franchise) taxes based on income, including income taxes from an entity's operations that are consolidated, combined or accounted for under the equity method, both foreign and domestic. Although the wording differs from IFRS Accounting Standards, we would not generally expect significant differences from IFRS Accounting Standards in practice.
- Like IFRS Accounting Standards, the total income tax expense (income) recognised in a period is the sum of current tax plus the change in deferred tax assets and liabilities during the period, excluding tax recognised outside profit or loss – i.e. in OCI or directly in equity, or arising from a business combination.
- Like IFRS Accounting Standards, 'current tax' is the amount of income taxes payable (recoverable) in respect of the taxable profit (loss) for a period.
- Like IFRS Accounting Standards, 'deferred tax' is generally recognised for the estimated future tax effects of temporary differences, unused tax losses carried forward and unused tax credits carried forward.
- Like IFRS Accounting Standards, a deferred tax liability is not recognised if it arises from the initial recognition of goodwill.
- Unlike IFRS Accounting Standards, there is no exemption from recognising a deferred tax asset or liability for the initial recognition of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting profit nor taxable profit and does not give rise to equal taxable and deductible temporary differences.

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Overview (continued)

- A deferred tax liability (asset) is recognised for the step-up in tax bases as a result of an intra-group transfer of assets between jurisdictions.
- A deferred tax liability (asset) is recognised for exchange gains and losses related to foreign non-monetary assets and liabilities that are remeasured into the functional currency using historical exchange rates or indexing for tax purposes.
- Deferred tax is not recognised in respect of investments in subsidiaries, associates and joint arrangements (both foreign and domestic) if certain criteria are met.
- A deferred tax asset is recognised to the extent that it is probable that it will be realised – i.e. a net approach.
- Current and deferred tax are measured based on rates and tax laws that are enacted or substantively enacted at the reporting date.
- Deferred tax is measured based on the expected manner of settlement (liability) or recovery (asset).
- Deferred tax is measured on an undiscounted basis.
- Deferred tax assets and liabilities are classified as non-current in a classified statement of financial position.

Overview (continued)

- Like IFRS Accounting Standards, a deferred tax liability (asset) is recognised for the step-up in tax bases as a result of an intra-group transfer of assets other than inventory between jurisdictions. Unlike IFRS Accounting Standards, when the asset transferred is inventory, the tax effects for the seller are deferred and a deferred tax asset is not recognised for the step-up in tax bases for the buyer.
- Unlike IFRS Accounting Standards, if the reporting currency is the functional currency, then a deferred tax liability (asset) is not recognised for exchange gains and losses related to foreign non-monetary assets and liabilities that are remeasured into the reporting currency using historical exchange rates or indexing for tax purposes.
- Like IFRS Accounting Standards, deferred tax is not recognised in respect of investments in foreign or domestic subsidiaries, foreign corporate joint ventures and equity-method investees if certain criteria are met; however, these criteria differ from IFRS Accounting Standards, which may give rise to differences from IFRS Accounting Standards.
- Unlike IFRS Accounting Standards, all deferred tax assets are recognised and a valuation allowance is recognised to the extent that it is more likely than not that the deferred tax assets will not be realised – i.e. a gross approach.
- Unlike IFRS Accounting Standards, current and deferred tax are only measured based on rates and tax laws that are enacted at the reporting date.
- Like IFRS Accounting Standards, deferred tax is measured based on the expected manner of settlement (liability) or recovery (asset).
- Like IFRS Accounting Standards, deferred tax is measured on an undiscounted basis.
- Like IFRS Accounting Standards, deferred tax assets and liabilities are classified as non-current in a classified statement of financial position.

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Overview (continued)

- Income tax relating to items recognised outside profit or loss, in the current or a previous period, is itself recognised outside profit or loss.
- Deferred tax assets recognised in relation to share-based payment arrangements are adjusted each period to reflect the amount of tax deduction that the entity would receive if the award were tax-deductible in the current period based on the current market price of the shares.
- Current tax assets and liabilities are offset only if there is a legally enforceable right to set off and the entity intends to offset or to settle simultaneously.
- Deferred tax liabilities and assets are offset if the entity has a legally enforceable right to set off current tax liabilities and assets, and the deferred tax liabilities and assets relate to income taxes levied by the same tax authority on either the same taxable entity or different taxable entities that intend to settle current taxes on a net basis or their tax assets and liabilities will be realised simultaneously.
- In the case of uncertainty about an income tax treatment, an entity considers whether it is probable that a tax authority will accept the treatment used in its tax filing. If the tax authority is unlikely to accept the entity's tax treatment, then the effect of the tax uncertainty is reflected in measuring current or deferred tax under either the most likely amount or the expected value method.

Overview (continued)

- Like IFRS Accounting Standards, income tax relating to items recognised outside profit or loss during the current reporting period is itself recognised outside profit or loss. However, unlike IFRS Accounting Standards, subsequent changes are generally recognised in profit or loss.
- Unlike IFRS Accounting Standards, temporary differences related to share-based payment arrangements are based on the amount of compensation cost that is recognised in profit or loss without any adjustment for the entity's current share price until the tax benefit is realised.
- Like IFRS Accounting Standards, current tax assets and liabilities are offset only if there is a legally enforceable right to set off and the entity intends to set off.
- For a particular tax-paying component of an entity and within a particular tax jurisdiction, entities offset and present as a single amount all deferred tax liabilities and assets (including any related valuation allowance), like IFRS Accounting Standards. Deferred tax liabilities and assets attributable to different tax-paying components of the entity or to different tax jurisdictions may not be offset, which differs from IFRS Accounting Standards in certain aspects.
- Unlike IFRS Accounting Standards, the benefits of uncertainty in income taxes are recognised only if it is more likely than not that the tax positions are sustainable based on their technical merits. Unlike IFRS Accounting Standards, neither the most likely amount nor the expected value method are accepted. For tax positions that are more likely than not to be sustained, the largest amount of tax benefit that is greater than 50 percent likely to be realised on settlement is recognised.

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IFRS Accounting Standards

Scope

The scope of the income taxes standard is limited to 'income taxes', which are taxes based on taxable profits, and taxes that are payable by a subsidiary, associate or joint arrangement on distribution to the reporting entity (e.g. withholding taxes). [IAS 12.2]

Taxes that are not based on taxable profits are not in the scope of the income taxes standard; examples include social taxes payable by an employer based on a percentage of an employee's wages, which may be employee benefits (see chapter 4.4), and taxes payable on capital and reserves.

The following are also excluded from the scope of the income taxes standard: government grants (see chapter 4.3), and investment tax credits (see below). [IAS 12.4]

Taxes that are not based on taxable profit – e.g. taxes on sales such as value-added tax – are accounted for in accordance with the provisions standard (see chapter 3.12), unless they are dealt with specifically in another accounting standard – e.g. the employee benefits standard for social security taxes (see chapter 4.4). [IU 03-06, 05-09, 07-12]

'Income tax' comprises current tax and deferred tax. The total income tax expense (income) recognised in a period is the sum of current tax plus the change in deferred tax assets and liabilities during the period, excluding tax recognised outside profit or loss – i.e. either in OCI or directly in equity, or arising from a business combination. [IAS 12.5–6]

'Pillar Two taxes' are taxes arising from tax laws enacted or substantively enacted to implement rules published by the Organisation for Economic Co-operation and Development. The mechanisms under these rules are often referred to as 'global minimum top-up tax' or 'top-up tax'. Pillar Two top-up taxes are determined based on taxable profit or loss in a specific jurisdiction included in the consolidated financial statements of the ultimate parent entity – i.e. they are levied on a net amount. Therefore, in our view all Pillar Two top-up taxes levied by tax authorities are generally income taxes in the scope of the income taxes standard, for the purposes of all financial statements, including the consolidated financial statements of the ultimate parent entity or intermediate parent entities and separate financial statements of group entities. [IAS 12.BC97–99(a)]

US GAAP

Scope

US GAAP defines 'income taxes' as all domestic and foreign federal, state and local (including franchise) taxes based on income, including income taxes from an entity's operations that are consolidated, combined or accounted for under the equity method, both foreign and domestic. Although the wording differs from IFRS Accounting Standards, we would not generally expect significant differences from IFRS Accounting Standards in the application of the scope of the income taxes Codification Topic. [740-10-15-3 – 15-4]

Like IFRS Accounting Standards, taxes that are not based on taxable profits do not fall in the scope of the topic; examples include social taxes payable by an employer based on a percentage of an employee's wages, which are employee benefits (see chapter 4.4), and taxes payable on capital and reserves. [740-10-15-3 – 15-4]

Government grants in the form of tax benefits are excluded from the scope of the income taxes Codification Topic, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, investment tax credits are in the scope of the topic (see below). [740-10-25-20(f)]

Taxes that are not based on taxable profits are accounted for based on other guidance, including the guidance on contingencies (see chapter 3.12) and sales taxes (see chapter 4.2). In the absence of specific guidance, practice may vary and therefore differences from IFRS Accounting Standards may arise in practice. [740-10-15-3 – 15-4]

Like IFRS Accounting Standards, 'income tax' comprises current tax and deferred tax. Like IFRS Accounting Standards, the total income tax expense (income) recognised in a period is the sum of current tax plus the change in deferred tax assets and liabilities during the period, excluding tax recognised outside profit or loss – i.e. either in OCI or directly in equity, or arising from a business combination. [740-10-30-3 – 30-4]

Under US GAAP, Pillar Two tax is an alternative minimum tax (AMT) because it is a separate but parallel system for an entity to pay a minimum level of tax. Like IFRS Accounting Standards, AMT is in the scope of the income tax standard.

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As a temporary mandatory exception, an entity subject to Pillar Two top-up taxes neither recognises nor discloses information about the related deferred taxes. However, from 31 December 2023, an entity is required to provide new specific disclosures about its potential exposure to the top-up tax at the reporting date in periods in which a tax law is enacted but the top-up tax is not yet in effect. [IAS 12.4A, 88A–88D]

Interest and penalties related to income taxes are not explicitly included in the scope of the income taxes standard. To determine the appropriate accounting, an entity first considers whether interest or a penalty is itself an income tax. If it is, then it applies the income taxes standard; if not, then it applies the provisions standard (see chapter 3.12) to that amount. This is not an accounting policy choice – i.e. an entity needs to apply judgement based on the specific facts and circumstances. [IU 09-17]

Current tax

'Current tax' is the amount of income taxes payable or recoverable in respect of the taxable profit or loss for a period. A current tax liability or asset is recognised for income tax payable or paid but recoverable in respect of all periods to date. [IAS 12.5, 12]

Deferred tax

Temporary differences

A 'temporary difference' is the difference between the tax base of an asset or liability and its carrying amount in the financial statements that will result in taxable or deductible amounts in future periods when the carrying amount is recovered or settled. This approach focuses on the statement of financial position carrying amounts, rather than on the differences between the profit or loss and taxable profits. [IAS 12.5]

Liability recognition

Unless an exemption applies (see below), a deferred tax liability is recognised for all taxable temporary differences; the partial recognition method is not permitted. Therefore, it is not relevant under IFRS Accounting Standards that some or all of the differences may not be expected to be incurred in the future. [IAS 12.15]

Like IFRS Accounting Standards, entities will not record Pillar Two-specific deferred taxes or remeasure existing deferred taxes under local regular income tax systems to the Pillar Two rate. Instead, entities will recognise the incremental effect of the Pillar Two top-up tax as incurred. Unlike IFRS Accounting Standards, additional disclosures related to the Pillar Two top-up tax are not required under US GAAP.

Unlike IFRS Accounting Standards, the classification of interest and penalties either as income tax or as an expense is an accounting policy choice. [740-10-45-25]

Current tax

Like IFRS Accounting Standards, 'current tax' is the amount of income taxes payable or recoverable in respect of the taxable profit or loss for a period. A current tax liability or asset is recognised for income tax payable or paid but recoverable in respect of all periods to date, like IFRS Accounting Standards. [740-10-20]

Deferred tax

Temporary differences

Like IFRS Accounting Standards, a 'temporary difference' is the difference between the tax carrying amount (tax base) of an asset or liability and its carrying amount in the financial statements that will result in taxable or deductible amounts in future periods when the carrying amount is recovered or settled. Like IFRS Accounting Standards, this approach focuses on the statement of financial position carrying amounts, rather than on the differences between the profit or loss and taxable profits. [740-10-20]

Liability recognition

Like IFRS Accounting Standards, unless an exemption applies (see below), a deferred tax liability is recognised for all taxable temporary differences and the partial recognition method is not permitted. Therefore, like IFRS Accounting Standards, it is not relevant that some or all of the differences may not be expected to be incurred in the future. However, the exemptions under US GAAP differ from those under IFRS Accounting Standards (see below). [740-10-25-3]

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Initial recognition exemption

Deferred tax is not recognised for certain temporary differences that arise on the initial recognition of assets and liabilities. The exemption applies to:

- a deferred tax liability (but not a deferred tax asset) that arises from the initial recognition of goodwill (see below); and
- a deferred tax asset or liability that arises from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction:
  - affects neither accounting profit nor taxable profit; and
  - does not give rise to equal taxable and deductible temporary differences.

  [IAS 12.15, 22(c), 22A, 24, 32A, 33, IU 03-17]

In respect of the second part of the exemption, if the exemption applies and no deferred tax is recognised initially, then generally no deferred tax is recognised subsequently as the carrying amount of the asset or liability changes. However, in our view exceptions arise if an asset is revalued subsequent to initial recognition or if a partial tax deduction will be received. [IAS 12.15(b), 21A–21B, 22(c)]

If a transaction gives rise to equal taxable and deductible temporary differences on initial recognition (e.g. leases, see below, or decommissioning provisions), then an entity recognises a deferred tax liability and a deferred tax asset separately. However, if these deferred tax assets and liabilities meet the criteria for offsetting, then they are presented as a single item in the statement of financial position. [IAS 12.22A]

If a new levy in the scope of the income taxes standard is introduced in addition to the existing income tax and some assets or liabilities are treated differently for the purposes of that levy, then new temporary differences may arise in relation to the existing assets or liabilities. In our view, the initial recognition exemption does not apply to such temporary differences. However, the initial recognition exemption does apply to assets and liabilities recognised on or after the date on which the tax law is enacted or substantively enacted. [IAS 12.15, 24]

Asset recognition

Unlike deferred tax liabilities, a deferred tax asset is recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences or the unused tax losses and tax credits can be used. [IAS 12.24, 34]

Initial recognition exemption

Like IFRS Accounting Standards, a deferred tax liability (but not a deferred tax asset) that arises on the initial recognition of goodwill is exempt from recognition. Unlike IFRS Accounting Standards, US GAAP does not have an exemption for the initial recognition of an asset or liability in a transaction that is not a business combination, and at the time of the transaction affects neither accounting profit nor taxable profit and does not give rise to equal taxable and deductible temporary differences. Under US GAAP, the deferred tax is determined under the 'simultaneous equation' method. [740-10-25-3, 25-51]

Unlike IFRS Accounting Standards, because there is no initial recognition exemption for the initial recognition of an asset or liability in a transaction that is not a business combination, and that at the time of the transaction affects neither accounting profit nor taxable profit and does not give rise to equal taxable and deductible temporary differences, deferred tax is recognised on all subsequent temporary differences as the carrying amount of the asset or liability changes. [740-10-25-3]

Like IFRS Accounting Standards, an entity recognises a deferred tax liability and a deferred tax asset that arise at inception of a lease or decommissioning provision (asset retirement obligations). If the deferred tax assets and liabilities meet the criteria for offsetting under US GAAP, then they are netted, but only if the entity has a legally enforceable right to offset the current tax amounts and intends to offset those amounts (see below).

Asset recognition

Unlike IFRS Accounting Standards, all deferred tax assets are recognised and a valuation allowance is recognised to the extent that it is more likely than not that the deferred tax assets will not be realised – i.e. deferred tax assets are recognised on a gross basis with a corresponding valuation allowance. [740-10-30-5]

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'Probable' is not defined in the income taxes standard. In our experience, entities often use a working definition of 'more likely than not' (i.e. a likelihood of more than 50 percent).

Taxable profit used for the asset recognition test is different from taxable profit on which income taxes are payable. To avoid double counting, an entity excludes reversals of existing taxable and deductible temporary differences in determining whether sufficient future taxable profits are available to recognise deferred tax assets in excess of taxable temporary differences. In addition, an entity does not include in that assessment new deductible temporary differences that originate in future periods, because the deferred tax asset arising from these deductible temporary differences will itself require future taxable profit in order to be utilised. [IAS 12.29(a), BC56, IE.Ex7]

All deductible temporary differences are assessed together unless, under tax law, their use is restricted to deductions against income of a specific type. [IAS 12.27A]

The estimate of probable future profits may include the recovery of some of the assets for more than their carrying amounts if there is sufficient evidence that it is probable that a higher amount will be realised. [IAS 12.29A]

In considering whether taxable profit will be available in the future, an entity considers, among other things, tax planning opportunities. There is no specific guidance in IFRS Accounting Standards on whether management's intention to use the tax planning opportunities should affect whether the opportunities are taken into account in assessing the recognition of a deferred tax asset. However, in our view it should be more likely than not that management will take advantage of the opportunities, before they can be used to justify the recognition of deferred tax assets. IFRS Accounting Standards are silent on whether any related tax expenses or losses that would be incurred are taken into account, and practice may vary. [IAS 12.28–30]

Like IFRS Accounting Standards, 'more likely than not' is a likelihood of more than 50 percent. [450-20-20, 740-10-20, 30-17]

Like IFRS Accounting Standards, an entity excludes reversals of existing taxable and deductible temporary differences in determining whether sufficient future taxable profits are available to recognise deferred tax assets in excess of taxable temporary differences. Unlike IFRS Accounting Standards, future originating temporary differences and their subsequent reversals are implicit in estimates of future taxable income. Like IFRS Accounting Standards, an entity does not include in that assessment new deductible temporary differences that originate in future periods if the newly originated deferred tax assets are not more likely than not of being realised when the newly originated deferred tax assets reverse. [740-10-30-18]

All applicable provisions of enacted tax law are considered in determining the amount of the valuation allowance that should be recognised, like IFRS Accounting Standards. Additionally, under US GAAP an entity assesses the need for a valuation allowance on a deferred tax asset related to available-for-sale debt securities in combination with other deferred tax assets. [740-10-30-2(b), 30-16, 55-12]

Like IFRS Accounting Standards, the estimate of probable future profits may include the recovery of assets for more than their carrying amounts if an entity has identified a qualified tax planning opportunity (see below). Because a qualifying tax planning opportunity needs to be primarily within an entity's control, it generally cannot anticipate recovery of an asset for an amount that is dependent upon a change in market conditions. [740-10-30-19, 30-20, 55-39 – 55-48]

Like IFRS Accounting Standards, an entity takes into account tax planning opportunities in assessing whether a valuation allowance is required. However, unlike practice under IFRS Accounting Standards, for a tax planning opportunity to be considered, it needs to be prudent and feasible, and an action that management may not ordinarily take but has the intent and ability to implement to prevent the tax benefit from expiring unused. Additionally, unlike IFRS Accounting Standards, when tax planning opportunities are taken into account, any attributable expenses or losses that would be incurred are considered in determining the appropriate valuation allowance. [740-10-30-16, 30-19 – 30-20]

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When an entity has a history of recent losses, a deferred tax asset is recognised only to the extent that the entity has sufficient taxable temporary differences or there is convincing evidence that sufficient taxable profit will be available against which the tax losses or tax credits can be used. [IAS 12.34–36]

Loss-making entities recognise a deferred tax asset for the carry-forward of unused tax losses only to the extent of the taxable temporary differences of an appropriate type that reverse in an appropriate period. Consequently, future tax losses are not considered when measuring the amount of the deferred tax asset. In addition, if a tax law limits the extent to which unused tax losses can be recovered against future taxable profits in each year, then the amount of a deferred tax asset from unused tax losses is restricted as specified by the tax law. [IU 05-14]

Measurement

Deferred tax assets and liabilities are measured based on:

- the expected manner of recovery (asset) or settlement (liability); and
- the tax rates expected to apply when the underlying asset (liability) is recovered (settled), based on rates that are enacted or substantively enacted at the reporting date. [IAS 12.47, 51]

When income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is distributed, deferred tax is based on the tax rate applicable to undistributed profits. [IAS 12.52A]

In some jurisdictions, the applicable tax rate or tax base depends on how the carrying amount of an asset or liability is recovered or settled. In such cases, management's intentions are key in determining the amount of deferred tax to recognise. [IAS 12.51–51A, IU 11-11]

The existence of recent cumulative accounting losses is significant negative evidence that is difficult to overcome that future taxable profit may not be available, and the recognition of a deferred tax asset reflecting a valuation allowance (net deferred tax asset) is generally limited to available taxable temporary differences in such cases, like IFRS Accounting Standards. [740-10-30-21]

During the assessment of whether a valuation allowance is required for deferred tax assets, an entity that has experienced cumulative losses in recent years has a significant piece of negative evidence to evaluate in determining the recoverability of deferred tax assets. Existing taxable temporary differences of an appropriate character that are expected to reverse in an appropriate period are one source of potential recoverability of the deferred tax assets. The recognition of deferred tax assets reflecting a valuation allowance (net deferred tax assets) may be limited to such available taxable temporary differences and available carry-backs when cumulative losses exist (this evaluation is based on the specific facts and circumstances, considering all positive and negative evidence that Exists). In addition, like IFRS Accounting Standards, provisions in the tax law that limit the use of an operating loss carry-forward are applied in determining whether a valuation allowance is required. [740-10-30-18 – 30-22, 55-36]

Measurement

Deferred tax assets and liabilities are measured based on:

- the expected manner of recovery (asset) or settlement (liability), like IFRS Accounting Standards; and
- the rate of tax expected to apply when the underlying asset (liability) is realised (settled), like IFRS Accounting Standards; but based on rates that are enacted at the reporting date, unlike IFRS Accounting Standards. [740-10-25-2 – 25-23, 25-47]

Unlike IFRS Accounting Standards, US GAAP requires the use of the distributed rate on profits of the foreign subsidiary if the parent is not applying the 'indefinite reversal criteria' (see below). If the parent is applying the indefinite reversal criteria, then the undistributed rate is used for profits of the foreign subsidiary to the extent that the parent has not provided for deferred tax on the unremitted earnings of the foreign subsidiary. [740-10-25-41, 740-30-25-17 – 25-19]

Like IFRS Accounting Standards, deferred tax is measured based on an assumption that the underlying asset (liability) will be recovered (settled) in a manner consistent with its intended use in the business. [740-10-25-23]

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If an entity has a dual intention in respect of an asset (e.g. to operate the asset and then to sell it before the end of its useful life) or a dual intention results from a tax law, then it follows from the general principle that the carrying amount will be recovered in more than one way and the deferred tax needs to reflect multiple tax consequences. In our view, the recognition, measurement and presentation of deferred tax related to an asset that is expected to be recovered in multiple ways depends on whether these expected ways of recovery are subject to different sections of the income tax law – e.g. corporate tax vs capital gains tax – and whether taxable gains and tax losses determined under those different sections of the income tax law may be offset. [IU 03-15, 04-20]

For investment property measured using the fair value model (see chapter 3.4), the measurement of deferred tax is based on a rebuttable presumption that the carrying amount of the investment property will be recovered entirely through sale. The presumption is rebutted if the investment property is depreciable and is held within a business model whose objective is to consume substantially all of the asset's economic benefits over time, rather than through sale. [IAS 12.51C]

When a non-depreciable item of property, plant and equipment is revalued (see chapter 3.2), the deferred tax on the revaluation is measured using the tax rate that applies on disposal. [IAS 12.51B]

The tax treatment of an asset may be different depending on whether the asset is treated as an individual asset or as part of a corporate structure. In our view, the tax base in consolidated financial statements should be determined based on the tax treatment of individual assets and liabilities on an item-by-item basis.

In an extreme case, an asset (e.g. a building) might be held by a group as the sole asset within a corporate shell for tax planning reasons. If a tax law attributes separate tax bases to the asset and the shares, then the entity recognises:

- the deferred tax related to the asset; and separately
- the deferred tax related to the shares. [IU 07-14]

Unlike IFRS Accounting Standards, US GAAP does not specifically address the accounting for deferred tax assets and liabilities when there are multiple tax consequences of recovering an asset. It does require an entity to measure its deferred tax assets and liabilities using the enacted tax rate expected to apply to taxable income in the periods in which the deferred tax liability or asset is expected to be settled or realised. This is based on management's expectations of the manner of recovery of the asset and may be affected by future elections or actions regarding the asset's use. As a result, we believe that entities could reach similar conclusions under US GAAP and IFRS Accounting Standards. [740-10-25-20]

Unlike IFRS Accounting Standards, assets that would be classified as investment property under IFRS Accounting Standards are not measured using the fair value model (see chapter 3.4).

Unlike IFRS Accounting Standards, property, plant and equipment is not revalued under US GAAP (see chapter 3.2).

The tax treatment of an asset may be different depending on whether the asset is treated as an individual asset or as part of a corporate structure. Like IFRS Accounting Standards, the tax base in consolidated financial statements should be determined based on the tax treatment of individual assets and liabilities on an item-by-item basis. [740-10-25-18 – 25-21]

In an extreme case, an asset (e.g. a building) might be held by a group as the sole asset within a corporate shell for tax planning reasons. Like IFRS Accounting Standards, in that case the entity recognises any deferred taxes associated with the asset (inside basis) and the shares (outside basis) separately.

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Classification and presentation

Where to recognise income tax

Income tax is recognised in profit or loss except that:

- deferred tax recognised as part of the acquisition accounting in a business combination is recognised as an adjustment to goodwill (see below); and
- income tax related to items recognised, in the current or a previous period, outside profit or loss is recognised consistently with that item – i.e. in OCI or directly in equity. [IAS 12.57–58, 61A, 66]

IFRS Accounting Standards are silent on intra-period tax allocation, and practice may vary.

A change in deferred tax caused by a change in tax rate is recognised in profit or loss in the period in which the change is substantively enacted, except to the extent that it relates to an item recognised outside profit or loss in the current or in a previous period. [IAS 12.60]

Certain tax effects of share-based payment transactions are recognised directly in equity (see below).

Whether the initial recognition of a deferred tax related to a revaluation or fair value remeasurement is recognised in profit or loss or in OCI depends on the treatment of the revaluation or remeasurement under IFRS Accounting Standards. [IAS 12.61A, 62, 64]

Because transactions involving an entity's own shares (e.g. the purchase and reissue of treasury shares) are recognised directly in equity, the related income tax is also initially recognised directly in equity. [IAS 12.61A]

The requirement to recognise in OCI or directly in equity the tax effect of items recognised in OCI or directly in equity extends beyond the initial recognition of a deferred tax liability (or asset) to certain subsequent revisions to the tax balance – e.g. subsequent changes due to changes in tax rates or from the assessment of the recoverability of a deferred tax asset. [IAS 12.61A]

Classification and presentation

Where to recognise income tax

Income tax is recognised in profit or loss except that:

- deferred tax recognised as part of the acquisition accounting in a business combination is recognised as an adjustment to goodwill (see below), like IFRS Accounting Standards; and
- income tax related to items recognised, in the current period, either in OCI or directly in equity, is recognised consistently with that item, like IFRS Accounting Standards. However, subsequent changes in the deferred tax on those items are generally recognised in profit or loss (see below), unlike IFRS Accounting Standards. [740-20-45-2, 805-740-25-8 – 25-9]

Unlike IFRS Accounting Standards, US GAAP prescribes the calculation for intra-period tax allocation and identifies the classification of the tax effect of specific items that are to be charged or credited directly to continuing operations, discontinued operations, OCI and equity. [740-20-45-2]

Unlike IFRS Accounting Standards, the recognition of a change in deferred tax caused by a change in tax rate is always recognised in profit or loss (income from continuing operations) in the period in which the change is enacted. [740-10-35-4, 740-20-45-8]

In most cases, the tax effects of share-based payment transactions are recognised in profit or loss, unlike IFRS Accounting Standards (see below).

Like IFRS Accounting Standards, whether the initial recognition of a deferred tax related to a fair value remeasurement is recognised in profit or loss or in OCI depends on the treatment of the remeasurement. [740-20-45-11]

Like IFRS Accounting Standards, because transactions involving an entity's own shares are recognised directly in equity, the resulting income tax is also initially recognised directly in equity. [740-20-45-11]

Like IFRS Accounting Standards, the tax effect of items charged or credited to OCI or directly to equity during the current reporting period is itself charged or credited to OCI or directly to equity. However, unlike IFRS Accounting Standards, subsequent changes to deferred tax from changes in tax rates or from the assessment of the recoverability of a deferred tax asset are recognised in profit or loss. [740-20-45-2, 45-8, 45-11]

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The income tax consequences of dividends are recognised in profit or loss, unless the transactions or events that generated distributable profits were recognised outside profit or loss. The classification between profit or loss, OCI and directly in equity of those tax consequences follows the same general principles as outlined above. [IAS 12.57A, 58, 61A]

If dividend withholding taxes are collected by the entity on behalf of the tax authorities, then they are recognised directly in equity as part of the distribution to shareholders. [IAS 12.65A]

The recognition or elimination of deferred taxes caused by a change in the tax status of an entity or its shareholders is recognised in profit or loss in the current period, except to the extent that it relates to an item recognised in OCI or directly in equity in the current or in a previous period. [SIC-25.4]

Current vs non-current

Deferred tax liabilities and assets are classified as non-current when a classified statement of financial position is presented (see chapter 3.1), even though some part of the tax balance may be expected to reverse within 12 months of the reporting date. [IAS 1.56]

Deferred tax liabilities and assets are presented separately from current tax liabilities and assets. [IAS 1.54]

IFRS Accounting Standards do not provide specific guidance on the classification of current tax liabilities and assets as current or non-current. Therefore, the general classification requirements in the presentation standard apply (see chapter 3.1).

Current tax liabilities are classified as current if any of the four criteria in the presentation standard are met (see chapter 3.1); however, the 'normal operating cycle' criterion is irrelevant because income taxes are listed as an example of liabilities that are not settled as part of an entity's normal operating cycle. In our view, the classification analysis for current tax liabilities is driven by the payment terms for the particular tax – not the filing dates for tax returns – because filing does not constitute a settlement. [IAS 1.66, 69, 71, 76A]

Unlike IFRS Accounting Standards, income taxes linked to the payment of dividends are recognised in profit or loss. [740-20-45-8]

Unlike IFRS Accounting Standards, dividend withholding taxes are recognised directly in equity as part of the dividend distribution if:

- the tax is payable by the entity if and only if a dividend is distributed to shareholders, and the tax does not reduce future income taxes that the entity would otherwise pay; and
- shareholders receiving the dividend are entitled to a tax credit that is at least equal to the tax paid by the entity and that credit is realisable either as a refund or as a reduction of taxes otherwise due, regardless of the tax status of the shareholders. [740-10-15-4]

Unlike IFRS Accounting Standards, the recognition or elimination of deferred taxes caused by a change in the tax status of an entity or its shareholders is recognised in profit or loss (income from continuing operations) in the current period. [740-10-45-19]

Current vs non-current

Like IFRS Accounting Standards, deferred tax liabilities and assets are classified as non-current when a classified statement of financial position is presented (see chapter 3.1), even though some part of the tax balance may be expected to reverse within 12 months of the reporting date. [740-10-45-4]

Like IFRS Accounting Standards, deferred tax liabilities and assets are presented separately from current tax liabilities and assets. [740-10-45-4]

Like IFRS Accounting Standards, under US GAAP the general guidance for classification of accounts in the statement of financial position applies to current tax liabilities and assets (see chapter 3.1). [740-10-45-3]

Unlike IFRS Accounting Standards, if current tax liabilities are anticipated to be settled in cash within a relatively short period (usually 12 months) or directly relate to the operating cycle, then they are generally presented as current. Current tax liabilities and assets are otherwise presented as non-current. [210-10-45-1(g)(4), 45-8]

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Discounting

In some cases, an entity is not required to settle its current tax liability for at least 12 months after the reporting date and the current tax liability is classified as non-current (see above). If the tax liability does not bear interest at a market rate, then an issue arises about whether the liability should be discounted. In our view, the approach to discounting depends on whether the entity's right to defer settlement of the tax liability arises from the tax legislation or an agreement with the tax authority to restructure an outstanding tax liability.

If the entity's right to defer settlement of the current tax liability for at least 12 months after the reporting date arises from the tax legislation, then we believe that the entity should choose an accounting policy, to be applied consistently, to:

- not discount the non-current current tax liability; or
- discount the non-current current tax liability. [IFRS 9.B5.1.1–B5.1.2, IAS 12.53, IU 06-04]

We also believe that these approaches can be applied to current tax receivables classified as non-current based on the payment terms in the tax legislation. [IFRS 9.B5.1.1–B5.1.2, IAS 12.53, IU 06-04]

If the entity's right to defer settlement of the current tax liability for at least 12 months after the reporting date arises from an agreement with the tax authority to restructure an outstanding tax liability that ordinarily would be settled within 12 months under the tax legislation and the restructured tax liability does not bear interest at a market rate, then we believe that the entity should discount the restructured tax liability by analogy to the treatment in the financial instruments standard. The same rationale applies to current tax receivables classified as non-current based on the restructured deferred payment terms. [IFRS 9.B5.1.1–B5.1.2, IU 06-04]

Deferred tax amounts are not discounted. [IAS 12.53]

Offsetting

Current tax liabilities and assets are offset if the entity:

- has a legally enforceable right to offset current tax liabilities and assets. This will normally be the case only if the tax payable or receivable relates to income taxes levied by the same taxation authority and the taxation authority permits the entity to make or receive a single net payment; and
- intends to offset or to settle its tax assets and liabilities simultaneously. [IAS 12.71–72]

Discounting

Unlike IFRS Accounting Standards, an entity classifies a current tax liability directly related to the operating cycle as current (see above). Current tax liabilities are generally not discounted.

Like IFRS Accounting Standards, deferred taxes are not discounted. [740-10-30-8]

Offsetting

Like IFRS Accounting Standards, the net current tax liabilities or assets of one tax-paying component of an entity are netted against the net current tax liabilities or assets of another tax-paying component of the entity, but only if the entity has a legally enforceable right to offset the current tax amounts and the entity intends to set off those amounts. Like IFRS Accounting Standards, the offsetting of tax assets and liabilities that relate to different tax jurisdictions is not permitted. [210-20-45-1]

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Deferred tax liabilities and assets are offset if the entity has a legally enforceable right to offset current tax liabilities and assets, and the deferred tax liabilities and assets relate to income taxes levied by the same tax authority on either:

- the same taxable entity; or
- different taxable entities, but these entities intend to settle current tax liabilities and assets on a net basis, or their tax assets and liabilities will be realised simultaneously for each future period in which these differences reverse. [IAS 12.74]

Deferred tax assets and liabilities are not offset against current tax assets and liabilities.

Specific application issues

Intra-group transactions

Intra-group transactions are eliminated on consolidation (see chapter 2.5). However, any corresponding tax effects – e.g. arising from a change in the tax base of those assets or liabilities or from the tax rate applicable to the recovery or settlement of those assets or liabilities – are not eliminated. Any related deferred tax effects are measured based on the tax rate of the purchaser. Additionally, the current tax effects for the seller are recognised in the current tax provision. [IAS 12.IE.A.14, IE.B.11, IU 05-14]

Under US GAAP, for a particular tax-paying component of an entity and within a particular tax jurisdiction, entities offset and present as a single amount all deferred tax liabilities and assets (including any related valuation allowance), like IFRS Accounting Standards. Deferred tax liabilities and assets attributable to different tax-paying components of the entity or to different tax jurisdictions may not be offset, which differs from IFRS Accounting Standards in certain respects. [740-10-45-6]

Like IFRS Accounting Standards, deferred tax assets and liabilities are not offset against current tax assets and liabilities. [740-10-45-4]

Specific application issues

Intra-group transactions

Like IFRS Accounting Standards, intra-group transactions are eliminated on consolidation (see chapter 2.5). However, unlike IFRS Accounting Standards, the tax effects of transfers of inventory are treated differently from the tax effects of transfers of other assets.

Like IFRS Accounting Standards, for transfers other than inventory, any corresponding tax effects – e.g. arising from a change in the tax base of those assets or liabilities or from the tax rate applicable to the recovery or settlement of those assets or liabilities – are not eliminated. Like IFRS Accounting Standards, any related deferred tax effects are measured based on the tax rate of the purchaser, and the current tax effects for the seller are recognised in the current tax provision. [740-10-25-2]

Like IFRS Accounting Standards, income taxes paid by the seller on intra-group profits related to inventory that remain within the consolidated group – including the tax effect of any reversing temporary differences in the seller's tax jurisdiction – are not eliminated. However, unlike IFRS Accounting Standards, such amounts are deferred and recognised as deferred charges or credits (generally classified among other assets or liabilities) in the statement of financial position until such time as the inventory leaves the consolidated group, at which point they are reclassified to income tax expense. Additionally, unlike IFRS Accounting Standards, the recognition of a deferred tax asset, for the excess of the new tax basis of the inventory in the buyer's tax jurisdiction over the carrying amount of the inventory in the consolidated financial statements, is prohibited. [810-10-45-8, 55-4]

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Consolidated tax return

In consolidated financial statements, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. However, when entities in the same consolidated group file separate tax returns, separate temporary differences arise in those entities. Consequently, when an entity prepares its consolidated financial statements, deferred tax balances are determined separately for temporary differences arising from separate tax returns, using the applicable tax rates for each entity's tax jurisdiction. [IAS 12.11, IU 05-14]

Investments in subsidiaries, branches, joint arrangements and associates

Taxable temporary differences in respect of investments in subsidiaries, branches, associates and joint arrangements are not recognised if:

- the investor is able to control the timing of the reversal of the temporary difference; and
- it is probable that the temporary difference will not reverse in the foreseeable future. [IAS 12.39, IU 06-20]

Because an entity controls an investment in a subsidiary or branch, there is generally no need to consider whether the entity can control the timing of the reversal of a taxable temporary difference.

An investor does not control an associate and therefore is not generally in a position to control the timing of the reversal of a temporary difference related to the investment in the associate. Therefore, a deferred tax liability is recognised unless the investor can otherwise control the timing of the reversal of the temporary differences – e.g. if the associate has agreed that profits will not be distributed in the foreseeable future. [IAS 12.42]

Deductible temporary differences in respect of investments in subsidiaries, branches, associates and joint arrangements are recognised only to the extent that it is probable that:

- the temporary difference will reverse in the foreseeable future; and
- taxable profit will be available against which the temporary difference can be used in the future. [IAS 12.44]

Consolidated tax return

Like IFRS Accounting Standards, subsidiaries that file a separate tax return determine income tax expense based on the separate tax return filed for that subsidiary. A parent entity with a subsidiary that files a separate return does not offset its deferred taxes and liabilities against those of the subsidiary. Deferred taxes are determined separately for each tax-paying component in each tax jurisdiction using the enacted tax rate(s) in the periods in which the deferred tax liability or asset is expected to be settled or realised. [740-10-30-5, 45-6]

Investments in subsidiaries, foreign corporate joint ventures and equity-method investees

Unlike IFRS Accounting Standards, taxable temporary differences in respect of investments in certain foreign subsidiaries and foreign corporate joint ventures, sometimes referred to as 'outside basis differences', are recognised unless (indefinite reversal criteria):

- the investor is able to control the timing of the reversal of the temporary difference, like IFRS Accounting Standards; and
- undistributed earnings will be reinvested indefinitely or can be distributed on a tax-free basis, unlike IFRS Accounting Standards. [740-30-25-17]

Unlike IFRS Accounting Standards, a deferred tax liability for outside basis differences is recognised in respect of domestic subsidiaries that are greater than 50 percent owned, unless the tax law permits a tax-free recovery of the investment and the parent entity expects that it will ultimately use that means of recovery. [740-30-25-5 – 25-7, 25-17 – 25-18]

Unlike IFRS Accounting Standards, there is no exception for investments in equity-method investees. Unlike IFRS Accounting Standards, there are exemptions from recognising the effect of an outside basis difference related to a foreign corporate joint venture that is essentially permanent in duration and undistributed pre-1993 earnings of a domestic corporate joint venture. [323-740-15-1, S99-1, 740-30-25-5 – 25-6, 25-18]

Like IFRS Accounting Standards, deductible temporary differences arising on investments in subsidiaries or corporate joint ventures (both foreign and domestic) are recognised only if it is apparent that the difference will reverse in the foreseeable future. Once it has been recognised, an entity determines whether there will be future taxable profit against which to use the deductible difference to establish whether there is a need for a valuation allowance, unlike IFRS Accounting Standards. [740-30-25-9, 25-11]

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Foreign currencies and hyperinflation

Temporary differences that arise when changes in exchange rates lead to changes in the tax basis rather than the carrying amounts under IFRS Accounting Standards are recognised in full – i.e. a deferred tax liability (asset) is recognised. [IAS 12.41, IU 01-16]

Temporary differences arise when current purchasing power adjustments are made to the assets and liabilities of entities operating in hyperinflationary economies if the value in the financial statements is increased but the tax base remains stated in the historical measuring unit. Such temporary differences are recognised in full. [IAS 12.IE.A.18]

In the opening statement of financial position of the first financial statements in which the functional currency becomes hyperinflationary, deferred tax is calculated based on the nominal carrying amounts of non-monetary items by applying the effect of inflation from the date of acquisition (or revaluation/remeasurement) to the opening date of the current reporting period. Then to calculate the opening balances, deferred tax is remeasured by applying the effects of inflation from the opening date to the reporting date. At the closing reporting date, deferred tax is calculated in accordance with the income taxes standard. [IFRIC 7.4]

In hyperinflationary economies, temporary differences that arise when changes in exchange rates lead to changes in the tax basis rather than the carrying amounts under IFRS Accounting Standards are recognised in full.

Foreign currencies and hyperinflation

Unlike IFRS Accounting Standards, when the reporting currency is the functional currency, US GAAP prohibits the recognition of deferred tax for differences related to exchange gains and losses on foreign non-monetary assets or liabilities that are remeasured from the local currency into the reporting currency using historical exchange rates, and that result from either changes in exchange rates or indexing for tax purposes. [830-740-25-10]

Unlike IFRS Accounting Standards, when the functional currency is that of a highly inflationary economy, temporary differences are determined based on the difference between the indexed tax basis amount of the asset or liability and the related price-level restated amount recognised in the financial statements. The deferred tax expense or benefit is calculated as the difference between (1) deferred tax assets and liabilities recognised at the current reporting date, using current reporting date purchasing power units, determined on the ending temporary difference; and (2) deferred tax assets and liabilities reported at the prior reporting date, remeasured to units of current general purchasing power at the current reporting date. The remeasurement of deferred tax assets and liabilities at the prior reporting date is recognised together with the remeasurement of all other assets and liabilities as an adjustment of opening equity. [830-740-25-2 – 25-4, 45-2]

Like IFRS Accounting Standards, in the opening statement of financial position of the first financial statements that will be price-level adjusted, deferred tax is calculated based on the nominal carrying amounts of non-monetary items by applying the effect of inflation from the date of acquisition (or remeasurement) to the opening date of the current reporting period. Then to calculate the opening balances, deferred tax is remeasured by applying the effects of inflation from the opening date to the reporting date, like IFRS Accounting Standards. At the closing reporting date, deferred tax is calculated in accordance with the Codification Topic on income taxes. [830-740-55-1 – 55-3]

Unlike IFRS Accounting Standards, for a foreign operation that is highly inflationary and that will be included in the parent's consolidated results, deferred tax is computed in accordance with the Codification Topic on income taxes and then is remeasured as a monetary item in accordance with the requirements for remeasurement of the financial statements of a foreign operation that is highly inflationary (see chapter 2.4). [830-10-45-11]

Unlike IFRS Accounting Standards, in highly inflationary economies US GAAP excludes the effects of changes in exchange rates and indexation for tax purposes in measuring temporary differences, which are based on historical carrying amounts in the local currency and the tax basis without indexation. [830-10-45-16]

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Uncertain income tax treatments

The term 'uncertain income tax treatments' generally refers to income tax treatments used or planned to be used by an entity that may be challenged by the tax authorities, and which may result in additional taxes, penalties or interest. The accounting for uncertain income tax treatments is addressed by the specific interpretation. However, it does not cover interest or penalties on uncertain income tax treatments. The accounting for those depends on whether the interest or a penalty is itself an income tax (see above). [IFRIC 23.3(c), 4, IU 09-17]

To the extent that an uncertain tax treatment affects the calculation of income tax in respect of the current or prior periods, it impacts current tax. To the extent that an uncertain tax treatment affects the carrying amount of an asset or liability for accounting or tax purposes, or the amount of unused tax losses or unused tax credits, it impacts deferred tax. [IAS 12.5]

If there is uncertainty about an income tax treatment, then an entity considers whether it is probable that the tax authority will accept the entity's tax treatment included or planned to be included in its tax filing. The underlying assumption in the assessment is that a tax authority will examine all amounts reported and will have full knowledge of all relevant information. [IFRIC 23.8–9]

If the tax authority is likely to accept the entity's tax treatment, then the current and deferred taxes are measured consistently with the tax treatment in the income tax filing. Conversely, if the tax authority is unlikely to accept the entity's tax treatment, then the effect of the tax uncertainty is reflected in determining the related taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates. To do so, the entity uses either the most likely amount or the expected value method – whichever better predicts the resolution of the uncertainty. [IFRIC 23.10–11]

The estimates and assumptions are reassessed if facts and circumstances change or new information emerges. [IFRIC 23.13–14, A1–A3]

Tax positions with uncertainty

Similar to IFRS Accounting Standards, the income taxes Codification Topic covers the accounting for uncertainty in income taxes. However, unlike IFRS Accounting Standards, it has guidance on accounting for and disclosure of interest and penalties on income taxes. [740-10-25-6, 25-56 – 25-57, 30-29, 40-5]

To the extent that a tax position affects the calculation of income tax in respect of the current or prior periods, it falls within the definition of current tax, like IFRS Accounting Standards. To the extent that a tax exposure affects the carrying amount of an asset or liability for accounting or tax purposes, or the amount of a carry-forward, it is within the definition of deferred tax, like IFRS Accounting Standards. [740-10-25-16 – 25-17]

Unlike IFRS Accounting Standards, if there is uncertainty about an income tax treatment, then an entity considers whether it is more likely than not, based on the technical merits, that some level of tax benefit related to the position will be sustained upon examination. Like IFRS Accounting Standards, the underlying assumption in the assessment is that the tax authority will examine all amounts reported and will have full knowledge of all relevant information. [740-10-25-6, 25-7, 55-3 – 55-4]]

Unlike IFRS Accounting Standards, for tax positions that are more likely than not to be sustained, the largest amount of tax benefit that is greater than 50 percent likely to be realised on settlement is recognised. Unlike IFRS Accounting Standards, neither the most likely amount nor the expected value method are accepted. If it is not more likely than not that tax positions will be sustained, then an unrecognised amount is established for the entire tax position, unlike IFRS Accounting Standards. [740-10-25-6, 25-8, 30-7]

Like IFRS Accounting Standards, the estimates and assumptions are reassessed if facts and circumstances change or new information emerges. [740-10-35-2]

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In some cases, an amount of current or deferred tax may be subject to a future condition that an entity needs to meet, and there is uncertainty about whether this condition will be met. In our view, an entity should apply the guidance on uncertain tax treatments by analogy (see above) and reflect the uncertainty in measuring the tax at the current reporting date based on its expectation of whether it is probable that it will meet the future condition and that the tax authority will accept its treatment. We believe that an entity should perform this assessment at each reporting date until the uncertainty is resolved. [IAS 12.5, 46–47, IFRIC 23.9–12]

Investment tax credits

The term 'investment tax credit' is not defined in IFRS Accounting Standards. In practice, the term refers to an incentive, typically delivered through the income tax system. The incentive may be in the form of either a tax credit or a tax deduction, is for a specific expenditure (either for an asset or related to a particular activity) and is non-refundable.

Some ITCs meet the definition of an income tax and are in the scope of the income taxes standard. Others meet the definition of a government grant and are in the scope of the government grants standard (see chapter 4.3). Most challenges relate to ITCs which do not meet the definition of an income tax or a government grant directly and are excluded from the scope of these two standards. Despite being specifically scoped out, in practice, entities generally account for such ITCs using one of these two accounting standards by analogy.

In our view, in determining which accounting standard to apply by analogy to an ITC, an entity should assess its economic substance. We believe that in performing this assessment, the entity should apply judgement considering its specific facts and circumstances and the indicators listed in Insights 3.13.710.10 and 3.13.720.10. Each individual indicator may not be determinative on its own. Once an entity determines which standard to apply to a specific type of ITC, it applies that standard consistently.

In some cases, an amount of current or deferred tax may be subject to a future condition that an entity needs to meet, and there is uncertainty about whether this condition will be met. Unlike IFRS Accounting Standards, an entity does not apply the guidance on uncertain tax treatments by analogy but measures current and deferred taxes that are subject to a future condition based on the expected future tax consequences and tax benefits. However, the outcome may be similar to IFRS Accounting Standards. Like IFRS Accounting Standards, an entity performs an assessment at each reporting date and applies judgement based on the specific facts and circumstances. [740-10-30-8]

Investment tax credits

Like IFRS Accounting Standards, the term 'investment tax credit' is not defined in US GAAP. Like IFRS Accounting Standards, in practice the term refers to an incentive, typically delivered through the income tax system. Unlike IFRS Accounting Standards, the term refers to an incentive that is in the form of a credit, rather than an exclusion or deduction from taxable income, is for the acquisition of an asset, and may be refundable or transferable or may be non-refundable and non-transferable.

Like IFRS Accounting Standards, some ITCs are in the scope of the income taxes standard, although others are not, and therefore are accounted for as a government grant (see chapter 4.3).

Unlike IFRS Accounting Standards, ITCs that are dependent on the existence of an entity's taxable income or income tax liability are in the scope of the income taxes standard. Those ITCs that do not depend on the existence of an income tax liability (either the entity's or a transferee's income tax liability) are accounted for as a government grant.

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Applying one or the other accounting standard by analogy will have different recognition, measurement, presentation and disclosure consequences.

- Following the income taxes standard by analogy, ITCs are presented in profit or loss as a deduction from current tax expense to the extent that the entity is entitled to claim the credit in the current reporting period. Any unused ITC is recognised as a deferred tax asset and income if it meets the recognition criteria (see above).
- Following the government grants standard by analogy, ITCs are recognised over the periods necessary to match them with the related costs that they are intended to compensate. The ITC is presented in the statement of financial position initially as a receivable from the government and deferred income; or alternatively, if the grant relates to an asset, as a deduction from the carrying amount of the asset. It is subsequently presented in profit or loss either as other income or as a deduction from the related expense, as appropriate. [IAS 12.1–4, 20.1, 2(b)]

An entity accounts for temporary differences arising from ITCs under the income taxes standard. This is the case regardless of which accounting standard (the income taxes standard or the government grants standard) an entity applies to the ITC itself. [IAS 12.4]

US tax laws (the Inflation Reduction Act and the CHIPS and Science Act) introduced mechanisms for monetising some credits, including an election for 'direct pay' (under which the credit is refundable) and a third party transfer (under which the credit is transferable). The accounting for credits under these laws depends on whether the credits are refundable or non-refundable.

In our view, refundable credits under the US tax laws meet the definition of government grants and should be accounted for under the government grants standard (see chapter 4.3), regardless of whether the credits are transferable.

Like IFRS Accounting Standards, the accounting for ITCs under the income taxes standard or as a government grant will have different recognition, measurement, presentation and disclosure consequences.

- Unlike IFRS Accounting Standards, ITCs in the scope of the income taxes standard are recognised in profit or loss either immediately in the period in which the credit arises (flow-through method), or over the productive life of the acquired asset (deferral method). The outcome of applying these methods may be similar to the outcome under IFRS Accounting Standards, although differences may arise in practice. [740-10-25-46]
- Unlike IFRS Accounting Standards, there is no specific US GAAP guidance on the accounting for grants from governments to profit-oriented entities. In our experience, entities analogise to other guidance, which may include the government grants standard under IFRS Accounting Standards or other US GAAP guidance like the not-for-profit revenue guidance (see chapter 4.3).

Like IFRS Accounting Standards, an entity accounts for temporary differences arising from ITCs under the income taxes standard. This is the case regardless of which accounting standard an entity applies to the ITC itself.

Like IFRS Accounting Standards, the accounting for credits under the Inflation Reduction Act and the CHIPS and Science Act depends on whether the credits are refundable or non-refundable.

Like IFRS Accounting Standards, we believe that refundable credits under the US tax laws are like government grants, regardless of whether the credits are transferable. However, unlike IFRS Accounting Standards, US GAAP for profit-oriented entities does not include specific guidance on the accounting for government grants. In our experience, entities analogise to other guidance, which may include the government grants standard under IFRS Accounting Standards or other US GAAP guidance like the not-for-profit revenue guidance (see chapter 4.3).

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In accounting for non-refundable credits, whether transferable or not, an entity applies judgement considering all relevant facts and circumstances. It determines an accounting policy, to be applied consistently, that reflects the economic substance of the credits.

- If the economic substance of the credits is close to a tax allowance, then we believe that it is appropriate to account for them by applying the income taxes standard.
- If the economic substance of the credits is similar to a government grant, then we believe it is appropriate to account for them by applying the government grant standards.

In our view, factors that an entity may consider in determining the economic substance of non-refundable, transferable credits include whether it generally expects to realise the benefits of the credits through reducing its taxable income or by transferring the credits to a third party.

US GAAP does not specifically address how the transferability feature in credits affects the accounting for the generation or sale of non-refundable, transferable credits. Like IFRS Accounting Standards, we believe that the acceptable approaches to accounting for non-refundable, transferable credits include the income taxes standard model or the government grant model. The accounting policy should be applied consistently to non-refundable, transferable credits. However, unlike IFRS Accounting Standards, economic substance need not be considered in determining the accounting policy. Unlike IFRS Accounting Standards, non-refundable, non-transferable credits are in the scope of the income taxes standard.

Share-based payments

In some tax jurisdictions, an entity may receive a tax deduction on share-based payment arrangements that in amount or timing differs from the cumulative expense recognised in profit or loss. Generally, this will give rise to the recognition of deferred tax on the temporary differences. For measurement purposes, the entity has to determine the amount of the tax deduction to which it will be entitled. The amount should be estimated based on the information available at the reporting date, including share price, exercise year and exercise price and number of options expected to be exercised. The information used to estimate the deductions available in future periods needs to be consistent with that applied in measuring the share-based payment expense. Changes in the amount of tax benefit that would be realised based on conditions as at the reporting date are recognised as an adjustment to the deferred tax asset. [IAS 12.68A–68C, IE.Ex5]

If the amount of a tax deduction (or estimated future tax deduction) for a share-based payment transaction is less than or equal to the related cumulative remuneration expense, then the associated tax benefit is recognised in profit or loss. If the amount of a tax deduction (or estimated future tax deduction) for a share-based payment transaction exceeds the amount of the related cumulative remuneration expense, then the excess is recognised directly in equity. [IAS 12.68A–68C, IFRS 2.BC326(a)]

IFRS Accounting Standards do not provide specific guidance for tax-deductible dividends paid on unallocated shares of an ESOP and the general recognition principle applies. [IAS 12.57–58, 61A]

Share-based payments

Unlike IFRS Accounting Standards, the temporary difference on share-based payment arrangements is based on the amount of compensation cost recognised in profit or loss without any adjustment for the entity's current share price. [718-740-25-2]

The difference between the deduction for tax purposes and the compensation cost recognised in the financial statements creates an excess tax benefit or tax deficiency. Unlike IFRS Accounting Standards, all excess tax benefits and tax deficiencies are recognised as income tax benefit or expense, respectively, in profit or loss in the period in which the tax deduction arises. [718-740-35-2]

Unlike IFRS Accounting Standards, tax-deductible dividends paid on unallocated shares of an ESOP are required to be recognised in profit or loss, as part of income taxes allocated to continuing operations. [718-740-45-7]

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Tax groups

IFRS Accounting Standards do not contain specific guidance on allocating taxes to the financial statements of members within a consolidated tax group that file a consolidated tax return, and practice may vary.

Business combinations

Deferred taxes are recognised in accordance with the principles discussed above in the acquisition accounting. This applies to unused tax losses and unused tax credits of the acquiree, and temporary differences between the tax bases of identifiable assets acquired and liabilities assumed in a business combination and the related amounts recognised in the acquisition accounting. [IAS 12.19, 26(c), 66, 68]

Deferred tax liabilities are not recognised for taxable temporary differences related to the initial recognition of goodwill in a business combination. A deferred tax asset is recognised (subject to a realisability assessment) for goodwill for which the tax base exceeds its carrying amount at the date of acquisition. [IAS 12.15(a), 19, 24]

Changes in the acquirer's deferred taxes, including the assessment of their realisability, that result from a business combination are accounted for separately from the acquisition accounting. [IAS 12.67]

Tax groups

Unlike IFRS Accounting Standards, US GAAP contains guidance on allocating taxes to the financial statements of members within a consolidated tax group that file a consolidated tax return. The consolidated amount of current and deferred tax expense for a group that files a consolidated tax return is allocated among the members of the group when those members issue separate financial statements – except that no allocation is required to a legal entity that is not subject to tax. The method of allocation adopted needs to be systematic, rational and consistent with the broad principles established by the income taxes Codification Topic. This would include, for example, allocating current and deferred taxes to members of the group on a pro rata basis or applying the guidance to each member as if it were a separate taxpayer. [740-10-30-27 – 30-28]

Business combinations

Like IFRS Accounting Standards, deferred taxes are recognised in accordance with the principles discussed above, which differ in some respects from IFRS Accounting Standards, in the acquisition accounting. This applies to unused tax losses and unused tax credits of the acquiree, and temporary differences between the tax bases of identifiable assets acquired and liabilities assumed in a business combination and the related amounts recognised in the acquisition accounting. [805-740-25]

Like IFRS Accounting Standards, deferred tax liabilities are not recognised for taxable temporary differences related to the initial recognition of goodwill in a business combination (referred to as 'second component financial statement' goodwill). Like IFRS Accounting Standards, a deferred tax asset is recognised for tax goodwill that is in excess of accounting goodwill (referred to as 'second component tax' goodwill) at the date of acquisition. Unlike IFRS Accounting Standards, a valuation allowance is used as an offset to the deferred tax asset to reflect the assessment of realisability. Also unlike IFRS Accounting Standards, the deferred tax asset is measured under the 'simultaneous equation' approach. [805-740-25-8 – 25-9, 55-9 – 55-13]

Like IFRS Accounting Standards, changes in the acquirer's deferred taxes, including the assessment of their realisability, that result from a business combination are accounted for separately from the acquisition accounting. [805-740-30-3, 740-10-45-20]

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If a liability (asset) in relation to contingent consideration recognised in the acquisition accounting will result in amounts that are deductible (taxable) in future periods, then deferred taxes are generally recognised for the resulting temporary differences. In our view, the tax effects of such contingent consideration should be recognised in the acquisition accounting consistently with the recognition of the contingent consideration. Subsequent tax effects resulting from the remeasurement or settlement of the contingent consideration are accounted for separately from the acquisition accounting. [IAS 12.61A, 66]

The tax effects of the recognition of equity-settled replacement share-based payment awards attributed to pre-combination service are recognised in the acquisition accounting, consistent with the recognition of such awards.

The deferred tax effects of items recognised separately from a business combination (e.g. acquisition costs or the settlement of a pre-existing relationship) are also recognised separately from the business combination.

An entity recognises deferred taxes that result from a business combination as part of the acquisition accounting. However, in our view, except for limited circumstances of a transaction and the applicable tax laws, the tax effect of post-acquisition events, or the acquirer's post-acquisition actions, should not be anticipated. [IAS 12.66]

In certain circumstances, the acquisition accounting is adjusted due to new information that becomes available during the measurement period. The related tax effects are recognised at the same time as the measurement-period adjustments. [IAS 12.68(a), IFRS 3.45–50]

Even if no deferred tax is recognised in respect of goodwill in the acquisition accounting, deferred tax may need to be recognised in respect of such temporary differences that arise subsequent to the business combination – e.g. if goodwill is amortised for tax purposes. [IAS 12.21B]

Unlike IFRS Accounting Standards, contingent consideration that will be deductible for tax purposes in future periods is characterised as tax-deductible goodwill when determining the first and second components of goodwill. Contingent consideration that will not be deductible for tax purposes in future periods results in a difference between the financial statement carrying amount and the tax basis of the acquirer's investment in the shares of the subsidiary (outside basis difference). Like IFRS Accounting Standards, subsequent tax effects resulting from the remeasurement or settlement of the contingent consideration are accounted for separately from the acquisition accounting. [805-740-25]

Like IFRS Accounting Standards, the tax effects of the recognition of equity-classified replacement share-based payment awards attributed to pre-combination service are recognised in the acquisition accounting, consistent with the recognition of such awards. However, US GAAP and IFRS Accounting Standards differ on the accounting for tax effects of share-based payment awards (see above). [805-740-25]

Like IFRS Accounting Standards, the deferred tax effects of items recognised separately from a business combination (e.g. acquisition costs or the settlement of a pre-existing relationship) are also recognised separately from the business combination. [805-740-25]

Like IFRS Accounting Standards, an entity recognises deferred taxes that result from a business combination as part of the acquisition accounting. However, the tax effect of post-acquisition events, or the acquirer's post-acquisition actions, is not anticipated, like IFRS Accounting Standards. [740-10]

Like IFRS Accounting Standards, in certain circumstances, the acquisition accounting is adjusted due to new information that becomes available during the measurement period. The related tax effects are recognised at the same time as the measurement-period adjustments, like IFRS Accounting Standards. [740-10-35, 805-740-35, 805-740-45]

Like IFRS Accounting Standards, even if no deferred tax is recognised in respect of goodwill in the acquisition accounting, deferred tax may need to be recognised in respect of such temporary differences that arise subsequent to the business combination – e.g. if goodwill is amortised for tax purposes. [740-10, 805-740-35]

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In our view, the deferred tax effect related to the gain or loss on the remeasurement of the acquirer's previously held investment in a step acquisition (see chapter 2.6) should be recognised separately from the acquisition accounting. [IAS 12.58]

A change in a parent's ownership interest in a subsidiary while retaining control is accounted for as an equity transaction. In our view, the direct tax effects of the transaction should also be recognised directly in equity.

Government grants

No deferred tax asset is recognised in respect of non-taxable government grants related to assets because the initial recognition exemption applies (see above). [IAS 12.22, 33]

Leases

A lessee records a right-of-use asset and a lease liability when entering into a lease (see chapter 5.1). In many tax jurisdictions, a single tax deduction is available for a lease transaction and it needs to be allocated to the right-of-use asset or the lease liability. In our view, if this allocation is not straightforward, then an entity should apply judgement, based on the terms of the local tax law. A temporary difference arises on initial recognition only if the tax deduction is allocated to the lease liability. In these circumstances, the lease transaction gives rise to equal taxable and deductible temporary differences, and therefore the initial recognition exemption does not apply (see above).

A lessor in a finance lease derecognises the underlying asset and recognises a finance lease receivable (equal to the net investment in the lease; see chapter 5.1). In some tax jurisdictions, the lease receipts are taxed on a cash basis. In our view, the initial recognition exemption does not apply in these circumstances and the finance lease receivable and the tax deductions arising on the underlying asset should be considered together for the purpose of recognising deferred tax.

Like IFRS Accounting Standards, the deferred tax effect related to the gain or loss on the remeasurement of the acquirer's previously held investment in a step acquisition (see chapter 2.6) are recognised separately from the acquisition accounting. [740-10]

Like IFRS Accounting Standards, a change in a parent's ownership interest in a subsidiary while retaining control is accounted for as an equity transaction. The direct tax effects of the transaction are also recognised directly in equity, like IFRS Accounting Standards. [740-20-45-2]

Government grants

Unlike IFRS Accounting Standards, a deferred tax asset is recognised in respect of deductible temporary differences that arise as a result of non-taxable government grants. Unlike IFRS Accounting Standards, US GAAP does not have the initial recognition exemption. Under US GAAP, the assigned value of the asset and the related deferred tax is determined under the 'simultaneous equation' method. [740-10-25-51]

Leases

Like IFRS Accounting Standards, a lessee records a right-of-use asset and a lease liability when entering into a lease (see chapter 5.1). There is no initial recognition exemption under US GAAP (see above) and the lessee considers the deferred tax to recognise on each of the right-of-use asset and lease liability separately. Although the specific requirements under US GAAP differ from IFRS Accounting Standards, the outcome may be similar.

Like IFRS Accounting Standards, for direct financing and sales-type leases, a lessor derecognises the underlying asset and recognises the net investment in the lease (see chapter 5.1). There is no initial recognition exemption under US GAAP (see above) and the lessor considers the deferred tax to recognise related to each of the lease receivable and tax deductions arising on the underlying asset separately, unlike IFRS Accounting Standards.

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Leveraged leases

There are no special requirements in respect of deferred tax on leveraged leases because IFRS Accounting Standards do not include the concept of leveraged leases.

Special deductions

IFRS Accounting Standards do not contain specific guidance on the recognition of tax benefits from special deductions and does not include a list of jurisdiction-specific special deductions.

Leveraged leases

The currently effective leases Codification Topic has eliminated leveraged lease accounting for all leases commencing on or after its effective date, like IFRS Accounting Standards. However, a lessor with a leveraged lease before the adoption of this Codification Topic will continue to apply leveraged lease accounting until that lease is subsequently modified. As a result, differences may still arise.

Special deductions

Unlike IFRS Accounting Standards, US GAAP specifies that the tax benefit from special deductions is ordinarily recognised no earlier than the period in which those special deductions are deductible on the tax return. US GAAP does not define a special deduction, but does give examples of special deductions available in the US.

[740-10-25-37]

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4 Specific items of profit or loss and OCI

4.1 General

(IAS 1)

Overview

- A statement of profit or loss and OCI is presented either as a single statement, or as a statement of profit or loss followed immediately by a statement of comprehensive income (beginning with profit or loss and displaying components of OCI).
- Although IFRS Accounting Standards require certain items to be presented in the statement of profit or loss and OCI, there is no prescribed format.
- Revenue comprises income arising in the course of an entity's ordinary activities, and is presented as a separate line item in the statement of profit or loss and OCI.
- An analysis of expenses is required, either by nature or by function, in the statement of profit or loss and OCI or in the notes.

4.1 General

(Topic 205, Topic 220, Reg G, Reg S-X, SAB Topic 7.D)

Overview

- Like IFRS Accounting Standards, an entity may present a statement of comprehensive income either as a single statement, or as an income statement followed immediately by a separate statement of comprehensive income (beginning with profit or loss and displaying components of OCI).
- Unlike IFRS Accounting Standards, SEC regulations prescribe the format and minimum line item presentation for SEC registrants. For non-SEC registrants, there is limited guidance on the presentation of the income statement or statement of comprehensive income, like IFRS Accounting Standards.
- Revenue comprises inflows or other enhancements of assets or settlements of an entity's liabilities from delivering or producing goods, rendering services or other activities that are the entity's ongoing major or central operations, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, only SEC registrants are required to present revenue as a separate line item in the income statement (or single statement of comprehensive income).
- Unlike IFRS Accounting Standards, there is no requirement for expenses to be classified according to their nature or function. SEC regulations prescribe expense classification requirements for certain specialised industries, unlike IFRS Accounting Standards.

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Overview (continued)

- **The presentation of alternative earnings measures is not prohibited, either in the statement of profit or loss and OCI or in the notes to the financial statements.**
- **In our view, the use of the terms 'unusual' or 'exceptional' should be infrequent and reserved for items that justify greater prominence.**
- **The presentation or disclosure of items of income and expense characterised as 'extraordinary items' is prohibited.**
- **Items of income and expense are not offset unless required or permitted by another accounting standard, or if the amounts relate to similar transactions or events that are not material.**

Definitions

'Comprehensive income' is the total change in equity during the period, excluding changes that arise from transactions with owners in their capacity as owners. Comprehensive income comprises profit or loss and items of 'other comprehensive income' (OCI). [IAS 1.7]

OCI comprises items of income and expense that are not recognised in profit or loss, as required or permitted by IFRS Accounting Standards. [IAS 1.7]

Overview (continued)

- **Unlike IFRS Accounting Standards, the presentation of non-GAAP measures in the financial statements by SEC registrants is generally prohibited. In practice, non-GAAP measures are also not presented in the financial statements by non-SEC registrants, unlike IFRS Accounting Standards.**
- **Unlike IFRS Accounting Standards, transactions of an 'unusual' nature are defined as possessing a high degree of abnormality and of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity. Unlike IFRS Accounting Standards, material events or transactions that are unusual and/or occur infrequently are presented separately in the income statement, and the nature and financial effects are described in the income statement or disclosed in the notes.**
- **Like IFRS Accounting Standards, the presentation or disclosure of items of income and expense characterised as 'extraordinary items' is prohibited.**
- **Like IFRS Accounting Standards, items of income and expense generally are not offset unless required or permitted by another Codification topic/subtopic, or if the amounts relate to similar transactions or events that are not material. However, offsetting is permitted in more circumstances than under IFRS Accounting Standards.**

Definitions

Like IFRS Accounting Standards, 'comprehensive income' is the total change in equity during the period, excluding changes that arise from transactions with owners in their capacity as owners. Comprehensive income comprises net income (profit or loss) and items of 'other comprehensive income' (OCI). [Master Glossary]

Like IFRS Accounting Standards, OCI comprises revenues, expenses, gains and losses that are not recognised in profit or loss, as required or permitted by US GAAP. However, as discussed throughout this publication, there are some differences from IFRS Accounting Standards in the specific items that comprise OCI. [Master Glossary]

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IFRS Accounting Standards do not use the term 'accumulated OCI', although in practice it is sometimes used to refer to the cumulative amount remaining in OCI at a particular point in time.

Format of the statement of profit or loss and OCI

Profit or loss and OCI may be presented in either:

- a single statement that includes all components of profit or loss and OCI in two separate sections; or
- a statement of profit or loss followed immediately by a 'statement of comprehensive income' beginning with profit or loss and displaying components of OCI. [IAS 1.10–10A]

Although the format of the statement of profit or loss and OCI is not prescribed, certain items are required to be presented in the statement. In our experience, there is limited flexibility over the order of these items, which tends to follow the order of the items set out in IAS 1. [IAS 1.81A–82A]

Presentation of revenue

In its statement of profit or loss and OCI, an entity presents a separate line item for revenue, which comprises income arising in the course of its ordinary activities. Some types of revenue – e.g. interest revenue calculated under the effective interest method (see chapter 7.7) and insurance revenue (see chapter 8.1) – are required to be presented separately in the statement of profit or loss and OCI. Other types – e.g. revenue from contracts with customers (see chapter 4.2) – can be disclosed separately in the notes. [IAS 1.82(a), IFRS 15.A, 113]

Various Codification topics/subtopics use the term 'accumulated OCI' (AOCI) to refer to the cumulative amount remaining in OCI at a particular point in time, like practice under IFRS Accounting Standards.

Format of the statement of comprehensive income

Like IFRS Accounting Standards, an entity may present comprehensive income in either:

- a single statement of comprehensive income, which includes all components of profit or loss and OCI; or
- an income statement followed immediately by a separate statement of comprehensive income beginning with profit or loss and displaying components of OCI. [220-10-45, 220-10-55]

Unlike IFRS Accounting Standards, SEC regulations prescribe the format of the income statement and minimum line item presentation for SEC registrants in general and by industry, which include:

- general instructions for financial statements;
- registered investment companies;
- commercial and industrial companies;
- insurance companies;
- employee stock purchase, savings and similar plans;
- certain brokers and dealers; and
- bank holding companies. [Reg S-X Art 3, 5, 6A, 7, 9]

For non-SEC registrants, US GAAP has limited guidance on the information to be presented in the income statement or statement of comprehensive income, like IFRS Accounting Standards. [220-10-45-7]

Presentation of revenue

Revenue comprises inflows or other enhancements of assets of an entity or settlements of its liabilities from delivering or producing goods, rendering services or other activities that are the entity's ongoing major or central operations, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, except for SEC registrants, there is no requirement to disclose a separate line item for revenue in an entity's income statement (or single statement of comprehensive income). Like IFRS Accounting Standards, some types of revenue are required to be disclosed, but this can be done in the notes – e.g. revenue from contracts with customers (see chapter 4.2). [Master Glossary, Reg S-X 210.5-03(1), 606-10-50-4]

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Classification of expenses

An entity presents an analysis of expenses recognised in profit or loss using a classification based on either their nature or their function within the entity, whichever provides information that is reliable and more relevant. This analysis may be presented in the notes to the financial statements. [IAS 1.99–100]

Additional, unusual or exceptional items

An entity presents additional items of income or expense, headings or subtotals if they are relevant to an understanding of the entity's financial performance. Factors to consider when determining whether to present additional items include materiality and the nature and function of the components of income and expenses. [IAS 1.85–86]

When an entity presents additional subtotals in the statement of profit or loss and OCI, the subtotals:

- comprise line items made up of amounts recognised and measured in accordance with IFRS Accounting Standards;
- are presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable;
- are consistent from period to period;
- are displayed with no more prominence than other subtotals and totals presented in the statement of profit or loss and OCI; and
- are reconciled in the statement of profit or loss and OCI with the subtotals and totals required by the accounting standard. [IAS 1.85A–85B, BC38G, BC58B]

IFRS Accounting Standards do not describe events or items of income or expense as 'unusual' or 'exceptional'. In our view, if the description 'unusual' or 'exceptional' is used, then its use should be infrequent and reserved for items that justify greater prominence than that achieved by separate presentation or disclosure. In addition, in our view an item is not exceptional or unusual merely because there is a requirement to present or disclose that item separately, either in the statement of profit or loss and OCI or in the notes to the financial statements. In our view, when classifying expenses by nature or function, any amount described as unusual or exceptional should be classified in the same way as usual or non-exceptional amounts of the same function or nature. [IAS 1.17(c), 97]

Classification of expenses

Unlike IFRS Accounting Standards, there is no requirement for expenses to be classified according to their nature or function. SEC regulations prescribe expense classification requirements for certain specialised industries, unlike IFRS Accounting Standards, and these may differ from the classifications permitted or required by IFRS Accounting Standards. [Reg S-X 210.5-03, 210.7-04, 210.9-04]

Unusual or infrequent items

A material event or transaction that is unusual in nature or occurs infrequently is reported as a separate component of income from continuing operations, which may differ from the approach under IFRS Accounting Standards. Like IFRS Accounting Standards, additional line items, headings and subtotals may be presented if they improve the understandability of the income statement. The nature and financial effects of each event or transaction are disclosed in the income statement or in the notes to the financial statements, like IFRS Accounting Standards. [220-20-45-1]

Unlike IFRS Accounting Standards, there is no specific guidance on the presentation of additional subtotals in the income statement that is equivalent to IFRS Accounting Standards. However, the general concepts of consistency, clarity and understandability would apply. For a discussion of the prohibition from presenting an income subtotal before depreciation and depletion, see below.

Transactions of an unusual nature are defined under US GAAP as events or transactions possessing a high degree of abnormality and of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity. Unlike IFRS Accounting Standards, material events or transactions that are of an unusual nature and/or occur infrequently are presented separately in the statement that reports profit or loss, and the nature and financial effects are described in that statement or disclosed in the notes. [Master Glossary, 220-20-45-1]

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IFRS Accounting Standards make no distinction between ordinary and extraordinary activities. The presentation, disclosure or characterisation of items of income and expense as 'extraordinary items' in the statement of profit or loss and OCI or in the notes to the financial statements is prohibited. [IAS 1.87]

Operating results

Entities are permitted, but not required, to provide a subtotal for the results of operating activities before profit or loss for the reporting period. There is no definition of 'operating' and 'non-operating' for the purposes of the statement of profit or loss. [IAS 1.82, 85–85A, BC55–BC56]

Share of profit of equity-accounted investees

An investor's share of profit or loss of equity-accounted investees is presented as a separate line item in profit or loss (see chapter 3.5). [IAS 1.82(c), IG6, 28.10]

Reclassifications from OCI

An entity presents the items of OCI that may be reclassified to profit or loss in the future if certain conditions are met separately from those that will never be reclassified to profit or loss. Examples of items of income and expense that may subsequently be reclassified to profit or loss include:

- foreign exchange differences on the translation of foreign operations (see chapter 2.7);
- the effects of cash flow hedging and cost of hedging reserve (see chapters 7.9 and 7.9B);
- gains and losses on FVOCI debt instruments (see chapter 7.6); and
- the income tax effect of the above items (see chapter 3.13). [IAS 1.82A]

The title of the 'statement of profit or loss and OCI' and other titles used in the accounting standard are not mandatory. [IAS 1.10]

Like IFRS Accounting Standards, US GAAP makes no distinction between ordinary and extraordinary activities. The presentation, disclosure or characterisation of items of income and expense as 'extraordinary items' in the statement of profit or loss and OCI or in the notes to the financial statements is prohibited.

Operating results

Like IFRS Accounting Standards, entities are permitted, but not required, to provide a subtotal for the results of operating activities before profit or loss for the reporting period. Like IFRS Accounting Standards, US GAAP does not define 'operating' and 'non-operating', and therefore differences may arise in practice.

Share of profit of equity-method investees

Like IFRS Accounting Standards, an investor's share of profit or loss from equity-method investees is presented as a separate line item in the income statement (see chapter 3.5). [323-10-35-4, 35-18]

Reclassifications from OCI

Unlike IFRS Accounting Standards, generally all items of OCI are reclassified to profit or loss in the future, and therefore there is no distinction similar to that made under IFRS Accounting Standards.

Like IFRS Accounting Standards, examples of items of income and expense that are subsequently reclassified to profit or loss include:

- foreign exchange differences on the translation of foreign operations (see chapter 2.7);
- the effects of cash flow hedging (see chapters 7.9 and 7.9B);
- unrealised holding gains and losses on available-for-sale debt instruments (see chapter 7.7); and
- the income tax effect of the above items (see chapter 3.13). [220-10-45-10A]

Unlike IFRS Accounting Standards, and depending on the accounting policy chosen, an entity reclassifies gains or losses associated with pension or other post-retirement benefits initially recognised in OCI in the future to profit or loss (see chapter 4.4). [715-30-35-4(e)]

The title of the 'statement of comprehensive income' is not mandatory, like IFRS Accounting Standards.

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Alternative earnings measures

An entity may wish to present alternative earnings measures in the statement of profit or loss and OCI. IFRS Accounting Standards do not prohibit the presentation of subtotals, including certain alternative earnings measures, if relevant criteria are met (see above). [IAS 1.85A–85B, BC38G]

In our view, if a measure (e.g. EBITDA or EBIT) is made up of amounts recognised and measured in accordance with IFRS Accounting Standards, then it may be considered an additional subtotal (see above).

If an entity uses EBITDA or a similar measure to evaluate an operating segment's performance, then that information is evaluated for inclusion in the segment disclosures (see chapter 5.2).

EPS amounts for alternative earnings measures cannot be presented on the face of the financial statements but may be presented elsewhere. [IAS 33.73–73A]

Non-GAAP measures

Unlike IFRS Accounting Standards, SEC rules define non-GAAP measures as numerical measures of financial performance, financial position or cash flows that (1) exclude amounts that are included in the most directly comparable measure calculated and presented in accordance with US GAAP, or (2) include amounts that are excluded from the most directly comparable measure calculated and presented in accordance with US GAAP. Financial measures expressly required or permitted to be disclosed by US GAAP, are not considered non-GAAP measures. [Reg G, Reg S-K Rule 10(e)]

SEC registrants can present non-GAAP measures outside of the financial statements (such as in management's discussion and analysis). However, they are prohibited from presenting non-GAAP measures in the financial statements, with a narrow exception for certain voluntarily disclosed non-GAAP segment profit or loss measures (see chapter 5.2). [Reg G, Reg S-K Rule 10(e)]

Non-GAAP measures are subject to the SEC non-GAAP rules and regulations, which notably state that those measures:

- cannot be misleading;
- are reconciled to the most directly comparable GAAP measure; and
- may not be displayed more prominently than GAAP measures. [Reg G, Reg S-K Rule 10(e)]

There is no specific guidance for non-SEC registrants; generally in practice, non-GAAP measures are not presented anywhere in the financial statements.

Unlike IFRS Accounting Standards, SEC registrants are prohibited from presenting an income subtotal before depreciation and depletion in the statement of profit or loss. [SAB Topic 7.D]

Like IFRS Accounting Standards, if an entity uses EBITDA or a similar measure to evaluate an operating segment's performance, then that information is evaluated for inclusion in the segment disclosures (see chapter 5.2). [280-10-50-27, 28A]

Unlike IFRS Accounting Standards, EPS amounts for non-GAAP measures cannot be presented anywhere in the financial statements. [260-10-45-6]

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Offsetting

Items of income and expense are offset when it is required or permitted by an accounting standard. For example, an expense relating to a provision may be presented net of the amount recognised for a reimbursement. In addition, gains, losses and related expenses arising from the same transaction or event or from similar individually immaterial transactions and events are offset. [IAS 1.32–35, 37.54]

Forthcoming requirements

A new presentation and disclosure standard is effective for annual periods beginning on or after 1 January 2027; early adoption is permitted. [IFRS 18.C1]

This accounting standard is discussed in chapter 4.1A.

Offsetting

Like IFRS Accounting Standards, items of income and expense are generally not offset unless it is required or permitted by another Codification topic/subtopic, or when the amounts relate to similar transactions or events that are not significant. However, offsetting is permitted in more circumstances under US GAAP than under IFRS Accounting Standards. For example, derivatives executed with the same counterparty under a master netting arrangement may be offset, unlike IFRS Accounting Standards. Conversely, like IFRS Accounting Standards, recoveries for environmental losses are presented in the same line item as the related loss. In our experience, unlike IFRS Accounting Standards, this net presentation approach is also commonly used for other types of costs recharges. [815-10-45]

Forthcoming requirements

Amendments to the income statement Codification Topic are effective for annual periods beginning after 15 December 2026; early adoption is permitted (see appendix).

The amendments address disaggregation disclosure requirements for certain expenses and are discussed in chapter 4.1A.

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4.1A General: IFRS 18

(IFRS 18)

Overview of forthcoming requirements

- Profit or loss and OCI may be presented in either a single statement, or as two separate statements: a 'statement of profit or loss' followed immediately by a 'statement of comprehensive income' beginning with profit or loss and displaying components of OCI.
- The structure of the statement of profit or loss is determined by specific requirements and the statement's role of providing a useful structured summary of the entity's income and expenses.
- Income and expenses included in profit or loss are classified in one of five categories (operating, investing, financing, income taxes and discontinued operations). Classification is driven by an entity's main business activities and the nature of the asset or liability giving rise to the income or expense.
- Revenue comprises income arising in the course of an entity's ordinary activities, and is presented as a separate line item in the statement of profit or loss and OCI.
- An entity is required to present an analysis of operating expenses on the face of the statement of profit or loss – either by nature, function or a mixture of both.
- The presentation and disclosure standard specifies minimum line items to be presented in the statement of profit or loss. However, an entity is not required to present a line item separately, if doing so would not fulfil the statement's role of providing a useful structured summary. Conversely, additional line items may be necessary to provide a useful structured summary.

4.1A General: IFRS 18

(Topic 205, Topic 220, Reg G, Reg S-X, SAB Topic 7.D)

Overview

- Like IFRS Accounting Standards, profit or loss and OCI may be presented in either a single statement, or as two separate statements: an 'income statement' followed immediately by a separate 'statement of comprehensive income' beginning with profit or loss and displaying components of OCI.
- Unlike IFRS Accounting Standards, US GAAP has limited guidance on the structure of the income statement for non-registrants. SEC regulations prescribe the format of the income statement, including minimum line item presentation, for SEC registrants.
- Unlike IFRS Accounting Standards, US GAAP does not require a five-category classification. However, like IFRS Accounting Standards, discontinued operations and income taxes are presented separately.
- Revenue comprises inflows or other enhancements of assets or settlements of an entity's liabilities from delivering or producing goods, rendering services or other activities that are the entity's ongoing major or central operations, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, only SEC registrants are required to present revenue as a separate line item in the income statement (or single statement of comprehensive income).
- Unlike IFRS Accounting Standards, US GAAP does not generally require expenses to be classified according to their nature or function on the face of the income statement. However, SEC regulations prescribe minimum expense line items and expense classification requirements for SEC registrants in certain specialised industries.
- Unlike IFRS Accounting Standards, US GAAP does not provide a framework for omitting or adding line items based on the usefulness of the structured summary. SEC regulations specify minimum line item presentation in general and by industry. In our experience, the income statement of non-SEC registrants is generally presented similar to that of registrants.

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Overview (continued)

- **Items of income and expense are offset when required or permitted by an accounting standard or when the substance of the transaction or event is reflected by offsetting income and related expenses arising on the same transaction.**

- **Management-defined performance measures (MPMs) capture some, but not all, non-GAAP measures. An entity clearly labels and describes each MPM and discloses specific information on these measures in a single note.**

The requirements in this chapter are forthcoming from the new standard on presentation and disclosure which is effective for annual periods beginning on or after 1 January 2027; early adoption is permitted. On transition, an entity applies a retrospective approach. [IFRS 18.C1-C2]

This chapter highlights only the key differences between the forthcoming requirements of IFRS Accounting Standards and US GAAP. For more detailed information about the new presentation and disclosure standard, see our First Impressions: Presentation and disclosure – IFRS 18.

Definitions

'Comprehensive income' is the total change in equity during the reporting period, excluding changes that arise from transactions with owners in their capacity as owners. Comprehensive income comprises profit or loss and items of 'other comprehensive income' (OCI). [IFRS 18.A]

OCI comprises items of income and expense, including reclassification adjustments, that are recognised outside profit or loss as required or permitted by IFRS Accounting Standards. [IFRS 18.A]

Overview (continued)

- **Like IFRS Accounting Standards, items of income and expense generally are only offset when required or permitted by a Codification topic/subtopic, or when the substance of the transaction or event is reflected by offsetting income and related expenses arising on the same transaction. However, offsetting is permitted in more circumstances than under IFRS Accounting Standards.**

- **Unlike IFRS Accounting Standards, US GAAP does not include the concept of MPMs. The presentation and disclosure of non-GAAP measures in the financial statements is generally prohibited.**

The requirements in this chapter are the currently effective requirements under US GAAP, except for the forthcoming requirement for public entities to disclose selling expenses and disaggregated income statement expenses based on natural expense categories under the expense disaggregation disclosures Subtopic. These new disclosures are effective for annual periods beginning after 15 December 2026; early adoption is permitted (see appendix). They apply prospectively. [220-40]

Definitions

Like IFRS Accounting Standards, 'comprehensive income' is the total change in equity during the reporting period, excluding changes that arise from transactions with owners in their capacity as owners. Comprehensive income comprises net income (profit or loss) and items of 'other comprehensive income' (OCI). [Master Glossary]

Like IFRS Accounting Standards, OCI comprises revenues, expenses, gains and losses that are not recognised in profit or loss, as required or permitted by US GAAP. However, as discussed throughout this publication, there are some differences from IFRS Accounting Standards in the specific items that comprise OCI. [Master Glossary]

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IFRS Accounting Standards do not use the term 'accumulated OCI', although in practice it is sometimes used to refer to the cumulative amount remaining in OCI at a particular point in time. [IFRS 18.111]

Format of the statement of profit or loss and OCI

Profit or loss and OCI may be presented in either:

- a single statement that includes all components of profit or loss and OCI in two separate sections; or
- two separate statements: a 'statement of profit or loss' displaying components of profit or loss, followed immediately by a 'statement of comprehensive income' beginning with profit or loss and displaying components of OCI. [IFRS 18.10, 12, 86–87]

Structure of the statement of profit or loss

The presentation and disclosure standard provides specific requirements on the structure of the statement of profit or loss (e.g. classification of income and expenses, minimum line items and subtotals) which are discussed below. An entity also considers the statement's role of providing a useful structured summary of the entity's income and expenses (see chapter 2.2). [IFRS 18.16, 21–22(a), 47, 69, 75–76, 78]

Classification of income and expenses

Income and expenses included in profit or loss are classified in one of five categories (operating, investing, financing, income taxes and discontinued operations), which are explained in more detail below. [IFRS 18.47, B42, B52–B68, BC89]

Classifying income and expenses in the operating, investing and financing categories is driven by an entity's main business activities (e.g. whether it is a bank, an investment property company or a manufacturer) and the nature of the asset or liability giving rise to the income or expenses. An entity with a specified main business activity (i.e. investing in assets and/or providing financing to customers) classifies additional income and expenses in the operating category that would otherwise be classified in the investing or financing categories. The discussion below does not address classification by an entity with a specified main business activity. [IFRS 18.49–50]

Specific classification requirements also apply to the following:

- income and expenses from hybrid contracts;
- income and expenses from derecognition and changes in classification;
- foreign exchange differences; and
- gains and losses on derivatives and hedging instruments. [IFRS 18.48, B65–B76]

Various Codification topics/subtopics use the term 'accumulated OCI' (AOCI) to refer to the cumulative amount remaining in OCI at a particular point in time, like practice under IFRS Accounting Standards.

Format of the statement of comprehensive income

Like IFRS Accounting Standards, profit or loss and OCI may be presented in either:

- a single statement of comprehensive income, which includes all components of profit or loss and OCI; or
- two separate statements: an 'income statement' followed immediately by a separate 'statement of comprehensive income' beginning with profit or loss and displaying components of OCI. [220-10-45, 220-10-55]

Structure of the income statement

Unlike IFRS Accounting Standards, US GAAP has limited guidance on the structure of the income statement for non-registrants. SEC regulations prescribe the format of the income statement, including minimum line items and subtotals to be presented for SEC registrants in general and by industry. In our experience, the income statement of non-registrants is generally presented similar to that of registrants. Due to the significant differences in the extent of specific requirements, we expect pervasive differences from IFRS Accounting Standards.

Classification of income and expenses

Unlike IFRS Accounting Standards, US GAAP does not require a five-category classification. However, like IFRS Accounting Standards, discontinued operations and income taxes are presented separately.

Unlike IFRS Accounting Standards, there is no concept of specified main business activities as a specific consideration in determining the structure of the income statement. However, the structure of the income statement may vary between entities in different industries – e.g. commercial and industrial entities vs financial institutions.

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Operating

The operating category typically includes income and expenses arising from an entity's main business activities (e.g. revenue from the sale of goods or services, depreciation of property, plant and equipment). Exceptions include income and expenses from:

- equity-accounted investments, which are always classified in the investing category, even if they arise from the entity's main business activities; and
- issued investment contracts with participation features recognised under the financial instruments standard and insurance finance income and expenses recognised in profit or loss under the insurance contracts standard, which are always classified in the operating category, even if they do not arise from the entity's main business activities. [IFRS 18.52, 55(a), 64, B42]

The operating category is not limited to income and expenses arising from an entity's main business activities. It is also a 'default' category that includes all income and expenses not classified in the other categories in the statement of profit or loss, and includes such income and expenses that are volatile or non-recurring. [IFRS 18.52, B42]

Investing

The investing category includes specific income and expenses arising from the following non-operating assets:

- investments in associates, joint ventures and unconsolidated subsidiaries;
- cash and cash equivalents; and
- other non-operating assets – i.e. those that generate a return individually and largely independently of an entity's other resources. [IFRS 18. 53–54]

The following are the specific income and expenses from non-operating assets that are classified in the investing category:

- income generated by the assets (e.g. interest, dividends, rental income and depreciation);
- income and expenses from the initial and subsequent measurement of the assets, including derecognition (e.g. fair value gains and losses, impairment losses and reversals); and
- incremental expenses directly attributable to the acquisition and disposal of the assets (e.g. transaction costs and costs to sell the assets). [IFRS 18.54, B47]

Operating

Unlike IFRS Accounting Standards, US GAAP does not require a specific operating category, although certain items are explicitly included in or excluded from an operating profit or loss subtotal if one is presented. In practice, many entities present an operating profit or loss subtotal. Further, for commercial and industrial SEC registrants, SEC regulations require certain items to be presented as non-operating income or non-operating expenses separately from other income statement line items. Unlike IFRS Accounting Standards, US GAAP does not define the term operating, and therefore differences may arise in practice. In our experience, operating activities are often viewed as those activities that are part of the entity's ongoing operations (e.g. revenue, cost of sales, research and development costs). Conversely, non-operating items are generally expected to not recur frequently (e.g. interest on securities, net profits or losses on securities). [Reg S-X 210.5-03]

Investing

Unlike IFRS Accounting Standards, US GAAP does not require a specific investing category. US GAAP requires separate presentation of certain line items, including equity in earnings of unconsolidated subsidiaries and 50 percent or less owned entities. For commercial and industrial SEC registrants, SEC regulations require separate presentation of non-operating income (which includes dividends, interest on securities, and profits or losses on securities) and non-operating expenses (which includes losses on securities). [323-10-45-1, Reg S-X 210.5-03]

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Financing

The financing category includes specific income and expenses arising from two distinct types of liabilities:

- financing liabilities – i.e. liabilities that relate only to the raising of finance; and
- other liabilities. [IFRS 18.59]

The following are the specific income and expenses that are classified in the financing category:

- income and expenses from the initial and subsequent measurement of financing liabilities, including derecognition (e.g. interest expenses on debt instruments);
- incremental expenses directly attributable to the issue and extinguishment of financing liabilities (e.g. transaction costs); and
- interest income and expenses, and effects of changes in interest rates, from other liabilities required to be identified by another accounting standard (e.g. interest expense on trade payables, the effect of any change in the discount rate on provisions). [IFRS 18.59–61, B51–B54]

Income taxes

The income taxes category includes tax expenses or tax income recognised under the income tax standard (see chapter 3.13) and any related foreign exchange differences. [IFRS 18.67, B29, B65–B68]

Discontinued operations

The discontinued operations category includes income and expenses from discontinued operations (see chapter 5.4). [IFRS 18.68, B29]

Presentation of revenue

In its statement of profit or loss, an entity presents a separate line item for revenue, which comprises income arising in the course of its ordinary activities. Some types of revenue – e.g. interest revenue calculated using the effective interest method (see chapter 7.7) and insurance revenue (see chapter 8.1) – are required to be presented separately if such presentation is necessary for the statement to provide a useful structured summary (see chapter 2.2). Other types – e.g. revenue from contracts with customers (see chapter 4.2) – are not required to be presented separately unless such presentation is necessary for the statement to provide a useful structured summary. However, if these amounts are material and not presented separately, then they are disclosed in the notes. [IFRS 15.A, 113, IFRS 18.23–24, 75(a)]

Financing

Unlike IFRS Accounting Standards, US GAAP does not require a specific financing category. For commercial and industrial SEC registrants, SEC regulations require interest and amortisation of debt discount and expense to be presented as a separate line item. [Reg S-X 210.5-03]

Income taxes

Like IFRS Accounting Standards, the income taxes category includes tax expenses or tax income recognised under the income tax standard (see chapter 3.13). Unlike IFRS Accounting Standards, US GAAP does not require a specific classification of related foreign exchange differences. [Reg S-X 210.5-03)]

Discontinued operations

Like IFRS Accounting Standards, the discontinued operations category includes income and expenses from discontinued operations (see chapter 5.4). [220-10-45-7]

Presentation of revenue

Revenue comprises inflows or other enhancements of assets of an entity and/or settlements of its liabilities from delivering or producing goods, rendering services or other activities that are the entity's ongoing major or central operations, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, except for SEC registrants, a separate line item for revenue is not required in an entity's income statement (or single statement of comprehensive income). Like IFRS Accounting Standards, the amounts of some types of revenue are required to be disclosed in the notes if the amounts are material and not presented separately – e.g. revenue from contracts with customers (see chapter 4.2). Unlike IFRS Accounting Standards, SEC registrants present separately certain categories of revenues if they exceed 10 percent of total revenues (e.g. sales of goods, sales of services, related-party transactions). [Master Glossary, Reg S-X 210.5-03(1), 606-10-50-4]

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Presentation and disclosure of operating expenses

An entity is required to present an analysis of operating expenses on the face of the statement of profit or loss – either by nature, function or a mixture of both. An entity classifies and presents expenses in line items in the operating category in a way that provides the most useful structured summary of its expenses (see chapter 2.2) [IFRS 18.78–79]

If any line items presented in the operating category comprise expenses classified by function, then an entity presents a separate cost of sales line item (if it has a cost of sales function), which includes the total of inventory expense, and discloses a qualitative description of the nature of expenses included in each function line item. [IFRS 18.82, B84(b), IAS 2.38]

In addition, an entity discloses in a single note specific quantitative and qualitative information about the nature of five operating expenses (depreciation; amortisation; employee benefits; impairment losses and their reversals; and write-downs of inventories and their reversals). [IFRS 18.83, B84(b)]

Line items, totals and subtotals

The presentation and disclosure standard specifies minimum line items to be presented in the statement of profit or loss. However, an entity is not required to present a line item separately, even if material and required by IFRS Accounting Standards, if doing so would not fulfil the statement's role of providing a useful structured summary (see chapter 2.2). Conversely, an entity might determine that presenting additional line items in the statement is necessary to provide a useful structured summary. Any material information that is not presented in the statement of profit or loss needs to be disclosed in the notes. [IFRS 18.15, 19, 23, 75, B1–B5, B8]

Presentation and disclosure of operating expenses

Unlike IFRS Accounting Standards, US GAAP does not generally require expenses to be classified according to their nature or function on the face of the income statement. However, SEC regulations prescribe minimum expense line items and expense classification requirements for SEC registrants in certain specialised industries. These requirements are often applied by non-registrants and may differ from the classifications permitted or required by IFRS Accounting Standards. For example, commercial and industrial SEC registrants present cost of sales and selling, general and administrative expenses amongst other required line items. Further, a cost of sales subcategory is required for each subcategory of revenues presented (e.g. cost of goods, cost of services). [Reg S-X 210.5-03, 210.7-04, 210.9-04]

Like IFRS Accounting Standards, when expenses are classified by function, an entity presents a cost of sales line item (if it has a cost of sales function), which includes the total of inventory expense. [Reg S-X 210.5-03]

Unlike IFRS Accounting Standards, when expenses are classified by function, there is no requirement to disclose the nature of expenses included in each function line item. However, under the forthcoming requirements in the expense disaggregation disclosures Subtopic, public entities will need to provide in a single note a quantitative disaggregation of relevant income statement line items into five prescribed natural expense categories (purchases of inventory, employee compensation, depreciation, amortisation and depletion). In addition, public entities will disclose in the notes an amount for selling expenses (a management defined measure) and qualitatively describe its composition. [Reg S-X 210.5-03, 220-40-50-6, 220-40-50-35 – 50-36]

Line items, totals and subtotals

Unlike IFRS Accounting Standards, US GAAP does not provide a framework for omitting or adding line items based on the usefulness of the structured summary. SEC regulations specify minimum line item presentation in general and by industry. Registrants are required to present these line items if applicable, unless immaterial. In our experience, the income statement of non-SEC registrants is generally presented similar to that of registrants. Like IFRS Accounting Standards, material information not presented on the face of the statement needs to be disclosed in the notes. [Reg S-X Art 3, 5, 6A, 7, 9]

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IFRS Accounting Standards do not define or describe events or items of income or expense as 'unusual'. However, income and expenses are disaggregated whenever the resulting information is material and a single dissimilar characteristic may result in disaggregation. Non-recurring income and expenses may have sufficiently dissimilar characteristics such that a separate presentation in the statement of profit or loss is necessary to provide a useful structured summary of the entity's income and expenses or disclosure in the notes is necessary to provide material information. [IFRS 18 24, 41–42, B16–B22, B78–B79, B110, BC413]

An entity presents the following totals and subtotals in the statement of profit or loss:
- operating profit or loss, comprising all income and expenses classified in the operating category;
- profit or loss before financing and income taxes, comprising operating profit or loss and all income and expenses classified in the investing category; and
- profit or loss, comprising all income and expenses included in the statement. [IFRS 18.69]

However, entities that provide financing to customers as their only main business activity are not permitted to present the 'profit or loss before financing and income taxes' subtotal. [IFRS 18.69–74, IE.10–IE.11, IE.13]

An entity presents additional line items and subtotals if necessary for the statement of profit or loss to provide a useful structured summary. Additional line items or subtotals are required to be:
- comprised of amounts recognised and measured in accordance with IFRS Accounting Standards;
- compatible with the statement's structure;
- consistent from period to period; and
- displayed with no more prominence than required totals and subtotals. [IFRS 18.24, B9]

Reclassifications from OCI

In the OCI section of the statement of profit or loss and OCI, income and expenses are classified into one of two categories based on whether they may be reclassified to profit or loss when certain conditions are met or will never be reclassified to profit or loss. [IFRS 18.88]

Unlike IFRS Accounting Standards, US GAAP defines transactions of an unusual nature as events or transactions possessing a high degree of abnormality and of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity. US GAAP requires an entity to present separately in the income statement or disclose the nature and financial effects of material events or transactions that are of an unusual nature and/or occur infrequently. [Master Glossary, 220-20-45-1]

Under US GAAP, entities present the following totals or subtotals in the income statement:
- income or loss before income tax expense;
- income from continuing operations; and
- net income or loss. [Reg S-X Art 5, 6, 7, 9]

Unlike IFRS Accounting Standards, presenting an operating profit or loss subtotal is permitted but not required.

Unlike IFRS Accounting Standards, SEC registrants in specific industries are required to present additional subtotals. For example, financial institutions present subtotals for net interest income, and net interest income after provision for loan losses. [Reg S-X Art 9]

Unlike IFRS Accounting Standards, there is limited guidance on the presentation of additional subtotals in the income statement. SEC registrants are prohibited from presenting an income subtotal before depreciation and depletion in the statement of profit or loss. In practice, many entities present subtotals such as gross margin or operating profit or loss. Further, in addition to the restrictions related to non-GAAP measures discussed below, the general concepts of consistency, clarity and understandability apply. [SAB Topic 7.D]

Reclassifications from OCI

Unlike IFRS Accounting Standards, generally all items of OCI are reclassified to profit or loss in the future, and therefore there is no distinction similar to that made under IFRS Accounting Standards.

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Examples of items of income and expenses that may subsequently be reclassified to profit or loss include:

- foreign exchange differences on the translation of foreign operations (see chapter 2.7);
- the effects of cash flow hedging and cost of hedging reserve (see chapters 7.9 and 7.9B);
- gains and losses on FVOCI debt instruments (see chapters 7.4 and 7.6); and
- the income tax effect of the above items (see chapter 3.13). [IFRS 18.88–89]

Offsetting

Items of income and expense are offset when it is required or permitted by an accounting standard or when the substance of the transaction or event is reflected by offsetting income and related expenses arising on the same transaction. In addition, gains and losses arising from a group of similar transactions are presented on a net basis. For example, foreign exchange gains and losses, or gains and losses arising on financial instruments held for trading that are included in the same category of the statement of profit or loss may be presented on a net basis. These gains and losses are separately disclosed in the notes if such disclosure provides material information. [IFRS 18.44–45, B27–B28]

Management-defined performance measures

The presentation and disclosure standard defines management-defined performance measures (MPMs) and requires information about such measures to be disclosed in a single note. [IFRS 18.117-125]

Like IFRS Accounting Standards, examples of items of income and expense that are subsequently reclassified to profit or loss include:

- foreign exchange differences on the translation of foreign operations (see chapter 2.7);
- the effects of cash flow hedging (see chapters 7.9 and 7.9B);
- unrealised holding gains and losses on available-for-sale debt instruments (see chapter 7.7); and
- the income tax effect of the above items (see chapter 3.13). [220-10-45-10A]

Unlike IFRS Accounting Standards, and depending on the accounting policy chosen, an entity reclassifies gains or losses associated with pension or other post-retirement benefits initially recognised in OCI in the future to profit or loss (see chapter 4.4). [715-30-35-4(e)]

Offsetting

Like IFRS Accounting Standards, items of income and expense generally are only offset when it is required or permitted by a Codification topic/subtopic, or when the substance of the transaction or event is reflected by offsetting income and related expenses arising on the same transaction. However, offsetting is permitted in more circumstances under US GAAP than under IFRS Accounting Standards. For example, derivatives executed with the same counterparty under a master netting arrangement may be offset, unlike IFRS Accounting Standards. Conversely, like IFRS Accounting Standards, recoveries for environmental losses are presented in the same line item as the related loss. In our experience, unlike IFRS Accounting Standards, this net presentation approach is also commonly used for other types of costs recharges. [IFRS 18.88, 815-10-45]

Non-GAAP measures

Unlike IFRS Accounting Standards, US GAAP does not include the concept of MPMs. Instead, SEC regulations define non-GAAP measures and prohibit SEC registrants from presenting them in the financial statements, with a narrow exception for certain voluntarily disclosed non-GAAP segment profit or loss measures (see chapter 5.2). However, SEC registrants can present non-GAAP measures outside the financial statements (e.g. in management's discussion and analysis). [Reg G, Reg S-K Rule 10(e)]

There is no specific guidance for non-SEC registrants; generally in practice, non-GAAP measures are not presented in the financial statements.

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MPMs capture some, but not all, non-GAAP measures. MPMs are subtotals of income and expenses that:

- are used in public communications outside the financial statements (e.g. management commentary, press releases and investor presentations); and
- communicate to users of financial statements management's view of an aspect of the financial performance of the entity as a whole.

The following are not MPMs:

- non-financial performance measures (e.g. number of subscribers);
- financial performance measures that are not subtotals of income and expenses (e.g. subtotals of only income or only expenses);
- subtotals of income or expenses specifically required to be presented or disclosed by IFRS Accounting Standards (see 'Line items, totals and subtotals' above); and
- common income and expenses subtotals listed in the presentation and disclosure standard (e.g. gross profit or loss). [IFRS 18.117–120, IE.6, BC362]

An entity clearly labels and describes each MPM and discloses specific information including a reconciliation to the most directly comparable total or subtotal (e.g. operating profit) specified in IFRS Accounting Standards. [IFRS 18.121–123]

Non-GAAP measures are numerical measures of financial performance, financial position or cash flows that:

- exclude amounts that are included in the most directly comparable measure calculated and presented in accordance with US GAAP; or
- include amounts that are excluded from the most directly comparable measure calculated and presented in accordance with US GAAP. [Reg G, Reg S-K Rule 10(e)]

Financial measures expressly required or permitted to be disclosed by US GAAP are not considered non-GAAP measures. [IFRS 18.121–123, Reg G, Reg S-K Rule 10(e)]

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4.2 Revenue from contracts with customers

(IFRS 15)

Overview

- A five-step model is used to apply the core 'transfer of control' principle that is used to determine when to recognise revenue, and at what amount.
- Under Step 1 (identify the contract), an entity accounts for a contract under the model when it is legally enforceable and specific criteria are met. These criteria include that collection of consideration is 'probable', which means 'more likely than not'.
- Under Step 2 (identify the performance obligations in the contract), an entity breaks down the contract into one or more distinct performance obligations.
- Under Step 3 (determine the transaction price), an entity determines the amount of consideration to which it expects to be entitled in exchange for transferring goods or services to a customer.
- Consideration includes an estimate of variable consideration to the extent that it is 'highly probable' that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.
- Under Step 4 (allocate the transaction price to the performance obligations in the contract) an entity generally allocates the transaction price to each performance obligation in proportion to its stand-alone selling price.

4.2 Revenue from contracts with customers

(Topic 606)

Overview

- Like IFRS Accounting Standards, a five-step model is used to apply the core 'transfer of control' principle that is used to determine when to recognise revenue, and at what amount.
- Like IFRS Accounting Standards, under Step 1 (identify the contract), an entity accounts for a contract under the model when it is legally enforceable and specific criteria are met. These criteria include that collection of consideration is 'probable', which, unlike IFRS Accounting Standards, means 'likely'.
- Like IFRS Accounting Standards, under Step 2 (identify the performance obligations in the contract), an entity breaks down the contract into one or more distinct performance obligations.
- Like IFRS Accounting Standards, under Step 3 (determine the transaction price), an entity determines the amount of consideration to which it expects to be entitled in exchange for transferring goods or services to a customer.
- Like IFRS Accounting Standards, consideration includes an estimate of variable consideration to the extent it is 'probable' that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Although 'probable' rather than 'highly probable' is used under US GAAP, the IASB and the FASB explain that these are intended to be the same threshold so differences of interpretation are not expected.
- Like IFRS Accounting Standards, under Step 4 (allocate the transaction price to the performance obligations in the contract) an entity generally allocates the transaction price to each performance obligation in proportion to its stand-alone selling price.

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Overview (continued)

- Under Step 5 (recognise revenue) an entity recognises revenue when or as it satisfies a performance obligation by transferring a good or service to a customer, either at a point in time or over time. A good or service is transferred when or as the customer obtains control of it.
- An entity generally capitalises incremental costs to obtain a contract with a customer if it expects to recover those costs. An entity capitalises the costs of fulfilling a contract if certain criteria are met. An impairment loss recognised in respect of capitalised costs is reversed if the carrying amount is no longer impaired.
- A contract modification is accounted for prospectively or using a cumulative catch-up adjustment depending on whether the modification results in additional goods or services that are 'distinct'.
- If the entity is a principal, then revenue is recognised on a gross basis – corresponding to the consideration to which the entity expects to be entitled. If the entity is an agent, then revenue is recognised on a net basis – corresponding to any fee or commission to which the entity expects to be entitled.
- An entity presents a contract liability or a contract asset in its statement of financial position when either party to the contract has performed. Any unconditional rights to consideration are presented separately as a receivable.
- The revenue standard contains extensive disclosure requirements designed to enable users of the financial statement to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. There are no exemptions from these disclosure requirements for specific types of entities.

Overview (continued)

- Like IFRS Accounting Standards, under Step 5 (recognise revenue) an entity recognises revenue when or as it satisfies a performance obligation by transferring a good or service to a customer, either at a point in time or over time. Like IFRS Accounting Standards, a good or service is transferred when or as the customer obtains control of it.
- Like IFRS Accounting Standards, an entity generally capitalises incremental costs to obtain a contract with a customer if it expects to recover those costs. Like IFRS Accounting Standards, an entity capitalises the costs of fulfilling a contract if certain criteria are met. Unlike IFRS Accounting Standards, an impairment loss recognised in respect of capitalised costs is not reversed.
- Like IFRS Accounting Standards, a contract modification is accounted for prospectively or using a cumulative catch-up adjustment depending on whether the modification results in additional goods or services that are 'distinct'.
- Like IFRS Accounting Standards, if the entity is a principal, then revenue is recognised on a gross basis – corresponding to the consideration to which the entity expects to be entitled. Like IFRS Accounting Standards, if the entity is an agent, then revenue is recognised on a net basis – corresponding to any fee or commission to which the entity expects to be entitled.
- Like IFRS Accounting Standards, an entity presents a contract liability or a contract asset in its statement of financial position when either party to the contract has performed. Like IFRS Accounting Standards, any unconditional rights to consideration are presented separately as a receivable.
- Like IFRS Accounting Standards, the revenue Codification Topic contains extensive disclosure requirements designed to enable users of the financial statement to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Unlike IFRS Accounting Standards, non-public entities may elect to present more simplified disclosures.

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The revenue standard was developed with the FASB and is therefore largely converged with US GAAP; however, some differences exist between the two accounting standards. This chapter highlights only the key differences between them.

Scope

The revenue standard applies to all contracts with customers, except for:

- leases (see chapter 5.1);
- insurance contracts (see chapter 8.1);
- financial instruments and other contractual rights or obligations in the scope of other accounting standards, including financial guarantees; and
- non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. [IFRS 15.5]

For contracts partially in the scope of another accounting standard and partially in the scope of the revenue standard, if the other accounting standard specifies how to separate and/or initially measure one or more parts of the contract with a customer, then an entity first applies those requirements. Next, the entity applies the revenue standard to separate and/or initially measure the remaining separately identified parts of the contract. [IFRS 15.7]

There is no specific guidance in IFRS Accounting Standards on accounting for fees and loyalty programmes related to credit cards. The general scoping and accounting considerations apply.

The revenue standard is generally applied to an individual contract with a customer. However, as a practical expedient, an entity may apply the revenue model to a portfolio of contracts with similar characteristics if the entity reasonably expects that the financial statement effects of applying the revenue standard to the portfolio or to individual contracts within that portfolio would not differ materially. [IFRS 15.4]

The revenue Codification Topic was developed with the IASB and is therefore largely converged with IFRS Accounting Standards; however, some differences exist between the two accounting standards. This chapter highlights only the key differences between them.

Scope

The Codification Topic applies to all contracts with customers except for:

- leases (see chapter 5.1), like IFRS Accounting Standards;
- insurance contracts issued by insurance entities (see chapter 8.1), which is narrower than the scope-out under IFRS Accounting Standards;
- financial instruments and other contractual rights or obligations in the scope of the applicable Codification Topics, which differ from IFRS Accounting Standards in certain respects;
- guarantees in the scope of the Codification Topic on guarantees, which is broader than IFRS Accounting Standards; and
- non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers, like IFRS Accounting Standards, although the specific accounting requirements differ from IFRS Accounting Standards (see chapter 5.7). See forthcoming requirements [606-10-15-2]

Like IFRS Accounting Standards, for contracts partially in the scope of another Codification topic/subtopic and partially in the scope of the revenue Codification Topic, if the other Codification topic/subtopic specifies how to separate and/or initially measure one or more parts of the contract with a customer, then an entity first applies those requirements. Next, the entity applies the revenue Codification Topic to separate and/or initially measure the remaining separately identified parts of the contract. [606-10-15-4]

Unlike IFRS Accounting Standards, US GAAP has specific accounting guidance for credit card fees that entitle the cardholder to use the credit card. That guidance does not permit separate accounting for credit card fees and therefore goods and services covered by the credit card fee are scoped out of the revenue Codification Topic. Credit card loyalty programmes may also be scoped out of the revenue Codification Topic, depending on facts and circumstances. [310-20-25-15, 606-10-15-2]

Like IFRS Accounting Standards, the revenue Codification Topic is generally applied to an individual contract with a customer. However, like IFRS Accounting Standards, as a practical expedient, an entity may apply the revenue model to a portfolio of contracts with similar characteristics if the entity reasonably expects that the financial statement effects of applying the revenue Codification Topic to the portfolio or to individual contracts within that portfolio would not differ materially. [606-10-10-4]

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The model

The core principle of the revenue standard is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. [IFRS 15.2]

Entities implement the core principle by applying a five-step model to determine when to recognise revenue, and at what amount.

- Step 1: Identify the contract with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognise revenue when or as the entity satisfies a performance obligation.

Step 1: Identify the contract with a customer

A contract with a customer is in the scope of the revenue standard when it is legally enforceable and all of the following criteria are met:

- the contract is approved and the parties are committed to their obligations;
- rights to goods or services and payment terms can be identified;
- the contract has commercial substance; and
- collection of consideration is 'probable'. [IFRS 15.9]

In applying the collection criterion, 'probable' means 'more likely than not'. The collection criterion applies to the consideration to which an entity will be entitled in exchange for the goods or services that will be transferred to the customer. [IFRS 15.9(e)]

Contracts entered into at or near the same time with the same customer (or related parties) are combined if one or more of the following criteria are met:

- the contracts were negotiated as a single commercial package;
- the consideration in one contract depends on the other contract; or
- the goods or services (or some of the goods or services) promised in the contracts are a single performance obligation. [IFRS 15.17]

The model

Like IFRS Accounting Standards, the core principle of the revenue Codification Topic is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. [606-10-05-3]

Like IFRS Accounting Standards, entities implement the core principle by applying a five-step model to determine when to recognise revenue, and at what amount.

- Step 1: Identify the contract with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognise revenue when or as the entity satisfies a performance obligation.

Step 1: Identify the contract with a customer

Like IFRS Accounting Standards, a contract with a customer is in the scope of the revenue Codification Topic when it is legally enforceable and all of the following criteria are met:

- the contract is approved and the parties are committed to their obligations;
- rights to goods or services and payment terms can be identified;
- the contract has commercial substance; and
- collection of consideration is 'probable'. [606-10-25-1]

Unlike IFRS Accounting Standards, in applying the collection criterion, 'probable' means 'likely', which creates a higher threshold than IFRS Accounting Standards. Additionally, under US GAAP the collection criterion is for 'substantially all' of the consideration to which an entity will be entitled in exchange for the goods or services that will be transferred to the customer. Therefore, differences may arise in practice from IFRS Accounting Standards. [606-10-25-1(e)]

Like IFRS Accounting Standards, contracts entered into at or near the same time with the same customer (or related parties) are combined if one or more of the following criteria are met:

- the contracts were negotiated as a single commercial package;
- the consideration in one contract depends on the other contract; or
- the goods or services (or some of the goods or services) promised in the contracts are a single performance obligation. [606-10-25-9]

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If the contract existence criteria are not initially met, then an entity continually reassesses the contract against the criteria and applies the requirements of the revenue standard to the contract from the date on which the criteria are met. Any consideration received for an arrangement that does not meet the criteria is generally recognised as a liability. [IFRS 15.14–16]

Such consideration is recognised as revenue only when:
- a contract exists and revenue is recognised under the model;
- the entity has no remaining obligations to transfer goods or services to the customer and substantially all of the consideration has been received by the entity and the amount is non-refundable; or
- the contract has been terminated and the consideration received from the customer is non-refundable. [IFRS 15.15]

Step 2: Identify the performance obligations in the contract

An entity assesses the goods or services promised in a contract with a customer and identifies as a performance obligation either:
- a good or service (or a bundle or goods or services) that is distinct; or
- a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer. [IFRS 15.22, 26]

A good or service is 'distinct' if both of the following criteria are met:
- the customer can benefit from the good or service on its own or together with other readily available resources (i.e. it is capable of being distinct); and
- the entity's promise to transfer the good or service is separately identifiable from other promises in the contract (i.e. it is distinct within the context of the contract). [IFRS 15.27]

If a promised good or service is determined not to be distinct, then an entity continues to combine that good or service with other goods or services until the combined bundle is a distinct performance obligation, or until all of the goods or services in the contract have been combined into a single performance obligation. [IFRS 15.30]

Like IFRS Accounting Standards, if the contract existence criteria are not initially met, then an entity continually reassesses the contract against the criteria and applies the requirements of the revenue Codification Topic to the contract from the date on which the criteria are met. Any consideration received for an arrangement that does not meet the criteria is recognised initially as a liability, like IFRS Accounting Standards. [606-10-25-6 – 25-8]

Such consideration is recognised as revenue only when:
- a contract exists and revenue is recognised under the model, like IFRS Accounting Standards;
- the entity has no remaining obligations to transfer goods or services to the customer and substantially all of the consideration has been received by the entity and the amount is non-refundable, like IFRS Accounting Standards;
- the contract has been terminated and the consideration received from the customer is non-refundable, like IFRS Accounting Standards; or
- unlike IFRS Accounting Standards:
  - the entity has transferred control of the goods or services;
  - the entity has stopped transferring additional goods or services, and is not obliged to transfer additional goods or services; and
  - the consideration from the customer is non-refundable. [606-10-25-6 – 25-8]

Step 2: Identify the performance obligations in the contract

Like IFRS Accounting Standards, an entity assesses the goods or services promised in a contract with a customer and identifies as a performance obligation either:
- a good or service (or a bundle or goods or services) that is distinct; or
- a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer. [606-10-25-14, 25-18]

Like IFRS Accounting Standards, a good or service is 'distinct' if both of the following criteria are met:
- the customer can benefit from the good or service on its own or together with other readily available resources (i.e. it is capable of being distinct); and
- the entity's promise to transfer the good or service is separately identifiable from other promises in the contract (i.e. it is distinct within the context of the contract). [606-10-25-19]

Like IFRS Accounting Standards, if a promised good or service is determined not to be distinct, then an entity continues to combine that good or service with other goods or services until the combined bundle is a distinct performance obligation, or until all of the goods or services in the contract have been combined into a single performance obligation. [606-10-25-22]

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IFRS Accounting Standards do not provide specific guidance on immaterial goods or services and therefore the general materiality guidance applies. [IFRS 15.BC116A–BC116E]

Under the revenue standard, shipping and handling activities undertaken after the customer has obtained control of the related goods may represent a performance obligation. [IFRS 15.BC116R–BC116U]

Step 3: Determine the transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer, excluding amounts collected on behalf of third parties – e.g. some sales taxes or excise duties. To determine whether to include sales taxes or duties in the transaction price, an entity uses judgement to assess whether it is primarily obliged for payment of the taxes or whether it collects the amount from the customer on behalf of the tax authorities. This determination is made based on an analysis of local regulatory requirements. [IFRS 15.47, BC188B]

The transaction price includes variable consideration (e.g. rebates, incentives, performance bonuses, compensation for delays or other penalties), based on the estimated amount to which the entity expects to be entitled, having regard to the risk of revenue reversal in making the estimate. [IFRS 15.48, 50–51, IU 09-19]

An entity includes an estimate of variable consideration in the transaction price to the extent that it is 'highly probable' that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. [IFRS 15.56, BC208–BC212]

Unlike IFRS Accounting Standards, US GAAP explicitly permits an entity not to identify promised goods or services that are immaterial in the context of the contract as performance obligations. When an entity chooses to use this practical expedient, it does not need to evaluate whether the financial statements, taken as a whole, are materially affected. [606-10-25-16A]

Unlike IFRS Accounting Standards, US GAAP includes an accounting policy choice to treat shipping and handling activities undertaken after the customer has obtained control of the related goods as a fulfilment activity instead of treating them as a performance obligation. [606-10-25-18A – 25-18B]

Step 3: Determine the transaction price

Like IFRS Accounting Standards, the transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer, excluding amounts collected on behalf of third parties – e.g. some sales taxes or excise duties. Like IFRS Accounting Standards, to determine whether to include sales taxes or duties in the transaction price, an entity uses judgement to assess whether it is primarily obliged for payment of the taxes or whether it collects the amount from the customer on behalf of the tax authorities. Like IFRS Accounting Standards, this determination is made based on an analysis of local regulatory requirements.

However, unlike IFRS Accounting Standards, US GAAP includes an accounting policy choice to exclude from the measurement of transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with the specific revenue-producing transaction and collected by the entity from a customer – e.g. sales, use, value-added and some excise taxes. [606-10-32-2 – 32-2A]

Like IFRS Accounting Standards, the transaction price includes variable consideration (e.g. rebates, incentives, performance bonuses, performance penalties), based on the estimated amount to which the entity expects to be entitled, having regard to the risk of revenue reversal in making the estimate. [606-10-32-3, 606-10-32-6]

Like IFRS Accounting Standards, an entity includes an estimate of variable consideration to the extent it is 'probable' that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Although 'probable' rather than 'highly probable' is used under US GAAP, the IASB and the FASB explain that these are intended to be the same threshold so differences of interpretation are not expected. [606-10-32-11, ASU 2014-09.BC208–BC212]

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To estimate the transaction price in a contract, an entity adjusts the promised amount of consideration for the time value of money if that contract contains a significant financing component. The discount rate used is the rate that would be reflected in a separate financing transaction between the entity and the customer at contract inception. As a practical expedient, an entity is not required to adjust the transaction price for the effects of a significant financing component if the entity expects, at contract inception, that the period between customer payment and the transfer of goods or services will be one year or less. [IFRS 15.60–61, 63–64]

Non-cash consideration received from a customer is measured at fair value (see chapter 2.4). No specific guidance is provided in respect of the measurement date for non-cash consideration. Therefore, in our view an entity should apply judgement, based on the relevant facts and circumstances, to determine whether to measure non-cash consideration with reference to the date on which the contract is entered into, the date it is received or the date the performance obligation is satisfied. If an entity cannot make a reasonable estimate of the fair value, then it refers to the stand-alone selling price of the promised goods or services. [IFRS 15.66–67, BC254A–BC254E]

An entity evaluates any consideration payable to a customer (e.g. cash, a coupon or voucher) to determine whether the amount represents a reduction of the transaction price, a payment for distinct goods or services, or a combination of the two. [IFRS 15.70]

There is no specific guidance in IFRS Accounting Standards on equity-based instruments granted to customers in conjunction with selling goods or services. Depending on the facts and circumstances, such arrangements may represent variable consideration and/or consideration payable to a customer, and therefore a reduction in the transaction price. An entity considers the guidance on non-cash consideration (see above) in arriving at the transaction price and then determines when to recognise that reduction in the transaction price as a reduction in revenue. An entity also considers the guidance in the financial instruments standards in determining the accounting for the instruments (see section 7).

Step 4: Allocate the transaction price to the performance obligations in the contract

An entity generally allocates the transaction price to each performance obligation in proportion to its stand-alone selling price. [IFRS 15.73–75]

Like IFRS Accounting Standards, to estimate the transaction price in a contract, an entity adjusts the promised amount of consideration for the time value of money if that contract contains a significant financing component. The discount rate used is the rate that would be reflected in a separate financing transaction between the entity and the customer at contract inception. As a practical expedient, an entity is not required to adjust the transaction price for the effects of a significant financing component if the entity expects, at contract inception, that the period between customer payment and the transfer of goods or services will be one year or less. [606-10-32-15 – 32-16, 32-18]

Like IFRS Accounting Standards, non-cash consideration received from a customer is measured at fair value (see chapter 2.4). Unlike IFRS Accounting Standards, the measurement date for non-cash consideration is the date of the contract inception. Like IFRS Accounting Standards, if an entity cannot make a reasonable estimate of the fair value, then it refers to the stand-alone selling price of the promised goods or services. [606-10-32-21 – 32-22, 55-250]

Like IFRS Accounting Standards, an entity evaluates any consideration payable to a customer (e.g. cash, a coupon or voucher) to determine whether the amount represents a reduction of the transaction price, a payment for distinct goods or services, or a combination of the two. [606-10-32-25]

Unlike IFRS Accounting Standards, US GAAP states that consideration payable to a customer includes equity-based instruments (liability- or equity-classified) granted to customers in conjunction with selling goods or services. When equity-based instruments are accounted for as a reduction of revenue, the grant-date fair value is recognised as a reduction of revenue in the same manner as if the entity made a cash payment to the customer. These instruments are measured and classified under the share-based payment Codification Topic and the grant-date fair value is ultimately recorded as a reduction of revenue (see chapter 4.5). The subsequent remeasurement of a liability-classified instrument is recorded elsewhere in the entity's income statement. See forthcoming requirements. [606-10-32-25, 32-25A]

Step 4: Allocate the transaction price to the performance obligations in the contract

Like IFRS Accounting Standards, an entity generally allocates the transaction price to each performance obligation in proportion to its stand-alone selling price. [606-10-32-28 – 32-30]

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An entity considers all information that is reasonably available when estimating a stand-alone selling price – e.g. market conditions, entity-specific factors and information about the customer or class of customer. It also maximises the use of observable inputs and applies consistent methods to estimate the stand-alone selling price of other goods or services with similar characteristics. [IFRS 15.78]

Step 5: Recognise revenue

An entity recognises revenue when or as it satisfies a performance obligation by transferring a good or service to a customer, either at a point in time or over time. A good or service is transferred when or as the customer obtains control of it. [IFRS 15.31–32]

If one or more of the following criteria are met, then the entity recognises revenue over time, under a method that depicts the pattern of transfer of control of the good or service to the customer:

- the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs, and another entity would not need to substantially reperform the work completed to date;
- the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date. [IFRS 15.35, B4, IU 03-18]

If none of the criteria for over-time recognition (see above) is met, then control transfers to the customer at a point in time and the entity recognises revenue at that point in time. [IFRS 15.38]

Contract costs

An entity capitalises incremental costs to obtain a contract with a customer (e.g. sales commissions) if it expects to recover those costs. However, as a practical expedient, an entity is not required to capitalise the incremental costs to obtain a contract if the amortisation period for the asset would be one year or less. [IFRS 15.91–92, 94]

Like IFRS Accounting Standards, an entity considers all information that is reasonably available when estimating a stand-alone selling price – e.g. market conditions, entity-specific factors, and information about the customer or class of customer. Like IFRS Accounting Standards, it also maximises the use of observable inputs and applies consistent methods to estimate the stand-alone selling price of other goods or services with similar characteristics. [606-10-32-33]

Step 5: Recognise revenue

Like IFRS Accounting Standards, an entity recognises revenue when or as it satisfies a performance obligation by transferring a good or service to a customer, either at a point in time or over time. A good or service is transferred when or as the customer obtains control of it. [606-10-25-23]

Like IFRS Accounting Standards, if one or more of the following criteria are met, then the entity recognises revenue over time, under a method that depicts the pattern of transfer of control of the good or service to the customer:

- the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs, and another entity would not need to substantially reperform the work completed to date;
- the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date. [606-10-25-27, 55-6]

Like IFRS Accounting Standards, if none of the criteria for over-time recognition (see above) is met, then control transfers to the customer at a point in time and the entity recognises revenue at that point in time. [606-10-25-30]

Contract costs

Like IFRS Accounting Standards, an entity capitalises incremental costs to obtain a contract with a customer (e.g. sales commissions) if it expects to recover those costs. However, as a practical expedient, an entity is not required to capitalise the incremental costs to obtain a contract if the amortisation period for the asset would be one year or less. [340-40-25-1 – 25-2, 25-4]

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IFRS Accounting Standards

If the costs incurred in fulfilling a contract with a customer are not in the scope of another accounting standard (e.g. inventories or training costs), then an entity recognises an asset only if the fulfilment costs meet the following criteria:

- they relate directly to an existing contract or specific anticipated contract;
- they generate or enhance resources of the entity that will be used to satisfy performance obligations in the future; and
- they are expected to be recovered. [IFRS 15.95–96, IU 03-20]

An entity amortises the asset recognised for the costs to obtain and/or fulfil a contract on a systematic basis, consistent with the pattern of transfer of the good or service to which the asset relates. [IFRS 15.99]

Before an entity recognises an impairment loss for capitalised costs (see below), it first recognises any impairment loss on assets related to the contract that are recognised under another accounting standard (e.g. the inventories standard – see chapter 3.8). [IFRS 15.103]

An impairment related to the capitalised costs is recognised in profit or loss to the extent that the carrying amount exceeds recoverable amount, which is defined as:

- the remaining expected amount of consideration to be received in exchange for the goods or services to which the asset relates; less
- the costs that relate directly to providing those goods or services and that have not been recognised as expenses. [IFRS 15.101]

After applying the impairment test, the resulting carrying amount is included in the relevant CGU for impairment testing (see chapter 3.10). [IFRS 15.103]

An impairment loss is reversed, limited to the carrying amount, net of amortisation, that would have been determined if no impairment loss had been recognised when the carrying amount is no longer impaired. [IFRS 15.104]

US GAAP

Like IFRS Accounting Standards, if the costs incurred in fulfilling a contract with a customer are not in the scope of another Codification topic/subtopic (e.g. inventories), then an entity recognises an asset only if the fulfilment costs meet the following criteria:

- they relate directly to an existing contract or specific anticipated contract;
- they generate or enhance resources of the entity that will be used to satisfy performance obligations in the future; and
- they are expected to be recovered. [340-40-25-5]

Unlike IFRS Accounting Standards, US GAAP has some specific cost guidance that is not superseded by the revenue Codification Topic – e.g. relating to pre-production costs or hook-up costs for cable companies. [340-10-25, 922-360-25-7, 922-720-25-3]

Like IFRS Accounting Standards, an entity amortises the asset recognised for the costs to obtain and/or fulfil a contract on a systematic basis, consistent with the pattern of transfer of the good or service to which the asset relates. [340-4-35-1]

Like IFRS Accounting Standards, before an entity recognises an impairment loss for capitalised costs (see below), it first recognises any impairment loss on assets related to the contract that are recognised under another Codification topic/subtopic (e.g. the inventories Codification Topic – see chapter 3.8). [340-40-35-5]

Like IFRS Accounting Standards, an impairment related to the capitalised costs is recognised in profit or loss to the extent that the carrying amount exceeds recoverable amount, which is defined as:

- the remaining expected amount of consideration to be received and any consideration that the entity has received but has not recognised as revenue, in exchange for the goods or services to which the asset relates; less
- the costs that relate directly to providing those goods or services and that have not been recognised as expenses. [340-40-35-3]

After applying the impairment test, the resulting carrying amount is included in the relevant asset group or reporting unit for impairment testing, which differs from IFRS Accounting Standards (see chapter 3.10). [340-40-35-5]

Unlike IFRS Accounting Standards, an impairment loss is not reversed. [340-40-35-6]

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Contract modifications

A contract modification is a change in the scope or price of a contract, or both. When a contract modification is approved, it creates or changes the enforceable rights and obligations of the parties to the contract. [IFRS 15.18]

A contract modification is treated as a separate contract (prospective treatment) if the modification results in:

- a promise to deliver additional goods or services that are distinct; and
- an increase to the price of the contract by an amount of consideration that reflects the entity's stand-alone selling price of those goods or services adjusted to reflect the circumstances of the contract. [IFRS 15.20]

A contract modification is treated as the termination of the existing contract and the creation of a new contract (prospective treatment) if the remaining performance obligations are distinct from the goods or services transferred on or before the date of the contract modification and the change to the price of the contract does not reflect the entity's stand-alone selling price of those goods or services adjusted to reflect the circumstances of the contract. [IFRS 15.21(a)]

If the modification to the contract does not add distinct goods or services, then the entity accounts for the modification on a combined basis with the original contract, as if the additional goods or services were part of the initial contract – i.e. a cumulative catch-up adjustment. The modification is recognised as either an increase or reduction in revenue at the date of modification. [IFRS 15.21(b)]

Licensing of intellectual property

If a licence of IP is *not* distinct from the other promised goods or services in the contract, then an entity recognises revenue for the single performance obligation when or as the combined goods or services are transferred to the customer. [IFRS 15.B54–B55]

If a licence is distinct from the other promised goods or services in the contract, and is therefore a separate performance obligation, then the entity applies the guidance applicable to licences to determine whether the licence is a performance obligation satisfied over time (i.e. a 'right to access' the IP) or at a point in time (i.e. a 'right to use' the IP). [IFRS 15.B56]

Contract modifications

Like IFRS Accounting Standards, a contract modification is a change in the scope or price of a contract, or both. Like IFRS Accounting Standards, when a contract modification is approved, it creates or changes the enforceable rights and obligations of the parties to the contract. [606-10-25-10]

Like IFRS Accounting Standards, a contract modification is treated as a separate contract (prospective treatment) if the modification results in:

- a promise to deliver additional goods or services that are distinct; and
- an increase to the price of the contract by an amount of consideration that reflects the entity's stand-alone selling price of those goods or services adjusted to reflect the circumstances of the contract. [606-10-25-12]

Like IFRS Accounting Standards, a contract modification is treated as the termination of the existing contract and the creation of a new contract (prospective treatment) if the remaining performance obligations are distinct from the goods or services transferred on or before the date of the contract modification and the change to the price of the contract does not reflect the entity's stand-alone selling price of those goods or services adjusted to reflect the circumstances of the contract. [606-10-25-13(a)]

Like IFRS Accounting Standards, if the modification to the contract does not add distinct goods or services, then the entity accounts for the modification on a combined basis with the original contract, as if the additional goods or services were part of the initial contract – i.e. a cumulative catch-up adjustment. The modification is recognised as either an increase or reduction in revenue at the date of modification. [606-10-25-13(b)]

Licensing of intellectual property

Like IFRS Accounting Standards, if a licence of IP is *not* distinct from the other promised goods or services in the contract, then an entity recognises revenue for the single performance obligation when or as the combined goods or services are transferred to the customer. [606-10-55-56 – 55-57]

Like IFRS Accounting Standards, if a licence is distinct from the other promised goods or services in the contract, and is therefore a separate performance obligation, then the entity applies the guidance applicable to licences to determine whether the licence is a performance obligation satisfied over time (i.e. a 'right to access' the IP) or at a point in time (i.e. a 'right to use' the IP). [606-10-55-58]

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The nature of the licence is a right to access if all of the following criteria are met (otherwise it is a right to use):

- the contract requires, or the customer reasonably expects, that the entity will undertake activities that significantly affect the IP to which the customer has rights;
- the rights granted by the licence directly expose the customer to any positive or negative effects of the entity's activities that significantly affect the IP; and
- those activities do not result in the transfer of a good or a service to the customer as those activities occur. [IFRS 15.B58, B61]

There is no explicit guidance in IFRS Accounting Standards on distinguishing attributes of a licence from additional licences; therefore, judgement is required to determine when a restriction creates multiple licences and when it is an attribute of the licence.

If the renewal (or extension) of an existing licence is agreed before the start of the renewal period, then, in our view, an entity should choose an accounting policy, to be applied consistently, to recognise revenue for the renewal when:

- the renewal is agreed, on the basis that the renewal is regarded as a modification of an existing contract in which the licence has already been delivered; or
- the renewal period starts, on the basis that this is the date from which the customer can use and benefit from the renewal.

Sale or transfer of non-financial assets not part of entity's ordinary activities

When an entity sells or transfers a non-financial asset that is not an output of its ordinary activities, it derecognises the asset when control of that asset transfers to the recipient, using the guidance on transfer of control in the revenue standard. [IAS 16.69, 38.114, 40.67]

Unlike IFRS Accounting Standards, to determine whether an entity's promise to provide a right to access or a right to use, an entity considers the nature of the IP to which the customer will have rights. IP is classified into either of the following.

- *Functional IP (conveying a right to use):* IP that has significant stand-alone functionality (e.g. the ability to process a transaction, perform a function or task, or be played or aired).
- *Symbolic IP (conveying a right to access):* IP that is not functional IP. [606-10-55-59]

Unlike IFRS Accounting Standards, US GAAP contains specific guidance under which any explicit or implicit contractual provisions that require an entity to transfer additional licences to the customer, because they are deemed to convey additional rights to the customer, are distinguished from contractual provisions that define the attributes of a single promised licence (e.g. restriction on time, use or geography). 'Attributes of a promised licence' do not create an obligation for the entity to transfer any additional rights to use or access its IP. [606-10-55-64]

Unlike IFRS Accounting Standards, if the renewal (or extension) of an existing licence is agreed before the start of the renewal period, then the entity does not recognise revenue for the renewal until the beginning of the renewal period. [606-10-55-58C]

Sale or transfer of non-financial assets not part of entity's ordinary activities

Like IFRS Accounting Standards, when an entity sells or transfers a non-financial asset that is not an output of its ordinary activities, it derecognises the asset when control of that asset transfers to the recipient, using the guidance on transfer of control in the revenue Codification Topic. Unlike IFRS Accounting Standards, this guidance also applies to the sale of entities that are an in-substance non-financial asset. [610-20]

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Other issues

Sale with a right of return

When an entity makes a sale with a right of return, it initially recognises the following:

- *revenue:* measured at the gross transaction price, less the expected level of returns calculated using the guidance on estimating variable consideration and the constraint;
- *refund liability:* measured at the expected level of returns – i.e. the difference between the cash or receivable amount and the revenue as measured above;
- *return asset:* measured with reference to the carrying amount of the products expected to be returned, less the expected recovery costs (including potential decreases in the value to the entity of returned products); and
- *adjustment to cost of sales:* measured as the carrying amount of the products sold less the asset as measured above. [IFRS 15.B21, B23, B25]

The entity updates its measurement of the refund liability and return asset at each reporting date for changes in expectations about the amount of the refunds, and recognises:

- adjustments to the refund liability as revenue; and
- adjustments to the return asset as an expense. [IFRS 15.B24–B25]

The guidance does not apply to:

- exchanges by customers of one product for another of the same type, quality, condition and price; and
- returns of faulty goods or replacements, which are instead evaluated under the guidance on warranties (see below). [IFRS 15.B26–B27]

Warranties

A warranty is considered a performance obligation if the customer has an option to purchase the good or service with or without the warranty. In that case, the entity allocates a portion of the transaction price to the performance obligation for the service. [IFRS 15.B29]

When a warranty is not sold separately, the warranty (or part thereof) may still be a performance obligation, if the warranty (or part thereof) provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. A warranty that only covers the compliance of a product with agreed-upon specifications (an 'assurance warranty') is accounted for under the provisions standard (see chapter 3.12). [IFRS 15.B29–B30]

Other issues

Sale with a right of return

Like IFRS Accounting Standards, when an entity makes a sale with a right of return, it initially recognises the following:

- *revenue:* measured at the gross transaction price, less the expected level of returns calculated using the guidance on estimating variable consideration and the constraint;
- *refund liability:* measured at the expected level of returns – i.e. the difference between the cash or receivable amount and the revenue as measured above;
- *asset:* measured with reference to the carrying amount of the products expected to be returned, less the expected recovery costs (including potential decreases in the value to the entity of returned products); and
- *adjustment to cost of sales:* measured as the carrying amount of the products sold less the asset as measured above. [606-10-55-23, 55-25, 55-27]

Like IFRS Accounting Standards, an entity updates its measurement of the refund liability and asset at each reporting date for changes in expectations about the amount of the refunds, and recognises:

- adjustments to the refund liability as revenue; and
- adjustments to the asset as an expense. [606-10-55-26 – 55-27]

Like IFRS Accounting Standards, the guidance does not apply to:

- exchanges by customers of one product for another of the same type, quality, condition and price; and
- returns of faulty goods or replacements, which are instead evaluated under the guidance on warranties (see below). [606-10-55-28 – 55-29]

Warranties

Like IFRS Accounting Standards, a warranty is considered a performance obligation if the customer has an option to purchase the good or service with or without the warranty. In that case, like IFRS Accounting Standards, the entity allocates a portion of the transaction price to the performance obligation for the service. [606-10-55-31]

Like IFRS Accounting Standards, when a warranty is not sold separately, the warranty (or part thereof) may still be a performance obligation, if the warranty (or part thereof) provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. A warranty that only covers the compliance of a product with agreed-upon specifications (an 'assurance warranty') is accounted for under the guarantees Codification Topic (see chapter 3.12). [606-10-55-31 – 55-32]

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Principal vs agent considerations

When an entity provides goods or services directly to its customers and no other parties are involved, the entity is the principal. However, when other parties are involved the entity determines whether the nature of its promise is a performance obligation to provide the specified good or services itself, or to arrange for them to be provided by another party – i.e. whether it is a principal or an agent. [IFRS 15.B34]

If the entity acts as an agent, then its performance obligation is to arrange for the provision of the specified good or service. Therefore, it recognises revenue on a net basis – corresponding to any fee or commission to which it expects to be entitled. It recognises this revenue when its obligation to arrange for the provision of the specified good or service is fulfilled, which may be before it is provided to the customer by the principal. [IFRS 15.B36]

An entity is acting as a principal when it obtains control of the specified good or service in advance of transferring this good or service to the customer. [IFRS 15.B35]

To determine whether it controls a specified good or service before it is transferred to the customer, the entity applies the general guidance on transfer of control (see above). If the assessment based on this guidance is not conclusive, then an entity considers the specific indicators of whether it acts as a principal. These indicators include, but are not limited to, the following:

- the entity is primarily responsible for providing the specified good or service;
- the entity has discretion in establishing the price for the specified good or service; and
- the entity has inventory risk. [IFRS 15.B34A, B37]

Customer options for additional goods or services

When an entity grants the customer an option to acquire additional goods or services, that option gives rise to a performance obligation in the contract if the option provides a material right that the customer would not receive without entering into that contract. In such cases, a portion of the transaction price is allocated to the option on a relative stand-alone selling price basis. [IFRS 15.B40, B42]

Principal vs agent considerations

Like IFRS Accounting Standards, when an entity provides goods or services directly to its customers and no other parties are involved, the entity is the principal. However, when other parties are involved the entity determines whether the nature of its promise is a performance obligation to provide the specified good or services itself, or to arrange for them to be provided by another party – i.e. whether it is a principal or an agent. [606-10-55-36]

Like IFRS Accounting Standards, if the entity acts as an agent, then its performance obligation is to arrange for the provision of the specified good or service. Therefore, it recognises revenue when it satisfies its performance obligation on a net basis – corresponding to any fee or commission to which it expects to be entitled, like IFRS Accounting Standards. Like IFRS Accounting Standards, it recognises this revenue when its obligation to arrange for the provision of the specified good or service is fulfilled, which may be before it is provided to the customer by the principal. [606-10-55-36A, 55-37 – 55-38]

Like IFRS Accounting Standards, an entity is acting as a principal when it obtains control of the specified good or service in advance of transferring this good or service to the customer. [606-10-55-37, 55-39]

Like IFRS Accounting Standards, to determine if it controls a specified good or service before it is transferred to the customer, the entity applies the general guidance on transfer of control (see above). If the assessment based on this guidance is not conclusive, then an entity considers the specific indicators of whether it acts as a principal. These indicators include, but are not limited to, the following:

- the entity is primarily responsible for providing the specified good or service;
- the entity has discretion in establishing the price for the specified good or service; and
- the entity has inventory risk. [606-10-55-39]

Customer options for additional goods or services

Like IFRS Accounting Standards, when an entity grants the customer an option to acquire additional goods or services, that option gives rise to a performance obligation in the contract if the option provides a material right that the customer would not receive without entering into that contract. In such cases, a portion of the transaction price is allocated to the option on a relative stand-alone selling price basis, like IFRS Accounting Standards. [606-10-55-42, 55-44]

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If the goods or services that the customer has a material right to acquire are similar to the original ones in the contract (e.g. when the entity has an option to renew the contract), then an entity may, as a practical alternative, allocate the transaction price to the optional goods or services with reference to the goods or services expected to be provided and the corresponding consideration expected to be received. [IFRS 15.B43]

Customers' unexercised rights (breakage)

An entity recognises a prepayment received from a customer as a contract liability, and recognises revenue when the promised goods or services are transferred in the future. However, a portion of the contract liability recognised may relate to contractual rights that the entity does not expect to be exercised (i.e. a breakage amount). [IFRS 15.B44–B45]

If the entity expects to be entitled to a breakage amount, then revenue is recognised in proportion to the pattern of rights exercised by the customer. If the entity does *not* expect to be entitled to a breakage amount, then revenue is recognised when the likelihood of the customer exercising its remaining rights becomes remote. [IFRS 15.B46]

The assessment of whether an entity expects to be entitled to a breakage amount depends on whether it is 'highly probable' that recognising breakage will not result in a significant reversal of the cumulative revenue recognised. [IFRS 15.B46]

Non-refundable up-front fees

An entity assesses whether a non-refundable up-front fee relates to the transfer of a promised good or service to the customer. If the related activity does not result in the transfer of a promised good or service to the customer, then the up-front fee is an advance payment for performance obligations to be satisfied in the future and is recognised as revenue when those future goods or services are provided. [IFRS 15.B48–B51, IU 01-19]

Like IFRS Accounting Standards, if the goods or services that the customer has a material right to acquire are similar to the original ones in the contract (e.g. when the entity has an option to renew the contract), then an entity may, as a practical alternative, allocate the transaction price to the optional goods or services with reference to the goods or services expected to be provided and the corresponding consideration expected to be received. [606-10-55-45]

Customers' unexercised rights (breakage)

Like IFRS Accounting Standards, an entity recognises a prepayment received from a customer as a contract liability, and recognises revenue when the promised goods or services are transferred in the future. However, like IFRS Accounting Standards, a portion of the contract liability recognised may relate to contractual rights that the entity does not expect to be exercised (i.e. a breakage amount). [606-10-55-46, 55-47]

Like IFRS Accounting Standards, if the entity expects to be entitled to a breakage amount, then revenue is recognised in proportion to the pattern of rights exercised by the customer. Like IFRS Accounting Standards, if the entity does *not* expect to be entitled to a breakage amount, then revenue is recognised when the likelihood of the customer exercising its remaining rights becomes remote. [606-10-55-48]

Like IFRS Accounting Standards, the assessment of whether an entity expects to be entitled to a breakage amount depends on whether it is 'probable' that recognising breakage will not result in a significant reversal of the cumulative revenue recognised. Although 'probable' rather than 'highly probable' is used under US GAAP, the IASB and the FASB explain that these are intended to be the same threshold so differences of interpretation are not expected. [606-10-55-48]

Non-refundable up-front fees

Like IFRS Accounting Standards, an entity assesses whether a non-refundable up-front fee relates to the transfer of a promised good or service to the customer. Like IFRS Accounting Standards, if the related activity does not result in the transfer of a promised good or service to the customer, then the up-front fee is an advance payment for performance obligations to be satisfied in the future and is recognised as revenue when those future goods or services are provided. [606-10-55-50 – 55-53]

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Onerous contracts

Onerous contracts are accounted for under the provisions standard (see chapter 3.12).

Presentation

An entity presents a contract liability or a contract asset in its statement of financial position when either party to the contract has performed. The entity performs by transferring goods or services to the customer, and the customer performs by paying consideration to the entity. Any unconditional rights to consideration are presented separately as a receivable. [IFRS 15.105]

Disclosures

The revenue standard contains extensive disclosure requirements designed to enable users of the financial statement to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The disclosures cover the following:

- disaggregation of revenue;
- contract balances;
- performance obligations;
- significant judgements made; and
- costs to obtain or fulfil a contract. [IFRS 15.110, 114–128, B87–B89]

There are no exemptions from the disclosure requirements for specific types of entities in the revenue standard.

Onerous contracts

Under US GAAP, onerous contracts may be accounted for under specific Codification topics/subtopics depending on the type of contract involved. These requirements differ from and are narrower than IFRS Accounting Standards (see chapter 3.12).

Presentation

Like IFRS Accounting Standards, an entity presents a contract liability or a contract asset in its statement of financial position when either party to the contract has performed. Like IFRS Accounting Standards, the entity performs by transferring goods or services to the customer, and the customer performs by paying consideration to the entity. Like IFRS Accounting Standards, any unconditional rights to consideration are presented separately as a receivable. [606-10-45-1]

Disclosures

Like IFRS Accounting Standards, the revenue Codification Topic contains extensive disclosure requirements designed to enable users of the financial statement to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Like IFRS Accounting Standards, the disclosures cover the following:

- disaggregation of revenue;
- contract balances;
- performance obligations;
- significant judgements made; and
- costs to obtain or fulfil a contract. [606-10-50-1, 50-5 – 50-6, 55-89 – 55-91]

Unlike IFRS Accounting Standards, non-public entities may elect to present more simplified disclosures that are specified in the revenue Codification Topic. [606-10-50-7, 50-11, 50-16, 50-21, 340-40-50-4]

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Forthcoming requirements

There are no forthcoming requirements under IFRS Accounting Standards.

There is no specific guidance in IFRS Accounting Standards on equity-based instruments granted to customers in conjunction with selling goods or services.

Forthcoming requirements

Amendments to the revenue and share-based payment Codification Topics are effective for annual periods beginning after 15 December 2026; early adoption is permitted (see appendix).

The amendments:

- revise the definition of performance conditions in the share-based payment Codification Topic to explicitly include conditions based on a volume or monetary amount of purchases;
- eliminate the policy election in the share-based payment Codification Topic to recognise forfeitures as incurred (instead of estimating forfeitures) for share-based consideration granted to customers;
- clarify that the variable consideration constraint in the revenue Codification Topic should not be applied to share-based consideration payable to a customer; and
- clarify that the revenue Codification Topic applies initially to share-based non-cash consideration received from a customer for the transfer of goods or services. The guidance in other Codification topics, including derivatives and equity securities, is not applied unless and until the entity's right to receive or retain the share-based non-cash consideration is unconditional under the revenue Codification Topic.

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4.3 Government grants

(IAS 20, IAS 41, SIC-10)

Overview

- Government grants are recognised when there is reasonable assurance that the entity will comply with the relevant conditions and the grant will be received. Government grants that relate to the acquisition of an asset, other than a biological asset measured at fair value less costs to sell, are recognised in profit or loss as the related asset is depreciated or amortised.
- If a government grant is in the form of a non-monetary asset, then both the asset and the grant are recognised either at the fair value of the non-monetary asset or at a nominal amount.
- Unconditional government grants related to biological assets measured at fair value less costs to sell are recognised in profit or loss when they become receivable; conditional grants for such assets are recognised in profit or loss when the required conditions are met.
- Interest is imputed on low-interest or interest-free loans from a government.
- The accounting for a financial guarantee provided by a government depends on whether an economic benefit is transferred and who receives it (i.e. the lender or the borrower).

4.3 Government grants

Overview

- Unlike IFRS Accounting Standards, there is no specific US GAAP guidance on the accounting for grants from governments to profit-oriented entities. However, US practice may look to IFRS Accounting Standards as a source of non-authoritative guidance in some instances.
- Unlike IFRS Accounting Standards, a contributed non-monetary asset is generally recognised at fair value.
- Like IFRS Accounting Standards, government contributions of biological assets are recognised initially at fair value when they become unconditionally receivable; however, unlike IFRS Accounting Standards, there is no specific guidance on whether this amount should be recognised in profit or loss or in equity. In our experience, conditional grants for such assets are recognised when the required conditions are met, like IFRS Accounting Standards.
- Unlike IFRS Accounting Standards, interest may not always be imputed on low-interest or interest-free loans from a government.
- Like IFRS Accounting Standards, the accounting for a financial guarantee provided by a government depends on whether an economic benefit is transferred and who receives it (i.e. the lender or the borrower). However, differences from IFRS Accounting Standards may arise in practice because of the underlying differences in accounting for government assistance and financial guarantees.

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Scope and definitions

'Government grants' are transfers of resources to an entity by a government entity in return for compliance with certain past or future conditions related to the entity's operating activities. [IAS 20.3]

Government assistance is not considered a government grant if the assistance cannot reasonably have a value placed on it, or is a transaction with a government body that cannot be distinguished from the normal operating transactions of the entity. [IAS 20.3, 34–38]

To account for a normal operating transaction with a government body, an entity applies the appropriate accounting standard. For example, if an entity sells goods or services to a government body as a customer, then it applies the revenue standard (see chapter 4.2) to account for the transaction.

Government assistance in the form of income tax relief is in the scope of the income tax standard (see chapter 3.13).

Recognition and measurement

Government grants are recognised when there is reasonable assurance that the entity will comply with the relevant conditions and the grant will be received. [IAS 20.7]

Grants that relate to the acquisition of an asset are recognised in profit or loss as the asset is depreciated or amortised. These grants are recognised either as a reduction in the cost of the asset or as deferred income that is amortised as the related asset is depreciated or amortised; the elected presentation format is applied consistently to all government grants related to assets. [IAS 8.13, 20.17, 24]

For a grant related to income, an entity chooses a presentation format, to be applied consistently, either to offset the grant against the related expenditure (net presentation) or to present it separately or under a general heading such as 'other income' (gross presentation). [IAS 8.13, 20.29]

A grant that is compensation for expenses or losses already incurred, or for which there are no future related costs, is recognised in profit or loss in the period in which it becomes receivable. [IAS 20.20]

Scope and definitions

Unlike IFRS Accounting Standards, US GAAP for profit-oriented entities does not define government grants; nor is there specific guidance applicable to government grants. However, US practice may look to IFRS Accounting Standards as a source of non-authoritative guidance in some instances. Also, US GAAP has specialised industry accounting requirements applicable to not-for-profit entities that receive government grants.

Like IFRS Accounting Standards, to account for a normal operating transaction with a government body, an entity applies the appropriate guidance under US GAAP. For example, if an entity sells goods or services to a government body as a customer (or if a government body pays on behalf of an entity's customer), then it applies the revenue Codification Topic (see chapter 4.2) to account for the transaction.

Like IFRS Accounting Standards, government assistance in the form of income tax relief is in the scope of the income taxes Codification Topic (see chapter 3.13).

Recognition and measurement

Unlike IFRS Accounting Standards, US GAAP for profit-oriented entities does not contain specific guidance on the accounting for government grants, and there is diversity in practice. However, agricultural subsidies are recognised when the amount of and right to receive the payment can be reasonably determined. [905-605-25-1]

In the absence of the specific US GAAP guidance, entities analogise to other guidance to determine the recognition pattern, which may include the guidance under IFRS Accounting Standards or the US GAAP not-for-profit revenue guidance. For entities applying the guidance under IFRS Accounting Standards, we understand that the SEC staff equates 'reasonable assurance' with 'probable' under US GAAP, which means that 'the future event or events are likely to occur'.

When analogising to other US GAAP guidance, unlike IFRS Accounting Standards, an entity generally does not have a choice to present the grant income as a reduction in the cost of the asset or as an offset to the related expenditure. Government grants are generally presented under a heading such as 'other income' (gross presentation) when an entity is not analogising to IFRS Accounting Standards for the accounting for government grants. [CON 8]

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If some or all of a government grant becomes repayable unexpectedly, then the repayment is accounted for prospectively as a change in accounting estimate (see chapter 2.8). [IAS 20.32]

Non-monetary grants

If a government grant is in the form of a non-monetary asset, then an entity chooses an accounting policy, to be applied consistently, to recognise the asset and grant at either the fair value of the non-monetary asset or at a nominal amount. [IAS 20.23]

Grants related to biological assets

As an exception to the general recognition principle, an unconditional government grant related to biological assets that are measured at fair value less costs to sell (see chapter 3.9) is recognised in profit or loss when it becomes receivable. If the government grant is conditional, then it is recognised in profit or loss when the required conditions are met. [IAS 412(c), 34–35, 37]

Low-interest loans

Low-interest or interest-free loans from a government are initially measured at fair value and interest expense is recognised on the loan subsequently under the effective interest method (see chapter 7.7). The benefit that is the government grant is measured as the difference between the fair value of the loan on initial recognition and the amount received. [IAS 20.10A, IFRS 9.5.1.1, B5.1.1]

Government-guaranteed loans

A government may provide to a lender a full or partial financial guarantee of qualifying loans made by the lender. The accounting for this guarantee depends on whether there is a transfer of an economic benefit and who receives it (i.e. the lender or the borrower).

Unlike IFRS Accounting Standards, if some or all of the government grant becomes repayable unexpectedly, then the accounting depends on the policy initially followed to recognise the grant.

Non-monetary grants

Unlike IFRS Accounting Standards, US GAAP does not provide an accounting policy choice and a contributed non-monetary asset is generally recognised at fair value (see chapter 5.7).

Grants related to biological assets

Like IFRS Accounting Standards, an unconditional contribution from government related to biological assets is initially recognised at fair value (see chapter 3.9). Unlike IFRS Accounting Standards, there is no specific guidance on whether this amount should be recognised in profit or loss or in equity for profit-oriented entities, and therefore differences may arise in practice. In our experience, a conditional grant is not recognised until the required conditions are met, like IFRS Accounting Standards.

Low-interest loans

Unlike IFRS Accounting Standards, interest may not always be imputed on low-interest or interest-free loans from a government. [835-30-15-3(e)]

Government-guaranteed loans

A government may provide to a lender a full or partial financial guarantee of qualifying loans made by the lender. Like IFRS Accounting Standards, the accounting for this guarantee depends on whether there is a transfer of an economic benefit and who receives it (i.e. the lender or the borrower). However, differences from IFRS Accounting Standards may arise in practice because of the underlying differences in accounting for government assistance (see below) and financial guarantees.

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IFRS Accounting Standards

If a government provides a financial guarantee for an *existing* loan for free or for an amount that is less than the guarantee's fair value, then this normally represents government assistance to the lender and not to the borrower. This guarantee is accounted for as follows.

- If the guarantee is integral to the loan, then the lender considers the guarantee, including whether the conditions attached to it will be met, in measuring the loan (see chapter 7.1).
- If the guarantee is not integral to the loan, then the lender accounts for it separately applying the requirements in the government grants standard.

If a government provides a financial guarantee for a *new* qualifying loan for free or for an amount that is less than the guarantee's fair value, then this normally represents government assistance to the borrower and not to the lender. In our view, a borrower should choose an accounting policy, to be applied consistently, to account for the guarantee under the gross or the net approach.

- If an entity applies the gross approach to government assistance, then it is accounted for as a separate government grant. Under this approach, the entity presents the related income in profit or loss applying the presentation policy chosen for government grants related to income (see above).
- If an entity applies the net approach to government assistance, then it is considered part of the unit of account in measuring the loan, including determining its fair value.

US GAAP

Like IFRS Accounting Standards, if a government provides a financial guarantee for an *existing* loan for free or for an amount that is less than the guarantee's fair value, then this normally represents government assistance to the lender and not to the borrower. Unlike IFRS Accounting Standards, there is no specific US GAAP guidance on the accounting for government assistance, except for not-for-profit entities. However, US practice may look to IFRS Accounting Standards as a source of non-authoritative guidance.

Like IFRS Accounting Standards, if a government provides a financial guarantee for a *new* qualifying loan for free or for an amount that is less than the guarantee's fair value, then this normally represents government assistance to the borrower and not to the lender. Unlike IFRS Accounting Standards, there is no specific US GAAP guidance on the accounting for government assistance, except for not-for-profit entities. However, unlike IFRS Accounting Standards, interest may not always be imputed on low-interest or interest-free loans with a financial guarantee from a government and the borrower may account for such loans at their stated terms.

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4.4 Employee benefits

(IAS 19, IFRIC 14)

Overview

- 'Short-term employee benefits' are employee benefits that are expected to be settled wholly within 12 months of the end of the period in which the services have been rendered, and are accounted for using normal accrual accounting.
- 'Post-employment benefits' are employee benefits that are payable after the completion of employment (before or during retirement).
- A 'defined contribution plan' is a post-employment benefit plan under which the employer pays fixed contributions into a separate entity and has no further obligations. All other post-employment plans are 'defined benefit plans'.
- Contributions to a defined contribution plan are accounted for on an accrual basis.
- Accounting for defined benefit plans involves the following steps:
  - determining the present value of the defined benefit obligation by applying an actuarial valuation method;
  - deducting the fair value of any plan assets;
  - adjusting the amount of the deficit or surplus for any effect of limiting a net defined benefit asset to the asset ceiling; and
  - determining service costs, net interest and remeasurements of the net defined benefit liability (asset).

4.4 Employee benefits

(Topic 715, Subtopic 710-10, Subtopic 712-10)

Overview

- Unlike IFRS Accounting Standards, US GAAP does not contain specific guidance on short-term employee benefits other than compensated absences. However, accrual accounting principles are generally applied in accounting for short-term employee benefits.
- Unlike IFRS Accounting Standards, post-employment benefits are divided into 'post-retirement benefits' (provided during retirement) and 'other post-employment benefits' (provided after the cessation of employment but before retirement). The accounting for post-employment benefits depends on the type of benefit provided, unlike IFRS Accounting Standards.
- Like IFRS Accounting Standards, a 'defined contribution plan' is a post-retirement benefit plan under which the employer pays specified contributions into a separate entity and has no further obligations. All other post-retirement plans are 'defined benefit plans'. However, unlike IFRS Accounting Standards, other post-employment benefit plans do not have to be classified as either defined contribution or defined benefit plans.
- Like IFRS Accounting Standards, contributions to a defined contribution plan are accounted for on an accrual basis.
- Accounting for defined benefit plans involves the following steps:
  - determining the present value of the defined benefit obligation by applying an actuarial valuation method, which differs in some respects from IFRS Accounting Standards;
  - deducting the fair value of any plan assets, like IFRS Accounting Standards;
  - unlike IFRS Accounting Standards, there is no adjustment for any effect of limiting a net defined benefit asset to the asset ceiling; and
  - determining service costs, net interest and remeasurements of the net defined benefit liability (asset), which in a number of cases differ from IFRS Accounting Standards in terms of measurement, recognition and presentation.

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Overview (continued)

- The projected unit credit method is used to determine the present value of the defined benefit obligation and the related current service cost and, if applicable, any past service cost.
- To qualify as plan assets, assets need to meet specific criteria, including a requirement that they be unavailable to the entity's creditors (even in bankruptcy).
- Insurance policies issued to the sponsor meet the definition of plan assets if they are issued by a party unrelated to the entity and meet certain other criteria.
- Insurance policies issued to the plan by the reporting entity meet the definition of plan assets if they are transferable and meet certain other criteria.
- Assets that meet the definition of plan assets, including qualifying insurance policies, and the related liabilities are presented on a net basis in the statement of financial position.
- If a defined benefit plan is in surplus, then the amount of any net asset recognised is limited to the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan (the 'asset ceiling').
- Minimum funding requirements to cover existing shortfalls give rise to a liability if payments under the requirement would create a surplus in excess of the asset ceiling.

Overview (continued)

- The liability and expense are generally measured actuarially under the projected unit credit method for pay-related plans, like IFRS Accounting Standards; and under the traditional unit credit method (projected unit credit method without future increases in salary) for certain cash balance plans, unlike IFRS Accounting Standards.
- Like IFRS Accounting Standards, to qualify as plan assets, assets need to meet specific criteria. However, unlike IFRS Accounting Standards, in general there is no requirement to affirmatively demonstrate that the assets would be unavailable to the entity's creditors in bankruptcy.
- Unlike IFRS Accounting Standards, insurance policies issued to the sponsor do not meet the definition of plan assets.
- Unlike IFRS Accounting Standards, plan assets include insurance policies issued to the plan by the sponsor or a related party of the sponsor if the policies are transferable and meet certain other criteria. US GAAP does not require the insurance policy to be issued by the reporting entity.
- Like IFRS Accounting Standards, assets that meet the definition of plan assets and the related liabilities are presented on a net basis in the statement of financial position.
- Unlike IFRS Accounting Standards, the recognition of an asset in respect of a defined benefit plan is not restricted.
- Unlike IFRS Accounting Standards, the funded status is recognised as a liability if the plan is underfunded; the liability is not subject to additional adjustments related to minimum funding requirements.

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Overview (continued)

- Benefits are attributed to periods of service in accordance with the plan's benefit formula unless that formula is back-end loaded, in which case straight-line attribution is used instead.
- Curtailments and other plan amendments are recognised at the same time as the related restructuring or related termination benefits if these events occur before the curtailment or other plan amendments occur.
- 'Multi-employer plans' are post-employment plans that pool the assets contributed by various entities that are not under common control to provide benefits to employees of more than one entity. Such plans are classified as defined contribution or defined benefit plans following the above definitions. However, if insufficient information is available to permit defined benefit accounting, then the plan is treated as a defined contribution plan and additional disclosures are required.
- If defined contribution plan accounting is applied to a multi-employer defined benefit plan and there is an agreement that determines how a surplus in the plan would be distributed or a deficit in the plan funded, then an asset or liability that arises from the contractual agreement is recognised.
- There is no specific guidance on the application of defined benefit accounting to plans that would be defined contribution plans except that they contain minimum benefit guarantees. In our view, a minimum benefit guarantee causes a plan to be a defined benefit plan.
- 'Termination benefits' are employee benefits provided as a result of either an entity's decision to terminate an employee's employment before the normal retirement date or an employee's decision to accept an offer of benefits in exchange for the termination of employment.
- A termination benefit is recognised at the earlier of the date on which the entity recognises costs for a restructuring that includes the payment of termination benefits and the date on which the entity can no longer withdraw the offer of the termination benefits.

Overview (continued)

- Like IFRS Accounting Standards, benefits are attributed to periods of service in accordance with the plan's benefit formula unless that formula is back-end loaded, in which case a straight-line attribution is used instead.
- Unlike IFRS Accounting Standards, curtailment gains are recognised when they occur. Also unlike IFRS Accounting Standards, curtailment losses are recognised when they are probable.
- Like IFRS Accounting Standards, 'multi-employer plans' are post-retirement plans that pool the assets contributed by various entities to provide benefits to the employees of more than one entity. However, unlike IFRS Accounting Standards, all multi-employer plans are accounted for as defined contribution plans, supplemented with additional disclosures.
- Unlike IFRS Accounting Standards, even if there is an agreement that determines how the surplus in a multi-employer plan would be distributed or a deficit in the plan funded, an asset or liability is not recognised until the liability is assessed or the refund received.
- Unlike IFRS Accounting Standards, there is specific guidance on the application of defined benefit accounting to certain plans that would be defined contribution plans except that they contain minimum benefit guarantees. Depending on the form of the minimum guarantee, the plan would be accounted for as a defined benefit plan or as a cash balance plan.
- Unlike IFRS Accounting Standards, termination benefits are categorised into different types of benefits: ongoing benefit arrangements, contractual terminations, special terminations and one-time terminations.
- Unlike IFRS Accounting Standards, there is not a single model for the recognition of termination benefits, and the timing of recognition depends on the category of termination benefit.

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Overview (continued)

- **'Other long-term employee benefits' are all employee benefits other than short-term benefits, post-employment benefits and termination benefits.**
- **The expense for other long-term employee benefits, calculated on a discounted basis, is usually accrued over the service period. The computation is similar to defined benefit plans.**

This chapter deals with employee benefits provided under formal plans and agreements between an entity and its employees, under legislation or through industry arrangements, including those provided under informal practices that give rise to constructive obligations.

Short-term employee benefits

'Short-term employee benefits' are those benefits (other than termination benefits) that are expected to be settled wholly within 12 months of the end of the period in which the employees render the related service, and are accounted for using normal accrual accounting. [IAS 19.8–11]

Short-term paid absences

An entity accrues the obligation for paid absences if the obligation both relates to employees' past services and accumulates. A liability is recognised whether or not the employees are entitled to payment for unused benefits if they leave. However, whether the employee may leave before they use their entitlement impacts the measurement of the benefit. [IAS 19.13, 15–16]

Profit-sharing and bonus plans

A provision is recognised for the expected cost of bonus or profit-sharing plans if an entity has a present legal or constructive obligation and a reliable estimate of the obligation can be made. [IAS 19.19]

Overview (continued)

- **Unlike IFRS Accounting Standards, US GAAP does not distinguish between long- and short-term employee benefits.**
- **Like IFRS Accounting Standards, the expense for long-term employee benefits is accrued over the service period; however, the computation may differ from IFRS Accounting Standards.**

This chapter deals with employee benefits provided under formal plans and agreements between an entity and its employees, under legislation or through industry arrangements, including informal practices that give rise to obligations through substantive plans.

Short-term employee benefits

Unlike IFRS Accounting Standards, US GAAP does not contain specific guidance on short-term employee benefits other than compensated absences – e.g. vacation accruals. However, accrual accounting principles are generally applied in accounting for short-term employee benefits, which is likely to be the same as IFRS Accounting Standards in practice. [710-10-25-1]

Compensated absences

Like IFRS Accounting Standards, an employer accrues the obligation for paid absences if the obligation both relates to employees' past services and vests or accumulates. Like IFRS Accounting Standards, a liability for the expected benefit is recognised whether or not the benefits are vesting. Whether the employee may leave before they use the non-vested benefit impacts the measurement of the benefit, like IFRS Accounting Standards. [710-10-25-1]

Profit-sharing and bonus plans

Like IFRS Accounting Standards, a provision is recognised for the expected cost of bonus or profit-sharing plans if a reliable estimate of the obligation can be made. However, unlike IFRS Accounting Standards, there is no requirement for there to be a legal or constructive obligation; notwithstanding this difference, we would not generally expect significant differences from IFRS Accounting Standards in practice. [712-10-25-4]

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The amount provided is the best estimate of the undiscounted amount that the entity expects to pay. If payment is conditional (e.g. on the employee remaining in service), then the conditions and the possibility of forfeiture are taken into account in measuring the obligation. [IAS 19.20, BC55]

Low-interest loans

Loans given to employees at lower than market interest rates are measured at fair value – i.e. the present value of the anticipated future cash flows discounted using a market interest rate (see chapter 7.7). In our view, the employee benefit is the difference between the fair value of the loan and the amount advanced to the employee. [IFRS 9.5.1.1]

Post-employment benefits

'Post-employment benefits' are employee benefits (other than termination benefits and short-term employee benefits) that are payable after completion of employment (before or during retirement) – e.g. pensions, lump sum payments on retirement and medical benefits after employment. [IAS 19.5(b), 8]

Post-employment benefit plans include both formal arrangements and informal practices that give rise to constructive obligations. [IAS 19.61]

All post-employment benefits are accounted for under a single set of requirements. [IAS 19]

Defined benefit vs defined contribution plans

Post-employment plans are classified as either defined contribution or defined benefit plans. The classification determines the accounting treatment. [IAS 19.27]

Like IFRS Accounting Standards, the amount provided for is the best estimate of the amount that the entity expects to pay in cash. Like IFRS Accounting Standards, if payment is conditional (e.g. on the employee remaining in service), then the conditions and the possibility of forfeiture are taken into account in measuring the obligation. [712-10-25-4]

Low-interest loans

Like IFRS Accounting Standards, loans granted to employees at lower than market interest rates are measured at fair value – i.e. the present value of the anticipated future cash flows discounted using a market interest rate (see chapter 7.7). Like IFRS Accounting Standards, the employee benefit is the difference between the fair value of the loan and the amount advanced to the employee.

Post-employment and post-retirement benefits

Unlike IFRS Accounting Standards, 'post-employment benefits' include only benefits payable after employment but before retirement; 'post-retirement benefits' are benefits payable after retirement. [712, 715]

Like IFRS Accounting Standards, post-employment and post-retirement benefit plans include both arrangements in formal plans and informal arrangements that constitute substantive plans. [712-10-15-3, 715-10-15-3]

Unlike IFRS Accounting Standards, US GAAP distinguishes between post-employment (after employment but before retirement) benefits and post-retirement (during retirement) benefits. Additionally, the accounting and reporting requirements for post-employment and post-retirement benefits differ depending on the type of benefit provided. The discussion that follows is based on post-retirement plans, with additional information on post-employment plans when appropriate. [712, 715]

Defined benefit vs defined contribution plans

Like IFRS Accounting Standards, post-retirement benefits are classified as either defined contribution or defined benefit plans. However, unlike IFRS Accounting Standards, post-employment benefit plans are not required to be classified as defined contribution or defined benefit plans; instead, they are accounted for based on the type of benefit, and therefore differences from IFRS Accounting Standards may arise in practice. [712-10, 715-20, 715-70]

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IFRS Accounting Standards

A post-employment plan is classified as a defined contribution plan if the entity pays fixed contributions into a separate entity (a fund) and will have no further obligation (legal or constructive) to pay further amounts if the fund has insufficient assets to pay all employee benefits relating to current and prior service. All other post-employment plans are defined benefit plans. [IAS 19.8]

Severance payments

Amounts that are payable on cessation of employment, regardless of the reason for the employee's leaving, are post-employment benefits rather than termination benefits. The normal principles apply in determining whether such payments give rise to defined benefit or defined contribution plans. [IAS 19.164]

Minimum benefit guarantees

In certain cases, a plan that would otherwise be a defined contribution plan contains minimum benefit guarantees – e.g. the employer may guarantee a minimum return on the investment or contributions. IFRS Accounting Standards do not contain specific guidance on such plans, except for certain guaranteed minimum returns on plan assets. In our view, a minimum benefit guarantee causes a plan to be a defined benefit plan.

Multi-employer and multiple-employer plans

'Multi-employer plans' are plans that pool the assets contributed by various entities that are not under common control to provide benefits to the employees of more than one entity. [IAS 19.8]

There are no specific requirements for the classification of multi-employer plans. Such plans are classified and accounted for in the same way as single-employer plan – i.e. as a defined contribution or a defined benefit plan – considering the characteristics of the scheme and the obligation of the employer, except as outlined below. [IAS 19.32]

US GAAP

US GAAP uses the term 'projected benefit obligation' for defined benefit pension plans and the term 'accumulated postretirement benefit obligation' for non-pension defined benefit plans. This chapter uses the generic term 'defined benefit obligation' for ease of comparison.

Like IFRS Accounting Standards, a post-retirement plan is classified as a defined contribution plan if the entity pays specified contributions into a separate entity and will have no further obligation (legal or constructive) to pay further amounts. However, unlike IFRS Accounting Standards, the definition of a defined contribution plan generally requires the plan to provide an individual account for each participant's assets. All other post-retirement plans are defined benefit plans. [715-70-05, 715-70-20]

Severance payments

Under US GAAP, severance payments that are part of an ongoing benefit arrangement are post-employment rather than post-retirement benefits. Therefore, unlike IFRS Accounting Standards, they are not classified as either defined benefit or defined contribution plans, and differences from IFRS Accounting Standards may arise in practice. Severance payments that are part of a pension plan or post-retirement benefit plan are recognised when they are probable and reasonably estimable; therefore, differences from IFRS Accounting Standards may arise in practice. [712-10-5, 715-30, 715-60]

Minimum benefit guarantees

Like IFRS Accounting Standards, under US GAAP plans that provide a minimum benefit guarantee are generally defined benefit plans. For some benefit arrangements determined to be non-pay-related defined benefit plans – e.g. cash balance plans with fixed interest crediting rates – the plan's benefit obligation does not include the impact of expected future salary increases, which may differ from practice under IFRS Accounting Standards. [715-30-35-71]

Multi-employer and multiple-employer plans

Under US GAAP, a 'multi-employer plan' is a plan to which two or more unrelated employers contribute, usually under one or more collective bargaining agreements. A characteristic of multi-employer plans is that assets contributed by one participating employer may be used to pay the benefits of employees of another participating employer, like IFRS Accounting Standards. [715-80]

Unlike IFRS Accounting Standards, if a plan is determined to be a multi-employer plan, then the employer accounts for the plan like a defined contribution plan, supplemented with additional disclosures. [715-80-35]

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If insufficient information is available for a multi-employer defined benefit plan to be accounted for in accordance with the requirements for defined benefit plans, then it is treated as a defined contribution plan except that:

- an asset or liability for any surplus or deficit is recognised if there is a contractual agreement that determines how a surplus in the plan would be distributed or a deficit in the plan funded; and
- additional disclosures are required. [IAS 19.34, 37]

A liability that arises from the wind-up of a multi-employer defined benefit plan, or the entity's withdrawal from a multi-employer defined benefit plan, is recognised and measured in accordance with the provisions standard (see chapter 3.12). [IAS 19.39]

Plans that allow participating employers to pool their assets for investment purposes while maintaining separate accounts for the purposes of benefit payments (multiple-employer plans) do not share actuarial risks and therefore are not considered multi-employer plans. Therefore, each employer within the plan would account for the portion related to their employees as a defined contribution plan or a defined benefit plan based on the general requirements on classifying plans. For defined benefit plans, each employer accounts for its respective share of the assets and liabilities of the plan following the general principles for single-employer plans. [IAS 19.8, 38]

Group plans

Defined benefit plans in which entities (subgroups) under common control share risks are group plans rather than multi-employer plans. Group plans are classified as either a defined contribution plan or a defined benefit plan in accordance with the terms of the plan. The accounting for defined benefit group plans in subgroup financial statements depends on whether there is a contractual agreement or stated policy for charging the net defined benefit cost to individual group entities. [IAS 19.40–41]

State plans

State plans are accounted for in the same way as multi-employer plans – i.e. they are classified as defined contribution or defined benefit plans, as appropriate. [IAS 19.43, 45]

Unlike IFRS Accounting Standards, even if there is an agreement that determines how the surplus in a multi-employer plan would be distributed or a deficit in the plan funded, an asset or liability is not recognised until the liability is assessed or the refund received. [715-80-35]

Like IFRS Accounting Standards, if withdrawal from a multi-employer plan is probable and would result in the employer having an obligation to the plan for a portion of the plan's unfunded benefit obligation, then the employer recognises a liability for the withdrawal funding amount. However, because of differences in the meaning of 'probable', the liability may be recognised at a date different from IFRS Accounting Standards (see chapter 3.12). [715-80-35-2]

Like IFRS Accounting Standards, a 'multiple-employer plan' is intended to allow participating employers to pool their assets for investment purposes while maintaining separate accounts for the purposes of benefit payments. Like IFRS Accounting Standards, multiple-employer plans are accounted for by each employer as defined benefit plans or defined contribution plans based on the general requirements on classifying plans. Like IFRS Accounting Standards, for defined benefit plans, each employer accounts for its respective share of the assets and liabilities of the plan following the general principles for single-employer plans. [715-60-20, 715-60-35-131]

Group plans

Unlike IFRS Accounting Standards, defined benefit plans in which entities (subgroups) under common control share risks are accounted for similarly to multi-employer plans, and therefore as defined contribution plans, in the financial statements of the subsidiary entity. Accordingly, the subsidiary subgroup records expenses each period based on any contributions being made to the parent entity. In certain cases, the subsidiary subgroup records an allocated portion of costs from the parent; any difference between cumulative costs recognised and cumulative funding recorded as a liability to the parent for future contributions, or as a capital contribution from the parent. [715-30-55-64, 715-80-55-2]

State plans

Like IFRS Accounting Standards, the employer determines the substance of its obligation under a state plan to determine whether the plan is a defined contribution or a defined benefit plan.

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Accounting for defined contribution plans

An entity accounts for its contributions to a defined contribution plan on an accrual basis. An asset or liability may result from advance payments or payments due, respectively, to a defined contribution fund. [IAS 19.51]

Accounting for defined benefit plans

Accounting for defined benefit plans involves the following steps.

- Determining the present value of the defined benefit obligation by applying an actuarial valuation method.
- Deducting the fair value of any plan assets.
- Adjusting the amount of the deficit or surplus for any effect of limiting a net defined benefit asset to the asset ceiling.
- Determining service costs (current, past and settlement) and net interest to be recognised in profit or loss, and remeasurements of the net defined benefit liability (asset) to be recognised in OCI. [IAS 19.57]

The net defined benefit liability (asset) recognised in the statement of financial position is determined as follows.

- *Step 1:* Present value of the defined benefit obligation minus the fair value of any plan assets equals the deficit or surplus in the defined benefit plan.
- *Step 2:* Adjust for any effect of limiting a net defined benefit asset to the asset ceiling (see below). [IAS 19.8, 63–64]

Benefits are attributed to periods of service in accordance with the plan's benefit formula unless that formula is back-end loaded, in which case straight-line attribution is used instead. [IAS 19.70]

Benefits are attributed from the date on which service by the employee first leads to benefits under the plan until the date from which further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases. [IAS 19.70, 73, IU 04-21]

Accounting for defined contribution plans

Like IFRS Accounting Standards, an entity accounts for its contributions to a defined contribution plan on an accrual basis. Like IFRS Accounting Standards, an asset or liability may result from advance payments or payments due, respectively, to a defined contribution fund. [715-70-35]

Accounting for defined benefit plans

Accounting for defined benefit plans involves the following steps.

- Determining the present value of the defined benefit obligation by applying an actuarial valuation method, like IFRS Accounting Standards.
- Deducting the fair value of any plan assets, like IFRS Accounting Standards.
- Unlike IFRS Accounting Standards, there is no adjustment for any effect of limiting a net defined benefit asset to the asset ceiling.
- Determining service costs (current, past and settlement) and net interest to be recognised in profit or loss and remeasurements of the net defined benefit liability (asset). There are a number of differences from IFRS Accounting Standards in the measurement and recognition of these items, which are discussed below. [715-20-35]

The net defined benefit liability (asset) recognised in the statement of financial position is the present value of the defined benefit obligation minus the fair value of any plan assets (the deficit or surplus in the defined benefit plan), like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, this amount is not adjusted for an asset ceiling. [715-30-25-1]

Like IFRS Accounting Standards, benefits are attributed to periods of service in accordance with the plan's benefit formula unless that formula is back-end loaded, in which case a straight-line attribution is used instead. [715-30-35-36, 715-60-35-61]

Like IFRS Accounting Standards, benefits are attributed from the date on which service by the employee first leads to benefits under the plan until the date from which further service by the employee will lead to no additional benefits under the plan. Unlike IFRS Accounting Standards, this period includes additional benefits attributable to further salary increases, which can create differences in certain pay-related non-pension benefit schemes. [715-30-35-38, 715-60-35-66, 35-68]

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Actuarial valuation method

The projected unit credit method is used to determine the present value of the defined benefit obligation. [IAS 19.67]

Contribution-based promises are defined benefit plans with a promised return on actual or notional contributions that is based on either or both of the following features:

- a guaranteed return of a fixed amount or rate; and/or
- a benefit that depends on future asset returns. [IU 05-14]

Because these plans are defined benefit plans, the projected unit credit method generally applies to the measurement of the related defined benefit obligation. However, in our experience, in some jurisdictions entities predominantly apply a methodology under which benefits that depend on future asset returns are measured at the fair value of the related assets. [IU 05-14]

The actuarial assumptions represent the entity's best estimates of the future variables that will determine the ultimate cost of settling the defined benefit obligation and are unbiased and mutually compatible. The financial assumptions are based on current market expectations of future events. Also, the assumptions take into account estimated future salary increases and include any future changes in state benefits that affect benefits payable under the plan and for which there is reliable evidence that the change will occur. [IAS 19.75–80, 87]

The calculation takes into account not only the stated plan benefits, but also any constructive obligations. [IAS 19.87]

Actuarial valuation method

US GAAP requires the actuarial method selected to reflect the benefit plan's benefit formula. Like IFRS Accounting Standards, the projected unit credit method is used to determine the present value of the defined benefit obligation, with the exception of certain cash balance plans for which the traditional unit credit method is used, unlike IFRS Accounting Standards. [715-30-35-36]

Unlike IFRS Accounting Standards, the traditional unit credit method is used to determine the present value of the defined benefit obligation for certain cash balance plans that provide for a fixed crediting rate as a percentage of salary and a fixed interest crediting rate until retirement. For other cash balance plans, the projected unit credit method is used in practice. [715-30-35-36, 35-71]

Unlike IFRS Accounting Standards, *each* assumption is a best estimate assumption, which means that it is judged on its own in the absence of other assumptions. The financial assumptions are based on current market expectations and reflect estimated future salary increases, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, anticipated future changes in state benefits that may affect benefits payable under the plan are not reflected until they are enacted. [715-30-35-42, 715-60-35-71]

Like IFRS Accounting Standards, the calculation takes into account stated plan benefits as well as any obligations that constitute the substantive plan. [715-30-35-34, 715-60-35-48]

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The obligation is discounted using a high-quality corporate bond rate, or a government bond rate if there is an insufficiently deep high-quality corporate bond market. The depth of the market for high-quality corporate bonds is assessed at the currency level. The currency and maturity of the bonds need to be consistent with the currency and maturity of the defined benefit obligation. If bonds with a maturity that matches the maturity of the obligation are not available, then an appropriate discount rate is estimated by extrapolating interest rates on shorter-term bonds using the yield curve and considering any available evidence about likely longer-term interest rates. [IAS 19.83, 86, IU 02-02, 11-13, 06-17]

In practice, an entity often uses a single weighted-average discount rate to measure the defined benefit obligation, reflecting the estimated timing and amount of benefit payments and the currency in which the benefits are to be paid. In such cases, the entity also uses a single rate to calculate current service cost and interest cost. However, in our view, in measuring the defined benefit obligation, current service cost and interest cost, an entity might instead use different weighted-average discount rates derived from the same yield curve for different categories of plan members (e.g. active members and pensioners) or separately for each member in the plan, to match more closely the expected timing of the benefit payments for each category. [IAS 19.85]

The net benefit liability (asset) is measured as at the reporting date. For practical reasons, the detailed valuation of the defined benefit obligation may be prepared before the reporting date. In this case, the results of the valuation are updated for any material transactions and changes in circumstances up to the reporting date. [IAS 19.58–59]

Taxes payable by the plan on contributions relating to service before the reporting date or on benefits resulting from that service are distinguished from all other taxes payable by the plan. An actuarial assumption is made about the first type of taxes, which are taken into account in measuring current service cost and the defined benefit obligation. All other taxes payable by the plan are included in the return on plan assets. [IAS 19.8, 76(b)(iv), 130]

Like IFRS Accounting Standards, the obligation is discounted using a high-quality corporate bond rate; however, unlike IFRS Accounting Standards, there is no guidance for situations in which the corporate bond market is not deep, although in practice the government bond rate is typically used in those circumstances. Also, like IFRS Accounting Standards, the currency and maturity of the bonds match the currency and maturity of the pension obligation. Like IFRS Accounting Standards, if bonds with a maturity that matches the maturity of the obligation are not available, then an appropriate discount rate is estimated by extrapolating interest rates on bonds using the yield curve and considering any available evidence about likely longer-term interest rates, or based on an appropriately adjusted high-quality bond index. However, US GAAP has additional guidance on the determination of the high-quality bond rate, and therefore differences from IFRS Accounting Standards may arise in practice. [715-30-35-43 – 35-44, 715-60-35-79, 35-81]

In practice, an entity often measures the defined benefit obligation using spot rates on an appropriate yield curve reflecting the estimated timing and amount of benefit payments and the currency in which the benefits are to be paid, like IFRS Accounting Standards. From that information, a single weighted-average rate is computed (and disclosed) as the discount rate used to measure the obligation. In our view, current service cost and interest cost may be measured using either the single weighted-average discount rate for the entire obligation, or different weighted-average discount rates, derived from the same yield curve for different categories of plan members (e.g. active members and pensioners or separately for each member in the plan), like IFRS Accounting Standards. However, in our view spot rates may also be used to determine interest cost, derived from the same yield curve, but applied to each projected cash flow and weighted for one year, unlike IFRS Accounting Standards.

Like IFRS Accounting Standards, plan assets and benefit obligations are measured as at the employer's reporting date. Unlike IFRS Accounting Standards, US GAAP provides a practical expedient whereby plan assets and benefit obligations may be measured at the month-end that is closest to the reporting date of the sponsor and adjusted for certain specific, identified transactions when the sponsor's year does not end on the last day of a month. [715-30-35-62, 35-63A, 715-60-35-121]

Unlike IFRS Accounting Standards, the income tax effects from plan assets are included in the determination of the return on plan assets.

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Plan assets

'Plan assets' comprise:

- assets held by a legally separate fund, which:
  - can be used solely to pay or fund employee benefits;
  - are not available to the employer's creditors – even in the event of bankruptcy; and
  - cannot be returned to the entity except as reimbursement for employee benefits paid or when the fund is in surplus; and
- qualifying insurance policies, which are insurance policies issued to the sponsor by an unrelated entity, the proceeds from which:
  - can be used solely to pay or fund defined benefit obligations;
  - are not available to the employer's creditors – even in the case of bankruptcy; and
  - cannot be returned to the entity except as reimbursement for employee benefits paid or when the proceeds are surplus to requirements. [IAS 19.8]

Plan assets also include insurance policies issued to the plan by the reporting entity if the policies are transferable and the other criteria for treatment as assets held by a legally separate fund are met (see above). [IAS 19.8, IU 01-08]

Plan assets include *transferable* financial instruments issued by the reporting entity if the criteria for treatment as plan assets are met (see above). Plan assets exclude contributions receivable from the reporting entity and other financial instruments issued by the reporting entity and held by the fund that cannot be transferred to third parties. In our view, if financial instruments issued by associates and joint ventures are not transferable, then we believe that an entity can still treat them as plan assets because such investees are not part of the group. Other plan assets – i.e. those not issued by the reporting entity – are not required to be transferable. [IAS 19.8, 114, BC177, CF 3.10–13]

Plan assets are measured at fair value (see chapter 2.4). This overrides the requirements of other accounting standards that would otherwise apply to these assets. [IAS 19.57(a)(iii), 113]

Plan assets

Like IFRS Accounting Standards, 'plan assets' comprise assets held by a legally separate fund, which:

- can be used solely to pay or fund employee benefits;
- are not available to the employer's creditors – even in the event of bankruptcy; and
- cannot be returned to the entity except as reimbursement for employee benefits paid or when the proceeds are surplus to requirements. [715-30-55-35]

However, unlike IFRS Accounting Standards:

- companies are not required to affirmatively demonstrate that plan assets are not legally isolated from the employer's creditors in bankruptcy; however, if the provisions of a trust provide that assets are available to creditors in the event of bankruptcy (such as in most grantor or rabbi trusts), then the assets would not qualify as plan assets, like IFRS Accounting Standards; and
- insurance policies can be plan assets only if they are held by the plan. [715-30-55-35]

Unlike IFRS Accounting Standards, plan assets include insurance policies issued to the plan by the sponsor or a related party of the sponsor if the policies are transferable. [715-30-55-36]

Like IFRS Accounting Standards, financial instruments – e.g. shares, bonds and intra-group insurance contracts – issued by the reporting entity need to be transferable to qualify as plan assets. Like IFRS Accounting Standards, plan assets exclude contributions receivable from the employer and other non-transferable financial instruments issued by the employer to the fund. However, unlike IFRS Accounting Standards, US GAAP considers transferability of not just assets issued by the reporting entity, but also assets issued by the sponsor or a related party of the sponsor. Other plan assets – i.e. those not issued by the sponsor or a related party of the sponsor – are not required to be transferable, like IFRS Accounting Standards. [715-30-20, 715-30-55-35]

Like IFRS Accounting Standards, plan assets are primarily measured at fair value (see chapter 2.4); such measurement overrides the requirements of other Codification topics/subtopics that would otherwise apply to these assets. Unlike IFRS Accounting Standards, plan assets used in plan operations, if any, are measured at cost less accumulated depreciation. [715-30-35-50, 715-60-35-107]

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If the timing and amount of payments under a qualifying insurance policy exactly match some or all of the benefits payable under a plan, then the present value of the related obligation is determined and is deemed to be the fair value of the insurance policy. Generally, the fair value of such insurance policies held by the fund is determined in the same way – i.e. matching that of the related obligation. [IAS 19.115]

The employer offsets qualifying plan assets against the related obligation to employees; it does not consolidate the fund that holds the plan assets. [IAS 19.57(a)(iii), 113]

The costs of managing plan assets reduce the return on plan assets. No specific requirements regarding the accounting for other administration costs are provided. However, an entity should recognise administration costs (except for the costs of handling medical claims) when the administration services are provided. Therefore, the inclusion of such costs in the measurement of the defined benefit obligation is not allowed. In our view, they should instead be recognised as an expense in profit or loss. [IAS 19.8, 76(b)(iii), 130, BC125–BC127, 1.88]

Defined benefit cost

Except to the extent that another accounting standard requires or permits its inclusion in the cost of an asset (see below), the cost of defined benefit plans is made up of the following components:

- service cost, recognised in profit or loss, which comprises:
  - current service cost;
  - past service cost, resulting from plan amendments or curtailments; and
  - the gain or loss on settlements;
- net interest on the net defined benefit liability (asset), recognised in profit or loss; and
- remeasurements of the net defined benefit liability (asset), recognised in OCI. [IAS 19.120]

All of the components of defined benefit cost are eligible for capitalisation under other accounting standards. [IAS 19.121]

Unlike IFRS Accounting Standards, there is no special guidance for qualifying insurance policies. Accordingly, the obligation is not measured by reference to the fair value of the insurance policy. Also, unlike IFRS Accounting Standards, insurance policies can be plan assets only if they are held by the plan.

Like IFRS Accounting Standards, the employer offsets qualifying plan assets against the related obligation to employees; it does not consolidate the fund that holds the plan assets. [715-30-25, 715-60-25]

Like IFRS Accounting Standards, the costs of managing plan assets reduce the return on plan assets. An entity should recognise administration costs as an expense when the administration services are provided, like IFRS Accounting Standards. [715-30-35-50, 715-60-35-107]

Defined benefit cost

Except to the extent that another Codification topic/subtopic requires or permits its inclusion in the cost of an asset (see below), the periodic cost of defined benefit plans is made up of the following:

- current service cost recognised in profit or loss, like IFRS Accounting Standards;
- interest cost on the obligation recognised in profit or loss, like IFRS Accounting Standards;
- expected return on plan assets recognised in profit or loss, like IFRS Accounting Standards (although the amount differs from IFRS Accounting Standards);
- actuarial gains and losses recognised in OCI, like IFRS Accounting Standards (although measured differently), and subsequently reclassified to profit or loss, unlike IFRS Accounting Standards;
- prior (past) service costs recognised in OCI, unlike IFRS Accounting Standards, and subsequently reclassified to profit or loss, unlike IFRS Accounting Standards;
- any gain or loss on curtailment included in profit or loss, like IFRS Accounting Standards (although the amount and timing of the recognition may differ from IFRS Accounting Standards); and
- any gain or loss on settlement recognised in profit or loss, like IFRS Accounting Standards (although the settlement amount may differ from IFRS Accounting Standards). [715-30-35, 715-60-35]

Unlike IFRS Accounting Standards, only the service cost component is eligible for capitalisation, when applicable. [715-20-45-3A]

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Current service cost

The 'current service cost' is the increase in the present value of the defined benefit obligation resulting from employee service in the current period. It is determined using actuarial assumptions at the start of an annual reporting period. However, if an amendment, curtailment or settlement of a defined benefit plan occurs during that annual reporting period, then the entity determines current service cost for the remainder of the period using the same actuarial assumptions as those used to remeasure the net defined benefit liability (asset). [IAS 19.8, 67, 122A]

It is unclear where interest that accumulates on service cost should be recognised in the financial statements. In our view, it should be recognised in profit or loss and it would be appropriate for it to be classified as part of service cost. For a discussion of where service cost and net interest cost are presented, see below.

Past service cost

Past service cost is the change in the present value of the defined benefit obligation, in respect of prior periods' service, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (see below). [IAS 19.8, 102, 104]

When determining past service cost (resulting from a plan amendment or curtailment), an entity remeasures the net benefit liability (asset) using the current fair value of plan assets and current actuarial assumptions – e.g. current market interest rates or current market prices. [IAS 19.99]

When measuring past service cost (resulting from a plan amendment or curtailment), the entity does not consider the effect of the asset ceiling that is reversed separately through OCI. This is because the assessment of the asset ceiling is a distinct step from the calculation of the past service cost, not a part of it. [IAS 19.101A]

Amendments

Past service cost (positive or negative) as a result of a plan amendment is recognised in profit or loss immediately, at the earliest of the following:

- when the plan amendment occurs;
- when the related restructuring costs are recognised, if the plan amendment arises as part of a restructuring; and
- when the related termination benefits are recognised, if the plan amendment is linked to termination benefits. [IAS 19.8, 103, 106]

Current service cost

The 'current service cost' is defined as the actuarial present value of benefits attributed by the plan's benefit formula to services rendered by employees during the period, which we would expect to be generally consistent with IFRS Accounting Standards in practice. [715-30-35-6, 715-60-35-10]

Unlike IFRS Accounting Standards, US GAAP requires entities to classify all components of net periodic benefit cost together. Practice varies as to whether supplemental disclosures include interest on service cost as part of service cost or interest cost. [715-30-35-4, 715-60-35-9]

Prior service cost

Like IFRS Accounting Standards, prior (past) service cost is the change in the present value of the obligation, in respect of prior periods' service, due to changes in benefit entitlement including the introduction or changes to a defined benefit plan. Unlike IFRS Accounting Standards, a curtailment differs from a prior service cost. [715-30-35-10, 715-60-35-12]

Like IFRS Accounting Standards, an entity remeasures plan assets and the defined benefit obligation using current actuarial assumptions – e.g. current discount rate or current market prices – before computing the settlement or curtailment gain or loss, or computing the impact on prior service costs of plan amendments. [715-30-35-81, 715-60-35-151]

Unlike IFRS Accounting Standards, US GAAP does not have an asset ceiling, so there is no consideration of the effect of an asset ceiling when remeasuring plan assets and the defined benefit obligation before computing a settlement or curtailment gain or loss, or computing the impact on prior service costs of plan amendments.

Amendments

Unlike IFRS Accounting Standards, prior service cost related to a plan amendment is initially recognised in full in OCI in the reporting period of the amendment. Further, unlike IFRS Accounting Standards, it is amortised from accumulated OCI into employee benefit cost over the average remaining working lives (to full eligibility for non-pension benefits) of active participants in the plan unless substantially all participants are inactive (i.e. retired), in which case the prior service cost is amortised into employee benefit cost over the remaining life expectancy of participants. [715-30-35-11, 715-60-35-13]

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Curtailments

A 'curtailment' occurs when a significant reduction in the number of employees covered by the plan takes place. A curtailment may arise from an isolated event, such as the closing of a plant, discontinuance of an operation or termination or suspension of a plan. [IAS 19.105]

A curtailment gives rise to past service cost and is recognised at the earliest of the following:

- when the curtailment occurs;
- when the related restructuring costs are recognised, if the curtailment arises as part of a restructuring; and
- when the related termination benefits are recognised, if the curtailment is linked to termination benefits. [IAS 19.8, 103]

Gains or losses from curtailments are recognised in profit or loss. [IAS 19.103]

Settlements

A 'settlement' is a transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that are set out in the terms of the plan and included in the actuarial assumptions. Lump sum cash payments to participants in exchange for their rights to ongoing payments is not a settlement if provided for in the terms of the plan. [IAS 19.8, 111]

Like IFRS Accounting Standards, if benefits are reduced, then those changes result in a negative prior service cost (credit). Unlike IFRS Accounting Standards, a negative prior service cost is first offset against any existing positive prior service cost in accumulated OCI, with any excess amortised to employee benefit cost on the same basis as positive prior service cost. [715-30-35-17]

Curtailments

Like IFRS Accounting Standards, a 'curtailment' is an event that significantly reduces the expected years of future service of present employees, or eliminates for a significant number of employees the accrual of defined benefits for some or all of their future service. [715-30-20 Glossary]

Unlike IFRS Accounting Standards, curtailment losses are recognised when they are probable and curtailment gains are recognised when they occur.

Like IFRS Accounting Standards, gains and losses from curtailments of defined benefit obligations are recognised in profit or loss. Unlike IFRS Accounting Standards, when a curtailment occurs, prior service cost associated with years of service no longer expected to be rendered is recognised in profit or loss. Additionally, a decrease (increase) in the benefit obligation that exceeds the net actuarial gain (loss) is recognised in profit or loss, unlike IFRS Accounting Standards. [715-30-35-92, 715-60-35-151, 35-164]

Settlements

Like IFRS Accounting Standards, a 'settlement' eliminates all or a part of the defined benefit plan obligation. However, US GAAP is more prescriptive than IFRS Accounting Standards in stating that a settlement is a transaction that: (1) is an irrevocable action; (2) relieves the employer (or the plan) of primary responsibility for the plan obligation; and (3) eliminates significant risks related to the obligation and the assets used to effect the settlement. Unlike IFRS Accounting Standards, lump sum cash payments meet the definition of settlements. Also, unlike IFRS Accounting Standards, if settlements during the year, including lump sum payments, exceed the sum of service and interest cost, recognition of a settlement is required. If settlements are less than that sum, an accounting policy choice is made as to whether to recognise a settlement or to record any difference as an actuarial gain or loss in the next remeasurement. [715-30-20, 715-30-35-82]

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In our view, an increase or a decrease in contingent benefits – e.g. plan benefits contingent on the funding level of the plan – that does not arise from a plan amendment is not a plan settlement or past service cost, but rather a potential outcome that was contemplated as part of the original pension plan. Therefore, the change should be accounted for as a remeasurement (actuarial gain or loss).

An approach to measuring a gain or loss on settlement is the same for measuring past service costs (see above). [IAS 19.99, 101A]

A gain or loss on settlement is recognised in profit or loss, calculated as the difference between:

- the present value of the defined benefit obligation being settled, as determined on the date of settlement; and
- the settlement price, including any plan assets transferred and any payments made directly by the entity in connection with the settlement. [IAS 19.109]

Net interest

'Net interest' is the change during the period in the net defined benefit liability (asset) that arises from the passage of time. It is determined by multiplying the net defined benefit liability (asset) by the discount rate at the start of the annual period, taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. [IAS 19.8, 123]

Like IFRS Accounting Standards, a decrease in contingent benefits that does not arise from a plan amendment is not a plan settlement or curtailment, but rather a potential outcome that was contemplated as part of the original pension plan. [715-30-35-1A]

Unlike IFRS Accounting Standards, a settlement differs from an amendment that results in prior service cost (see above); and, unlike IFRS Accounting Standards, under US GAAP, prior service costs are recognised in OCI at the date of the amendment. However, like IFRS Accounting Standards, the approach for measuring a settlement gain or loss (therefore, the use of current assumptions) is similar to the approach for measuring the impact of a plan amendment that results in prior service costs recognised in OCI.

Like IFRS Accounting Standards, gains and losses from settlements of defined benefit obligations are recognised in profit or loss. However, unlike IFRS Accounting Standards (for which it is unnecessary), guidance is provided on the allocation of actuarial gains and losses and prior service costs (to be recognised in OCI) in determining the amount of the settlement gain or loss.

Unlike IFRS Accounting Standards, the maximum gain or loss subject to recognition in profit or loss when a pension obligation is settled is the net gain or loss included in accumulated OCI, plus any remaining unrecognised net transition amount from the initial application of the Codification Topic included in accumulated OCI. That maximum amount includes any gain or loss first measured at the time of settlement. The maximum amount is recognised in profit or loss if the entire benefit obligation is settled. If only part of the benefit obligation is settled, then the employer recognises in profit or loss a pro rata portion of the maximum amount that is equal to the percentage reduction in the benefit obligation. If the purchase of a participating annuity contract constitutes a settlement, then the maximum gain (but not the maximum loss) is reduced by the cost of the participation before determining the amount to be recognised in profit or loss. [715-30-35-79, 715-60-35-151, 35-164]

Interest cost and expected return on plan assets

Unlike IFRS Accounting Standards, instead of net interest, an entity recognises:

- interest cost on the defined benefit liability, which is determined by applying the discount rate used to measure the defined benefit obligation at the start of the annual period to the defined benefit liability at the start of the annual period; and
- expected return on plan assets, which is determined by applying the expected long-term rate of return on plan assets to the market-related value of the plan assets at the beginning of the period. [715-30-35-47, 715-60-35-84]

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For an amendment, curtailment or settlement during the annual reporting period, the entity determines net interest for the remainder of the period using the net defined benefit liability (asset) that reflects the benefits offered under the plan and plan assets after the plan amendment, curtailment or settlement, and the discount rate used to remeasure that net defined benefit liability (asset). [IAS 19.123A]

Remeasurements

Remeasurements of the net defined benefit liability (asset) comprise:

- actuarial gains and losses, which arise on the defined benefit obligation;
- the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and
- any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset). [IAS 19.8, 127]

Actuarial gains and losses arise from changes in the present value of the defined benefit obligation as a result of:

- experience adjustments: i.e. the effects of differences between the previous actuarial assumptions and the actual outcome; and
- the effects of changes in actuarial assumptions. [IAS 19.8, 128]

The return on plan assets comprises interest, dividends and other income derived from the plan assets, as well as realised and unrealised gains or losses on the plan assets, less:

- any costs of managing plan assets; and
- any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the present value of the defined benefit obligation. [IAS 19.8]

Although the approach is similar to IFRS Accounting Standards, under US GAAP, if there is a curtailment or settlement during an annual reporting period, then the entity determines the interest cost on the defined benefit liability, and the expected return on plan assets for the remainder of the period, using assumptions that reflect the benefits offered under the plan and plan assets at the time of the curtailment or settlement.

Unlike IFRS Accounting Standards, the expected return on plan assets reflects the best estimate at the beginning of the period of future market returns on plan assets over the life of the obligation.

Actuarial gain or loss

Unlike IFRS Accounting Standards, actuarial gains and losses comprise:

- actuarial gains and losses on the defined benefit obligation; and
- the return on plan assets, excluding amounts included in the expected return on plan assets. [715-30-20]

Unlike IFRS Accounting Standards, US GAAP does not have an asset ceiling.

Unlike IFRS Accounting Standards, actuarial gains and losses arise from differences between the actual and expected outcome in both the valuation of the obligation *and* the plan assets. [715-30-20]

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Remeasurements of the net defined benefit liability (asset) are recognised in full in OCI in the reporting period during which they arise and are not reclassified to profit or loss in a subsequent period. However, the entity may transfer cumulative amounts recognised through OCI to another component of equity. [IAS 19.122]

Presentation of service cost and net interest

The employee benefits standard does not specify where service cost and net interest on the net defined benefit liability (asset) are presented. It also does not specify whether an entity presents service cost and net interest separately or as components of a single item of income or expense. An entity therefore chooses an approach, to be applied consistently, for the presentation of service cost and net interest on the net defined benefit liability (asset) in profit or loss. [IAS 19.134, BC201, 1.45]

Unlike IFRS Accounting Standards, actuarial gains and losses arising in the period are recognised immediately in OCI to the extent that they are not recognised in employee benefit cost (see below). Unlike IFRS Accounting Standards, employers can elect to amortise from accumulated OCI into employee benefit cost the amount of actuarial gains and losses in excess of the 'corridor' amount. The corridor is 10 percent of the greater of the defined benefit obligation and the market-related value of plan assets at the beginning of the period; the 'market-related value' is a calculated amount that includes deferred gains and losses that differs from fair value. The difference between the market-related value and the fair value of plan assets is recognised as a component of the expected return on plan assets over a period of five years or less, unlike IFRS Accounting Standards. The corridor is calculated and applied separately for each plan. [715-30-35-18, 35-21, 715-60-35-23]

Unlike IFRS Accounting Standards, the net cumulative (unamortised) actuarial gain or loss at the beginning of the period in excess of the corridor is amortised into employee benefit cost on a straight-line basis over the expected average remaining working lives of the employees participating in the plan or, if substantially all participants are inactive, over the remaining life expectancy of participants; generally, US GAAP is explicit that the calculation needs to be based on active employees in the plan. Unlike IFRS Accounting Standards, an entity is permitted to recognise actuarial gains and losses in employee benefit cost using any systematic and rational method that results in faster recognition than using the corridor method. [715-30-35-18, 35-21, 715-60-35-23]

Any balance of actuarial gain or loss within the corridor amount is recognised as a component of OCI for the reporting period, and remains in accumulated OCI until it is reclassified to employee benefit cost; an entity is also permitted to recognise all actuarial gains and losses immediately in profit or loss, unlike IFRS Accounting Standards. However, recognition in OCI without any reclassification to employee benefit cost is not permitted, unlike IFRS Accounting Standards. [715-30-35-18, 35-21, 715-60-35-23]

Presentation of cost components

Unlike IFRS Accounting Standards, there are specific presentation requirements under US GAAP. The service cost component of net benefit cost is presented in the same line item or items as other compensation cost. Other components of net benefit cost are presented separately from the service cost component and outside operating income if the operating income subtotal is presented. [715-20-45-3A, 715-30-35-7A, 715-60-35-10A]

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Asset ceiling

If a plan is in surplus, then the amount recognised as an asset in the statement of financial position is limited to the 'asset ceiling'. This is the present value of any economic benefits available to the entity in the form of a refund from the plan or a reduction in future contributions to the plan. [IAS 19.8, 64]

An economic benefit is available to an entity if, in accordance with the terms of the plan and applicable statutory requirements, it is realisable during the life of the plan or on settlement of the plan liabilities. [IFRIC 14.7–8]

The economic benefit available as a refund of a plan surplus is measured as the amount of the surplus at the reporting date less any associated costs, and is available only if an entity has an unconditional right to such a refund during the life of the plan, on gradual settlement of plan liabilities, or on plan wind-up. [IFRIC 14.11, 13–14]

The economic benefit available as a reduction in future contributions is measured as follows.

- If there is no minimum funding requirement for contributions relating to future service, then as the present value of the future service cost to the entity for each year over the shorter of the expected life of the plan and the expected life of the entity.
- If there is a minimum funding requirement for contributions for future services, then as the sum of:
  - any prepaid amount that reduces future minimum funding requirement contributions for future service; and
  - the present value of the estimated future service cost to the entity in each year less the estimated minimum funding requirement contributions that would be required for future service in the given year if there were no prepayment of future minimum funding requirement contributions. This amount cannot be less than zero. [IAS 19.64, IFRIC 14.16, 20, 22]

A liability is recognised for contributions payable to fund an existing shortfall with respect to service already received under a minimum funding requirement if the contributions payable are not expected to be available as a refund or reduction in future contributions after they are paid into a plan. [IFRIC 14.23–24]

Asset ceiling

Unlike IFRS Accounting Standards, the funded status (the difference between the fair value of plan assets and the defined benefit obligation) is recognised as an asset if the plan is overfunded (i.e. the measured amount of plan assets exceeds the measured amount of plan liabilities); the asset is not subject to additional adjustments related to an asset ceiling or a minimum funding requirement. [715-30-25, 715-60-25]

Unlike IFRS Accounting Standards, there is no requirement to evaluate whether an economic benefit is available to an entity; the funded status (see above) is recognised as an asset if the plan is overfunded. [715-30-25, 715-60-25]

Unlike IFRS Accounting Standards, the funded status – the defined benefit obligation minus the fair value of the plan assets – is recognised as a liability if the plan is underfunded; the liability is not subject to additional adjustments related to an asset ceiling or a minimum funding requirement. [715-30-25, 715-60-25]

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Insured benefits

If employee benefits are insured, then the accounting treatment depends on the nature of the obligation retained by the employer. [IAS 19.46]

If an employer purchases an insurance policy from an unrelated third party and in so doing settles its legal and constructive obligations under a defined benefit plan, then the purchase of the insurance policy is treated as a settlement of some or all of the employer's obligations. [IAS 19.46, 49, 112]

If the employer retains an indirect obligation – e.g. if actuarial risk will be transferred back to the employer by way of increased premiums, or the employer retains an obligation to pay the benefits through a plan – then the plan continues to be treated as a defined benefit plan. The insurance policy is treated as a plan asset or as a separate asset, depending on whether it is a qualifying insurance policy (see above). [IAS 19.48]

Current salary policies

An employer may purchase insurance policies each period to settle all of its defined benefit obligations. In this case, recognising as an expense the cost of the policies bought – in effect, defined contribution accounting – will have the same effect as applying defined benefit accounting and recognising a settlement gain or loss, although the disclosure requirements for defined benefit plans may still be relevant. [IAS 19.46]

However, an insurance policy may not cover all of the employer's defined benefit obligations. If the employer has an obligation to make payments if the insurer does not pay *all* future employee benefits related to employee service in the current and prior periods, then in our view the resultant plan should be accounted for as a defined benefit plan, even if some of the obligations have been settled and are no longer recognised. [IAS 19.46]

Reimbursement rights

If an entity will be reimbursed for expenditures required to settle a defined benefit obligation, but the reimbursement right does not give rise to a plan asset, then it is recognised as a separate asset when recovery is virtually certain. [IAS 19.48, 116]

Insured benefits

Like IFRS Accounting Standards, if employee benefits are insured, then the accounting treatment depends on the nature of the obligation retained by the employer.

Like IFRS Accounting Standards, if annuity contracts purchased from an insurance company are irrevocable and involve the transfer of significant risk from the employer to the insurance company then, to the extent covered by the annuity contract, the cost of current benefits is the cost of purchasing the contracts in recognising the settlement of the obligation. [715-30-35-53, 715-60-35-109]

Like IFRS Accounting Standards, if the substance of the contract with the insurance company is such that the employer remains subject to all or most of the risks and rewards associated with the defined benefit obligation and any assets transferred to the insurance company, then that contract does not qualify as an annuity contract and a settlement has not occurred. Like IFRS Accounting Standards, the insurance policy is treated as a plan asset or as a separate asset, depending on whether the insurance policy is held by the plan or, unlike IFRS Accounting Standards, by the employer (see above). [715-30-35-59, 715-60-35-120]

Current salary policies

If all the benefits attributed by the plan's benefit formula to service in the current period are covered by the purchase of nonparticipating annuity contracts, then the cost of the contracts determines the service cost component of pension cost for that period, similar to defined contribution accounting, like IFRS Accounting Standards. Benefits covered by the annuity contracts are excluded from the benefit obligation and the annuity contract is excluded from plan assets, like IFRS Accounting Standards. [715-30-35-53]

Benefits beyond those covered under nonparticipating annuity contracts are accounted for as defined benefit plans, which would generally be like the treatment under IFRS Accounting Standards. [715-30-35-55]

Reimbursement rights

Unlike IFRS Accounting Standards, if an entity will be reimbursed for expenditures required to settle a defined benefit obligation but the reimbursement right does not give rise to a plan asset, then it is recognised when recovery is probable (likely to occur) to the extent that benefits cost has been incurred.

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Reimbursement rights are measured at fair value and the changes in fair value are accounted for in the same way as the changes in the fair value of plan assets (see above). Remeasurements arising on reimbursement rights are recognised in OCI. [IAS 19.116]

Reimbursement rights in respect of post-retirement healthcare plans are measured at the present value of the expected reimbursement amount; however, we would not generally expect significant differences to arise in practice. Unlike IFRS Accounting Standards, reimbursements may be recognised immediately in employee benefit cost or initially in OCI depending on the type of reimbursement and whether or not the reimbursement is coming from a governmental body. [715-60-35-137 – 35-138]

Other long-term employee benefits

'Other long-term employee benefits' are all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits. Such benefits may include accumulating annual leave that can be carried forward and used more than 12 months after the end of the annual reporting period in which the employees render the related services, paid long-service leave, other long-service benefits (e.g. a bonus or extra salary after 20 years of service) and profit-sharing and other bonus schemes that are not expected to be settled wholly within 12 months of the end of the annual reporting period in which the employee services were received by the entity. [IAS 19.8, 153, IU 11-05]

Other long-term employee benefits that are defined benefit plans are accounted for in a manner similar to post-employment defined benefit plans, except that the components of the defined benefit cost are not disaggregated and are recognised in profit or loss. [IAS 19.155–156]

Deferred compensation contracts are accounted for in the same way as other long-term employee benefits. [IAS 19.153]

Other long-term employee benefits

Unlike IFRS Accounting Standards, US GAAP does not distinguish between long- and short-term employee benefits.

Like IFRS Accounting Standards, other long-term employee benefits are accounted for in a manner similar to post-employment benefits if there is a plan in place. If a plan is not in place, then other long-term benefits are recognised over the period during which service is rendered. In addition, unlike IFRS Accounting Standards, for post-employment benefits actuarial gains and losses and past service costs may, but are not required to, be recognised in the same manner as for defined benefit pension plans. [712-10-35-1]

Unlike IFRS Accounting Standards, deferred compensation contracts with individual employees that are not equivalent to a post-retirement benefit plan are accounted for individually on an accrual basis in accordance with the terms of the underlying contract. [710-10-25-9]

Reclassifications

Reclassification of a short-term employee benefit as long-term need not occur if the entity's expectations of the timing of settlement change temporarily. However, the benefit is reclassified if the entity's expectations of the timing of settlement change other than temporarily, or the characteristics of the benefit change – e.g. from a non-accumulating to an accumulating benefit. [IAS 19.10]

Reclassifications

Unlike IFRS Accounting Standards, US GAAP does not contain specific guidance on short-term employee benefits other than compensated absences, and there is no distinction between long- and short-term employee benefits.

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Termination benefits

'Termination benefits' are those benefits provided in exchange for termination of an employee's employment as a result of either an entity's decision to terminate that employment before the normal retirement date or an employee's decision to accept an offer of benefits in exchange for termination (see chapter 3.12). [IAS 19.8, 159]

An obligation for termination benefits is regarded as arising from the termination and not from the employee's service. An entity recognises a liability and an expense for termination benefits at the earlier of:

- when it recognises costs for a restructuring in the scope of the provisions standard that includes the payment of termination benefits; and
- when it can no longer withdraw the offer of those benefits. [IAS 19.165]

The entity can no longer withdraw the offer when it has communicated to the affected employees a plan of termination meeting all of the following criteria:

- actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made;
- the plan identifies:
  - the number of employees whose employment is to be terminated;
  - their job classifications or functions and their locations (although the plan need not identify these for individual employees); and
  - the expected completion date; and
- the plan establishes the termination benefits that employees will receive in sufficient detail so that employees can determine the type and amount of benefits they will receive when their employment is terminated. [IAS 19.167]

If the termination benefits are payable as the result of an employee's decision to accept an offer of benefits in exchange for the termination of employment – i.e. to take voluntary redundancy – then the entity can no longer withdraw the offer of termination benefits at the earlier of:

- when the employee accepts the offer; and
- when a restriction (such as a legal, regulatory or contractual requirement) on the entity's ability to withdraw the offer takes effect. [IAS 19.166]

Under IFRS Accounting Standards, if the benefit is conditional on future services being provided, then it is not a termination benefit. [IAS 19.162]

Termination benefits

Unlike IFRS Accounting Standards, US GAAP distinguishes four types of termination benefits: ongoing benefit arrangements, contractual terminations, special terminations and one-time terminations (see chapter 3.12). [420-10, 712-10]

Unlike IFRS Accounting Standards, the recognition of termination benefits depends on whether it is a one-time benefit, a contractual benefit, or a benefit payment pursuant to a plan. The criteria for recognition of one-time benefits are similar to IFRS Accounting Standards (see below). Contractual termination benefits and benefits payable pursuant to a plan are recognised when it is probable that the benefits will be paid and the amounts can be reasonably estimated, unlike IFRS Accounting Standards. [420-10-25-4, 712-10-25-1 – 25-4]

The criteria that need to be met under US GAAP before an obligation for one-time termination benefits is recognised are similar to the criteria under IFRS Accounting Standards on when an entity can no longer withdraw the offer of termination benefits payable as a result of an entity's decision to terminate an employee's employment. However, unlike IFRS Accounting Standards, there is also a criterion that management with the appropriate authority to approve the action commits to the plan. In addition, unlike IFRS Accounting Standards, one-time termination benefits cannot be recognised earlier if they are related to a restructuring. [420-10-25-4]

Unlike IFRS Accounting Standards, special termination benefits are distinguished from one-time termination benefits. Special termination benefits are generally additional benefits offered for a short period of time to induce voluntary termination or early retirement and are recognised when the employee irrevocably accepts the offer and the amount can be reasonably estimated. [712-10-25-1]

Like IFRS Accounting Standards, for one-time termination benefits, if future service beyond legally mandated minimums (which is unlike IFRS Accounting Standards) is required, then the cost of the termination benefit is recognised ratably over the employees' remaining service period. [420-10-25-9]

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IFRS Accounting Standards

Benefits forming part of an ongoing arrangement or contractual termination arrangement are subject to the general requirements for the recognition of termination benefits.

Termination benefits are measured in accordance with the nature of the employee benefit provided:

- if they are provided as an enhancement to a post-employment benefit, then an entity applies the requirements for post-employment benefits, except that the requirements for the attribution of benefits are not relevant;
- if they are expected to be settled wholly before 12 months after the end of the annual reporting period in which the termination benefit is recognised, then an entity applies the requirements for short-term employee benefits; and
- if they are not expected to be settled wholly before 12 months after the annual reporting date, then an entity applies the requirements for other long-term employee benefits. [IAS 19.169–170]

For a discussion of the recognition of other costs associated with a restructuring, including voluntary redundancies, see chapter 3.12.

US GAAP

Unlike IFRS Accounting Standards, costs related to an ongoing benefit arrangement or contractual termination benefit arrangement are recognised when they are probable and reasonably estimable. [712-10-25-2]

Unlike IFRS Accounting Standards, US GAAP distinguishes four types of termination benefits: ongoing benefit arrangements, contractual terminations, special terminations and one-time terminations. Unlike IFRS Accounting Standards, measurement of termination benefits is not dependant on whether the termination benefits are short-term or long-term benefits. [712-10-30-1]

For a discussion of the recognition of other costs associated with a restructuring, including voluntary redundancies, see chapter 3.12.

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4.5 Share-based payments

(IFRS 2)

Overview

- Goods or services received in a share-based payment transaction are measured using a fair value-based measure.
- Goods are recognised when they are obtained and services are recognised over the period in which they are received.
- Equity-settled transactions with employees are generally measured based on the grant-date fair value of the equity instruments granted.
- 'Grant date' is the date on which the entity and the employee have a shared understanding of the terms and conditions of the arrangement.
- Equity-settled transactions with non-employees are generally measured based on the fair value of the goods or services obtained. The measurement date is the date on which the goods or services are received, which means that there may be multiple measurement dates.
- An intrinsic value approach is permitted only in the rare circumstance that the fair value of the equity instruments cannot be estimated reliably.

4.5 Share-based payments

(Topic 718, Subtopic 505-50)

Overview

- Like IFRS Accounting Standards, goods or services received in a share-based payment transaction are measured using a fair value-based measure.
- Like IFRS Accounting Standards, goods are recognised when they are obtained and services are recognised over the period in which they are received.
- Like IFRS Accounting Standards, equity-classified transactions with employees are generally measured based on the grant-date fair value of the equity instruments granted.
- Like IFRS Accounting Standards, 'grant date' is the date on which the entity and the employee have a shared understanding of the terms and conditions of the arrangement. However, unlike IFRS Accounting Standards, employees should also begin to benefit from or be adversely affected by changes in the entity's share price.
- Unlike IFRS Accounting Standards, for public entities, equity-classified transactions with non-employees are generally measured based on the grant-date fair value of the equity instruments granted. For public entities, the measurement date is the grant date, which may differ from IFRS Accounting Standards. Also, unlike IFRS Accounting Standards, for non-public entities, awards to non-employees are accounted for using measurement practical expedients, which generally results in different measurement approaches.
- Like IFRS Accounting Standards, an intrinsic value approach is permitted in the rare circumstance that the fair value of the equity instruments cannot be estimated reliably. However, unlike IFRS Accounting Standards, non-public entities may apply an intrinsic value approach for liability-classified share-based payments as an accounting policy choice.

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Overview (continued)

- For equity-settled transactions, an entity recognises a cost and a corresponding increase in equity. For cash-settled transactions, an entity recognises a cost and a corresponding liability. For both, the cost is recognised as an expense unless it qualifies for recognition as an asset.
- The liability for cash-settled transactions is remeasured, until settlement date, for subsequent changes in the fair value of the liability. The remeasurements are recognised in profit or loss and are not eligible for capitalisation.
- Market conditions are reflected in the measurement of the fair value of share-based payment transactions. There is no true-up if the expected and actual outcomes differ because of market conditions.
- Like market conditions, non-vesting conditions are reflected in the measurement of the fair value of share-based payment transactions and there is no subsequent true-up for differences between the expected and the actual outcome.
- Service and non-market performance conditions are not reflected in the measurement of the fair value of share-based payment transactions, but are considered in estimating the number of instruments that are expected to vest. Initial estimates of the number of instruments that are expected to vest are adjusted to current estimates and on vesting date to the actual number of instruments that ultimately vest.

Overview (continued)

- Like IFRS Accounting Standards, for equity-classified transactions an entity recognises a cost and a corresponding increase in equity. Like IFRS Accounting Standards, for liability-classified transactions, an entity recognises a cost and a corresponding liability. For both, the cost is recognised as an expense unless it qualifies for recognition as an asset, like IFRS Accounting Standards.
- Like IFRS Accounting Standards, the liability is remeasured, until settlement date, for subsequent changes in the fair value of the liability. Unlike IFRS Accounting Standards, remeasurements are generally recognised as compensation cost, which is eligible for capitalisation.
- Like IFRS Accounting Standards, market conditions are reflected in the measurement of the fair value of share-based payment transactions and there is no true-up if the expected and actual outcomes differ because of market conditions.
- Unlike IFRS Accounting Standards, the concept of 'non-vesting conditions' is separated into two separate concepts: post-vesting restrictions and other conditions. Post-vesting restrictions are reflected in the initial measurement of fair value and there is no subsequent true-up for differences between the expected and the actual outcome, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, other conditions require the award to be liability-classified, irrespective of the settlement provisions of the award.
- Unlike IFRS Accounting Standards, an entity makes an accounting policy choice to account for the effect of forfeitures using one of the following approaches.
  - *True-up approach:* Like IFRS Accounting Standards, the effect of service conditions and (non-market) performance conditions on vesting is estimated at grant date, but it is not reflected in the grant-date fair value itself. Subsequently, these estimates are trued up for differences between the number of instruments expected to vest and the actual number of instruments vested, like IFRS Accounting Standards.
  - *Actual approach:* Unlike IFRS Accounting Standards, the effect of forfeitures is recognised as they occur, and previously recognised compensation cost is reversed in the period that the award is forfeited.

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Overview (continued)

- Modification of an equity-settled share-based payment results in the recognition of any incremental fair value but not in any reduction in fair value. Replacements are accounted for as modifications.
- When an entity modifies a cash-settled share-based payment transaction such that it becomes equity-settled, it measures the equity-settled award at its fair value and recognises any gain or loss in profit or loss.
- Cancellation of a share-based payment results in accelerated recognition of any unrecognised cost.
- Classification of grants in which the entity has the choice of equity or cash settlement depends on whether the entity has the ability and intent to settle in shares.
- Grants in which the employee has the choice of equity or cash settlement are accounted for as compound instruments. Therefore, the entity accounts for a liability component and an equity component separately.
- Awards with graded vesting, for which the only vesting condition is service, are accounted for as separate share-based payment arrangements.
- There is specific guidance on group share-based payment arrangements, which are accounted for in each group entity's financial statements based on their own perspectives.

Overview (continued)

- Like IFRS Accounting Standards, the modification of an equity-classified share-based payment results in the recognition of any incremental fair value but not in any reduction in fair value unless the modification is an 'improbable-to-probable' modification, unlike IFRS Accounting Standards. Like IFRS Accounting Standards, replacements are accounted for as modifications.
- Like IFRS Accounting Standards, when an entity modifies a liability-classified share-based payment transaction such that it becomes equity-classified, it measures the equity-classified award at its fair value and recognises any gain or loss in profit or loss.
- Like IFRS Accounting Standards, cancellation of a share-based payment by the entity results in accelerated recognition of any unrecognised cost. Unlike IFRS Accounting Standards, cancellation by the counterparty does not change recognition of the compensation cost.
- Like IFRS Accounting Standards, the classification of grants in which the entity has the choice of equity or cash settlement depends on whether the entity has the ability and intent to settle in shares.
- Unlike IFRS Accounting Standards, an award for which the employee has the choice of equity or cash settlement is generally liability-classified in its entirety unless the award is a 'combination' award, which might be treated like a compound instrument.
- Awards with graded vesting, for which the only vesting condition is service, can be accounted for ratably over the longest vesting tranche, unlike IFRS Accounting Standards; or as separate share-based payment arrangements, like IFRS Accounting Standards.
- Unlike IFRS Accounting Standards, US GAAP does not contain specific guidance on group share-based payment arrangements, which may give rise to differences in practice.

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Scope

Transactions settled in shares or other equity instruments are referred to as 'equity-settled share-based payment transactions'. Transactions that create an obligation to deliver cash or other assets are referred to as 'cash-settled share-based payment transactions'. [IFRS 2.A]

An entity may grant a share-based payment without any specifically identifiable goods or services being received in return, in which case other circumstances may indicate that goods or services have been received. In other cases, there may be specifically identifiable goods or services received in exchange for the share-based payment. If the identifiable consideration received appears to be less than the fair value of the equity instruments granted or liability incurred, then this typically indicates that other consideration (i.e. unidentifiable goods or services) has also been (or will be) received. [IFRS 2.2, 13A]

If the entity does not settle in its own equity instruments but in a payment of cash or other assets, then the amount should be based on the price (or value) of its equity instruments for the transaction to qualify as a share-based payment. Judgement is required in determining whether an award is based on the price of the entity's shares, although we would generally expect a high degree of correlation between the calculation of the award and the share price. [IFRS 2.A]

Transactions with employees or other parties in their capacity as shareholders are outside the scope of the share-based payment standard. [IFRS 2.2, 4]

The following share-based payment transactions are covered by other accounting standards and are therefore outside the scope of the share-based payment standard:

- share-based consideration paid in a business combination (see chapter 2.6), in a combination of entities under common control (see chapter 5.13) or in connection with the contribution of a business on the formation of a joint venture (see chapter 3.6); and
- share-based consideration for certain commodity contracts that are directly in the scope of the financial instruments standards or meet the own use exemption but are designated as at FVTPL (see chapter 7.1). [IFRS 2.5–6, BC23–BC24D, BC25–BC28, 3.A, 9.2.4]

Scope

Under US GAAP, most but not all transactions settled in shares or other equity instruments are 'equity-classified share-based payment transactions'. Most but not all transactions that create an obligation to deliver cash or other assets are 'liability-classified (cash-settled) share-based payment transactions'. The principle difference between IFRS Accounting Standards and US GAAP in classifying share-based payment transactions is that US GAAP focuses on whether an equity relationship is created through the award, whereas IFRS Accounting Standards focus on the form of settlement of the award.

Unlike IFRS Accounting Standards, US GAAP does not include guidance on share-based payments granted without any specifically identifiable goods or services being received in return.

If the entity does not settle in its own equity instruments but in a payment of cash or other assets, then the amount should be based, at least in part, on the price (or value) of its equity instruments for the transaction to qualify as a share-based payment. Accordingly, there may be a lower threshold for being in the scope of the Codification Topic, which may give rise to differences from IFRS Accounting Standards in practice. [718-10-15-3]

Like IFRS Accounting Standards, transactions with employees or other parties in their capacity as shareholders are outside the scope of the Codification Topic. However, US GAAP has more guidance in this area, which can result in transactions being accounted for as share-based payments under US GAAP that are not under IFRS Accounting Standards. [718-10-15-4]

The following share-based payment transactions are covered by other Codification topics and are therefore outside the scope of the share-based payment Codification Topic:

- like IFRS Accounting Standards, share-based consideration paid in a business combination (see chapter 2.6), in a combination of entities under common control (see chapter 5.13) or in connection with the contribution of a business on the formation of a joint venture (see chapter 3.6); and
- like IFRS Accounting Standards, share-based consideration for certain commodity contracts that are in the scope of the financial instruments Codification Topics (see chapter 7.1). [718-10-15-6 – 15-7]

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In our view, the following are also outside the scope of the share-based payment standard:

- the acquisition of NCI after control is obtained (see chapter 2.5);
- the acquisition of associates (see chapter 3.5); and
- the acquisition of a joint controlling interest in a joint venture (see chapter 3.5).

The employer may pay employees an amount of cash to cover social taxes and/or income taxes related to share-based payment transactions in addition to the share-based payment arrangement. In our view, if the cash payment is not based on the price or value of the entity's shares, then this portion of the plan should be treated as an employee benefit (see chapter 4.4). If the cash payment is based on the value of the entity's shares, then it may be appropriate to treat this portion of the plan as a cash-settled share-based payment transaction. [IFRS 2.1]

If the employer is the obligor for the tax, then the employer recognises the cost and a liability. In our view, an entity should choose an accounting policy, to be applied consistently, to treat the employer's obligation to pay the taxes either as a provision (see chapter 3.12) or as a share-based payment transaction.

An arrangement may provide for a cash payment to be made that is based on the share price of an entity, but is subject to a cap. In our view, the arrangement should be accounted for as a cash-settled share-based payment if the payment is expected to be largely based on the entity's share price; otherwise, it should be accounted for as an employee benefit (see chapter 4.4). There is no guidance on arrangements that provide for settlement in equity subject to a monetary cap, and practice may vary.

All employee share purchase plans are considered compensatory. The share-based payment standard does not permit exemptions for purchase plans with small discounts and/or broad-based plans offered to all employees.

Unlike IFRS Accounting Standards, US GAAP contains specific guidance on equity instruments held by an employee stock ownership plan (ESOP). [718-40]

Like IFRS Accounting Standards, the following are also outside the scope of the share-based payment Codification Topic:

- the acquisition of NCI after control is obtained (see chapter 2.5);
- the acquisition of significant influence over an investee (see chapter 3.5); and
- the acquisition of a joint controlling interest in a joint venture (see chapter 3.5).

The employer may pay employees an amount of cash to cover social taxes and/or income taxes related to share-based payment transactions in addition to the share-based payment arrangement. Like IFRS Accounting Standards, if the cash payment is not based on the price or value of the entity's shares, then this portion of the plan should be treated as an employee benefit under the employee benefits Codification Topics (see chapter 4.4). If the cash payment is based on the value of the entity's shares, then this portion of the plan may be accounted for as a liability-classified share-based payment transaction; however, differences from IFRS Accounting Standards may arise in practice.

Like IFRS Accounting Standards, if the employer is the obligor for the tax, then the employer recognises the cost and a liability. Unlike IFRS Accounting Standards, an entity would normally recognise a liability to pay taxes based on the contingencies Codification Topic (see chapter 3.12), which may result in differences from IFRS Accounting Standards in the timing of recognition. [718-740-05]

An arrangement may provide for a cash payment to be made that is based on the share price of an entity, but is subject to a cap. Like IFRS Accounting Standards, the arrangement should be accounted for as a liability-classified share-based payment if the payment is expected to be largely based on the entity's share price; otherwise, it should be accounted for as an employee benefit (see chapter 4.4). Unlike IFRS Accounting Standards, share-based payments that are settled in shares but are subject to a monetary cap are evaluated to determine whether the payoff is predominantly tied to the value of the entity's shares (in which case the award is equity-classified) or to a fixed monetary payoff (in which case the award is liability-classified). [718-10-25]

Unlike IFRS Accounting Standards, employee share purchase plans are considered non-compensatory if certain conditions are met. However, in practice many employee share purchase plans are compensatory. [718-50-25-1]

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Classification of share-based payment transactions

Generally, the classification as cash- or equity-settled is based on the entity's obligation to the counterparty (i.e. whether the entity is or can be required to settle in equity instruments or settle in cash) and the entity's intended settlement method. However, classification is not affected by how an entity obtains the shares that it will use to settle its obligations. [IFRS 2.B49]

A share-based payment transaction in which the employees are granted the right to shares that are redeemable (e.g. shares that are redeemable on cessation of employment) at the employees' option is a cash-settled share-based payment arrangement. [IFRS 2.31]

In our view, an award that is net share settled, sometimes referred to in practice as cashless exercise, would be viewed as equity-settled as long as the recipient has no ability to require a cash payment for the equity instruments tendered. A transaction that is settled in a variable number of shares is generally classified as an equity-settled share-based payment transaction. [IFRS 2.BC106]

In our view, a payment that is settled in equity instruments is a share-based payment, provided that no scope exemption applies, even if the design of the payment is to grant shares with a value equal to a certain cash amount.

Classification of share-based payment transactions

The classification as liability or equity is based on both the entity's obligation to the counterparty (i.e. whether the entity is or can be required to settle in equity instruments or settle in cash) and the intended settlement method, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, it is also based on whether the arrangement creates an equity relationship with the counterparty such that the recipient is exposed to the risks and rewards of share price movements as a shareholder. Like IFRS Accounting Standards, classification is not affected by how an entity obtains the shares that it will use to settle its obligations. [718-10-25-3 – 25-4]

For public entities, a share-based payment transaction settled in shares that are mandatorily redeemable is liability-classified, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, if the employee is subject to risks and rewards of ownership for at least six months following vesting (or exercise for share options) and awards are redeemable at fair value at the redemption date, the awards are equity-classified. SEC registrants are required to present a portion of such an award's value in 'temporary equity' (i.e. between total liabilities and equity), unlike IFRS Accounting Standards. Also unlike IFRS Accounting Standards, for certain non-public entities such awards are equity-classified because the redeemable share is classified as equity (see chapter 7.3). [718-10-25, 480-10-30, 480-10-S99-3A]

Like IFRS Accounting Standards, cashless exercise can result in an award being equity-classified as long as the recipient has no ability to require a cash payment for the equity instruments tendered. However, unlike IFRS Accounting Standards, cashless exercise should also create an equity relationship such that the recipient is exposed to the risks and rewards of share price movements as a shareholder. Unlike IFRS Accounting Standards, an award is classified as a liability if it is for a fixed monetary amount settleable in a variable number of shares. [718-10-25-3]

Like IFRS Accounting Standards, a payment that is settled in equity instruments is a share-based payment, provided that no scope exemption applies. However, unlike IFRS Accounting Standards, if the design of the payment is to grant shares with a value equal to a fixed cash amount that is settled by issuing a variable number of shares, then it is classified as a liability. [718-10-25-7]

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An employer may be obliged to collect or withhold the tax payable by its employee on a share-based payment arrangement and transfer it to the tax authority. This type of arrangement is classified as equity-settled in its entirety if the share-based payment would otherwise be classified as equity-settled without the net settlement feature. Any amount withheld in excess of the employee's tax obligation associated with the share-based payment is accounted for as a cash-settled share-based payment. [IFRS 2.33E–33H]

When the entity has the choice of whether to settle in cash or by issuing shares, classification as equity-settled is appropriate if the entity has the intent and a substantive ability to settle in shares and has no past practice of settling in cash. [IFRS 2.41]

There is no specific guidance on the classification of a share-based payment in which equity instruments are cash-settleable only on the occurrence or non-occurrence of a contingent event. In our view, if an entity issues a share-based payment that is contingently cash-settleable and the contingency is not within the control of the entity or the counterparty, then the entity should determine whether to classify the share-based payment as cash- or equity-settled based on the liability recognition criteria of the provisions standard. Based on the classification guidance in that accounting standard (see chapter 3.12), we believe that in determining whether a liability to the employee exists, the contingent feature would affect the classification only if the contingent event is probable (i.e. more likely than not). [IAS 37.14, IU 01-10]

There is no specific guidance on the classification of share-based payment arrangements that are denominated in a currency other than the issuing entity's functional currency. In our view, the classification should be based on what form of consideration the entity is providing to the employees (e.g. shares or cash) as for other compensation arrangements. In our view, in determining the grant-date fair value of the foreign currency-denominated option, the entity should translate the exercise price into its functional currency at the exchange rate on that date and consider additional factors, such as volatility of the exchange rate, the correlation of the exchange rate and the share price, and risk-free interest rates in both currencies. We believe that the grant-date fair value should not be remeasured for subsequent changes in exchange rates.

Some share-based arrangements may allow the employer to net-settle the award for the number of shares required to settle the tax obligation. If the award can be net-settled for up to the maximum statutory tax withholding amount, then the award is equity-classified in its entirety if it otherwise qualifies for equity classification, like IFRS Accounting Standards. If the award can be net-settled for an amount in excess of the maximum statutory tax withholding, then the entire award is liability-classified, unlike IFRS Accounting Standards. [718-10-25-18]

Like IFRS Accounting Standards, equity classification is appropriate if the entity has the intent and a substantive ability to settle in shares and has no past practice of settling in cash. However, unlike IFRS Accounting Standards, the award needs to create an equity relationship between the counterparty and the entity. As such, awards settled in equity for a fixed monetary amount and awards that vest on the achievement of an 'other' condition are liability-classified, unlike IFRS Accounting Standards. An 'other' condition is one that impacts vesting, exercise price or other factors in measuring the fair value of an award, but does not meet the definition of a market, performance or service condition under US GAAP. [718-10-25, 718-10-55-60]

Like IFRS Accounting Standards, if the contingent events are outside the control of the entity, then the employer should consider whether the occurrence of the contingent event is probable of occurring. If the occurrence of the contingent event is not probable, then the award is equity-classified, assuming that it otherwise qualifies for equity classification. However, unlike IFRS Accounting Standards, such awards (or a portion thereof) are presented in temporary equity if the entity is an SEC registrant, regardless of the event's likelihood of occurring. In addition, 'probable' has a different meaning under IFRS Accounting Standards, so differences may arise in situations in which the likelihood is greater than more likely than not, but less than probable. [480-10-S-99-3A]

Unlike IFRS Accounting Standards, share-based payment arrangements that are denominated in a currency other than the issuing entity's functional currency are equity-classified only if they otherwise qualify as equity and the award either:

- is granted to an employee of an entity's foreign operations and contains a fixed exercise price denominated in the foreign operation's functional currency or the currency in which the employee's pay is denominated; or
- contains an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trade. [718-10-25-14 – 25-14A]

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Equity-settled transactions with employees

Conditions

Conditions that determine whether the counterparty receives the share-based payment are separated into vesting conditions and non-vesting conditions. 'Vesting conditions' are all conditions that determine whether the entity receives the services that entitle the counterparty to the share-based payment, and may be differentiated further between service and performance conditions. 'Performance conditions' are either market conditions or non-market performance conditions. All other conditions are considered non-vesting conditions. [IFRS 2.IG4A, IG24]

'Service conditions' require the employees to complete a specified period of service. The service requirement can be explicit or implicit. [IFRS 2.A, BC171A, BC346]

'Performance conditions' require the counterparty to (1) complete a specified period of service – i.e. a service condition; and (2) meet specified performance targets while the counterparty is rendering the services. Performance conditions are either market conditions or non-market performance conditions.

- *Non-market performance conditions:* Vesting or exercisability of an equity instrument is related to specific performance targets associated with an entity's own operations or activities, or the operations or activities of another entity in the same group – e.g. a specified increase in profit or EPS target.
- *Market conditions:* Vesting or exercisability of an equity instrument is related to the market price (or value) of the entity's equity instruments (or the equity instruments of another entity in the same group). Examples include attaining a specified share price or achieving a specified target that is based on the market price of the entity's equity instruments relative to a stock-exchange index, or an index of market prices of equity instruments of other entities. [IFRS 2.A]

For equity-classified awards in which the exercise price is denominated in the same currency as the currency in which the share price is quoted, the grant-date fair value is measured in that currency. If the exercise price is denominated in a currency different from the currency in which the share price is quoted, then the grant-date fair value measurement includes the current exchange rate and the volatility of the exchange rate against the entity's functional currency as additional inputs to the valuation model. In either case, the grant-date fair value is not remeasured for subsequent changes in exchange rates, like IFRS Accounting Standards. [718-10-25-14 – 25-14A]

Equity-settled transactions with employees

Conditions

Conditions that determine whether the employee receives the share-based payment are separated into vesting conditions, like IFRS Accounting Standards, and post-vesting restrictions, unlike IFRS Accounting Standards. Conditions that determine whether the employee receives the share-based payments are vesting conditions, which are service conditions (like IFRS Accounting Standards), performance conditions (which are generally like non-market performance conditions under IFRS Accounting Standards), market conditions (which are like market conditions under IFRS Accounting Standards) or 'other' conditions (unlike IFRS Accounting Standards). [718-10-20]

Like IFRS Accounting Standards, 'service conditions' require employees to complete a specific period of service. The service requirement can be explicit or implicit, like IFRS Accounting Standards. See forthcoming requirements. [718-10-20]

'Performance conditions' relate to both (1) an employee's rendering service for a specified period, like IFRS Accounting Standards; and (2) the achievement of a specified performance target that is defined solely with reference to the employer's operations (e.g. EPS targets), which is like a non-market performance condition under IFRS Accounting Standards. Unlike IFRS Accounting Standards, the assessment period for performance conditions can be longer than an explicit or implicit service condition, which can result in differences in the measurement of the grant-date fair value of awards and the attribution of compensation cost. [718-10-30-28]

'Market conditions' relate to achieving a target share price or specified amount of intrinsic value, or a specified growth in the entity's share price compared with a similar equity security or index of equity securities. Market conditions under US GAAP are defined similarly to market conditions under IFRS Accounting Standards, and, like IFRS Accounting Standards, market conditions affect grant-date fair value. [718-10-20]

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The share-based payment standard does not explicitly define a non-vesting condition, but does illustrate the following three types of non-vesting conditions:

- conditions that the entity can choose to meet (e.g. continuation of the plan by the entity);
- conditions that the counterparty can choose to meet (e.g. participation in a share purchase programme by paying monthly contributions or transfer restrictions after vesting); and
- conditions that neither the entity nor the counterparty can choose to meet (e.g. an award can be exercised only when the price of gold does not exceed a specified price). [IFRS 2.BC171B, BC364, IG24]

An award can require the counterparty to meet a performance target in addition to a service condition, with a performance assessment period shorter or longer than the service period. In such instances, in order for the target to be a vesting condition, the period of achieving the performance target:

- cannot extend beyond the end of the service period (including any implicit service period); but
- may start before the service period on condition that the commencement date of the performance target is not substantially before the commencement of the service period. [IFRS 2.A]

The performance target is a non-vesting condition if the performance assessment period extends beyond the end of the service period. [IFRS 2.A]

If an exit event is required to occur during the service period, then it is a non-market performance condition. Conversely, if the exit event applies after the counterparty has become entitled to the share-based payment, then it is a non-vesting condition. [IFRS 2.A]

Like IFRS Accounting Standards, US GAAP does not define non-vesting conditions. Under US GAAP, the three types of post-vesting restrictions illustrated under IFRS Accounting Standards would be treated as follows:

- conditions that the entity can choose to meet (e.g. continuation of the plan by the entity) – generally, such conditions would be ignored in the recognition and measurement of a share-based payment award unless the conditions were such that there was not a shared understanding of the award, so differences from IFRS Accounting Standards may arise in practice;
- conditions that the counterparty can choose to meet (e.g. participation in a share purchase programme by paying monthly contributions) – such conditions would be ignored in the recognition and measurement of a share-based payment award, which may result in differences from IFRS Accounting Standards; or transfer restrictions after vesting – such conditions would be incorporated into the grant-date fair value, like IFRS Accounting Standards; or
- conditions that neither the entity nor the counterparty can choose to meet (e.g. an award can be exercised only when the price of gold does not exceed a specified price) – unlike IFRS Accounting Standards, such conditions are not post-vesting restrictions under US GAAP, but rather would be treated as 'other' conditions, resulting in the award being liability-classified. [718-10-25-13]

An award can require the counterparty to meet a performance target in addition to a service condition, with a performance assessment period shorter or longer than the service period. Unlike IFRS Accounting Standards, the performance target is a performance (vesting) condition even if the period of achieving the performance target extends beyond the end of the service period. Compensation cost is recognised over the requisite service period, starting in the period in which it becomes probable that the performance target will be met. This can be different from the stated vesting period (which includes the period in which the performance target could be achieved) and is adjusted to the actual number of awards issued, unlike IFRS Accounting Standards. For awards that allow for the performance condition to be met after the completion of the service condition, compensation cost related to the award may be recognised after employment has terminated if the performance condition had not been considered probable of being met during the period of employment. [718-10-30-28]

Like IFRS Accounting Standards, an exit event that is required to occur during the service period is an example of a performance condition. Unlike IFRS Accounting Standards, if the exit event applies after the counterparty has become entitled to the share-based payment, then the event is still a performance condition. [718-10-20, 718-10-30-28]

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The entity recognises a share-based payment if the exit event that is a non-market performance condition is expected to occur. [IFRS 2.15, 20]

Who is an employee

Employees and others providing similar services are defined as individuals who render personal services to the entity and either:

- they are regarded as employees for legal or tax purposes;
- they work for the entity under its direction in the same way as individuals who are regarded as employees for legal or tax purposes; or
- the services rendered are similar to those rendered by employees. [IFRS 2.A]

The term 'employee' encompasses all management personnel – i.e. those persons having authority and responsibility for planning, directing and controlling the activities of the entity, including non-executive directors. [IFRS 2.A]

The requirements for transactions with employees are also applied to transactions with individuals who may not be employees, but provide personal services similar to the services provided by an employee. [IFRS 2.11, A]

Recognition

If the employee is not required to satisfy a specified vesting condition before becoming unconditionally entitled to the instruments granted, then the equity instruments vest immediately. There is no specific guidance in IFRS Accounting Standards on whether a fully vested deeply out-of-the-money award contains an implied market condition, and practice may vary. [IFRS 2.14]

If the equity instruments do not vest until the employee completes a period of service, then the entity presumes that services are to be provided in the future. The entity accounts for the services as they are received during the vesting period. [IFRS 2.15, IGEx1– IGEx2, IGEx5, IGEx6]

Under US GAAP, 'probable' means likely, which is a higher threshold than expected to occur. Additionally, US practice is that an initial public offering or a change in control are not generally deemed probable of occurring before they actually occur, resulting in later recognition of the cost in comparison to IFRS Accounting Standards. [450-20-20]

Who is an employee

An employee is an individual over whom the grantor of a share-based award exercises or has the right to exercise sufficient control to establish an employer-employee relationship based on common law. Although common law includes many of the same characteristics as under IFRS Accounting Standards, differences from IFRS Accounting Standards may arise in practice. [718-10-20]

Like IFRS Accounting Standards, the term 'employee' encompasses all management personnel – i.e. those persons having authority and responsibility for planning, directing and controlling the activities of the entity. Although non-executive directors do not meet the definition of common law employees, there is an exception that generally results in them being treated as employees, like IFRS Accounting Standards, as long as certain conditions are met. However, differences can arise when preparing group financial statements and non-executive directors are compensated for service at multiple levels within the group. [718-10-55-91]

The requirements for transactions with employees are also applied to transactions with individuals who may not be employees, but who provide personal services similar to the services provided by an employee. However, US GAAP provides specific requirements that must be met for 'leased' employees to be treated as employees, which may create differences from IFRS Accounting Standards in practice. [718-10-20]

Recognition

Like IFRS Accounting Standards, if an employee is not required to satisfy a specified vesting condition before becoming unconditionally entitled to the award, then the equity instruments vest immediately. Unlike IFRS Accounting Standards, US GAAP specifies that the grant of a fully vested deeply out-of-the-money award contains an implied market condition and a service period must be derived for the award. [718-10-20, 10-35]

Like IFRS Accounting Standards, if the equity instruments do not vest until the employee completes a period of service, then the entity presumes that services are to be provided in the future. The entity accounts for the services as they are received during the requisite service (vesting) period, like IFRS Accounting Standards. [718-10-35]

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Modified grant-date method

The modified grant-date method is used to recognise and measure equity-settled share-based payment transactions. Under this method, the fair value of the equity instruments is measured at grant date, with some true-up for instruments that do not vest (commonly known as 'forfeiture'). [IFRS 2.19–20, IG9]

Vesting conditions

Market conditions are reflected as an adjustment (discount) to the initial estimate of fair value of the instrument to be received at grant date. There is no true-up for differences between estimated and actual vesting due to market conditions. [IFRS 2.21, IG24]

The effect of service conditions and non-market performance conditions on vesting is estimated at grant date, but it is not reflected in the grant-date fair value itself. Instead, it is reflected in attribution, so that the accounting for the share-based payment is based on the number of equity instruments for which the service and non-market performance conditions are expected to be met. Subsequently, these estimates are trued up for differences between the number of instruments expected to vest and the actual number of instruments vested. [IFRS 2.20, IG24]

Under the modified grant-date method, the estimated share-based payment cost is trued up for forfeiture due to an employee failing to meet the service condition. For grant dates on or after 1 July 2014, failure to complete the service period, regardless of the reason – i.e. whether an employee resigns voluntarily or is dismissed by the employer – results in the service condition not being met. [IFRS 2.A, BC368]

Similarly, if an employee may be prevented from providing services due to the sale of an operation that results in the termination of employment, then this is considered a forfeiture for grant dates on or after 1 July 2014. [IFRS 2.A, BC368]

Modified grant-date method

Like IFRS Accounting Standards, the modified grant-date method is used to recognise and measure equity-classified share-based payment transactions. Under this method, like IFRS Accounting Standards, the fair value of the equity instruments is measured at grant date, with some true-up for instruments that do not vest (commonly known as 'forfeiture'). [718-10-30-2 – 30-11]

Vesting conditions

Under US GAAP, a market condition is not a vesting condition and is treated as an exercisability condition. However, like IFRS Accounting Standards, market conditions are reflected as an adjustment (discount) to the initial estimate of fair value of the instrument to be received at grant date. Like IFRS Accounting Standards, there is no true-up for differences between estimated and actual vesting due to market conditions. [718-10-30-14 – 30-15]

Unlike IFRS Accounting Standards, an entity makes an accounting policy choice to account for the effect of forfeitures using one of the following approaches.

- *True-up approach:* Like IFRS Accounting Standards, the effect of service conditions and (non-market) performance conditions on vesting is estimated at grant date, but it is not reflected in the grant-date fair value itself. Subsequently, these estimates are trued up for differences between the number of instruments expected to vest and the actual number of instruments vested, like IFRS Accounting Standards.
- *Actual approach:* Unlike IFRS Accounting Standards, the effect of forfeitures is recognised as they occur, and previously recognised compensation cost is reversed in the period that the award is forfeited. [718-10-35-3]

Like IFRS Accounting Standards, under the modified grant-date approach, the estimated share-based payment cost is trued up for forfeiture due to an employee failing to provide the requisite service (e.g. if the employee resigns before the end of the vesting period). Like IFRS Accounting Standards, forfeiture accounting also applies if the employer terminates the services of the employee and therefore prevents the required service from being provided. [718-10-35-3]

Like IFRS Accounting Standards, if an employee is prevented from providing services due to a sale of an operation that results in the termination of employment, then it is considered a forfeiture (unless the transaction is a spin-off, unlike IFRS Accounting Standards).

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Equity-settled transactions are not remeasured subsequent to grant date for fair value changes, unlike cash-settled share-based payments. [IFRS 2.16]

Multiple vesting conditions

In our view, in a share-based payment that is subject to both market and non-market performance conditions, the grant-date fair value used to measure the share-based payment should reflect the probability of not achieving the market condition.

In our view, if the non-market performance condition is not satisfied in a share-based payment that is subject to both market and non-market performance conditions, then the entity should true up the cumulative share-based payment cost to zero.

Some share-based payment arrangements may require the satisfaction of both a service condition and at least one of two performance conditions (e.g. one market condition or one non-market performance condition) for the share-based payment arrangement to vest. Such arrangements with multiple vesting conditions are sometimes referred to as containing 'multiple interactive vesting conditions'.

In our view, a switching approach should be followed by analogy for a grant with multiple interactive vesting conditions. At grant date, the entity should estimate the fair value of the equity instruments for each possible outcome and account for the share-based payment based on the most likely outcome at each reporting date. [IFRS 2.15, 21, IGEx4]

Non-vesting conditions

Like market conditions, non-vesting conditions are reflected in measuring the grant-date fair value of the share-based payment and there is no true-up for differences between the expected and actual outcome of non-vesting conditions. [IFRS 2.21A, IG24]

Like IFRS Accounting Standards, equity-classified transactions are not remeasured for subsequent changes in the fair value of the award, unlike liability-classified share-based payments. [718-10-35]

Multiple vesting conditions

In a share-based payment that is subject to both market and performance conditions, the grant-date fair value used to measure the share-based payment reflects the probability of not achieving the market condition. However, depending on the nature of the interaction between the conditions, differences from IFRS Accounting Standards may arise in practice. [718-10-30-15]

Like IFRS Accounting Standards, if the performance condition is not satisfied in a share-based payment that is subject to both market and performance conditions, then the entity should true up the cumulative share-based payment cost to zero. However, depending on the nature of the interaction between the conditions, differences from IFRS Accounting Standards may arise in practice. [718-10-25-21, 55-63]

Some share-based payment arrangements may require the satisfaction of both a service condition and at least one of either a performance or a market condition for the share-based payment arrangement to vest. Under US GAAP, the recognition and measurement depend on whether the conditions are 'or' or 'and' conditions (i.e. whether only one or both conditions must be met).

Unlike IFRS Accounting Standards, there is specific guidance on accounting for awards with multiple interactive vesting conditions. Under US GAAP, if it is an 'or' condition (i.e. the award should satisfy either the performance or the market condition), then the entity estimates which condition is expected to be achieved, with compensation cost based on the most likely outcome. Like IFRS Accounting Standards, the entity reassesses each period and 'switches' or adjusts the cumulative compensation cost based on the most likely outcome at each reporting date. [718-10-35, 55-69 – 55-79, 718-10-55-93 – 55-106]

Non-vesting conditions

Unlike IFRS Accounting Standards, US GAAP does not define non-vesting conditions and the accounting depends on whether the condition is a post-vesting restriction, in which case the condition is incorporated into the grant-date fair value (like IFRS Accounting Standards) or an 'other' condition, which is not a post-vesting restriction under US GAAP, resulting in the award being liability-classified, unlike IFRS Accounting Standards. [718-10-25-13, 30-10]

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If either the entity or the counterparty can choose whether to meet a non-vesting condition and one chooses not to do so during the vesting period, then the failure to meet the condition is treated as a cancellation. Under cancellation accounting, the amount of the cost that would otherwise have been recognised over the remainder of the vesting period is generally recognised immediately in profit or loss. [IFRS 2.28(a), 28A]

If neither the entity nor the counterparty can choose whether to meet a non-vesting condition, then there is no change to the accounting if the non-vesting condition is not satisfied, and the entity continues to recognise the compensation cost over the vesting period. [IFRS 2.21A, IG24]

Determination of grant date

The determination of grant date is important because this is the date at which the fair value of equity instruments granted is measured. Usually, the grant date is also the date when recognition of the employee services received begins. [IFRS 2.11]

'Grant date' is the date on which the entity and the employee agree to a share-based payment arrangement, and requires that the entity and the employee have a shared understanding of the terms and conditions of the arrangement. If a grant is made subject to approval – e.g. by a board of directors – then the grant date is normally when that approval is obtained. [IFRS 2.A, IG1]

For the employer and the employee to 'agree' to a share-based payment transaction, there needs to be both an offer and an acceptance of that offer. The grant date is not reached until there is acceptance of the offer. The acceptance may be explicit (e.g. by signing a contract) or implicit (e.g. by starting to render services). [IFRS 2.IG2]

If the entity can choose whether to meet a condition such as continuation of the plan and the entity chooses not to do so during the vesting period, then the action by the entity is treated as a cancellation, like IFRS Accounting Standards. Under cancellation accounting, the amount of the cost that would otherwise have been recognised over the remainder of the vesting period is recognised immediately in profit or loss, like IFRS Accounting Standards.

Unlike IFRS Accounting Standards, conditions that the counterparty can choose to meet (e.g. participation in a share purchase programme by paying monthly contributions) are ignored and treated as notification of intent not to exercise, resulting in continuing recognition of cost over the requisite service period. [718-50-35-2]

Conditions that neither the entity nor the counterparty can choose to meet (e.g. an award can be exercised only when the price of gold exceeds a specified price) are treated as 'other' conditions, resulting in the award being liability-classified, unlike IFRS Accounting Standards. [718-10-25-13]

Determination of grant date

Like IFRS Accounting Standards, grant date is the date on which the fair value of the equity instruments granted is measured. Usually, grant date is also the date on which recognition of the employee services received begins. However, unlike IFRS Accounting Standards, US GAAP has explicit guidance on when the service inception date precedes the grant date. [718-10-20, 25-5]

The 'grant date' is the date on which the employer and employee have a mutual understanding of the terms and conditions of the award, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, the employee also must begin to benefit from or be adversely affected by changes in the employer's share price, which results in differences in practice from IFRS Accounting Standards for certain awards. Like IFRS Accounting Standards, the grant date cannot occur before approval is obtained unless approval is perfunctory. [718-10-25-5, 55-81 – 55-83]

The definition of the grant date does not require explicit employee acceptance; however, for broad-based awards there needs to be employee notification of the award within a reasonable period of time of the decision to grant awards. As a result, differences from IFRS Accounting Standards may arise in practice. [718-10-55-81 – 55-82]

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In our view, there will not generally be 'agreement on terms and conditions' if the outcome is based primarily on *subjective* factors – e.g. if the number of shares to be awarded is a discretionary determination of a compensation committee at the end of the service period.

Determination of vesting period

The 'vesting period' is the period during which all of the specified vesting conditions are to be satisfied for the employees to be unconditionally entitled to the equity instrument. This is normally the period between grant date and vesting date. [IFRS 2.A]

If the grant date occurs *after* service commencement date, then the entity estimates the grant-date fair value of the equity instruments for the purpose of recognising the services from service commencement date until grant date. Once the grant date has been established, the entity revises its earlier estimates. [IFRS 2.IG4]

It is possible for the service commencement date to be before the award is approved. [IFRS 2.IG4]

Graded vesting

In some situations, the equity instruments granted vest in instalments over the specified vesting period. Assuming that the only vesting condition is service from the grant date to the vesting date of each tranche, each instalment is accounted for as a separate share-based payment arrangement and there will be different fair values and vesting periods for each tranche. [IFRS 2.IG11]

Like IFRS Accounting Standards, there will not generally be 'agreement on terms and conditions' if the outcome is primarily based on subjective factors – e.g. if the number of shares to be awarded is a discretionary determination of a compensation committee at the end of the service period. However, the evaluation of whether the factors are sufficiently subjective to preclude the conclusion that a grant date has occurred requires judgement, and therefore differences from IFRS Accounting Standards may arise in practice. [718-10-20]

Determination of requisite service period

The 'requisite service period' is the period during which an employee is required to provide service in exchange for an award. Normally, the period between grant date and vesting date is the requisite service period, like IFRS Accounting Standards; however, because there are differences in guidance on the service inception date, grant date and vesting conditions, differences from IFRS Accounting Standards can arise in practice. [718-10-20, 718-10-35]

Like IFRS Accounting Standards, when the grant date occurs after the service inception date, the entity estimates the grant-date fair value of the equity instruments for the purpose of recognising the services from service inception date until grant date. Each period until the grant date has been established, the entity revises its earlier estimates, like IFRS Accounting Standards. [718-10-35-6, 55-108]

Like IFRS Accounting Standards, the service inception date can occur before the award is approved. However, because US GAAP has explicit guidance on when a service inception date precedes a grant date, differences from IFRS Accounting Standards may arise in practice. [718-10-55-108]

Graded vesting

US GAAP allows entities with equity instruments vesting in tranches based only on service conditions to make an accounting policy choice to recognise compensation cost either:

- based on each separately vesting tranche (graded vesting), like IFRS Accounting Standards; or
- ratably over the period of the longest vesting tranche, subject to a 'floor' that the minimum amount of cumulative compensation cost recognised is not less than the portion of the award vested to date, unlike IFRS Accounting Standards. [718-10-35-8, 55-108]

Unlike IFRS Accounting Standards, regardless of which attribution policy is chosen, the entity may also choose to determine a separate grant-date fair value for each tranche or to value the entire award using a single grant-date fair value measure. [718-10-30-3]

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Determination of the type of equity instruments granted

In an ESPP, the employees are usually entitled to purchase shares at a discounted price. [IFRS 2.IG17]

In our view, the predominant feature of the share-based payment arrangement determines the accounting for the entire fair value of the grant – either as an ESPP or as an option plan.

In our view, the principal characteristic of an ESPP is the right to buy shares at a discount to current market prices. ESPPs that grant short-term fixed purchase prices do not have significant option characteristics, because they do not allow the grant holder to benefit from volatility. We believe that ESPPs that provide a longer-term option to buy shares at a specified price are, in substance, option plans, and should be accounted for as such. [IFRS 2.B4–B41]

Measurement

Determining the fair value of equity instruments granted

Share-based payment transactions with employees are measured with reference to the fair value of the equity instruments granted. [IFRS 2.11]

The fair value of the equity instruments granted is determined as follows.

- If market prices are available for the equity instruments granted, then the estimate of fair value is based on these market prices.
- If market prices are not available for the equity instruments granted, then the fair value of equity instruments granted is estimated using a valuation technique. [IFRS 2.16–17]

Post-vesting restrictions are included in the grant-date measurement of fair value to the extent that the restriction affects the price that a knowledgeable, willing market participant would pay for the equity instrument granted. [IFRS 2.B3, B10, IU 11-06]

Determination of the type of equity instruments granted

Like IFRS Accounting Standards, in an ESPP, the employees are usually entitled to purchase shares at a discounted price. [718-50-55-22]

Like IFRS Accounting Standards, the predominant feature of the share-based payment arrangement determines the accounting for the entire fair value of the grant. [718-10-15-3]

Unlike IFRS Accounting Standards, ESPPs with an option feature are treated as a grant of a share option and not a share, regardless of the length of the option period. Unlike IFRS Accounting Standards, if a small discount (normally 5 percent or less) is offered and certain other conditions are met, then such awards are treated as non-compensatory – i.e. compensation cost is not recognised. [718-50-25, 50-30-1 – 30-3]

Measurement

Determining the fair value of equity instruments granted

Like IFRS Accounting Standards, share-based payment transactions with employees are measured with reference to the fair value of the equity instruments granted. [718-10-30]

Like IFRS Accounting Standards, the fair value of the equity instruments granted is determined as follows.

- If market prices are available for the equity instruments granted, then the estimate of fair value is based on these market prices.
- If no market prices are available for the equity instruments granted, then the fair value of equity instruments granted is estimated using a valuation technique. [718-10-30]

Like IFRS Accounting Standards, post-vesting restrictions are included in the grant-date measurement of fair value if the shares obtained on exercise are restricted beyond the vesting period. However, as explained under performance conditions, unlike IFRS Accounting Standards, performance conditions with assessment periods that are longer than the service period are not considered post-vesting restrictions, so differences can arise in practice for those types of awards. [718-10-30]

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The share-based payment standard generally requires the use of the fair value-based method, except in rare cases when fair value cannot be estimated reliably. In these cases, the instrument would be measured at intrinsic value subject to remeasurement until settlement. [IFRS 2.16–17, 24]

Dividends

If the employees are not entitled to dividends declared during the vesting period, then the fair value of these equity instruments is reduced by the present value of dividends expected to be paid compared with the fair value of equity instruments that are entitled to dividends. [IFRS 2.B34]

In our view, forfeitable dividends should be treated as dividend entitlements during the vesting period. If the vesting conditions are not met, then any true-up of the share-based payment would automatically recognise the profit or loss effect of the forfeiture of the dividend because the dividend entitlements are reflected in the grant-date fair value of the award.

In our view, an entity should choose an accounting policy, to be applied consistently, to account for non-forfeitable dividends using one of the following two approaches. [IFRS 2.B31–B36]

One approach is to treat non-forfeitable dividends as a dividend entitlement during the vesting period in determining the grant-date fair value of the share-based payment. The value of the dividend right is reflected in the grant-date fair value of the share-based payment, and therefore increases the cost of the share-based payment. If the share-based payment does not vest, then in our view the total amount previously recognised as a share-based payment cost should be split into: (1) the value for the non-forfeitable dividends; and (2) the balance of the share-based payment. We believe that only the balance of the share-based payment cost (the amount excluding the non-forfeitable dividends) would be subject to any true-up for failure to satisfy vesting conditions in order to reflect the benefit retained by the employee.

Like IFRS Accounting Standards, US GAAP generally requires the use of the fair value-based method, except in the rare circumstances that fair value cannot be estimated reliably. In these cases, the instrument would be measured at intrinsic value subject to remeasurement until settlement, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, US GAAP allows non-public entities to measure share-based awards under the calculated-value method, if certain restrictive conditions are met. In addition, unlike IFRS Accounting Standards, US GAAP also permits non-public entities to use a midpoint expected term practical expedient when valuing employee share option awards, if certain restrictive conditions are met. [718-10-30-2, 30-20 – 30-22]

Dividends

Like IFRS Accounting Standards, if the employees are not entitled to dividends declared during the vesting period, then the fair value of these equity instruments is reduced by the present value of dividends expected to be paid compared with the fair value of equity instruments that are entitled to dividends. [718-10-55-23]

Under US GAAP, forfeitable dividends are included in the measure of the grant-date fair value of the award, like IFRS Accounting Standards. If the vesting conditions are not met, then any true-up of the share-based payment would automatically recognise the profit or loss effect of the forfeiture of the dividend because the dividend entitlements are reflected in the grant-date fair value of the award, like IFRS Accounting Standards. [718-10-55-45]

Unlike IFRS Accounting Standards, non-forfeitable dividends paid on awards that are expected to vest are charged to retained earnings, whereas non-forfeitable dividends paid on awards expected to be forfeited are recognised as additional compensation cost. The estimate of compensation cost for non-forfeitable dividends on awards not expected to vest is revised throughout the vesting period and ultimately trued up to the actual number of forfeitures. [718-10-55-45]

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The other approach is to view non-forfeitable dividends as a payment for services with vesting conditions different from the vesting conditions of the underlying share-based payment. Under this approach, the dividend rights would be considered to be a benefit (e.g. under the employee benefits standard – see chapter 4.4) rather than a share-based payment, because dividends are unlikely to be based on the price or value of the entity's equity instruments.

Cash-settled transactions with employees

Cash-settled share-based payment transactions result in a liability, generally an obligation to make a cash payment, based on the price of the equity instrument (e.g. share price). For cash-settled share-based payment transactions with employees, the services received and the liability incurred are initially measured at the fair value of the liability at grant date, and the liability is remeasured until settlement. The entity recognises the service received and the liability to pay for those services, as the employees render service during the vesting period. [IFRS 2.30–33]

At each reporting date, and ultimately at settlement date, the fair value of the recognised liability is remeasured. Remeasurements during the vesting period are recognised immediately to the extent that they relate to past services, and spread over the remaining vesting period (together with the initial fair value of the liability) to the extent that they relate to future services. The total net cost recognised in respect of the transaction is the amount paid to settle the liability. [IFRS 2.IG19, 30, 32]

Remeasurements after the vesting period are recognised immediately in full in profit or loss. [IFRS 2.33]

Only the grant-date fair value of the arrangement may qualify for asset recognition under other accounting standards. Accordingly, the remeasurement of the liability is recognised in profit or loss. However, there is no guidance on whether the remeasurement should be presented as an employee cost or as finance income or finance costs. In our view, an entity should choose an accounting policy, to be applied consistently, between these presentations. [IFRS 2.IG19, BC252–BC255]

Liability-classified transactions with employees

Like IFRS Accounting Standards, liability-classified share-based payment transactions result in a liability measured at fair value at grant date. However, as described above, the circumstances under which an award is liability-classified differ from awards being classified as cash-settled under IFRS Accounting Standards. Like IFRS Accounting Standards, for liability-classified share-based payment transactions with employees, the services received and the liability incurred are initially measured at the fair value of the liability at grant date, and the liability is remeasured until settlement. The entity recognises the service received and the liability to pay for those services, as the employees render service during the vesting period, like IFRS Accounting Standards. [718-10-35]

Unlike IFRS Accounting Standards, non-public entities are permitted to elect to measure liability-classified awards using intrinsic value rather than fair value. [718-30-30-2]

Like IFRS Accounting Standards, at each reporting date, and ultimately at settlement date, the fair value of the recognised liability is remeasured. Like IFRS Accounting Standards, remeasurements during the vesting period are recognised immediately to the extent that they relate to past services, and spread over the remaining vesting period (together with the initial fair value of the liability) to the extent that they relate to future services. The total net cost recognised in respect of the transaction is the amount paid to settle the liability, like IFRS Accounting Standards. [718-10-30-3, 30-35-2]

Like IFRS Accounting Standards, remeasurements after the vesting period are recognised immediately in full in profit or loss. [718-30-35-2]

Like IFRS Accounting Standards, entities may use only the grant-date fair value of the arrangement as the basis for capitalisation under other Codification topics/subtopics. Unlike IFRS Accounting Standards, entities may also choose a policy, to be applied consistently, of considering both the grant-date fair value of the arrangement and the remeasurement of the liability during the vesting period as the basis for capitalisation, if appropriate, under the relevant Codification topic. Unlike IFRS Accounting Standards, the remeasurement is presented as an employee cost. [718-30-35-2, 718-10-S99, SAB Topic 14.F]

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Market conditions and non-market performance conditions

All terms and conditions are considered in determining the fair value of a cash-settled share-based payment. [IFRS 2.33]

To measure the fair value of a cash-settled share-based payment and account for the effects of vesting and non-vesting conditions, an entity follows the approach used for equity-settled share-based payments (see above):

- market conditions and non-vesting conditions are included in measuring the fair value of a cash-settled liability, and there is no true-up for differences between estimated and actual vesting; and
- service and non-market performance conditions are not included in measuring the fair value of a cash-settled award, and there is a true-up for differences between estimated and actual vesting. [IFRS 2.33A–33D, BC371–BC382]

Grants of equity instruments that are redeemable are classified as cash-settled share-based payments under certain conditions, depending on which party has the option to redeem. [IFRS 2.31]

In our view, for a grant of options to acquire redeemable shares, the settlement of the share-based payment occurs only on redemption of the shares and not on exercise of the options. An entity therefore should recognise compensation cost and a corresponding cash-settled liability equal to the grant-date fair value of the options; this liability should be remeasured at each reporting date. At the date on which the option is exercised, the fair value of the share, and therefore of the liability recognised for the redeemable shares, will be equal to the sum of the exercise price and the intrinsic value of the option. Once the option is exercised, we believe that the entity should remeasure the cash-settled liability at FVTPL until the shares are redeemed. [IFRS 2.30–31]

Market conditions and performance conditions

Like IFRS Accounting Standards, all terms and conditions, subject to specified exceptions (e.g. reload features and vesting conditions) are considered in determining the fair value of a cash-settled share-based payment. [718-10-30-5]

In measuring the fair value of a liability-classified share-based payment, an entity includes market and post-vesting restrictions, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, US GAAP also includes 'other' conditions. Like IFRS Accounting Standards, there is no true-up for differences between estimated and actual vesting. However, as explained under 'Conditions' above, unlike IFRS Accounting Standards, performance conditions with assessment periods that are longer than the service period are not considered post-vesting restrictions, so differences can arise in practice for those types of awards. Like IFRS Accounting Standards, service and performance conditions are not included in the fair value measurement. [718-10-30, 718-30-30-1]

Unlike IFRS Accounting Standards, if an equity relationship has been established such that the employee is exposed to the economic risks and rewards of share ownership for a reasonable period of time (at least six months), then redeemable shares are equity-classified. However, unlike IFRS Accounting Standards, SEC registrants may be required to classify the awards as temporary equity, between liabilities and equity, in the statement of financial position. [480-10-S99, 718-10-25-9]

Unlike IFRS Accounting Standards, grants of options to acquire redeemable shares may be equity-classified, depending on the circumstances. If the employee is required to hold the shares for at least six months after exercise before the shares are redeemed, and the award will be redeemed at fair value, then the award is equity-classified. Additionally, in certain circumstances, redeemable shares of non-public entities are classified as equity and, as such, options to acquire such redeemable shares are equity-classified. If the options are equity-classified, then there is no remeasurement of the award after grant date. [718-10-25-8 – 25-9]

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Employee transactions with a choice of settlement

Employee's choice

If the employee has the choice of settlement, then the entity has granted a compound financial instrument that includes a liability component and an equity component. At the measurement date, the fair value of the compound instrument (the value of services to be received) is the sum of the values of the liability component and the equity component. The liability component is measured first. All of the fair value of the grant is recognised as a liability if the employee has to surrender the cash settlement right to receive the equity alternative with the same fair value. As a result, the incremental value of the equity component is zero, unless the employee receives a discount for choosing the equity alternative. [IFRS 2.35–38]

Entity's choice

If the entity has the choice of settlement, then it accounts for the transaction either as a cash-settled share-based payment or as an equity-settled share-based payment in its entirety. If the entity has a present obligation to settle in cash, then it accounts for the transaction as a cash-settled share-based payment; otherwise, it accounts for the transaction as an equity-settled share-based payment. [IFRS 2.41–43]

If the entity has the *stated intent to settle in equity instruments*, then it does not have a present obligation to settle in cash, unless it has a past practice of settling in cash or no ability to settle in equity instruments. [IFRS 2.41]

If the entity has the *stated intent to settle in cash*, then it has a present obligation to settle in cash, regardless of its past practice. [IFRS 2.41]

If the entity *does not have a stated intent,* then it classifies the transaction as cash-settled if it has either a past practice of settling in cash or no ability to settle in equity instruments; otherwise, the transaction is classified as equity-settled. [IFRS 2.41]

Employee transactions with a choice of settlement

Employee's choice

Unlike IFRS Accounting Standards, if the employee has the choice of settlement, then the award is generally liability-classified in its entirety. Under US GAAP, combination awards – i.e. an award with two (or more) components in which exercise of one part does not cancel the other(s) – might be treated like a compound instrument. However, these situations are not necessarily the same as under IFRS Accounting Standards, and there may be differences in practice. Like IFRS Accounting Standards, if the employee has the choice of settlement and the payoffs are the same for both the equity and the cash settlement feature, then the entire amount is recognised as a liability. As an exception, unlike IFRS Accounting Standards, if the employee is required to hold the shares for at least six months after exercise before settlement, and the award will be settled at fair value, then the award is equity-classified. [718-10-25]

Entity's choice

Like IFRS Accounting Standards, if the entity has the choice of settlement, then it accounts for the transaction either as a liability-classified share-based payment or as an equity-classified share-based payment in its entirety. Like IFRS Accounting Standards, if the entity has a present obligation to settle in cash, then it accounts for the transaction as a liability-classified share-based payment; otherwise, it accounts for the transaction as an equity-classified share-based payment. [718-10-25-6 – 25-19]

Like IFRS Accounting Standards, if the entity has the *stated intent to settle in equity instruments*, then it does not have a present obligation to settle in cash, unless it has a practice of settling in cash or no ability to settle in equity instruments. [718-10-25-15]

Like IFRS Accounting Standards, if the entity has the *stated intent to settle* in cash, then it has a present obligation to settle in cash, regardless of its past practice. [718-10-25-15]

Like IFRS Accounting Standards, if the entity *does not have a stated intent,* then it classifies the transaction as liability-classified if it has either a past practice of settling in cash or no ability to settle in equity instruments; otherwise, the transaction is classified as equity-classified, like IFRS Accounting Standards. [718-10-25-15]

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Modifications and cancellations of employee transactions

Modifications that do not change the classification of an arrangement

Modifications to equity-settled share-based payment transactions that *decrease* the fair value of the grant are generally ignored. When the fair value of the grant *increases* due to a modification, then the incremental fair value of the modified grant is accounted for in addition to the original grant. [IFRS 2.27, B43(a)]

If the modification increases the fair value of the share-based payment granted, then the incremental fair value is recognised over the remaining modified vesting period, whereas the balance of the grant-date fair value is recognised over the remaining original vesting period. [IFRS 2.B43(a)]

If the modification changes a market condition, then the impact of the change is treated as a change in the fair value of the award. [IFRS 2.B43(a), (c)]

Modifications and cancellations of employee transactions

Modifications that do not change the classification of an arrangement

Unlike IFRS Accounting Standards, modification accounting is not applied to an equity-classified award if the following are the same immediately before and after the modification:

- the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used);
- vesting conditions; and
- classification. [718-20-35-2A]

When the fair value of the grant increases due to a modification, then the incremental fair value of the modified grant is accounted for in addition to the original grant, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, an 'improbable-to-probable' modification is accounted for as a new award. Depending on the facts and circumstances, this may result in a lower amount of compensation cost than the grant-date fair value of the original award or a greater amount of compensation costs than the sum of the grant-date fair value of the original award plus the incremental fair value, unlike IFRS Accounting Standards. [718-20-35-3]

If the modification increases the fair value of the share-based payment granted, then the incremental value of the modified grant as compared with the fair value of the original grant at the date of modification is accounted for in addition to the grant-date fair value of the original grant. If the revised service period for the modified award is longer than the remaining portion of the original service period, then there is a policy choice to recognise the total amount of remaining compensation over the revised service period, unlike IFRS Accounting Standards, or to account for the remaining amount of compensation for the original award over the remaining portion of the original service period and the incremental compensation from the modified award over the revised service period, like IFRS Accounting Standards. [718-20-35-3, 55-98]

Like IFRS Accounting Standards, when an award with a market condition is modified, the probability of satisfying the original condition does not affect the recognition of compensation cost because the market condition has been incorporated into the grant-date fair value measurement and the impact of the change is treated as a change in the fair value of the award, like IFRS Accounting Standards. [718-20-35-3, 55-108, 55-116]

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If a modification increases the number of equity instruments granted, then the entity recognises the fair value of the additional equity instruments, measured at the date of modification. The additional share-based payment cost is attributed over the period from the date of modification to the end of the vesting period of the additional equity instruments. [IFRS 2.B43(b)]

If the modification changes a service condition or non-market performance condition in a manner that is beneficial to an employee, then the remaining grant-date fair value is recognised using the revised vesting expectations with true-up to actual outcomes. [IFRS 2.B43(c)]

A package of modifications might include several changes to the terms of a grant that affect its total fair value, some of which are favourable to the employee whereas other changes are not. In our view, it is appropriate to net the effects of all modifications, provided that they are agreed as part of a package. If the net effect is beneficial, then we believe that this net effect is accounted for by applying the requirements for beneficial modifications to the net change.

Modifications that change the classification of an arrangement

Not all changes to the classification of a share-based payment arrangement are modifications. In our view, the factors to consider in determining whether the change is a modification include the following:

- whether the different possible outcomes were contemplated when the award was granted; and
- whether the change is triggered by the entity or by an event that is outside the entity's control.

Like IFRS Accounting Standards, if a modification increases the number of equity awards granted (outside of a capital restructuring), then the entity will measure the fair value of the additional equity instruments at the date of modification. Also like IFRS Accounting Standards, the incremental share-based payment cost is attributed over the period from the date of modification to the end of the vesting period of the additional equity instruments. [718-20-35-3, 35-6]

Like IFRS Accounting Standards, if the modification changes a service condition or performance condition in a way that is beneficial to an employee, then the remaining grant-date fair value is recognised using the revised vesting expectations and requisite service period with true-up to actual outcomes. However, unlike IFRS Accounting Standards, if the original award was improbable of vesting under its original terms, then the fair value at the date of the modification, which could be less than the original grant-date fair value, is recognised using the revised vesting expectations with true-up to actual outcomes. [718-20-35-3, 55-108, 55-116]

Under US GAAP, a modification for a performance condition of a share-based payment arrangement results in recognition of the grant-date fair value of the award if both the original and the modified performance conditions are probable of achievement, or of the fair value of the modified award if the modified performance condition is probable and the original performance condition was not probable of achievement at the date of the modification, which may result in differences from IFRS Accounting Standards in practice. [718-20-55]

A package of modifications might include several changes to the terms of a grant, some of which are favourable to the employee whereas other changes are not. Like IFRS Accounting Standards, it is appropriate to net the effects of all such modifications, provided that the modifications are agreed as part of a package. However, modification accounting is applied to the net change, which may result in differences from IFRS Accounting Standards, because US GAAP does not have a beneficial modifications concept.

Modifications that change the classification of an arrangement

Unlike IFRS Accounting Standards, a change in the classification of a share-based payment award is a modification. [718-20-55-122]

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A change from equity-settled to cash-settled arising from a modification would occur if, for example, a cash alternative at the employee's discretion is subsequently added to an equity-settled share-based payment that results in its reclassification as a financial liability. Such a modification leads to a reclassification, at the date of modification, of an amount equal to the fair value of the liability from equity to liability, apportioned for the service provided to date. [IFRS 2.27, IGEx9]

If the amount of the liability recognised on the modification date is less than the amount previously recognised in equity, then no gain is recognised for the difference between the amount recognised to date in equity and the apportioned fair value of the liability; that difference remains in equity. Subsequent to the modification, the entity continues to recognise the grant-date fair value of equity instruments granted as the cost of the share-based payment. However, any subsequent remeasurement of the liability (from the date of modification until settlement date) is also recognised in profit or loss. [IFRS 2.IGEx9]

If the amount of the liability recognised on the modification date is *greater* than the amount previously recognised as an increase in equity, then in our view two approaches are acceptable for recognising the excess liability. We believe that an entity should choose an accounting policy, to be applied consistently, to recognise either:

- the excess as an expense in profit or loss at the modification date; or
- the entire liability as a reclassification from equity and not recognise any loss in profit or loss. In our view, it is appropriate for no gain or loss to be recognised in profit or loss when a change in the terms of the share-based payment leads to reclassification as a financial liability provided that the fair value of the liability at the date of modification is not greater than the fair value of the original share-based payment at the date of modification. [IAS 32.33, AG32, IU 11-06]

A change from cash-settled to equity-settled arising from a modification would occur if, for example, a new equity-settled share-based payment arrangement is identified as a replacement of a cash-settled share-based payment arrangement. To account for such a modification, at the modification date, an entity:

- derecognises the liability for the original cash-settled share-based payment;
- measures the equity-settled share-based payment at its fair value as at the modification date and recognises in equity that fair value to the extent that the services have been rendered up to that date; and
- immediately recognises in profit or loss the difference between the carrying amount of the liability and the amount recognised in equity. [IFRS 2.B44A–B44C, IGEx12C]

Like IFRS Accounting Standards, a modification may lead to a change in the classification of a share-based payment transaction. For example, a modification may change the classification from equity-classified to liability-classified. Such a modification leads to the recognition, at the date of modification, of an amount equal to the fair value of the liability, apportioned for the service provided to date, like IFRS Accounting Standards. [718-20-55-123 – 55-133]

Like IFRS Accounting Standards, if the amount of the liability recognised is less than the amount previously recognised in equity, then no gain is recognised for the difference between the amount recognised to date in equity and the apportioned fair value of the liability; that difference remains in equity, like IFRS Accounting Standards. Subsequent to the modification, the entity continues to recognise the grant-date fair value of equity instruments granted as the cost of the share-based payment, like IFRS Accounting Standards. Any subsequent remeasurement of the liability (from the modification date until settlement date) is only recognised in profit or loss if the subsequent fair value of the liability is in excess of the grant-date fair value of the award, unlike IFRS Accounting Standards. [718-20-55-127]

Unlike IFRS Accounting Standards, if a modification results in a change in classification of an award from equity to liability, then cumulative compensation cost recognised is the greater of the grant-date fair value of the original award and the fair value of the modified liability award when it is settled. Therefore, unlike IFRS Accounting Standards, any excess of the fair value of the award at the modification date over the amount in equity would be recognised in profit of loss at the date of the modification. [718-20-55-128]

Like IFRS Accounting Standards, to account for a modification from a liability-classified to an equity-classified share-based payment, at the modification date an entity:

- derecognises the liability for the original liability-classified share-based payment;
- measures the equity-classified share-based payment at its fair value as at the modification date and recognises that fair value to the extent that the services have been rendered up to that date; and
- immediately recognises the difference between the carrying amount of the liability and the amount recognised in equity in profit or loss. [718-20-55-135 – 55-138]

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Cancellations, replacements, settlements

Cancellations or settlements of equity-settled share-based payments during the vesting period by the entity or by the counterparty are accounted for as accelerated vesting. The amount that would otherwise have been recognised for services received is recognised immediately. [IFRS 2.28(a), 28A, IGEx9A]

If an entity identifies a new equity-settled arrangement as a replacement for a cancelled equity-settled arrangement, then the entity accounts for the grant of replacement equity instruments as a modification of the original arrangement. If the entity does not make this identification, then both awards are accounted for separately. [IFRS 2.28(c)]

Group share-based payment arrangements

If a shareholder grants equity instruments, or a cash payment based on those equity instruments, of the reporting entity's parent or another entity in the same group as the reporting entity to parties that have supplied goods or services to the reporting entity, then that grant is a group share-based payment transaction. [IFRS 2.3A]

A common group share-based payment transaction involving shareholders arises when a parent grants its equity instruments to employees of a subsidiary as compensation for services provided by the employees to the subsidiary. Such a transaction is in the scope of the share-based payment standard in the financial statements of the subsidiary and from the perspective of the parent. [IFRS 2.3A, B52(a)]

If a reporting entity grants equity instruments of its parent or equity instruments of another entity in the same group as the reporting entity (or a cash payment based on those equity instruments) to parties that have supplied goods or services to the reporting entity, then such a transaction is in the scope of the share-based payment standard from the perspective of the reporting entity. [IFRS 2.3A, B52(b)]

If a reporting entity grants its own equity instruments, or a cash payment based on those equity instruments, to parties that have supplied goods or services to another entity in the group, then the transaction is in the scope of the share-based payment standard from the perspective of the reporting entity. [IFRS 2.3A]

Cancellations, replacements, settlements

Cancellations or settlements *by the entity* of equity instruments during the vesting period are accounted for as accelerated vesting and any unrecognised cost is recognised immediately, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, cancellations *by the counterparty* are deemed to be notification of intent not to exercise and the unrecognised compensation cost continues to be recognised over the requisite service period. [718-20-35-7, 718-50-35-2]

Like IFRS Accounting Standards, if an entity identifies a new equity-classified arrangement as a replacement for a cancelled equity-classified arrangement, then the entity accounts for the grant of replacement equity instruments as a modification of the original arrangement. If the entity does not make this identification, then both awards are accounted for separately, like IFRS Accounting Standards. [718-20-35-8 – 35-9]

Group share-based payment arrangements

US GAAP does not have specific guidance on group share-based payment arrangements. However, if the shareholder grants equity instruments, or a cash payment based on those equity instruments, of the reporting entity's parent or another entity in the same group as the reporting entity to parties that have supplied goods or services to the reporting entity, then that grant is a group share-based payment transaction, like IFRS Accounting Standards. [718-10-15]

A common group share-based payment transaction involving shareholders arises when a parent grants its equity instruments to employees of a subsidiary as compensation for services provided by the employees to the subsidiary. Like IFRS Accounting Standards, such a transaction is in the scope of the share-based payment Codification Topic in the financial statements of the subsidiary and from the perspective of the parent. [718-10-15]

Like IFRS Accounting Standards, if a reporting entity grants equity instruments of its parent or equity instruments of another entity in the same group as the reporting entity (or a cash payment based on those equity instruments) to parties that have supplied goods or services to the reporting entity, then such a transaction is in the scope of the share-based payment Codification Topic from the perspective of the reporting entity. [505-50]

Like IFRS Accounting Standards, if a reporting entity grants its own equity instruments, or a cash payment based on those equity instruments, to parties that have supplied goods or service to another entity in the group, then the transaction is in the scope of the share-based payment Codification Topic from the perspective of the reporting entity. [718-10-15]

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A transaction in which the reporting entity receives services from its employees and the employees receive equity instruments of a shareholder that is not a group entity (e.g. an equity-accounted investee), or a cash payment based on those equity instruments, is outside the scope of the share-based payment standard from the perspective of the reporting entity. [IFRS 2.A]

If a shareholder that is not a group entity settles by granting equity instruments of the receiving entity (or a cash payment based on those equity instruments), then the transaction is in the scope of the share-based payment standard from the perspective of the receiving entity. [IFRS 2.3A]

Classification of group share-based payment arrangements

If the entity either has an obligation to settle in its own equity instruments or has no obligation to settle, then the transaction is accounted for as equity-settled. A settling entity that is not a receiving entity classifies a share-based payment transaction as equity-settled if it settles in its own equity instruments; otherwise, it classifies the transaction as cash-settled. [IFRS 2.43A–43C]

In a typical group share-based payment arrangement involving the parent and a subsidiary, separate classification assessments are made from the perspective of the consolidated financial statements of the parent and the consolidated financial statements (if any) of the subsidiary. Separate classification assessments are also made in any separate financial statements of the parent and/or subsidiary, which are outside the scope of this publication.

Accounting for a group share-based payment arrangement

A receiving entity that has no obligation to settle the transaction with the counterparty to the share-based payment transaction accounts for the transaction as equity-settled and recognises an expense (unless the goods or services received qualify for recognition as an asset) and an increase in its equity for the contribution received from the parent. [IFRS 2.B53]

Share-based payments awarded to employees of an entity from other related parties or other economic interest holders are in the scope of the share-based payment Codification Topic unless the transfer is clearly for purposes other than compensation for goods or services received by the entity; therefore, differences from IFRS Accounting Standards may arise in practice. The substance of such a transaction is that the economic interest holder makes a capital contribution to the reporting entity, and that entity makes a share-based payment to its employee in exchange for services rendered. [718-10-15]

Like IFRS Accounting Standards, equity-classified share-based payment transactions made directly by shareholders on behalf of the entity are in the scope of the share-based payment Codification Topic from the perspective of the receiving entity. [718-10-15]

Classification of group share-based payment arrangements

Unlike IFRS Accounting Standards, in general both the receiving entity and the settling entity classify the group share-based payment award as equity-classified or liability-classified in the same manner as the award is classified in the group's consolidated financial statements. Accordingly, differences from IFRS Accounting Standards will arise in practice.

Unlike IFRS Accounting Standards, in a typical group share-based payment arrangement involving the parent and a subsidiary, the classification assessment is made only from the perspective of the consolidated financial statements of the parent.

Accounting for a group share-based payment arrangement

Unlike IFRS Accounting Standards, a receiving entity that has no obligation to settle the transaction with the counterparty to the share-based payment transaction generally accounts for the transaction in the same manner as the transaction is accounted for in the parent's consolidated financial statements and, like IFRS Accounting Standards, recognises an expense (unless the goods or services received qualify for recognition as an asset). The credit would be recognised as an increase in equity for the contribution received from the parent for equity-classified awards (like IFRS Accounting Standards) or as either a credit to equity or a liability for liability-classified awards (unlike IFRS Accounting Standards).

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In our view, a settling entity with no direct or indirect investment in the entity receiving the services in a group share-based payment arrangement should recognise the cost of the share-based payment in equity as a distribution to its parent over the vesting period.

Employee benefit trusts

A plan sponsor may transfer or sell sufficient shares to enable a trust to meet obligations under share-based payment arrangements not only for current periods but also for future periods. In our view, the transfer of shares to an employee benefit trust does not represent a share-based payment transaction. Rather, the share-based payment arrangement is the arrangement between the employer and employees for which a grant date needs to be identified, generally based on the date on which the sponsor enters into an agreement with the employees.

Repurchase by the parent

A parent may be required to repurchase shares of a subsidiary that were acquired by employees of the subsidiary through a share-based payment arrangement. If the subsidiary only has an obligation to deliver its own equity instruments, then we believe that the arrangement should be classified as equity-settled in the subsidiary's financial statements. However, the arrangement should be classified as cash-settled in the consolidated financial statements of the parent because the parent has an obligation to settle in cash based on the subsidiary's shares.

Presentation in equity

If equity instruments of a subsidiary have been granted to a counterparty (who is not part of the consolidated reporting entity) in a share-based payment transaction, then the credit entry in equity in the consolidated financial statements of the parent is allocated to NCI. [IFRS 10.A]

Like IFRS Accounting Standards, a settling entity with no direct or indirect investment in the entity receiving the services in a group share-based payment arrangement should recognise the cost of the share-based payment in equity as a distribution to its parent. There is no guidance whether the amount should be recorded as a distribution when granted, over the vesting period or upon vesting, so practice may differ from IFRS Accounting Standards.

Employee benefit trusts

Like IFRS Accounting Standards, the transfer of shares to an employee benefit trust does not represent a share-based payment transaction. The accounting for some employee benefit trusts is addressed in the compensation Codification Topic applicable to ESOPs, in some cases the employee benefit trust may need to be consolidated under the consolidation Codification Topic, so differences from IFRS Accounting Standards may arise in practice. [710-10-05-8, 718-10-15-7]

Repurchase by the parent

A parent may be required to repurchase shares of a subsidiary that were acquired by employees of the subsidiary through a share-based payment arrangement. Unlike IFRS Accounting Standards, if the award is liability-classified in the consolidated financial statements of the parent, then the subsidiary likewise would account for the cost using the remeasurement requirements for liability-classified awards, although the credit may be recognised in equity. Like IFRS Accounting Standards, the arrangement would be liability-classified in the consolidated financial statements of the parent if it meets these requirements; however, as discussed above, obligations to repurchase shares issued pursuant to a share-based payment arrangement do not necessarily result in the award being liability-classified, so differences from IFRS Accounting Standards can arise in practice.

Presentation in equity

Practice varies for the timing of recognising equity instruments of a subsidiary that have been granted to a counterparty in a share-based payment arrangement. Some companies allocate the credit entry in equity in the consolidated financial statements of the parent to NCI as the compensation cost is recorded, like IFRS Accounting Standards, while some companies record the credit to equity (additional paid in capital) until the award is vested for a share or exercised for a share option, unlike IFRS Accounting Standards. [810-10-45-17A]

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Share-based payments with non-employees

Similar recognition requirements are applied to share-based payment transactions with employees and non-employees, although different measurement requirements apply. [IFRS 2.13]

For equity-settled share-based payment transactions with non-employees, there is a rebuttable presumption that the fair value of the goods or services obtained can be measured reliably. If the presumption is rebutted (in rare cases), then the entity measures the fair value of the goods or services obtained with reference to the fair value of the equity instruments granted (i.e. like an employee grant). [IFRS 2.13]

The fair value of the goods or services received is measured at the date on which the entity obtains the goods or the counterparty renders service. Therefore, a single agreement with a non-employee can have multiple measurement dates, one for each delivery of goods or services. [IFRS 2.13]

For cash-settled share-based payment transactions with non-employees, the liability is measured at its fair value. The liability is remeasured at each reporting date and ultimately at settlement date in the same way as cash-settled transactions with employees. [IFRS 2.30]

The treatment of vesting and non-vesting conditions for non-employee transactions that are measured with reference to the fair value of the equity instruments granted is similar to transactions with employees (see above). [IFRS 2.19–21A, BC120]

Share-based payments with non-employees

Like IFRS Accounting Standards, similar recognition requirements are applied to share-based payment transactions with employees and non-employees, although there are different measurement requirements, like IFRS Accounting Standards, and different attribution, unlike IFRS Accounting Standards. Under US GAAP, expense for awards to non-employees, including those providing services similar to employees, is recognised in the same manner as if the entity issuing equity had paid cash for the goods or services. [718-10-25-2, 35-1D]

Unlike IFRS Accounting Standards, equity-classified share-based payment transactions with non-employees are measured based on the grant-date fair value of the equity instruments issued. Also, unlike IFRS Accounting Standards, US GAAP allows non-public entities to measure share-based awards under the calculated-value method, if certain restrictive conditions are met. In addition, unlike IFRS Accounting Standards, US GAAP also permits non-public entities to use either the contractual term or a midpoint expected term practical expedient when valuing non-employee share option awards, if certain restrictive conditions are met. [718-10-30-2 – 30-3, 30-20A]

Under US GAAP, equity-classified share-based payment transactions with non-employees are measured on the grant date, which may result in measurement date differences from IFRS Accounting Standards, depending on the terms of the agreement. [718-10-30-2 – 30-3]

Like IFRS Accounting Standards, liability-classified share-based payment transactions for the goods or services received from non-employees are measured at the fair value of the liability; however, unlike IFRS Accounting Standards, non-public entities are permitted to elect to measure liability-classified awards using intrinsic value rather than fair value. Like IFRS Accounting Standards, the liability is remeasured at each reporting date and at the date of settlement in the same way as liability-classified transactions with employees. However, as described above, there are differences in determining liability classification between IFRS Accounting Standards and US GAAP. [718-10-35]

Like IFRS Accounting Standards, the accounting for non-employee awards with service and performance conditions is similar to transactions with employee awards; however, there are differences between what is considered a vesting or non-vesting condition under US GAAP and IFRS Accounting Standards and differences from IFRS Accounting Standards may arise (see above). [718-10-30-12]

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Share-based payment consideration payable to a customer

There are no specific requirements for share-based payment consideration payable to a customer, and the general requirements of the share-based payment standard (see above) and the revenue standard (see chapter 4.2) apply.

Forthcoming requirements

There are no forthcoming requirements under IFRS Accounting Standards.

There is no specific guidance in IFRS Accounting Standards on equity-based instruments granted to customers in conjunction with selling goods or services.

Share-based payment consideration payable to a customer

When accounting for share-based payment consideration payable to a customer, an entity:

- applies the share-based payment Codification Topic for the measurement and equity vs liability classification of the awards granted;
- measures the awards at their grant-date fair value and records the awards as a reduction in revenue or as an expense based on the revenue Codification Topic (see chapter 4.2); and
- estimates and adjusts the fair value of the awards each reporting date until a grant date is established, if an entity is required to estimate the transaction price in the revenue Codification Topic (see chapter 4.2) before a grant date is established.

See forthcoming requirements. [606-10-32-25A, 606-10-55-88A – 55-88B]

Forthcoming requirements

Amendments to the revenue and share-based payment Codification Topics are effective for annual periods beginning after 15 December 2026; early adoption is permitted (see appendix).

The amendments:

- revise the definition of performance conditions in the share-based payment Codification Topic to explicitly include conditions based on a volume or monetary amount of purchases;
- eliminate the policy election in the share-based payment Codification Topic to recognise forfeitures as incurred (instead of estimating forfeitures) for share-based consideration granted to customers;
- clarify that the variable consideration constraint in the revenue Codification Topic should not be applied to share-based consideration payable to a customer; and
- clarify that the revenue Codification Topic applies initially to share-based non-cash consideration received from a customer for the transfer of goods or services. The guidance in other Codification topics, including derivatives and equity securities, is not applied unless and until the entity's right to receive or retain the share-based non-cash consideration is unconditional under the revenue Codification Topic.

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4.6 Borrowing costs

(IAS 23)

Overview

- **Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset generally form part of the cost of that asset. Other borrowing costs are recognised as an expense.**
- **A 'qualifying asset' is one that necessarily takes a substantial period of time to be made ready for its intended use or sale. Financial assets, inventories that are manufactured or otherwise produced over a short period of time and contract assets that represent a conditional right to a financial asset, as well as investments (including in our view investments in subsidiaries and equity-accounted investees), are not qualifying assets. Property, plant and equipment, internally developed intangible assets and investment property can be qualifying assets.**
- **Borrowing costs may include interest calculated using the effective interest method, certain other interest charges and certain foreign exchange differences.**

Scope

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense in the period in which they are incurred.

[IAS 23.1, 8–9]

4.6 Capitalised interest

(Topic 835)

Overview

- **Like IFRS Accounting Standards, interest costs that are directly attributable to the acquisition, construction or production of a qualifying asset generally form part of the cost of that asset. However, the amount of interest cost capitalised may differ from IFRS Accounting Standards. Like IFRS Accounting Standards, other interest costs are recognised as an expense.**
- **Like IFRS Accounting Standards, financial assets, inventories that are manufactured or otherwise produced over a short period of time and contract assets that represent a conditional right to a financial asset are not qualifying assets. Like IFRS Accounting Standards, property, plant and equipment (including what would be investment property under IFRS Accounting Standards) can be a 'qualifying asset'. Unlike IFRS Accounting Standards, an equity-method investment might be a qualifying asset. However, like IFRS Accounting Standards, other investments cannot be qualifying assets. Unlike IFRS Accounting Standards, internally developed intangible assets generally do not qualify for capitalisation and therefore generally will not be qualifying assets.**
- **Like IFRS Accounting Standards, interest costs may include interest calculated using the effective interest method and certain other interest charges; but not foreign exchange differences, unlike IFRS Accounting Standards.**

Scope

Like IFRS Accounting Standards, interest costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Like IFRS Accounting Standards, other borrowing costs are recognised as an expense in the period in which they are incurred. [360-10-30-1, 835-20-15-5 – 15-6]

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Qualifying assets

A 'qualifying asset' is one that necessarily takes a substantial period of time to be made ready for its intended use or sale. Qualifying assets are generally those that are the subject of major development or construction projects. [IAS 23.5]

Financial assets and contract assets that represent a conditional right to a financial asset (e.g. a receivable; see chapter 4.2) are not qualifying assets. Investments, including in our view investments in subsidiaries and equity-accounted investees, are also not qualifying assets. [IAS 23.5, 7, IFRS 15.105–108, IU 03-19, IFRIC 12.19, 22, IE15, IE31]

Internally developed intangible assets (see chapter 3.3) may be qualifying assets. [IAS 23.7, 38.66]

The requirement to capitalise directly attributable borrowing costs is not required to be applied to:

- inventories that are manufactured or produced in large quantities on a repetitive basis or over a short period of time; however, other inventories that take a long time to produce may be qualifying assets (e.g. ships or real estate constructed for a customer and transferred at a point in time – see chapter 4.2); or
- qualifying assets measured at fair value (e.g. an investment property measured using the fair value model). [IAS 23.4, 7]

Borrowing costs eligible for capitalisation

Borrowing costs eligible for capitalisation may include:

- interest expense calculated using the effective interest method;
- interest in respect of lease liabilities; and
- exchange differences to the extent that they are regarded as an adjustment to interest costs. [IAS 23.6]

Qualifying assets

Unlike IFRS Accounting Standards, under US GAAP, 'qualifying assets' include assets that are constructed or otherwise produced for an entity's own use, including assets constructed or produced for the entity by others for which deposits or progress payments have been made, and assets intended for sale or lease that are constructed or otherwise produced as discrete projects (e.g. ships or real estate developments). [835-20-15-5 – 15-6]

Like IFRS Accounting Standards, financial assets (e.g. a receivable; see chapter 4.2) and contract assets that represent a conditional right to a financial asset are not qualifying assets. Unlike IFRS Accounting Standards, qualifying assets include equity-method investments when the investee has activities in progress necessary to start its planned principal operations, provided that the investee's activities include the use of the funds to acquire qualifying assets for its operations. However, other investments cannot be qualifying assets, like IFRS Accounting Standards. There is no concept of investment property under US GAAP (see chapter 3.4). However, assets that would be investment property under IFRS Accounting Standards may be qualifying assets under US GAAP. [835-20-15-5 – 15-6]

Unlike IFRS Accounting Standards, internally developed intangible assets do not generally qualify for capitalisation (see chapter 3.3). However, certain capitalised software developed for internal use may be a qualifying asset. [350-40-30-1]

The requirements for interest costs are not applied to inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis, like IFRS Accounting Standards; however, other inventories can be qualifying assets, like IFRS Accounting Standards (e.g. ships or real estate developments). Unlike IFRS Accounting Standards, the capitalisation of interest cost on assets measured at FVTPL is not addressed, but we would generally not expect differences in practice. [835-20-15-5 – 15-6]

Interest costs eligible for capitalisation

Like IFRS Accounting Standards, interest costs calculated using the effective interest method are eligible for capitalisation. Unlike IFRS Accounting Standards, under US GAAP interest cost is capitalisable in respect of lease liabilities only for finance leases (see chapter 5.1). Unlike IFRS Accounting Standards, foreign exchange differences are not eligible for capitalisation. [835-20-20, 835-20-15-2, 835-30-35-2, 35-5]

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Although the unwinding of a discount on decommissioning or restoration provisions is presented as a component of interest expense (see chapter 3.12), in our view it is not a qualifying borrowing cost that is eligible for capitalisation because these provisions do not represent a borrowing of funds. Instead, it is presented as a finance expense. [IAS 37.60, IFRIC 1.8, BC26–BC27]

If an entity accrues interest on a contract liability that represents advance consideration received under a contract with a customer (see chapter 4.2), then in our view this interest meets the definition of a borrowing cost because it represents the cost to the entity of borrowing funds from its customer. The interest should be capitalised to the extent that the other recognition criteria are met. [IFRS 15.60, BC229–BC230]

The borrowing costs that are capitalised are those that would otherwise have been avoided if the expenditure on the qualifying asset had not been made. This includes interest on borrowings taken specifically for the purpose of obtaining the qualifying asset (specific borrowings) and costs of other borrowings that could have been repaid if expenditure on the asset had not been incurred (general borrowings). [IAS 23.10–11]

In our view, the amount of borrowing costs to be capitalised should be calculated on a pre-tax basis.

Borrowing costs may include foreign exchange differences to the extent that these differences are regarded as an adjustment to interest costs. There is no further guidance on the conditions under which foreign exchange differences may be capitalised and judgement is required to apply the requirements to the particular circumstances of the entity. [IAS 23.6, 11, IU 01-08]

Calculating the amount of borrowing costs to capitalise

Specific borrowings

When an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the amount of specific borrowing costs capitalised is the actual borrowing costs incurred on that borrowing less investment income on any temporary investment of funds pending expenditure on the asset. [IAS 23.12]

Like IFRS Accounting Standards, the unwinding of a discount on decommissioning or restoration provisions (asset retirement obligations) is not a qualifying interest cost that is eligible for capitalisation. However, unlike IFRS Accounting Standards, it is presented as a component of operating expense (see chapter 3.12). [410-20-45-1, 835-20-15-7]

Unlike IFRS Accounting Standards, an entity is not permitted to capitalise interest cost on a contract liability that represents advance consideration received under a contract with a customer (see chapter 4.2). [835-30-15-3]

Like IFRS Accounting Standards, the interest costs that are capitalised are those that would otherwise have been avoided if the expenditure on the qualifying asset had not been made. Like IFRS Accounting Standards, the interest costs that are capitalised include interest on borrowings made specifically for the purpose of obtaining the qualifying asset (specific borrowings) and costs of other borrowings that could have been repaid if expenditure on the asset had not been incurred (general borrowings). [835-20-30-2 – 30-7]

Like IFRS Accounting Standards, the amount of interest costs to be capitalised is calculated on a pre-tax basis. [835-20-30-2 – 30-7]

Unlike IFRS Accounting Standards, foreign exchange differences on the debt principal are not eligible for capitalisation even if they are regarded as an adjustment to interest costs. [835-20-20, 835-20-15-2]

Calculating the amount of interest costs to capitalise

Specific borrowings

Unlike IFRS Accounting Standards, when an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the amount capitalised may be determined by applying the specific rate on that borrowing to the average accumulated expenditure for the asset (not exceeding the amount of that borrowing); interest earned is generally not offset against interest cost in determining either the capitalisation rate or the limitation on the amount of interest cost to be capitalised. As an exception, offsetting is required in certain circumstances involving tax-exempt borrowings that are restricted externally, like IFRS Accounting Standards. [835-20-30-3, 30-10]

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General borrowings

To the extent that the interest costs to be capitalised relate to financing that is part of the entity's general borrowings, the weighted-average interest cost applicable to all borrowings outstanding during the period (excluding the interest on any borrowings specific to any qualifying assets that are not yet ready for their intended use or sale) is applied to the expenditure on the asset to determine the amount of borrowing costs eligible for capitalisation. Therefore, the general borrowings pool includes specific borrowings that remain outstanding after the related qualifying asset is ready for its intended use or sale, and funds borrowed specifically to obtain an asset other than a qualifying asset. [IAS 23.14, BC14A–BC14E]

The amount of interest capitalised may not exceed the actual interest incurred by the entity. [IAS 23.14]

Period of capitalisation

Capitalisation begins when the entity first meets all of the following conditions:

- expenditure for the asset is incurred;
- borrowing costs are incurred; and
- activities that are necessary to prepare the asset for its intended use or sale are in progress. [IAS 23.17]

When an entity incurs expenditure on a qualifying asset before obtaining general borrowings to fund that expenditure, it is required to capitalise the related borrowing costs, but it begins doing so only once it incurs borrowing costs and the other conditions mentioned above are met. [IU 09-18]

Capitalisation of interest is suspended during extended periods in which active development is interrupted. There is no guidance on what length of time is considered an 'extended' period. Capitalisation may continue during a temporary interruption or during a period when substantial administrative or technical work is being carried out. [IAS 23.20–21]

Capitalisation ceases when substantially all of the activities necessary to prepare the asset for its intended use or sale are complete. [IAS 23.22]

General borrowings

Like IFRS Accounting Standards, the amount capitalised is determined by multiplying the capitalisation rate by the accumulated expenditure on the asset during the period. However, unlike IFRS Accounting Standards, there is specific additional guidance on the calculation of a capitalisation rate, which may result in differences in practice. Like IFRS Accounting Standards, the capitalisation rate is based on the rates applicable to borrowings outstanding during the period. [835-20-30-3]

Like IFRS Accounting Standards, the amount of interest capitalised may not exceed the actual interest incurred by the entity. [835-20-30-6]

Period of capitalisation

Like IFRS Accounting Standards, capitalisation begins when the entity first meets all of the following conditions:

- expenditure for the asset is being incurred;
- interest costs are being incurred; and
- activities that are necessary to prepare the asset for its intended use or sale are in progress. [835-20-25-2 – 25-3]

Unlike IFRS Accounting Standards, there is no specific guidance on capitalising borrowing costs in respect of expenditure on a qualifying asset incurred before obtaining the general borrowings to fund that expenditure.

Like IFRS Accounting Standards, if the entity suspends substantially all activities related to the acquisition of the asset, then capitalisation ceases until activities are resumed. However, brief interruptions in activities, interruptions that are externally imposed and delays that are inherent in the asset acquisition process do not require cessation of interest capitalisation. Although the precise language under US GAAP differs from IFRS Accounting Standards, we would generally not expect differences in practice. [835-20-25-4]

Like IFRS Accounting Standards, capitalisation ceases when the asset is substantially complete and ready for its intended use. [835-20-25-5]

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5 Special topics

5.1 Leases

(IFRS 16)

Overview

- The leases standard applies to leases of property, plant and equipment and other assets, with limited exclusions.
- A contract is or contains a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.
- Lessees apply a single on-balance sheet lease accounting model, except for leases to which they elect to apply the recognition exemptions for short-term leases or leases of low-value assets.
- A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make future lease payments.

5.1 Leases

(Topic 842)

Overview

- The leases Codification Topic applies to leases of property, plant and equipment. Unlike IFRS Accounting Standards, the scope excludes leases of inventory, leases of assets under construction and all leases of intangible assets.
- Like IFRS Accounting Standards, a contract is or contains a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.
- Unlike IFRS Accounting Standards, there is a dual classification on-balance sheet lease accounting model for lessees: finance leases and operating leases. Classification is determined by pass/fail tests intended to determine whether the lessee obtains control of the use of the underlying asset as a result of the lease. Classification is made at commencement of the lease and is reassessed only if there is a lease modification and that modification is not accounted for as a separate lease. Like IFRS Accounting Standards, the on-balance sheet accounting does not apply to short-term leases for which the lessee elects the recognition exemption; however, the definition of 'short-term' differs in some respects from IFRS Accounting Standards. Unlike IFRS Accounting Standards, there is no exemption for leases of low-value assets.
- Like IFRS Accounting Standards, a lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make future lease payments.

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Overview (continued)

- After initial recognition, a lessee measures the lease liability at amortised cost under the effective interest method. The lease liability is also remeasured to reflect lease modifications and changes in the lease payments, including changes caused by a change in an index or rate.
- A lessee measures the right-of-use asset at cost less accumulated depreciation and accumulated impairment losses, except when it applies the alternative measurement models for revalued assets and investment property.
- Lessors classify leases as either finance or operating leases.
- Lease classification by lessors is made at inception of the lease and is reassessed only if there is a lease modification and that modification is not accounted for as a separate lease. The classification depends on whether substantially all of the risks and rewards incidental to ownership of the underlying asset have been transferred, based on the substance of the arrangement.

Overview (continued)

- Like IFRS Accounting Standards, after initial recognition, a lessee measures the lease liability at amortised cost under the effective interest method. The lease liability is also remeasured to reflect lease modifications and changes in the lease payments, like IFRS Accounting Standards; however, unlike IFRS Accounting Standards, this does not include changes caused by a change in an index or rate unless the lease liability is remeasured for another reason.
- For a finance lease, a lessee measures the right-of-use asset at cost less accumulated amortisation and accumulated impairment losses, like IFRS Accounting Standards. For an operating lease, unless the right-of-use asset has been impaired or will be abandoned, a lessee amortises the right-of-use asset as a balancing amount that together with accretion on the lease liability generally produces straight-line total lease expense, unlike IFRS Accounting Standards. Unlike IFRS Accounting Standards, a lessee cannot revalue right-of-use assets, and there is no alternative measurement model for leases of investment property.
- Like IFRS Accounting Standards, lessors classify leases as either finance or operating leases. However, unlike IFRS Accounting Standards, finance leases are further classified as sales-type leases or direct financing leases.
- Lease classification by lessors is made at commencement of the lease, unlike IFRS Accounting Standards. In addition, unlike IFRS Accounting Standards, the classification is determined by a series of pass/fail tests intended to determine whether the lessee obtains control of the use of the underlying asset as a result of the lease. Like IFRS Accounting Standards, classification is reassessed only if there is a lease modification and that modification is not accounted for as a separate lease.

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Overview (continued)

- Under a finance lease, a lessor derecognises the underlying asset and recognises a net investment in the lease. A manufacturer or dealer lessor recognises the selling margin in a finance lease by applying its normal accounting policy for outright sales.
- Under an operating lease, the lessor recognises the lease payments as income over the lease term, generally on a straight-line basis. The lessor recognises the underlying asset in its statement of financial position.
- There is specific guidance on accounting for lease modifications by lessees and lessors. In addition, there is a practical expedient for lessees for COVID-19-related rent concessions.
- In a sale-and-leaseback transaction, the seller-lessee first determines if the buyer-lessor obtains control of the asset based on the revenue standard (see chapter 4.2). If not, then the transaction is accounted for as a financing arrangement.
- In a sub-lease transaction, the intermediate lessor accounts for the head lease and the sub-lease as two separate contracts. An intermediate lessor classifies a sub-lease by reference to the right-of-use asset arising from the head lease.

Overview (continued)

- Like IFRS Accounting Standards, under a sales-type or direct financing lease, a lessor derecognises the underlying asset and recognises a net investment in the lease. Like IFRS Accounting Standards, a lessor recognises the selling margin in a sales-type lease by applying its normal accounting policy for outright sales. Unlike IFRS Accounting Standards, any selling margin in a direct financing lease is recognised over the lease term. In addition, unlike IFRS Accounting Standards, there is specific guidance on collectability that may affect timing of recognition of income for a sales-type lease and require classification of a lease as operating that would otherwise be classified as direct financing.
- Like IFRS Accounting Standards, under an operating lease, the lessor recognises the lease payments as income over the lease term, generally on a straight-line basis. Like IFRS Accounting Standards, the lessor recognises the underlying asset in its statement of financial position. Unlike IFRS Accounting Standards, there is specific guidance on collectability that may result in operating lease income being recognised on a cash basis (i.e. rather than on a straight-line basis).
- There is specific guidance on accounting for lease modifications by lessees and lessors, which differs in some respects from IFRS Accounting Standards. In addition, there is a practical expedient for COVID-19-related rent concessions, which differs in some respects from IFRS Accounting Standards, including that it also applies to lessors.
- Like IFRS Accounting Standards, in a sale-leaseback transaction the seller-lessee first determines if the buyer-lessor obtains control of the asset based on the revenue Codification Topic (see chapter 4.2). However, unlike IFRS Accounting Standards, additional considerations apply if there is a seller-lessee repurchase option or if the leaseback would be classified as a finance lease by the seller-lessee (sales-type lease by the buyer-lessor). Like IFRS Accounting Standards, if the transaction does not qualify for sale accounting, then it is accounted for as a financing arrangement.
- Like IFRS Accounting Standards, in a sub-lease transaction, the intermediate lessor accounts for the head lease and the sub-lease as two separate contracts. Unlike IFRS Accounting Standards, an intermediate lessor classifies a sub-lease by reference to the underlying asset.

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Scope

The leases standard deals with all leases, including leases of right-of-use assets in a sub-lease, except for:

- leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (see chapter 5.11);
- leases of biological assets held by a lessee (see chapter 3.9);
- service concession arrangements (see chapter 5.12);
- licences of intellectual property granted by a lessor in the scope of the revenue standard (see chapter 4.2); and
- rights held by a lessee under licensing agreements in the scope of the standard on intangible assets for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights. [IFRS 16.3]

A lessee may, but is not required to, apply the leases standard to leases of intangible assets other than the rights described in the final bullet point above. [IFRS 16.4]

Identification of a lease

A lease is a contract, or part of a contract, that conveys the right to control the use of an identified asset for a period of time in exchange for consideration. An assessment of whether a contract is, or contains, a lease is made at inception of the contract and if its terms and conditions subsequently change. [IFRS 16.9, 11, A]

A contract relates to an identified asset if:

- the asset is specified, either explicitly or implicitly;
- the asset is physically distinct or the customer has the right to receive substantially all of the capacity of the asset; and
- the supplier has no substantive substitution right throughout the period of use. [IFRS 16.B9, B13, B20]

A contract conveys the right to control the use of an identified asset if the customer has the following rights throughout the period of use:

- to obtain substantially all of the economic benefits from using the identified asset; and
- to direct the use of the identified asset. [IFRS 16.B9]

Scope

The leases Codification Topic deals with all leases, including leases of right-of-use assets in a sub-lease, except for:

- leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (see chapter 5.11), like IFRS Accounting Standards;
- leases of biological assets held by a lessee (see chapter 3.9), like IFRS Accounting Standards; including leases of timber, unlike IFRS Accounting Standards;
- service concession arrangements (see chapter 5.12), like IFRS Accounting Standards;
- leases of inventory (see chapter 3.8), unlike IFRS Accounting Standards; and
- leases of assets under construction when the lessee does not control the asset before the lease commencement date, unlike IFRS Accounting Standards. [842-10-15-1, 853-10-25-2]

Unlike IFRS Accounting Standards, all leases of intangible assets are excluded from the scope of the leases Codification Topic. [842-10-15-1]

Identification of a lease

Like IFRS Accounting Standards, a lease is a contract, or part of a contract, that conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Like IFRS Accounting Standards, an assessment of whether a contract is, or contains, a lease is made at inception of the contract and if its terms and conditions subsequently change. [842-10-15-2 – 15-3, 15-6]

Like IFRS Accounting Standards, a contract relates to an identified asset if:

- the asset is specified, either explicitly or implicitly;
- the asset is physically distinct or the customer has the right to receive substantially all of the capacity of the asset; and
- the supplier has no substantive substitution right throughout the period of use. [842-10-15-4, 15-9, 15-16]

Like IFRS Accounting Standards, a contract conveys the right to control the use of an identified asset if the customer has the following rights throughout the period of use:

- to obtain substantially all of the economic benefits from using the identified asset; and
- to direct the use of the identified asset. [842-10-15-4]

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A customer has the right to direct the use of an identified asset only when:

- the customer has the right to direct how and for what purpose the asset is used throughout the period of use; or
- all relevant decisions about how and for what purpose the asset is used are predetermined and:
  - the customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those operating instructions; or
  - the customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use. [IFRS 16.B24–B30, IU 01-20]

An arrangement providing an operator with a right to place a pipeline (or similar – e.g. a telecommunications cable) in a specified underground space for a specific term in exchange for consideration contains a lease if:

- the underground space is physically distinct from the remainder of the land and the land owner does not have substantive substitution rights;
- the operator has exclusive use of the specified underground space; and
- the relevant decisions about how and for what purpose the asset is used are predetermined in the contract and the operator has the right to operate the asset by performing inspection, repairs and maintenance work. [IU 06-19]

Lease and non-lease components

If a contract is or contains a lease, then the lessee and lessor account for each lease component separately from non-lease components. [IFRS 16.12, B32–B33]

Subject to the practical expedient below, a lessee allocates the consideration in the contract to lease and non-lease components based on relative stand-alone prices.

If an observable stand-alone price is not readily available, then the lessee makes an estimate, maximising the use of observable information. [IFRS 16.13–14]

Although IFRS Accounting Standards do not provide specific guidance for lessees on suitable methods for estimating the stand-alone selling price, in our view a lessee can use the residual approach to estimate a stand-alone price if the price is highly variable or uncertain and other conditions are met. [IFRS 16.14, 15.79]

Like IFRS Accounting Standards, a customer has the right to direct the use of an identified asset only when:

- the customer has the right to direct how and for what purpose the asset is used throughout the period of use; or
- all relevant decisions about how and for what purpose the asset is used are predetermined and:
  - the customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those operating instructions; or
  - the customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use. [842-10-15-20–15-25]

When an arrangement provides an operator with a right to place a pipeline (or similar – e.g. a telecommunications cable) in a specified underground space for a specific term in exchange for consideration, the following analyses are acceptable under US GAAP:

- the arrangement is in the scope of the leases Codification Topic following the same analysis as IFRS Accounting Standards; or
- the land-use rights are analogous to air-use rights (a contract-based intangible asset) and therefore are outside the scope of the leases Codification Topic.

Lease and non-lease components

Like IFRS Accounting Standards, if a contract is or contains a lease, then both the lessee and lessor account for each lease component separately from non-lease components. [842-10-15-28, 15-30]

Subject to the practical expedient below, a lessee allocates the consideration in the contract to lease and non-lease components based on relative stand-alone prices, like IFRS Accounting Standards.

Like IFRS Accounting Standards, if an observable stand-alone price is not readily available, then the lessee makes an estimate, maximising the use of observable information. [842-10-15-33]

Unlike IFRS Accounting Standards, US GAAP explicitly allows a residual estimation approach if the stand-alone price for a component is highly variable or uncertain. [842-10-15-33]

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A lessee may elect, by class of underlying asset, not to separate lease components from any associated non-lease components and instead account for them as a single lease component. [IFRS 16.15]

A lessor always separates lease and non-lease components and allocates the consideration in the contract under the requirements of the revenue standard – i.e. according to the stand-alone selling prices of the goods and services included in each component (see chapter 4.2).

A lessor allocates variable consideration under the requirements of the revenue standard – i.e. entirely to one or more, but not all, performance obligations in the contract if specific criteria are met. In the absence of specific guidance in the leases standard, in our view it is acceptable for a lessee to apply guidance similar to that applied by lessors from the revenue standard when allocating variable payments in a lease contract that contains multiple lease and/or non-lease components. [IFRS 15.85, 16.17, IE.Ex12]

Definitions

Lease term

The 'lease term' is the non-cancellable period of the lease, together with:

- optional renewal periods if the lessee is reasonably certain to extend; and
- periods after an optional termination date if the lessee is reasonably certain not to terminate at that date. [IFRS 16.18]

Like IFRS Accounting Standards, a lessee may elect, by class of underlying asset, not to separate lease components from any associated non-lease components and instead account for them as a single lease component. [842-10-15-37]

Unless the practical expedient discussed below is elected, a lessor separates lease and non-lease components and allocates the consideration in the contract under the requirements of the revenue Codification Topic, like IFRS Accounting Standards – i.e. according to the stand-alone selling prices of the goods and services included in each component (see chapter 4.2). [842-10-15-38]

Unlike IFRS Accounting Standards, a lessor may elect, by class of underlying asset, not to separate lease components from any associated non-lease components and instead account for them as a single component if:

- the non-lease component(s) would otherwise be accounted for under the revenue Codification Topic;
- the timing and pattern of transfer for the lease component and non-lease component(s) are the same; and
- the lease component, if it were accounted for separately, would be classified as an operating lease.

The single, combined component is accounted for as a performance obligation under the revenue Codification Topic if the non-lease component(s) is(are) 'predominant'; otherwise, as a single lease component. [842-10-15-42A – C]

Like IFRS Accounting Standards, a lessor allocates variable consideration under the requirements of the revenue Codification Topic – i.e. entirely to one or more, but not all, performance obligations in the contract if specific criteria are met. Unlike IFRS Accounting Standards, a lessee always allocates variable payments arising from a lease contract on a relative stand-alone price basis. [842-10-15-33, 15-38]

Definitions

Lease term

Like IFRS Accounting Standards, the lease term is the non-cancellable period of the lease, together with:

- optional renewal periods if the lessee is reasonably certain to extend; and
- periods after an optional termination date if the lessee is reasonably certain not to terminate at that date. [842-10-30-1, 55-24]

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When determining the lease term, an entity considers all relevant facts and circumstances that create an economic incentive making it reasonably certain that the lessee will exercise an option to renew or forfeit an option to terminate early. This includes non-removable leasehold improvements (made or planned to be made) over the term of the contract that are expected to have a significant economic benefit when the option to renew (or terminate) becomes exercisable. For a discussion of the useful life of non-removable significant leasehold improvements, see chapter 3.2. [IFRS 16.B37, IU 11-19]

The lease term includes periods during which the lessor has the unilateral right to terminate the lease, because the lessor can enforce its rights under the agreement during that period. [IFRS 16.B35]

A lease is no longer 'enforceable' (i.e. the lease term ends) when both the lessee and lessor have the right to terminate it without agreement from the other party with no more than an insignificant penalty. In performing this assessment, the broader economics of the contract are considered, not only contractual termination payments. [IFRS 16.B34, IU 11-19]

Lease payments

Both the lessee and the lessor include the following in the lease payments:

- fixed payments (including in-substance fixed payments) less any lease incentives;
- variable lease payments that depend on an index or a rate;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease, if the lease term reflects the assessment that the lessee will exercise an option to terminate the lease. [IFRS 16.A, 27, 70]

Variable payments that depend on performance or use of the underlying asset are not included in the lease payments. Such variable payments are excluded from the initial measurement of the lease liability and right-of-use asset. [IFRS 16.A, 24, 27, 38(b), BC169]

If a lessee provides a residual value guarantee, then it includes in the lease payments the amount that it expects to pay under that guarantee. [IFRS 16.A, 27]

When determining the lease term, an entity considers all relevant economic factors that affect whether the lessee is reasonably certain to exercise a renewal option (or not exercise a termination option), like IFRS Accounting Standards. Like IFRS Accounting Standards, a relevant economic factor is the economic life of significant leasehold improvements. [842-10-55-26]

Like IFRS Accounting Standards, the lease term includes periods during which the lessor has the unilateral right to terminate the lease, because the lessor can enforce its rights under the agreement during that period. [842-10-30-1, 55-24]

Like IFRS Accounting Standards, a lease is no longer 'enforceable' (i.e. the lease term ends) when both the lessee and lessor have the right to terminate it without agreement from the other party with no more than an insignificant penalty. Like IFRS Accounting Standards, when performing this assessment, the broad definition of a penalty, which takes into account the broader economics of the contract, is considered. [842-10-55-23, 842 Glossary]

Lease payments

Like IFRS Accounting Standards, both the lessee and the lessor include the following in the lease payments:

- fixed payments (including in-substance fixed payments) less any lease incentives paid or payable to the lessee;
- variable lease payments that depend on an index or a rate;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease, if the lease term reflects the assessment that the lessee will exercise an option to terminate the lease. [842-10-30-5]

Like IFRS Accounting Standards, variable payments that depend on performance or use of the underlying asset are not included in the lease payments. Such variable payments are excluded from the initial measurement of the lease liability and right-of-use asset. [842-10-30-5, 30-6(a), 842-20-25-5(b), 30-5, ASU 2016-12.BC209]

If a lessee provides a residual value guarantee, then it includes in the lease payments the amount probable of being owed under that guarantee, like IFRS Accounting Standards. [842-10-30-5]

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A lessee determines whether it is reasonably certain that it will exercise a purchase option under an approach similar to the one that it uses to assess whether it expects to exercise a renewal option (see above). [IFRS 16.27(d), B37]

For the lessor, lease payments also include any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee. [IFRS 16.A, 70]

Real estate is often subject to property taxes. In our view, the accounting for property tax is driven by the identity of the statutory obligor.

- If the *lessor* has the statutory obligation to pay the tax, then the lessor will account for it as a levy under the interpretation on levies (see chapter 3.12). If the lessee is required to reimburse or pay the lessor's statutory tax obligation, then we believe that the lessor and the lessee should both account for the reimbursement (or payment to the tax authority) as part of the contract consideration. The reimbursement (or payment) by the lessee is:
  - a fixed payment if the amount is fixed at or before lease commencement; or
  - a variable payment if the amount is determined when tax is incurred by the lessor over the lease term.
- If the *lessee* has the statutory obligation to pay the tax, then we believe that the lessee should account for it under the interpretation on levies (see chapter 3.12).

There is no practical expedient for VAT or similar taxes for lessees or lessors under IFRS Accounting Standards. In our view, VAT that is levied on the lessee and collected by the lessor (who is acting as an agent for the tax authority) is not a lease payment and should be accounted for under the interpretation on levies, whereas a lessee's payment of VAT that is levied on the lessor is a lease payment.

Like IFRS Accounting Standards, a lessee determines whether it is reasonably certain that it will exercise a purchase option under an approach similar to the one that it uses to assess whether it expects to exercise a renewal option (see above). [842-10-30-5]

Unlike IFRS Accounting Standards, for the lessor, lease payments exclude any residual value guarantees (whether provided by the lessee or by another unrelated third party). However, the residual value guarantees are included in the calculation of the lease receivable for sales-type and direct financing leases (see below). This results in similar outcomes in how a residual value guarantee affects a lessor's net investment in a lease under IFRS Accounting Standards and US GAAP. [842-10-30-5, 842-30-30-1 – 30-2]

In our view, a lessee's accounting for taxes relating to the underlying asset (e.g. property or sales taxes, including VAT) is driven by whether the lessee or the lessor is the primary obligor for the tax *and* whether the tax is incurred at or before lease commencement or over the lease term.

- If the *lessor* is the primary obligor for the tax then, like IFRS Accounting Standards, such taxes are either:
  - part of the lessee's 'consideration in the contract' if they are incurred at or before lease commencement; or
  - variable payments if they are incurred over the lease term.
- If the *lessee* is the primary obligor for the tax, then such taxes are not part of the lessee's lease accounting, like IFRS Accounting Standards; however, unlike IFRS Accounting Standards, there is no similar guidance under US GAAP on levies and the accounting outcome may differ from IFRS Accounting Standards.

Unlike IFRS Accounting Standards, a lessor's accounting for sales and other similar taxes (including VAT) first depends on whether the lessor elects the sales and other similar taxes practical expedient (which is available only to lessors). If the lessor elects the practical expedient, then the tax and related payments are presented net in the lessor's income statement. [842-10-15-39A]

Unlike IFRS Accounting Standards, when the lessor does not elect the sales and other similar taxes practical expedient, and for taxes other than sales and other similar taxes (e.g. property taxes), the accounting depends on who remits the tax payment(s) to the taxing authority.

- If the *lessee* remits payments, then the tax and related payments should be presented net in the lessor's income statement.

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There is no explicit guidance on payments by the lessee to the owners of a special purpose entity for structuring the transaction.

Discount rate

The interest rate implicit in the lease is the rate that causes the present value of the lease payments and the unguaranteed residual value to equal the sum of:

- the fair value of the underlying asset; and
- any initial direct costs of the lessor. [IFRS 16.A]

IFRS Accounting Standards do not specify whether the rate implicit in the lease can be negative.

The lessee's incremental borrowing rate is the rate that a lessee would have to pay at the commencement date of the lease for a loan of a similar term, and with a similar security, to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. In determining its incremental borrowing rate for a particular lease, a lessee may refer as a starting point to a readily observable rate for a similar loan with a similar payment profile to that of the lease. If the loan identified does not have a similar payment profile to that of the lease, then it is appropriate to make an adjustment to the incremental borrowing rate for this payment profile difference, although the leases standard does not explicitly require this. [IFRS 16.A, IU 09-19]

IFRS Accounting Standards do not include guidance for non-public entities. All lessees therefore apply the discount rate guidance in the leases standard.

- If the *lessor* remits payments, then the tax and related payments should be presented gross in the lessor's income statement – i.e. as its own cost and income. If the tax is incurred at or before lease commencement:
  - for operating leases, the tax should be capitalised to the underlying asset; and
  - for sales-type and direct financing leases, non-manufacturer or dealer lessors should capitalise the tax as part of their net investment in the lease, whereas manufacturers or dealer lessors should expense the tax at lease commencement. [842-10-15-40A]

Unlike IFRS Accounting Standards, US GAAP is explicit that lease payments include payments by the lessee to the owners of a special purpose entity for structuring the transaction. [842-10-30-5]

Discount rate

The interest rate implicit in the lease is the rate that causes the present value of the lease payments and the unguaranteed residual value to equal the sum of:

- the fair value of the underlying asset, like IFRS Accounting Standards; and
- only initial direct costs of the lessor that are deferred; although this wording differs from IFRS Accounting Standards, the overall accounting for initial direct costs is the same (see below). [842 Glossary]

Unlike IFRS Accounting Standards, US GAAP prohibits a negative (i.e. less than zero) rate implicit in the lease. [842 Glossary]

The lessee's incremental borrowing rate is the rate that a lessee would have to pay to borrow, on a collateralised basis and over a similar term, an amount equal to the lease payments in a similar economic environment, like IFRS Accounting Standards. Like IFRS Accounting Standards, the starting point in determining the lessee's incremental borrowing rate for a particular lease may be a readily observable rate for a similar loan. However, unlike IFRS Accounting Standards, if that loan does not have a similar payment profile to that of the lease, then the lessee makes an adjustment for this payment profile difference. [842 Glossary]

Unlike IFRS Accounting Standards, when the rate implicit in the lease is not readily determinable, US GAAP permits a private entity lessee to use a risk-free discount rate, determined using a period comparable to that of the lease term, as an accounting policy choice by class of underlying asset. [842-20-30-3]

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Initial direct costs

Initial direct costs are incremental costs of obtaining a lease that would not otherwise have been incurred, except for such costs incurred by manufacturer or dealer lessors in connection with finance leases. [IFRS 16.A]

Initial direct costs include commissions and payments made by a potential lessee to an existing tenant to vacate the property so that the potential lessee can obtain the lease. They exclude allocations of internal overhead costs (e.g. those incurred by a sales and marketing team or a purchase team). Legal fees and other costs that are incremental and directly attributable to negotiating and arranging a lease, including internal costs, are considered initial direct costs only if they are contingent on the origination of a lease. [IFRS 16.A]

Accounting for leases – Lessor

Classification of a lease

A lessor classifies each lease as either an operating lease or a finance lease. [IFRS 16.61, B53]

A 'finance lease' is a lease that transfers substantially all of the risks and rewards incidental to ownership of an underlying asset; title to the asset may or may not transfer under such a lease. An 'operating lease' is a lease other than a finance lease. [IFRS 16.62, 65]

Initial direct costs

Like IFRS Accounting Standards, initial direct costs are incremental costs of obtaining a lease that would not otherwise have been incurred. However, they exclude such costs incurred in connection with sales-type leases that give rise to manufacturer/dealer profit or loss (i.e. where the fair value of the asset differs from its carrying amount). In general, the IFRS Accounting Standards identification of costs by manufacturer or dealer lessors in connection with finance leases (see below) results in the same population of costs under IFRS Accounting Standards and US GAAP. [842 Glossary, 842-30-25-1(c)]

Like IFRS Accounting Standards, initial direct costs include commissions and payments made by a potential lessee to an existing tenant to vacate the property so that the potential lessee can obtain the lease. They exclude the costs that would have been incurred regardless of whether the lease was obtained, including allocations of general overheads, as well as legal fees and internal costs that are not contingent on the origination of a lease, like IFRS Accounting Standards. [842-10-30-9 – 30-10]

Accounting for leases – Lessor

Classification of a lease

Unlike IFRS Accounting Standards, a lessor classifies each lease as an operating lease, sales-type lease or direct financing lease. [842-10-25-2 – 25-3A]

The population of 'sales-type' and 'direct financing' leases is generally equivalent to the population of finance leases under IFRS Accounting Standards. However, US GAAP distinguishes between leases that:

- effectively transfer control – i.e. the ability to direct the use and obtain substantially all of the remaining benefits of the underlying asset – to the lessee (sales-type leases); and
- transfer substantially all of the risks and rewards incidental to ownership of an underlying asset to the lessee and one or more third parties unrelated to the lessor, but not control (direct financing leases).

An 'operating lease' is a lease other than a sales-type or direct financing lease, like IFRS Accounting Standards. [842-10-25-2 – 25-3A]

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The classification of a lease is determined at its inception date (i.e. the earlier of the date of the lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease). Classification is not revised unless the lease is modified and that modification is not accounted for as a separate lease (see below). [IFRS 16.A, 66]

The classification of a lease is not reassessed by the lessor when a lessee exercises an option (e.g. to renew the lease or to purchase the underlying asset) that, on inception, the lessor assessed that the lessee was not reasonably certain to exercise. [IFRS 16.66]

IFRS Accounting Standards do not have different types of finance leases. However, there is specific guidance for manufacturer or dealer lessors (see below). [IFRS 16.69, 71]

Indicators of a finance lease

The leases standard includes the following series of indicators that individually or in combination normally lead to classification as a finance lease:

- the lease transfers ownership of the underlying asset to the lessee by the end of the lease term;
- the lessee holds a purchase option that is considered reasonably certain to be exercised;
- the lease term is for the major part of the (remaining) economic life of the underlying asset;
- the present value of the lease payments amounts to substantially all of the fair value of the underlying asset; and
- the underlying asset is so specialised that only the lessee can use it without major modification. [IFRS 16.63]

IFRS Accounting Standards do not define what is meant by the 'major part' of an asset's economic life and no quantitative threshold is provided. In our view, although the optional 75 percent approach under US GAAP may be a useful reference point, it does not represent a bright line or automatic cut-off point under IFRS Accounting Standards.

IFRS Accounting Standards do not define what is meant by 'substantially all' and no quantitative threshold is provided. In our view, although the optional 90 percent approach under US GAAP may provide a useful reference point, it does not represent a bright line or automatic cut-off point under IFRS Accounting Standards.

Unlike IFRS Accounting Standards, the classification of a lease is determined at its commencement date (i.e. the date on which a lessor makes an underlying asset available for use by a lessee). Like IFRS Accounting Standards, the classification is not revised unless the lease is modified and that modification is not accounted for as a separate contract (see below). [842-10-20, 25-1]

Unlike IFRS Accounting Standards, the classification of a lease is required to be reassessed by the lessor when a lessee exercises an option (e.g. to renew the lease or purchase the underlying asset) that it was previously not reasonably certain to exercise. [842-10-35-3]

Lessors have to determine which of two types of finance lease an arrangement is: sales-type or direct financing. The differences between the accounting for these leases under IFRS Accounting Standards and US GAAP are discussed below. [842-10-25-2 – 25-3]

Criteria for a sales-type or direct financing lease

The criteria for determining whether a lease is a sales-type lease are generally the same as the indicators of a finance lease under IFRS Accounting Standards. However, unlike IFRS Accounting Standards, the US GAAP criteria function as pass/fail tests and each one is determinative (except as explained at the end of this section for leases that include variable payments that do not depend on an index or rate) such that a met criterion cannot be overridden by an assessment of other factors or qualitative considerations. Also unlike IFRS Accounting Standards, the 'lease term' and 'lease payments' criteria may be evaluated using bright-line thresholds (see more below). [842-10-25-2 – 25-3A, 55-2]

Unlike IFRS Accounting Standards, in determining whether the lease term is for the major part of the economic life of the underlying asset, a threshold of 75 percent or more of the remaining economic life of the asset may, but is not required to, be used. This criterion does not apply when the asset is at or near the end of its economic life (e.g. within the last 25 percent of its total economic life). [842-10-25-2, 55-2]

Unlike IFRS Accounting Standards, in determining whether the present value of the lease payments and any residual value guarantee equals or exceeds 'substantially all' of the underlying asset's fair value, a threshold of 90 percent or more of the asset's fair value may, but is not required to, be used. [842-10-25-2 – 25-3, 55-2]

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The following are additional indicators that an arrangement may be a finance lease:

- the lessee can cancel the lease but the lessor's losses associated with the cancellation are borne by the lessee;
- gains or losses from fluctuation in the fair value of the residual fall to the lessee; or
- the lessee can extend the lease at a rent that is substantially lower than the market rent. [IFRS 16.64]

However, lease classification is ultimately based on an overall assessment of whether substantially all of the risks and rewards incidental to ownership of the underlying asset have been transferred. [IFRS 16.61, 63, 65]

Classification issues related to land

Land leases

A lease of land is classified as an operating or finance lease with reference to the general indicators used for lease classification (see above). In determining the lease classification, an important consideration is that land normally has an indefinite economic life. However, the fact that the lease term is normally shorter than the economic life of the land does not necessarily mean that a lease of land is always an operating lease; the other classification requirements are also considered. Ultimately, the lease classification is based on an overall assessment of whether substantially all of the risks and rewards incidental to ownership of the asset have been transferred from the lessor to the lessee. [IFRS 16.B55]

Land and building leases

When a lease includes both land and a building, a lessor assesses the classification of the two leases separately: a lease of the land and a lease of the building, unless the value of the land at inception of the lease is immaterial or it is clear that both elements are either finance leases or operating leases. [IFRS 16.B55–B57]

Unlike IFRS Accounting Standards, if none of the sales-type lease criteria are met, then the lease is classified either as a direct financing lease or as an operating lease. The lease is classified as a direct financing lease if both of the following criteria are met:

- the present value of the following equals or exceeds substantially all of the underlying asset's fair value (see above):
  - the lease payments; and
  - any residual value guarantee (from the lessee or an unrelated third party); and
- it is probable that the lessor will collect the lease payments plus any amount necessary to satisfy a residual value guarantee. [842-10-25-3, 55-2]

Notwithstanding the above, leases that include variable payments and would, if classified as a sales-type or direct financing lease based on the criteria above, give rise to a commencement date selling loss, are required to be classified as operating leases. This US GAAP rule results in a lease classification (i.e. operating) that is usually consistent with that under IFRS Accounting Standards for the same leases. [842-10-25-3A]

Classification issues related to land

Land leases

A lease of land is classified with reference to the same pass/fail tests as other assets, which differ in some respects from IFRS Accounting Standards (see above). Like IFRS Accounting Standards, the fact that land normally has an indefinite economic life will influence the analysis; however, unlike IFRS Accounting Standards, that influence only extends to the 'lease term' criterion – it does not factor into any overriding assessment of a principle as it does under IFRS Accounting Standards.

Land and building leases

For leases that include a land element, the right to use the land is considered a separate lease component unless the accounting effect of separately accounting for the land element would be 'insignificant' (e.g. lease classification would not differ for either element or the amount that would be allocated to the land component would be insignificant), like IFRS Accounting Standards. [842-10-15-29]

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Manufacturer or dealer lessors

Initially, the manufacturer or dealer lessor derecognises the underlying asset and recognises a finance lease receivable at an amount equal to its net investment in the lease, which comprises the present value (using the rate implicit in the lease) of:

- the lease payments; and
- any unguaranteed residual value accruing to the lessor. [IFRS 16.67–68, A]

The leases standard does not include any additional requirements for a manufacturer or dealer lessor regarding the probability of collecting lease payments when accounting for a lease.

A finance lease of an asset by a manufacturer or dealer results in two types of income: initial selling profit, and finance income over the lease term. There is no definition of a manufacturer or dealer lessor. [IFRS 16.71–72, 74]

Manufacturer or dealer lessors recognise the selling margin in profit or loss for the period by applying their normal accounting policy for outright sales. [IFRS 16.71–72]

Costs incurred in connection with negotiating and arranging a lease (which are excluded from the definition of initial direct costs – see above) are recognised as an expense in profit or loss when the selling profit is recognised, which is generally at the commencement date of the lease term. [IFRS 16.74]

Sales-type leases

Initially, and only if collectability of the lease payments and any amount necessary to satisfy a residual value guarantee is probable (unlike IFRS Accounting Standards), then the sales-type lessor derecognises the underlying asset and recognises a net investment in the lease, which comprises, like IFRS Accounting Standards, the present value (using the rate implicit in the lease) of:

- the lease payments as defined under US GAAP (see above);
- any portion of the estimated residual value at the end of the lease term that is guaranteed either by the lessee or by a third party unrelated to the lessor; and
- any portion of the estimated residual value at the end of the lease term that is not guaranteed either by the lessee or by a third party unrelated to the lessor. [842-30-30-1]

Unlike IFRS Accounting Standards, if collectability is not probable at lease commencement, but becomes probable during the lease term, then the accounting described above occurs. In addition, the leases Codification Topic includes guidance about how to account for lease payments received when collectability is not probable, and how to account for those payments when either: (a) collectability becomes probable or (b) one of two specified events similar to those in the revenue Codification Topic occurs. [842-30-25-3 – 25-5, 606-10-25-7]

Like IFRS Accounting Standards, a sales-type lease results in two types of income: initial selling profit and finance income over the lease term. Unlike IFRS Accounting Standards, a sales-type lease is a lease that meets specific criteria (see above). [842-30-25-1 – 25-3]

Like IFRS Accounting Standards, sales-type lessors recognise the selling margin in profit or loss for the period by applying their normal accounting policy for outright sales. [842-30-25-1]

Initial direct costs are either:

- expensed at lease commencement (if the fair value of the underlying asset does not equal its carrying amount), like IFRS Accounting Standards; or
- deferred and included in the net investment in the lease (if the fair value of the underlying asset equals its carrying amount), unlike IFRS Accounting Standards. [842-30-25-1]

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The sales revenue recognised at commencement of the lease term by the manufacturer or dealer lessor is the fair value of the asset or, if it is lower, the present value of the lease payments computed using a market rate of interest. [IFRS 16.71]

If manufacturer or dealer lessors quote below-market interest rates, then selling profit is restricted to the amount that would have been earned if a market rate of interest was charged. [IFRS 16.73]

Lease receipts are allocated between finance income and reduction of the net investment so as to produce a constant rate of return on the net investment. [IFRS 16.75–76]

Other finance leases

Other finance leases are those entered into by lessors other than a manufacturer or dealer lessor; there is no specific definition of these leases.

Initially, the lessor derecognises the underlying asset and recognises a finance lease receivable at an amount equal to its net investment in the lease, which comprises the same components as for a manufacturer or dealer lessor (see above). [IFRS 16.67–68, A]

Initial direct costs are included in the measurement of the net investment in the lease because the interest rate implicit in the lease used for discounting the lease payments takes initial direct costs incurred into consideration. [IFRS 16.69]

A finance lessor may recognise a gain or loss on commencement of a finance lease. However, only a manufacturer or dealer lessor recognises revenue and cost of sales.

Over the lease term, the lessor accrues finance income on the net investment. Lease receipts are allocated between finance income and reduction of the net investment so as to produce a constant rate of return on the net investment. [IFRS 16.75–76]

The sales revenue recognised by the sales-type lessor is the lower of:

- the fair value of the underlying asset at the commencement date, like IFRS Accounting Standards; and
- the sum of the lease receivable and any lease payments prepaid by the lessee; the lease receivable is discounted using the interest rate implicit in the lease, unlike IFRS Accounting Standards. [842-30-30-1, 45-4]

Unlike IFRS Accounting Standards, there is no adjustment to the selling profit if the lessor quotes below-market interest rates.

Like IFRS Accounting Standards, lease receipts are allocated between interest income and reduction of the net investment so as to produce a constant rate of return on the net investment. [842-30-35-1]

Direct financing leases

Unlike IFRS Accounting Standards, a direct financing lease is a lease that meets specific criteria (see above). [842-10-25-2 – 25-3A2]

Initially, the lessor derecognises the underlying asset and recognises a net investment in the lease consistent with that of a sales-type lease (see above) except that, unlike IFRS Accounting Standards, the net investment in the lease is reduced by the amount of any selling profit on the lease (see the discussion about selling profit/loss below). [842-30-30-1 – 30-2]

Like IFRS Accounting Standards, initial direct costs are included in the measurement of the net investment in the lease because the interest rate implicit in the lease used for discounting the lease receivable and the unguaranteed residual asset takes initial direct costs incurred into consideration. [842 Glossary]

Unlike IFRS Accounting Standards, any selling profit in a direct financing lease is recognised as a reduction in the measurement of the net investment in the lease, and is instead recognised over the lease term. Any selling loss is recognised at lease commencement, like IFRS Accounting Standards. [842-30-25-8]

Like IFRS Accounting Standards, over the lease term the lessor accrues interest income on the net investment in the lease. Like IFRS Accounting Standards, lease receipts are allocated between interest income and reduction of the net investment so as to produce a constant rate of return on the net investment. [842-30-35-1]

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Leveraged leases

IFRS Accounting Standards do not include the concept of leveraged leases. All leases other than those entered into by manufacturers or dealers are accounted for under the requirements for other finance leases (see above).

Operating leases

A lessor under an operating lease continues to recognise the underlying asset in its statement of financial position, and accounts for it in the same way as other assets of the same type – e.g. property, plant and equipment (see chapter 3.2). [IFRS 16.88]

Initial direct costs incurred by the lessor are added to the carrying amount of the underlying asset. These initial direct costs are recognised as an expense on the same basis as the lease income. [IFRS 16.83]

The lessor generally recognises income on a straight-line basis over the lease term. The lessor recognises lease income using another systematic basis if that is more representative of the time pattern in which the benefit of the underlying asset is diminished. [IFRS 16.81]

Lease incentives granted to the lessee are recognised as reductions of rental income over the term of the lease. [IFRS 16.81, A]

Accounting for leases – Lessee

A lessee applies a single lease accounting model under which it recognises all leases on-balance sheet at the commencement date, except leases to which it elects to apply the recognition exemptions (see below). A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. [IFRS 16.22]

Leveraged leases

Like IFRS Accounting Standards, the leases Codification Topic does not include the concept of leveraged leases. However, unlike IFRS Accounting Standards, leveraged leases under the old leases Codification Topic that commenced before the effective date of the current leases Codification Topic are grandfathered and exempt from applying the new requirements unless they are modified on or after the effective date. [842-10-65-1(z)]

Operating leases

Like IFRS Accounting Standards, a lessor under an operating lease continues to recognise the leased asset in its statement of financial position and accounts for it in the same way as other assets of the same type – i.e. as property, plant and equipment (see chapter 3.2). [842-30-30-4]

Like IFRS Accounting Standards, initial direct costs incurred by the lessor are deferred and recognised over the life of the lease. Unlike IFRS Accounting Standards, initial direct costs are recognised as a separate asset (not included in the carrying amount of the underlying asset). [842-30-25-10 – 25-11]

Like IFRS Accounting Standards, the lessor generally recognises income on a straight-line basis over the lease term. Like IFRS Accounting Standards, the lessor recognises lease income using another systematic basis if that is more representative of the pattern in which benefit is expected to be derived from the use of the underlying asset. Unlike IFRS Accounting Standards, there is also specific guidance on collectability that may result in operating lease income being recognised on a cash basis until collectability of the lease payments and any amount necessary to satisfy a residual value guarantee becomes probable. [842-30-25-11 – 25-13]

Like IFRS Accounting Standards, lease incentives granted to the lessee are recognised as reductions of rental income over the term of the lease. [842-30-25-11]

Accounting for leases – Lessee

Unlike IFRS Accounting Standards, a lessee classifies a lease as a finance lease or an operating lease using the same classification criteria as lessors for a sales-type lease (see above), except that the specific classification guidance on leases with variable payments does not apply to lessees. [842-10-25-2]

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Recognition exemptions

A lessee can elect not to apply the lessee accounting model to leases with a lease term of 12 months or less (i.e. short-term leases). This election is made by class of underlying asset. [IFRS 16.5(a), 8]

A lease that contains a purchase option is not a short-term lease. [IFRS 16.A]

A lessee can elect not to apply the lessee accounting model to leases for which the underlying asset is of low value when it is new, even if the effect is material in aggregate. This election is made on a lease-by-lease basis. [IFRS 16.5(b), 8]

A lessee does not apply the low-value exemption to a lease of an individual asset in either of the following scenarios:

- if the underlying asset is highly dependent on, or highly inter-related with, other assets; or
- if the lessee cannot benefit from the underlying asset on its own or together with other readily available resources, irrespective of the value of that underlying asset. [IFRS 16.B5]

The low-value exemption also does not apply to a head lease of an asset that is sub-leased or that is expected to be sub-leased. [IFRS 16.B7]

If a lessee elects either or both recognition exemptions, then it recognises the related lease payments as an expense on either a straight-line basis over the lease term or another systematic basis if that basis is more representative of the pattern of the lessee's benefit. [IFRS 16.6]

If a lessee elects the short-term lease exemption and the lease term changes subsequently (e.g. because the lessee exercises an option not previously included in the determination of the lease term), then the lease is considered to be a new lease, which may or may not qualify as a short-term lease. [IFRS 16.7]

Both classifications result in the lessee recognising a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, there are differences between the two models relating to subsequent measurement.

Recognition exemptions

Like IFRS Accounting Standards, a lessee can elect not to apply the lessee accounting model to leases with a lease term of 12 months or less (i.e. short-term leases). This election is made by class of underlying asset. [842 Glossary, 842-20-25-2 – 25-3]

Unlike IFRS Accounting Standards, a lease that contains a purchase option can qualify as a short-term lease if the lessee is not reasonably certain to exercise its option to purchase the underlying asset. [842 Glossary]

Unlike IFRS Accounting Standards, there is no exemption for leases for which the underlying asset is of low value.

If a lessee elects the short-term lease exemption, then it recognises the related lease payments as an expense on a straight-line basis over the lease term, which is more restrictive than IFRS Accounting Standards. [842-20-25-2]

Unlike IFRS Accounting Standards, if the lease term changes such that the remaining lease term does not extend more than 12 months from the end of the previously determined lease term, the lease still qualifies as a short-term lease. [842-20-25-3]

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Initial measurement

The lease liability is initially measured at the present value of the future lease payments calculated using the interest rate implicit in the lease if it is readily determinable. If the lessee cannot readily determine that rate, then it uses its incremental borrowing rate. [IFRS 16.26]

IFRS Accounting Standards do not include guidance for non-public entities. All lessees therefore apply the discount rate guidance in the leases standard.

A lessee initially measures the right-of-use asset at cost that includes the following:

- the amount of the initial measurement of the lease liability (see above);
- any lease payments made at or before the commencement date, less any lease incentives received;
- any initial direct costs incurred by the lessee; and
- an estimate of the dismantling, removal and restoration costs to be incurred by the lessee based on the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period. [IFRS 16.23–24]

Subsequent measurement

There is a single model for lessee accounting.

Single model

After initial recognition, the lease liability is measured at amortised cost under the effective interest method. [IFRS 16.36, BC182]

Initial measurement

Like IFRS Accounting Standards, the lease liability is initially measured at the present value of the future lease payments calculated using the interest rate implicit in the lease if it is readily determinable. If the lessee cannot readily determine that rate, then it uses its incremental borrowing rate, like IFRS Accounting Standards. [842-20-30-1 – 30-3]

Unlike IFRS Accounting Standards, when the rate implicit in the lease is not readily determinable, US GAAP permits a private entity lessee to use a risk-free discount rate, determined using a period comparable to that of the lease term, as an accounting policy choice by class of underlying asset. [842-20-30-3]

Like IFRS Accounting Standards, a lessee initially measures the right-of-use asset at a cost that includes the following:

- the amount of the initial measurement of the lease liability (see above);
- any lease payments made at or before the commencement date, less any lease incentives received; and
- any initial direct costs incurred by the lessee. [842-20-30-5]

Like IFRS Accounting Standards, the initial measurement of the right-of-use asset also includes an estimate of the dismantling, removal and restoration costs to be incurred by the lessee based on the terms and conditions of the lease. However, unlike IFRS Accounting Standards, there is no exception when those costs are incurred to produce inventories. Like IFRS Accounting Standards, the lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period. [410-20-35-1, 35-8]

Subsequent measurement

Unlike IFRS Accounting Standards, there is a dual model for lessee accounting under US GAAP: finance leases and operating leases. Initial recognition and measurement are the same for both, but there are differences in the subsequent accounting.

Finance leases

Like IFRS Accounting Standards, after initial recognition, the lease liability is measured at amortised cost under the effective interest method. [842-20-35-1]

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A lessee remeasures the lease liability to reflect changes in the lease payments by discounting the revised lease payments using:

- an unchanged discount rate when:
  - the amount expected to be payable under a residual value guarantee changes;
  - future lease payments change to reflect market rates (e.g. based on a market rent review) or a change in an index or rate (other than in floating interest rates) used to determine lease payments; or
  - the variability of payments is resolved so that they become in-substance fixed payments; and
- a revised discount rate when:
  - future lease payments change as a result of a change in floating interest rates;
  - the lease term changes; or
  - the assessment of the exercise of a purchase option changes. [IFRS 16.40–43, B42]

A right-of-use asset is a non-monetary item, whereas a lease liability is a monetary item. Therefore, right-of-use assets are not retranslated after commencement date (unless they are measured at fair value), and lease liabilities are retranslated. Foreign currency exchange differences arising at the reporting date from the retranslation of lease liabilities denominated in a foreign currency are generally recognised in profit or loss (see chapter 2.7). [IAS 21.23, IFRS 16.BC196–BC199]

A lessee subsequently measures right-of-use assets at cost less accumulated depreciation and accumulated impairment losses, unless it applies:

- the revaluation model; or
- the right-of-use asset meets the definition of investment property and the lessee accounts for its investment property under the fair value model (see chapter 3.4). [IFRS 16.29–30, 34–35, IAS 40.40A]

A lessee adjusts the carrying amount of the right-of-use asset for remeasurement of the lease liability arising from a change in lease payments, unless the carrying amount has already been reduced to zero or the change relates to variable lease payments that do not depend on an index or rate. [IFRS 16.30(b), 38(b), 39]

Like IFRS Accounting Standards, a lessee remeasures the lease liability to reflect changes in the lease payments by discounting the revised lease payments using:

- an unchanged discount rate when:
  - the amount probable of being owed under a residual value guarantee changes;
  - the variability of payments is resolved so that they become fixed payments; and
- a revised discount rate when:
  - the lease term changes; or
  - the assessment of the exercise of a purchase option changes. [842-20-35-5]

Unlike IFRS Accounting Standards, a lessee does not remeasure the lease liability for changes in future lease payments arising from changes in an index or rate unless the lease liability is remeasured for another reason – e.g. the lease term changes. Instead, after initial recognition, such variable lease payments are recognised as they are incurred. [842-10-35-5]

Like IFRS Accounting Standards, the right-of-use asset is a non-monetary asset, whereas the lease liability is a monetary liability.

- Right-of-use assets denominated in a foreign currency are initially measured using the commencement date exchange rate, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, a right-of-use asset is remeasured using the exchange rate at the date of the most recent remeasurement for which a reset is required (subject to policy choice) or lease modification not accounted for as a separate contract (see chapter 2.7).
- Like IFRS Accounting Standards, the lease liability is remeasured using the current exchange rate. [842-20-55-10, 830-10-45-17 – 45-18]

Like IFRS Accounting Standards, translation differences are recognised in profit or loss (see chapter 2.7).

Unlike IFRS Accounting Standards, a lessee always measures right-of-use assets at cost less accumulated amortisation and accumulated impairment losses. [842-10-35-7]

Like IFRS Accounting Standards, a lessee adjusts the carrying amount of the right-of-use asset for remeasurement of the lease liability arising from a change in lease payments, unless the carrying amount has already been reduced to zero or the change relates to variable lease payments that do not depend on an index or rate. [842-20-35-4]

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Depreciation and impairment of right-of-use asset

A right-of-use asset is depreciated in accordance with the depreciation requirements for property, plant and equipment (see chapter 3.2).

If ownership of the underlying asset is transferred to the lessee, or the lessee is reasonably certain to exercise a purchase option, then the depreciation period runs to the end of the useful life of the underlying asset. Otherwise, the depreciation period runs to the earlier of:

- the end of the useful life of the right-of-use asset; or
- the end of the lease term. [IFRS 16.32]

Operating leases

After lease commencement, a lessee measures the lease liability at the present value of the unpaid lease payments discounted at the discount rate for the lease established at the commencement date. An exception to this general principle occurs when the rate is updated as a result of a lease remeasurement (which is the same as for finance leases) or a modification that is not accounted for as a separate contract (see below). [842-20-35-3]

After lease commencement, a lessee measures the right-of-use asset as follows, unless it has been impaired (see below):

- lease liability carrying amount;
- plus unamortised initial direct costs;
- plus or minus prepaid (accrued) lease payments; and
- the unamortised balance of lease incentives received. [842-20-35-3]

Alternatively, the carrying amount of an operating lease right-of-use asset can be determined based on the carrying amount of the right-of-use asset less accumulated amortisation. Under this method, amortisation each period is calculated as the difference between the straight-line lease cost for the period (which includes the amortisation of initial direct costs) and the periodic accretion of the lease liability using the effective interest method.

Once a right-of-use asset has been impaired (see below), its post-impairment carrying amount is subsequently amortised on a straight-line basis unless another systematic basis is more representative of the pattern in which the lessee expects to consume the future economic benefits. [842-20-35-10]

Amortisation and impairment of right-of-use asset

A right-of-use asset is amortised as explained above, which differs from IFRS Accounting Standards because of the additional operating lease model under US GAAP. In particular, the amortisation of operating lease right-of-use assets does not conform to the amortisation for any owned tangible or intangible assets under US GAAP.

Like IFRS Accounting Standards, if ownership of the underlying asset is transferred to the lessee, or the lessee is reasonably certain to exercise a purchase option, then the amortisation period runs to the end of the useful life of the underlying asset. Otherwise, the amortisation period runs to the earlier of:

- the end of the useful life of the right-of-use asset; or
- the end of the lease term. [842-20-35-8]

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A lessee applies the impairment standard to determine whether a right-of-use asset is impaired and to account for any impairment (see chapter 3.10). After recognition of an impairment loss, the future depreciation charges for the right-of-use asset are adjusted to reflect the revised carrying amount. [IFRS 16.33, IAS 36.33]

If a lessee commits to a plan to abandon a right-of-use asset (e.g. vacate leased property before the end of the lease term with no ability or no intent to sub-lease the property), then that may indicate that the right-of-use asset is impaired. In this case, the right-of-use asset is tested for impairment. If it is not fully impaired, then the lessee accelerates depreciation so that the right-of-use asset has a zero carrying amount by the date it is abandoned. [IAS 16.51, 55–57, 36.12(f), 17]

Lease modifications

A 'lease modification' is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease – e.g. adding or terminating the right to use one or more underlying assets. [IFRS 16.A]

Lessees may elect not to assess whether rent concessions that are a direct consequence of COVID-19 are lease modifications, and account for those rent concessions as if they were not lease modifications if the following conditions are met:

- the revised consideration is substantially the same as or less than the original consideration;
- any reduction in lease payments relates to payments originally due on or before 30 June 2022; and
- no other substantive changes have been made to the terms of the lease.

[IFRS 16.46A–46B]

Lessor

A lessor in a finance lease accounts for a lease modification as a separate lease if both of the following conditions exist:

- the modification increases the scope of the lease by adding the right to use one or more underlying assets; and
- the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract. [IFRS 16.79]

A lessee applies the long-lived asset impairment Codification section to determine whether a right-of-use asset is impaired and to account for any impairment, which differs in some respects from IFRS Accounting Standards (see chapter 3.10). Like IFRS Accounting Standards, after recognition of an impairment loss, the future amortisation charges for the right-of-use asset are adjusted to reflect the revised carrying amount. [360-10-35, 842-20-25-7, 35-9 – 35-10]

Like IFRS Accounting Standards, if a lessee commits to a plan to abandon a right-of-use asset, then that may indicate that the right-of-use asset is impaired. If it is not fully impaired, then the lessee accelerates amortisation so that the right-of-use asset has a zero carrying amount by the date it is abandoned. [360-10-35-21, 35-47]

Lease modifications

Like IFRS Accounting Standards, a 'lease modification' is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease – e.g. adding or terminating the right to use one or more underlying assets. [842 Glossary]

Lessees and lessors may elect not to assess whether COVID-19-related rent concessions were required under the original contract, and instead account for those rent concessions either (1) as if they were required under the original contract or (2) as lease modifications. The practical expedient is available when the changes to the lease do not result in a substantial increase in the rights of the lessor or the obligations of the lessee. Unlike IFRS Accounting Standards, the practical expedient:

- applies to both lessees and lessors; and
- does not require the concession to be a direct consequence of COVID-19 (merely that it is related to COVID-19) or that any reduced payments are only until 30 June 2022.

Lessor

Like IFRS Accounting Standards, a lessor in a sales-type or direct financing lease accounts for a lease modification as a separate contract (lease) if both of the following conditions exist:

- the modification grants the lessee an additional right of use that was not included in the original contract; and
- the lease payments increase commensurate with the stand-alone price for the additional right of use, as adjusted for the particular circumstances of the contract.

[842-10-25-8]

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If the modification is not a separate lease, then the lessor accounts for a modification to a finance lease as follows.

- If the lease would have been classified as an *operating lease* if the modification had been in effect at the inception date, then the lessor:
  - accounts for the lease modification as the termination of the original finance lease and the creation of a new operating lease from the effective date of the modification; and
  - measures the carrying amount of the underlying asset as the net investment in the original lease immediately before the effective date of the lease modification.
- Otherwise, it applies the requirements of the financial instruments standard. [IFRS 16.80]

A lessor accounts for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease. [IFRS 16.87]

If the modification is not a separate contract, then the lessor accounts for a modification to a *sales-type lease* as follows.

- Like IFRS Accounting Standards, if the modified lease is an *operating lease*, then the lessor measures the carrying amount of the underlying asset as equal to the carrying amount of the net investment in the original lease immediately before the modification. However, unlike IFRS Accounting Standards, the assessment of whether the modified lease is an operating lease occurs at the modification date, based on the facts and circumstances at that date.
- Unlike IFRS Accounting Standards, if the modified lease is a *sales-type or direct financing lease*, then the lessor measures the initial net investment in the modified lease as equal to the carrying amount of the net investment in the original lease immediately before the modification. [842-10-25-17]

If the modification is not a separate contract, then the lessor accounts for a modification to a *direct financing lease* as follows.

- Like IFRS Accounting Standards, if the modified lease is an *operating lease*, then the lessor measures the carrying amount of the underlying asset as equal to the carrying amount of the net investment in the original lease immediately before the modification. However, unlike IFRS Accounting Standards, the assessment of whether the modified lease is an operating lease occurs at the modification date, based on the facts and circumstances at that date.
- Unlike IFRS Accounting Standards, if the modified lease is a *sales-type lease*, then the lessor accounts for the lease in accordance with the guidance on sales-type leases (see above) such that a selling profit or selling loss is recognised. The commencement date of the modified lease is treated as the date of modification.
- Unlike IFRS Accounting Standards, if the modified lease is a *direct financing lease*, then the lessor measures the initial net investment in the modified lease as equal to the carrying amount of the net investment in the original lease immediately before the modification. [842-10-25-16]

Unlike IFRS Accounting Standards, the separate contract guidance described above for sales-type or direct financing leases also applies to operating lease modifications. If the modification is not a separate contract, then the lessor accounts for a modification to an *operating lease* as follows.

- Like IFRS Accounting Standards, if the modified lease is an *operating lease*, then the lessor accounts for the lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the modified lease.

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In some rent concessions, the only change to the lease contract is the lessor's forgiveness of lease payments due from the lessee under that contract. The lessor accounts for the rent concession by:

- measuring ECL on the operating lease receivable, in the period before the rent concession was granted, in a way that considers a range of possible outcomes and reasonable and supportable information that is available without undue cost or effort, including the lessor's expectations of forgiving lease payments recognised as part of that receivable;
- applying the derecognition requirements in the financial instruments standard to forgiven lease payments that the lessor had included in an operating lease receivable on the date the rent concession was granted; and
- applying the lease modification requirements in the leases standard to forgiven lease payments that the lessor had not included in an operating lease receivable at that date. [IFRS 16.87, IU 10-22]

Lessee

A lessee accounts for a modification as a separate lease if both conditions mentioned above for a lessor exist. [IFRS 16.44]

For a lease modification that is not a separate lease, at the effective date of the modification, the lessee accounts for the lease modification by remeasuring the lease liability using a discount rate determined at that date and:

- for lease modifications that decrease the scope of the lease (e.g. decrease the leased space or the lease term), the lessee decreases the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease, and recognises a gain or loss that reflects the proportionate decrease in scope in profit or loss; and
- for all other lease modifications, the lessee makes a corresponding adjustment to the right-of-use asset and does not generally recognise a gain in profit or loss. However, an exception arises if the carrying amount of the right-of-use asset is reduced to zero; then, any further reductions are recognised in profit or loss. [IFRS 16.45–46]

- Unlike IFRS Accounting Standards, if the modified lease is a *sales-type or direct financing lease*, then the lessor derecognises any deferred rent liability or accrued rent asset and adjusts the selling profit (loss) accordingly, which is deferred for a direct financing lease (see above). [842-10-25-15]

Unlike IFRS Accounting Standards, in general, a lessor's forgiveness of lease payments due from the lessee that was not required by the existing lease contract results in a lease modification for the lessee and the lessor, even if that forgiveness is the only change to the lease contract. The rent forgiveness is treated as a lease incentive in accounting for the modified lease.

Lessee

Like IFRS Accounting Standards, a lessee accounts for a modification to a finance or operating lease as a separate contract if both conditions mentioned above for a lessor exist. [842-10-25-8]

Like IFRS Accounting Standards, if the modification is not a separate contract, at the effective date of the modification, then the lessee accounts for the lease modification by remeasuring the lease liability using a discount rate determined at that date and:

- for lease modifications that decrease the scope of the lease, the lessee decreases the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease, and recognises a gain or loss that reflects the proportionate decrease in scope; and
- for all other lease modifications, the lessee makes a corresponding adjustment to the right-of-use asset and does not generally recognise a gain in profit or loss. However, an exception arises if the carrying amount of the right-of-use asset is reduced to zero; then, any further reductions are recognised in profit or loss. [842-10-25-11 – 25-13, 842-20-35-4]

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Specific application issues

Sale-and-leaseback transactions

For both the seller-lessee and buyer-lessor, the accounting for a sale-and-leaseback transaction depends on whether the initial transfer of the underlying asset from the seller-lessee to the buyer-lessor is a sale. The parties apply the revenue standard to determine whether a sale has taken place (see chapter 4.2). [IFRS 16.99]

If the seller-lessee has a substantive option to repurchase the underlying asset, then the transfer is not a sale. [IFRS 16.99, BC262(c), 15.BC427]

A party to a sale-and-leaseback transaction considers all facts and circumstances in determining whether a sale has taken place. Some individual factors, such as a substantive seller-lessee forward or call option on the transferred asset, preclude a conclusion that there is a sale. Other individual factors, on their own, may not be determinative – e.g. a classification of the leaseback by the buyer-lessor as a finance lease does not by itself preclude that conclusion. However, in our experience only in rare circumstances would the asset transfer qualify as a sale when the leaseback is a finance lease.

Unlike IFRS Accounting Standards, because leases are classified as finance or operating leases by the lessee, if the modification is not a separate contract, then the lessee reassesses the classification of the lease based on the facts and circumstances at the effective date of the modification.

Unlike IFRS Accounting Standards, a modification that reduces the term of the lease is not accounted for as a decrease in the scope of the lease. Therefore, no gain or loss is recognised.

Unlike IFRS Accounting Standards, if the original lease is a finance lease, the modification is not a separate contract and the modified lease is an operating lease, then the right-of-use asset is measured in accordance with the guidance for the initial recognition of a new operating lease (see above). The corresponding difference is accounted for as a rent prepayment or lease incentive. [842-10-25-14]

Specific application issues

Sale-leaseback transactions

Like IFRS Accounting Standards, for both the seller-lessee and buyer-lessor, the accounting for a sale-leaseback transaction depends on whether the initial transfer of the underlying asset from the seller-lessee to the buyer-lessor is a sale. Like IFRS Accounting Standards, the revenue Codification Topic applies to determine whether a sale has taken place (see chapter 4.2). [842-40-25-1]

Unlike IFRS Accounting Standards, if the seller-lessee has a substantive option to repurchase an underlying asset that is not real estate, then the transfer may be a sale if:

- the strike price to repurchase the asset is its fair value at the date of exercise; and
- assets that are substantially the same as the underlying asset are readily available. [842-40-25-3]

Unlike IFRS Accounting Standards, if the leaseback would be classified as a finance lease by the seller-lessee (or as a sales-type lease by the buyer-lessor), then sale recognition is automatically precluded. [842-40-25-2]

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Both parties account for a transaction that does not qualify for sale accounting as a financing arrangement in the scope of the financial instruments standard (see chapter 7.7). [IFRS 16.103]

If the transaction qualifies for sale accounting, then:

- the buyer-lessor recognises the underlying asset and applies the lessor accounting model to the leaseback; and
- the seller-lessee derecognises the underlying asset and applies the lessee accounting model to the leaseback. [IFRS 16.100]

The seller-lessee measures the right-of-use asset at the retained portion of the previous carrying amount (i.e. at cost). It recognises only the amount of any gain or loss related to the rights transferred to the buyer-lessor. [IFRS 16.100]

Adjustments are required if the sale is not at fair value or the lease payments are off-market. [IFRS 16.101–102]

Control of underlying asset before lease commencement

If the lessee controls the underlying asset before it is transferred to the lessor, then the transaction is accounted for as a sale-and-leaseback.

This guidance applies to completed assets and underlying assets that need to be constructed or redesigned for the lessee's use. [IFRS 16.B43, B46]

Like IFRS Accounting Standards, both parties account for a transaction that does not qualify for sale accounting as a financing arrangement. However, differences arise from the application of the financial instruments standards (see chapter 7.7). [842-40-25-5]

Like IFRS Accounting Standards, if the transaction qualifies for sale accounting, then:

- the buyer-lessor recognises the underlying asset and applies the lessor accounting model to the leaseback; and
- the seller-lessee derecognises the underlying asset and applies the lessee accounting model to the leaseback. [842-40-25-4]

Unlike IFRS Accounting Standards, the seller-lessee measures the right-of-use asset at the discounted present value of the lease payments as it would for any other lease (subject to any off-market adjustments described below). Unlike IFRS Accounting Standards, it recognises a gain or loss for the difference between the sale proceeds (subject to any off-market adjustments described below) and the carrying amount of the underlying asset. [842-40-30-1]

Like IFRS Accounting Standards, adjustments are required if the sale is not at fair value or the lease payments are off-market. [842-40-30-2 – 30-3]

Control of underlying asset before lease commencement

Like IFRS Accounting Standards, if the lessee controls the underlying asset before it is transferred to the lessor, then the transaction is accounted for as a sale-leaseback.

Like IFRS Accounting Standards, this guidance applies to completed assets and underlying assets that need to be constructed or redesigned for the lessee's use. [842-40-55-1, 55-3, 55-5]

Unlike IFRS Accounting Standards, US GAAP provides specific guidance on how to determine whether a lessee controls an underlying asset before the commencement date, including a definition of 'control'. In addition to providing a definition of control and an explanation of how to apply it, US GAAP provides five automatic indicators of lessee control. Any of the five indicators, if they are met, demonstrate lessee control of the underlying asset. Despite more extensive US GAAP guidance, we do not expect significant differences from IFRS Accounting Standards in practice. [842-40-55-5, ASU 2016-02.BC400(b)]

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Sub-leases

A 'sub-lease' is a transaction in which a lessee (or 'intermediate lessor') grants a right to use the underlying asset to a third party, and the lease (or 'head lease') between the original lessor and lessee remains in effect. The intermediate lessor accounts for the head lease and the sub-lease as two different contracts. [IFRS 16.A, 3]

An intermediate lessor classifies the sub-lease as a finance lease or as an operating lease with reference to the right-of-use asset arising from the head lease. [IFRS 16.B58]

Leases between related parties

There is no specific guidance on accounting for leases between related parties and the general requirements outlined above apply.

Common control arrangements

There is no specific guidance on accounting for leases between related parties under common control and the general requirements outlined above apply.

Sub-leases

Like IFRS Accounting Standards, a 'sub-lease' is a transaction in which a lessee (or 'intermediate lessor') grants a right to use the underlying asset to a third party, and the lease (or 'head lease') between the original lessor and lessee remains in effect. The intermediate lessor accounts for the head lease and the sub-lease as two different contracts. [842 Glossary]

Unlike IFRS Accounting Standards, an intermediate lessor classifies the sub-lease with reference to the underlying asset, which may frequently result in different sub-lease classification between IFRS Accounting Standards and US GAAP. [ASU 2016-02.BC116, 842-10-25-2 – 25-3]

Leases between related parties

Unlike IFRS Accounting Standards, an entity accounts for a lease between related parties on the basis of the legally enforceable terms and conditions of the lease. If a sale-leaseback transaction is between related parties, then neither party makes an adjustment for off-market terms. [842-10-55-12, 842-40-30-4]

Common control arrangements

For arrangements that exist between related parties under common control, a private entity may elect, on an arrangement-by-arrangement basis, a practical expedient to use the written terms and conditions of a common control leasing arrangement (without regard to enforceability) to determine whether a lease exists and, if so, the classification of and accounting for that lease. However, if no written terms and conditions exist, this practical expedient is not available. [842-10-15-3A]

For leases between related parties under common control, the amendments require an entity (public or private) to amortise related leasehold improvements over their useful life *to the common control group*, irrespective of the accounting lease term, as long as the lessee continues to control the use of the underlying asset. [842-20-35-12A]

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Forthcoming requirements

Amendments to the financial instruments standard relating to the derecognition of lease liabilities are effective for annual periods beginning on or after 1 January 2026; early adoption is permitted. The amendments clarify that gains or losses on extinguishment of lease liabilities in the scope of the financial instruments standard are recognised in profit or loss. [IFRS 9.2.1(b)(ii)]

A lease contract may be modified to forgive specifically identified lease payments. If this is the only change to the lease contract and the lessee does not apply the practical expedient for COVID-19-related rent concessions, then it is unclear how the lessee distinguishes between a lease modification and an extinguishment (or partial extinguishment) of a lease liability. As a result, it is also unclear whether the lessee should apply the requirements of the leases standard or the financial instruments standard.

In our view, a lessee should choose an accounting policy, to be applied consistently, to account for these modifications by applying one of the following approaches.

- Under the *full leases standard approach*, the lessee remeasures the lease liability using a revised discount rate and makes a corresponding adjustment to the carrying amount of the right-of-use asset.
- Under the *partial financial instruments standard approach*, the lessee derecognises the lease liability for the lease payments forgiven and makes a corresponding adjustment to profit or loss. The lessee then remeasures the lease liability for the remaining lease payments using a revised discount rate and adjusts the carrying amount of the right-of-use asset.
- Under the *full financial instruments standard approach*, the lessee derecognises the lease liability for the present value of the lease payments forgiven and makes a corresponding adjustment to profit or loss. The lease liability is not remeasured.

[IFRS 9.2.1(b)(ii), 3.3.1, 3.3.3, 16.46(b)]

Forthcoming requirements

There are no forthcoming requirements under US GAAP.

Unlike IFRS Accounting Standards, in general, a lessor's forgiveness of lease payments due from the lessee that was not required by the existing lease contract results in a lease modification for the lessee and the lessor, even if that forgiveness is the only change to the lease contract. The rent forgiveness is treated as a lease incentive in the accounting for the modified lease.

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5.2 Operating segments

(IFRS 8)

Overview

- Segment disclosures are required by entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market.
- Segment disclosures are provided about the components of the entity that management monitors in making decisions about operating matters (the 'management approach').
- Such components (operating segments) are identified on the basis of internal reports that the entity's CODM regularly reviews in allocating resources to segments and in assessing their performance.
- The aggregation of operating segments is permitted only when the segments have 'similar' economic characteristics and meet a number of other criteria.
- Reportable segments are identified based on quantitative thresholds of revenue, profit or loss or total assets.
- The amounts disclosed for each reportable segment are the measures reported to the CODM, which are not necessarily based on the same accounting policies as the amounts recognised in the financial statements.

5.2 Operating segments

(Topic 280)

Overview

- Like IFRS Accounting Standards, segment disclosures are required by entities whose debt or equity securities are traded in a public market, and by entities that are in the process of issuing such securities or that file their financial statements with the SEC.
- Like IFRS Accounting Standards, the Codification Topic is based on a 'management approach', which requires segment disclosures based on the components of the entity that management monitors in making decisions about operating matters.
- Like IFRS Accounting Standards, such components (operating segments) are identified on the basis of internal reports that the entity's CODM regularly reviews in allocating resources to segments and in assessing their performance.
- Like IFRS Accounting Standards, the aggregation of operating segments is permitted only when the segments have 'similar' economic characteristics and meet a number of other criteria.
- Like IFRS Accounting Standards, reportable segments are identified based on quantitative thresholds of revenue, profit or loss or total assets.
- Like IFRS Accounting Standards, the amounts disclosed for each reportable segment are the measures reported to the CODM, which are not necessarily based on the same accounting policies as the amounts recognised in the financial statements.

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Overview (continued)

- **As part of the disclosures, an entity reports a measure of profit or loss for each reportable segment and, if reported to the CODM, a measure of total assets and liabilities for each reportable segment.**
- **Disclosures are required for additions to non-current assets, with certain exceptions.**
- **Reconciliations between total amounts for all reportable segments and financial statement amounts are disclosed with a description of reconciling items.**
- **General and entity-wide disclosures include information about products and services, geographic areas, major customers, the factors used to identify an entity's reportable segments, and the judgements made by management in applying the aggregation criteria. Such disclosures are required even if an entity has only one segment.**
- **Comparative information is normally revised for changes in reportable segments.**

Overview (continued)

- **Like IFRS Accounting Standards, as part of the disclosures, an entity reports a measure of profit or loss and, if reported to the CODM, a measure of total assets for each reportable segment. Unlike IFRS Accounting Standards, there is no requirement to disclose information about liabilities.**
- **Like IFRS Accounting Standards, disclosures are required for additions to long-lived assets, with certain exceptions. However, the exceptions differ in certain respects from IFRS Accounting Standards.**
- **Like IFRS Accounting Standards, reconciliations between total amounts for all reportable segments and financial statement amounts are disclosed, with a description of reconciling items.**
- **Like IFRS Accounting Standards, general and entity-wide disclosures are required, including information about products and services, geographic areas, major customers and factors used to identify an entity's reportable segments. Such disclosures are required even if an entity has only one segment, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, there is no explicit requirement to disclose the judgements made by management in applying the aggregation criteria.**
- **Like IFRS Accounting Standards, comparative information is normally revised for changes in operating segments.**

Scope

The disclosure of segment information is required by those entities whose debt or equity instruments are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or that file, or are in the process of filing, their financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market. [IFRS 8.2]

Segment disclosures are made in the notes to the financial statements. [IFRS 8.20]

Scope

Like IFRS Accounting Standards, the disclosure of segment information is required by entities whose debt or equity securities are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), and by entities that are in the process of issuing such securities or that file their financial statements with the SEC. [280-10-15]

Like IFRS Accounting Standards, segment disclosures are made in the notes to the financial statements. [280-10-50]

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Objective

The objective of the operating segments standard is the disclosure of information that enables users of an entity's financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates. [IFRS 8.1]

Management approach

Segment disclosure is based on the components of the entity that the CODM monitors in making decisions about operating matters (the 'management approach'). [IFRS 8.BC4, BC10]

Components are identified as operating segments on the basis of internal reports that the entity's CODM regularly reviews in allocating resources to segments, and in assessing their performance. [IFRS 8.BC4, BC10]

The term 'CODM' refers to a function, rather than to a specific title. [IFRS 8.7]

Identification of operating segments

An 'operating segment' is a component of an entity:

- that engages in business activities from which it may earn revenues and incur expenses;
- whose operating results are reviewed regularly by the CODM; and
- for which discrete financial information is available. [IFRS 8.5]

The different stages in a vertically integrated operation may each be considered an operating segment if they meet the above definition of an operating segment – i.e. a segment is not required to have external revenues. [IFRS 8.5(a)]

Entities that have a 'matrix' form of organisation whereby business components are managed in more than one way (e.g. geographically and by products or services) determine operating segments consistent with the objective of the accounting standard (see above) if more than one set of components is reviewed by the CODM. [IFRS 8.10]

Objective

Like IFRS Accounting Standards, the objective of requiring disclosures about segments of an entity and related information is to provide information about the different types of business activities in which an entity engages and the different economic environments in which it operates, to help users. [280-10-10-1]

Management approach

Like IFRS Accounting Standards, segment disclosure is based on the components of the entity that the CODM monitors in making decisions about operating matters (the 'management approach'). [280-10-50]

Like IFRS Accounting Standards, components (operating segments) are identified on the basis of internal reports that the entity's CODM regularly reviews in allocating resources to segments, and in assessing their performance. [280-10-50-1]

Like IFRS Accounting Standards, the 'CODM' refers to a function, rather than to a specific title. [280-10-50-5]

Identification of operating segments

Like IFRS Accounting Standards, an 'operating segment' is a component of an entity:

- that engages in business activities from which it may earn revenues and incur expenses;
- whose operating results are reviewed regularly by the CODM; and
- for which discrete financial information is available. [280-10-50-1]

Like IFRS Accounting Standards, the different stages in a vertically integrated operation may each be considered an operating segment if they meet the above definition of an operating segment – i.e. a segment is not required to have external revenues. [280-10-50-2]

Unlike IFRS Accounting Standards, entities that have a 'matrix' form of organisation whereby business components are managed in more than one way (e.g. geographically and by products or services) may determine operating segments based on products and services if more than one set of components is reviewed by the CODM. [280-10-50-9]

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Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the objective of the accounting standard (see above), the segments have similar economic characteristics and the segments are similar in each of the following areas:

- the nature of the products and services;
- the nature of the production processes;
- the type or class of customer for their products and services;
- the methods used to distribute their products or provide their services; and
- if applicable, the nature of the regulatory environment – e.g. banking, insurance or public utilities. [IFRS 8.12]

Identification of reportable segments

A reportable segment is based on quantitative thresholds, compared with the combined total for all operating segments rather than with consolidated amounts. A 'reportable segment' is any operating segment that represents 10 percent or more of:

- revenue, both internal and external, from all operating segments;
- the greater in absolute value of the total profit of all operating segments reporting a profit, and the total loss of all operating segments reporting a loss; or
- total assets from all operating segments. [IFRS 8.13]

An operating segment below the quantitative size thresholds (see above) may be:

- designated as a reportable segment despite its size;
- combined with other operating segments that fall below the size thresholds if they have similar economic characteristics and share most of the additional aggregation criteria (see above); or
- combined and disclosed in an 'all other segments' category that is separate from other reconciling items, together with all other operating segments that fall below the size thresholds and for which neither of the above presentation options is selected. [IFRS 8.13–14, 16]

Total external revenue of the identified reportable segments needs to be 75 percent or more of total consolidated revenue. If not, then additional operating segments are required to be reported separately from 'other segments' until at least 75 percent of total consolidated revenue is accounted for by reportable segments. [IFRS 8.15]

Like IFRS Accounting Standards, two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the objective of the Codification Topic (see above), the segments have similar economic characteristics and the segments are similar in each of the following areas:

- the nature of the products and services;
- the nature of the production processes;
- the type or class of customer for their products and services;
- the methods used to distribute their products or provide their services; and
- if applicable, the nature of the regulatory environment – e.g. banking, insurance or public utilities. [280-10-50-11]

Identification of reportable segments

Like IFRS Accounting Standards, a reportable segment is based on quantitative thresholds, compared with the combined total for all operating segments rather than with consolidated amounts. Like IFRS Accounting Standards, a 'reportable segment' is any operating segment that represents 10 percent or more of:

- revenue, both internal and external, from all operating segments;
- the greater in absolute value of the total profit of all operating segments reporting a profit, and the total loss of all operating segments reporting a loss; or
- total assets from all operating segments. [280-10-50-12]

Like IFRS Accounting Standards, an operating segment below the quantitative size thresholds (see above) may be:

- designated as a reportable segment despite its size;
- combined with other operating segments that fall below the size thresholds if they have similar economic characteristics and share most of the additional aggregation criteria (see above); or
- combined and disclosed in an 'all other segments' category that is separate from other reconciling items, together with all other operating segments that fall below the size thresholds and for which neither of the above presentation options is selected. [280-10-50-13 – 50-19]

Like IFRS Accounting Standards, total external revenue of the identified reportable segments needs to be 75 percent or more of total consolidated revenue. If not, then additional operating segments are required to be reported separately from 'other segments' until at least 75 percent of total consolidated revenue is accounted for by reportable segment, like IFRS Accounting Standards. [280-10-50-14]

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Segment disclosures

An entity discloses the factors used to identify reportable segments and the judgements made by management in applying the aggregation criteria. The latter includes:

- a brief description of operating segments that have been aggregated; and
- the economic indicators that have been assessed in determining that the operating segments have similar economic characteristics. [IFRS 8.22]

An entity reports a measure of profit or loss for each reportable segment, as well as a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the CODM. [IFRS 8.23]

If a CODM uses multiple measures to evaluate segment performance, then an entity reports the measure that is most consistent with the principles used in the financial statements (i.e. IFRS Accounting Standards). [IFRS 8.26]

There is no explicit guidance in IFRS Accounting Standards on whether an entity can report multiple measures of a segment's profit or loss if the CODM uses more than one measure to evaluate segment performance and allocate resources.

Segment disclosures

Like IFRS Accounting Standards, an entity discloses the factors used to identify reportable segments. However, unlike IFRS Accounting Standards:

- there is no explicit requirement to disclose the judgements made by management in applying the aggregation criteria; and
- an entity is required to disclose the title and position of the individual or the name of the group or committee identified as the CODM. [280-10-50-21]

Like IFRS Accounting Standards, an entity reports a measure of profit or loss for each reportable segment, as well as a measure of total assets if such amounts are regularly provided to the CODM. Unlike IFRS Accounting Standards:

- there is no requirement to disclose information about liabilities by reportable segment; and
- an entity is required to disclose how the CODM uses the reported measure(s) of segment profit or loss in assessing segment performance and deciding how to allocate resources. [280-10- 50-22, 50-28 – 50-28C, 50-29(f)]

Like IFRS Accounting Standards, if a CODM uses multiple measures to evaluate segment performance, then an entity reports the measure that is most consistent with the principles used in the financial statements (i.e. US GAAP). Because this measure is required to be disclosed, it is not considered a non-GAAP measure by the SEC, regardless of how it is calculated. [280-10-50-27, 28A]

Unlike IFRS Accounting Standards, US GAAP contains explicit guidance that permits an entity to report additional measures of a segment's profit or loss that are used by the CODM to evaluate segment performance and allocate resources. However, if these measures are not calculated under US GAAP, then – unlike the required measure discussed above – they are considered non-GAAP measures by the SEC. The SEC will not object to their inclusion in the segment disclosure, provided the entity complies with the SEC's rules and regulations for non-GAAP financial measures. [280-10-50-27, 28A, Reg G, Reg S-K Rule 10(e)].

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Additionally, the following amounts are required to be disclosed for each reportable segment if they are included in the measure of segment profit or loss reviewed by the CODM (even if they are not separately provided to or reviewed by the CODM); or if they are regularly provided to the CODM (even if they are not included in that measure of segment profit or loss):

- revenue, distinguishing between external customers and inter-segment sales;
- interest revenue and expense;
- depreciation and amortisation, and other non-cash items;
- material items of income and expense disclosed in accordance with the presentation of financial statements standard;
- the share of results and carrying amount of equity-accounted investees (see chapter 3.5);
- income tax; and
- additions to non-current assets (including tangible and intangible assets), other than financial instruments, deferred tax assets, post-employment benefit assets and rights under insurance contracts. [IFRS 8.23–24, IU 06-24]

In determining the material items of income and expense to be disclosed for each reportable segment, an entity considers:

- the objective of the accounting standard and whether information about an item is material in the context of its financial statements taken as a whole because of its size or nature, or a combination of both;
- the requirements on aggregation of information; and
- circumstances that give rise to separate disclosure. [IFRS 8.23, IAS 1.7, 30-31, 97-98, IU 06-24]

An entity is not required to disclose by reportable segment each item of income and expense presented in its statement of profit or loss or disclosed in the notes. [IU 06-24]

A reconciliation is required between the total of all reported segments, including 'other' segments, and the amounts reported in the financial statements, including all adjustments to reconcile internal reports for segment disclosures to the financial statement information reported in accordance with IFRS Accounting Standards. [IFRS 8.28]

Additionally, the following amounts are required to be disclosed for each reportable segment if they are included in the measure of segment profit or loss reviewed by the CODM (even if they are not separately provided to or reviewed by the CODM); or if they are regularly provided to the CODM (even if they are not included in that measure of segment profit or loss):

- revenue, distinguishing between external customers and inter-segment sales, like IFRS Accounting Standards;
- interest revenue and expense, like IFRS Accounting Standards;
- depreciation and amortisation, and other non-cash items, like IFRS Accounting Standards;
- unusual items of income and expense disclosed in accordance with US GAAP, which may differ from material items of income and expense disclosed under IFRS Accounting Standards;
- the share of results and carrying amount of equity-method investees (see chapter 3.5), like IFRS Accounting Standards;
- income tax, like IFRS Accounting Standards; and
- additions to long-lived assets other than:
  - financial instruments and deferred tax assets, like IFRS Accounting Standards; and
  - deferred policy acquisition costs, long-term customer relationships of a financial institution, mortgage and other servicing rights, unlike IFRS Accounting Standards. [280-10-50-22, 50-25]

Unlike IFRS Accounting Standards, US GAAP uses a significant segment expense principle requiring disclosure of significant segment expenses regularly provided, or easily computable from information regularly provided, to the CODM and included in each reported measure of segment profit or loss, as well as an amount for other segment items. Under this principle, an entity considers relevant qualitative and quantitative factors when determining whether segment expense categories and amounts are significant, which may differ from material items of income and expense disclosed under IFRS Accounting Standards. [280-10-50-26A – 50-26C]

Like IFRS Accounting Standards, a reconciliation is required between the total of all reported segments, including 'other' segments, and the amounts reported in the financial statements, including all adjustments to reconcile internal reports for segment disclosures to the financial statement information reported in accordance with US GAAP. [280-10-50-30 – 50-31]

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IFRS Accounting Standards are silent on whether the reportable segment disclosures apply to single reportable segment entities.

Entity-wide disclosures

The following entity-wide disclosures are required, based on the financial information used to produce the entity's financial statements:

- revenue from external customers for each product/service or each group thereof;
- revenue from external customers, and non-current assets, by geographic area; and
- revenue from each major customer and the segment(s) reporting the revenue. [IFRS 8.32–34]

Revision of comparative information

A change in the composition of segments requires the revision of comparative information unless the information is not available and the cost to develop it would be excessive. If comparative segment information is not presented on the new basis, then segment information is presented on both the old and the new bases in the period in which segment composition changes, unless the necessary information is not available and the cost to develop it would be excessive. [IFRS 8.29–30]

Unlike IFRS Accounting Standards, US GAAP contains explicit guidance requiring single reportable segment entities to provide segment disclosures. [280-10-50-20]

Entity-wide disclosures

The following entity-wide disclosures are required, based on the financial information used to produce the entity's financial statements:

- revenue from external customers for each product/service or each group thereof, like IFRS Accounting Standards;
- revenue from external customers by geographic area, like IFRS Accounting Standards;
- long-lived tangible assets by geographic area, which is narrower than the IFRS Accounting Standards requirement in respect of non-current assets; and
- revenue from each major customer and the segment(s) reporting the revenue, like IFRS Accounting Standards. [280-10-50-38 – 50-42]

Revision of comparative information

Like IFRS Accounting Standards, a change in the composition of segments requires the revision of comparative information unless the information is not available and the cost to develop it would be excessive. If comparative segment information is not presented on the new basis, then segment information is presented on both the old and the new bases in the period in which segment composition changes unless it is impracticable to do so, like IFRS Accounting Standards. [280-10-50-17, 50-34 – 50-36]

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5.3 Earnings per share

(IAS 33)

Overview

- Basic and diluted EPS are presented by entities whose ordinary shares or potential ordinary shares are traded in a public market or that file, or are in the process of filing, their financial statements for the purpose of issuing any class of ordinary shares in a public market.
- Basic and diluted EPS for both continuing operations and profit or loss are presented in the statement of profit or loss and OCI, with equal prominence, for each class of ordinary shares that has a differing right to share in the profit or loss for the period.
- Separate EPS information is disclosed for discontinued operations, either in the statement of profit or loss and OCI or in the notes to the financial statements.
- Basic EPS is calculated by dividing the profit or loss attributable to holders of ordinary equity of the parent by the weighted-average number of ordinary shares outstanding during the period.
- To calculate diluted EPS, profit or loss attributable to ordinary equity holders, and the weighted-average number of ordinary shares outstanding, are adjusted for the effects of all dilutive potential ordinary shares.
- Potential ordinary shares are considered dilutive only if they decrease EPS or increase loss per share from continuing operations. In determining whether potential ordinary shares are dilutive or anti-dilutive, each issue or series of potential ordinary shares is considered separately, rather than in aggregate.

5.3 Earnings per share

(Subtopic 260-10)

Overview

- Like IFRS Accounting Standards, basic and diluted EPS are presented by entities whose common shares or potential common shares are traded in a public market or that file, or are in the process of filing, their financial statements for the purpose of issuing any class of common shares in a public market.
- Like IFRS Accounting Standards, basic and diluted EPS for both continuing operations and net income are presented in the statement that reports profit or loss, with equal prominence, for each class of common shares.
- Like IFRS Accounting Standards, separate EPS information is disclosed for discontinued operations either in the statement that reports profit or loss or in the notes to the financial statements.
- Like IFRS Accounting Standards, basic EPS is calculated by dividing the earnings attributable to holders of ordinary equity (i.e. income available to common shareholders) of the parent by the weighted-average number of common shares outstanding during the period.
- Like IFRS Accounting Standards, diluted EPS is calculated based on income available to common shareholders and the weighted-average number of common shares outstanding, adjusted for the effects of all dilutive potential common shares.
- Like IFRS Accounting Standards, potential common shares are considered dilutive only if they decrease EPS or increase loss per share from continuing operations. Like IFRS Accounting Standards, in determining whether potential common shares are dilutive or anti-dilutive, each issue or series of potential common shares is considered separately, rather than in aggregate.

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Overview (continued)

- Contingently issuable ordinary shares are included in basic EPS from the date on which all necessary conditions are satisfied. When the conditions are not yet satisfied, such shares are included in diluted EPS based on the number of shares that would be issuable if the reporting date were the end of the contingency period.
- If a contract may be settled in either cash or shares at the entity's option, then the presumption is that it will be settled in ordinary shares. If the resulting potential ordinary shares are dilutive, then they are used to calculate diluted EPS.
- If a contract may be settled in either cash or shares at the holder's option, then the more dilutive of cash and share settlement is used to calculate diluted EPS.
- For diluted EPS, diluted potential ordinary shares are determined independently for each period presented.
- When the number of ordinary shares outstanding changes, without a corresponding change in resources, the weighted-average number of ordinary shares outstanding during all periods presented is adjusted retrospectively for both basic and diluted EPS.

Overview (continued)

- Like IFRS Accounting Standards, contingently issuable common shares are included in basic EPS from the date on which all necessary conditions are satisfied. Like IFRS Accounting Standards, when the conditions are not yet satisfied, such shares are included in diluted EPS based on the number of shares that would be issuable if the reporting date were the end of the contingency period.
- Like IFRS Accounting Standards, if a contract may be settled in either cash or shares at the entity's option, then the presumption is that it will be settled in shares and the resulting potential common shares are used to calculate diluted EPS, if this is more dilutive. However, unlike IFRS Accounting Standards, for liability-classified share-based payment awards, existing practice or a stated policy of settling in cash may provide a reasonable basis to overcome the presumption of share settlement.
- Unlike IFRS Accounting Standards, if a contract may be settled in either cash or shares at the holder's option, then share settlement is presumed, if this is more dilutive. However, for liability-classified share-based payment awards, existing practice or a stated policy of settling in cash may provide a reasonable basis to overcome the presumption of share settlement.
- Unlike IFRS Accounting Standards, the computation of diluted EPS for year-to-date (including annual) periods is based on the weighted average of incremental shares included in each interim period resulting in the year-to-date period, considering previously anti-dilutive instruments and their dilution in the year-to-date period, in certain circumstances.
- Like IFRS Accounting Standards, when the number of common shares outstanding changes without a corresponding change in resources, the weighted-average number of common shares outstanding during all periods presented is adjusted retrospectively for both basic and diluted EPS.

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Overview (continued)

- **Adjusted basic and diluted EPS based on alternative earnings measures may be disclosed and explained in the notes to the financial statements.**

Scope

Basic and diluted EPS are presented by entities whose ordinary shares or potential ordinary shares are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or that file, or are in the process of filing, their financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of ordinary shares in a public market. [IAS 33.2]

An 'ordinary share' is an equity instrument that is subordinate to all other classes of equity instruments. Ordinary shares participate in profit for the period only after other types of shares such as preference shares have participated. [IAS 33.5–6]

If an entity voluntarily presents EPS information, then that data is calculated and presented in accordance with the EPS standard. [IAS 33.3]

If an entity has more than one class of ordinary shares, then EPS is disclosed for each class of ordinary shares; this is sometimes referred to as the 'two-class' method of calculating EPS. The two-class method is also required for computing EPS if an entity has equity instruments other than ordinary shares that participate in dividends with ordinary shareholders based on a predetermined formula (participating equity instruments). However, it is not required for participating debt instruments. To determine profit or loss attributable to ordinary equity holders, profit or loss for the period is allocated to the different classes of ordinary shares and participating equity instruments. This allocation is made in accordance with the rights of the other class to participate in distributions if the entire profit or loss were distributed. In our view, an entity is not required to present separate EPS information for participating preference shares that are not considered to be a separate class of ordinary shares. [IAS 33.6, 66, A13–A14, IU 06-17]

Overview (continued)

- **Like IFRS Accounting Standards, entities may choose to present basic and diluted other per-share amounts that are not required under US GAAP only in the notes to the financial statements. However, unlike IFRS Accounting Standards, presentation of cash flow per share is explicitly prohibited. Additionally, SEC regulations restrict the use of 'non-GAAP' measures in filings by SEC registrants, which is more restrictive than IFRS Accounting Standards.**

Scope

Like IFRS Accounting Standards, basic and diluted EPS are presented by entities whose common shares or potential common shares are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or that file, or are in the process of filing, their financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of common shares in a public market. [260-10-15-2]

'Common stock' (common shares) is a stock that is subordinate to all other stock of the issuer, like ordinary shares under IFRS Accounting Standards. [Master Glossary, 260-10-20]

Like IFRS Accounting Standards, if an entity voluntarily presents EPS information, then that data is calculated and presented in accordance with the EPS Codification Topic. [260-10-15-3]

Like IFRS Accounting Standards, entities with more than one class of common shares present EPS for each class of common shares under the two-class method. Like IFRS Accounting Standards, the two-class method is required to compute EPS when an entity has equity securities other than common shares that participate in dividends with common shareholders (participating securities). Also, like IFRS Accounting Standards, the disclosure of EPS is not required for participating securities that are not common shares. However, unlike IFRS Accounting Standards, the two-class method applies to all participating securities, regardless of whether they are equity- or liability-classified. In addition, US GAAP has more detailed guidance on participating securities so differences from IFRS Accounting Standards may arise in practice. [260-10-45-60 – 45-60A]

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Presentation and disclosure

EPS figures are presented for all periods presented. [IAS 33.67]

Basic and diluted EPS for both *continuing* operations attributable to ordinary equity holders of the parent entity and profit or loss attributable to ordinary equity holders of the parent entity are presented in the statement of profit or loss and OCI for each class of ordinary shares, with equal prominence for all periods. [IAS 33.66]

Disclosure of separate EPS information is required for discontinued operations, if relevant, either in the statement of profit or loss and OCI or in the notes to the financial statements. [IAS 33.68–68A]

An entity discloses a reconciliation of the earnings used in the basic and diluted EPS calculations to profit or loss attributable to the parent entity for each period presented. [IAS 33.70]

EPS information based on alternative measures of earnings may also be disclosed and explained in the notes to the financial statements (see chapter 5.8); presentation in the statement of profit or loss and OCI is not permitted. Other per-share amounts are calculated using the same denominator as determined in accordance with the EPS standard. An entity indicates the basis for determining the earnings amount, which is consistent over time, and the earnings used are reconciled to a line item that is reported in the statement of profit or loss and OCI. [IAS 33.73–73A]

Basic EPS

'Basic EPS' is the profit or loss attributable to ordinary equity holders of the parent entity for the period, divided by the weighted-average number of ordinary shares outstanding during the period. [IAS 33.10, 19, 66]

Presentation and disclosure

Like IFRS Accounting Standards, EPS figures are presented for all periods presented. [260-10-45-7]

Like IFRS Accounting Standards, basic and diluted EPS for both *continuing* operations attributable to common equity holders of the parent entity and net income attributable to ordinary equity holders (i.e. income available to common shareholders) of the parent entity are presented in the statement that reports profit or loss for each class of common shares, with equal prominence for all periods. [260-10-45-2]

Like IFRS Accounting Standards, disclosure of separate EPS information is required for discontinued operations, either in the statement that reports profit or loss or in the notes to the financial statements. [260-10-45-3]

An entity discloses a reconciliation of the earnings used in the basic and diluted EPS calculations to income from continuing operations; generally, this has the same overall effect as the reconciliation under IFRS Accounting Standards. [260-10-50-1(a)]

Like IFRS Accounting Standards, entities may choose to present basic and diluted other per-share amounts that are not required under US GAAP. However, presentation of cash flow per share is explicitly prohibited, unlike IFRS Accounting Standards. An entity that chooses to disclose other per-share amounts should compute those amounts in accordance with the requirements that apply to EPS calculations, and those other per-share amounts may be disclosed only in the notes to the financial statements, like IFRS Accounting Standards. Additionally, SEC regulations restrict the use of 'non-GAAP' measures in filings by SEC registrants (see chapter 5.8), which is more restrictive than IFRS Accounting Standards. [260-10-45-5 – 45-6]

Basic EPS

Like IFRS Accounting Standards, 'basic EPS' is income available to common shareholders of the parent entity for the period, divided by the weighted-average number of common shares outstanding during the period. [260-10-45-10]

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The numerator (earnings)

The profit or loss attributable to ordinary equity holders of the parent entity (i.e. after allocation to NCI) is the profit or loss adjusted for the post-tax amounts of dividends on preference shares classified as equity. Profit or loss is also adjusted for gains or losses on the settlement of preference shares classified as equity, and other similar effects of such preference shares, including the amortisation of the premium or discount on the original issue of preference shares and the effect of payments to induce conversion. [IAS 33.12–18]

Cumulative preference dividends are deducted from earnings attributable to ordinary equity holders, irrespective of whether they are declared. Non-cumulative preference dividends are not deducted unless they have been declared by the reporting date. [IAS 33.14, A14(a)]

To determine the profit or loss attributable to ordinary equity holders, profit or loss for the period is allocated to the different classes of ordinary shares and participating equity instruments in accordance with their rights to participate in the undistributed earnings. [IAS 33.A14]

In our view, the profit or loss for the purpose of calculating basic EPS should be adjusted for any non-forfeitable dividends and any undistributed earnings attributable to unvested shares or shares subject to recall, in accordance with their participating rights.

The denominator (weighted-average number of shares outstanding)

Share transactions that occur during the reporting period are included in the calculation of the weighted-average number of shares from the date of the transaction. [IAS 33.21]

Treasury shares

Treasury shares are not treated as outstanding ordinary shares in computing the weighted-average number of shares outstanding. [IAS 33.IE2]

The numerator (earnings)

Like IFRS Accounting Standards, income available to common shareholders is income (or loss) from continuing operations or net income (or loss) attributable to the controlling shareholders (i.e. after allocation to NCI) less: dividends declared or accumulated on preferred shares, changes in the carrying amount of redeemable preferred shares not classified as a liability, differences between the amount paid to redeem such preferred shares and the carrying amount of those shares, and consideration to induce conversion of convertible preferred shares not classified as a liability. [260-10-45-11 – 45-11A]

Cumulative dividends on preferred shares are deducted from income available to common shareholders, irrespective of whether they are declared, like IFRS Accounting Standards. Like IFRS Accounting Standards, non-cumulative dividends are not deducted unless they have been declared by the reporting date. [260-10-45-11]

Like IFRS Accounting Standards, to determine income available to common shareholders, undistributed income for the period is allocated to common shares and participating securities in accordance with their rights to participate in the undistributed income. However, unlike IFRS Accounting Standards, the two-class method applies to all participating securities, regardless of whether they are equity- or liability-classified. In addition, US GAAP has more detailed guidance on participating securities so differences from IFRS Accounting Standards may arise in practice. [260-10-45-60B]

Like IFRS Accounting Standards, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and are included in the computation of EPS under the two-class method. [260-10-45-61A]

The denominator (weighted-average number of shares outstanding)

Like IFRS Accounting Standards, share transactions that occur during the reporting period are included in the calculation of the weighted-average number of shares from the date of the transaction. [260-10-45-10]

Treasury shares

Like IFRS Accounting Standards, treasury shares are not treated as outstanding shares in computing the weighted-average number of shares outstanding. [260-10-45-10]

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Assets held by employee benefit plans may include an entity's own shares (see chapter 4.4). An entity's ordinary shares that are qualifying plan assets held by its employee benefit plan and netted against the employee benefit obligation are not the entity's treasury shares. However, if an entity's own shares held by its employee benefit plan do not meet the definition of plan assets, then they are presented as treasury shares even though the plan is not consolidated by the employer; in this case, in our view these shares should not be considered as outstanding shares when calculating EPS (see chapter 4.4).

Contingently issuable ordinary shares

Contingently issuable ordinary shares are ordinary shares that are issuable for little or no cash or other consideration on the satisfaction of specified conditions in a contingent share agreement. Contingently issuable shares are included in the calculation of the weighted-average number of shares outstanding from the date on which the conditions are met. [IAS 33.5, 24]

Shares that are issuable solely after the passage of time are not considered contingently issuable because the passage of time is a certainty. Instead, they are treated as outstanding for the purpose of calculating basic EPS from the date on which the right to the shares comes into existence. [IAS 33.24]

Unvested shares and unvested employee share options that require only service for vesting cannot be contingently issuable shares (see below). In contrast, unvested shares and unvested employee share options that do not only require service as a vesting condition, but instead also include performance conditions, are treated as contingently issuable shares if they are issuable for little or no cash or other consideration. [IAS 33.5, 21(g), 24]

Unvested shares and unvested employee share options

Unvested shares that require only service as a vesting condition are included in the calculation of basic EPS when the service condition is met.

Unvested share options are included in the calculation of basic EPS once the option has been exercised. However, in our view unvested share options that are issuable for little or no further consideration after vesting are included in the calculation of basic EPS as soon as the required vesting conditions have been met. [IAS 33.21(g), 48]

Like IFRS Accounting Standards, we believe that an entity's common shares that are qualifying plan assets held by an employee benefit plan and netted against the employee benefit obligation are not treasury shares. Like IFRS Accounting Standards, if shares do not meet the definition of plan assets, then we believe they are presented as treasury shares and therefore not as outstanding shares (see chapter 4.4). [715-30-20, 715-30-55-35]

Contingently issuable shares

Like IFRS Accounting Standards, contingently issuable shares are common shares that are issuable for little or no cash or other consideration on the satisfaction of specified conditions in a contingent share agreement. Like IFRS Accounting Standards, contingently issuable shares are included in the calculation of the weighted-average number of shares from the date on which the conditions are met. [260-10-45-12C – 45-13]

Like IFRS Accounting Standards, shares that are issuable solely after the passage of time are treated as outstanding for the purpose of calculating basic EPS from the date on which the right to the shares comes into existence. [260-10-45-12C – 45-13]

Like IFRS Accounting Standards, unvested shares and unvested employee share options that require only service for vesting are not contingently issuable shares (see below). In contrast, unvested shares and unvested employee share options that do not only require service to vest in the award, but instead also include performance conditions or market conditions, are treated as contingently issuable shares, if they are issuable for little or no cash or other consideration, like IFRS Accounting Standards (see below for service condition). [260-10-45-12-C – 45-13]

Unvested shares and unvested employee share options

Like IFRS Accounting Standards, unvested shares that require only service as a vesting condition are included in basic EPS when the service condition is met.

Like IFRS Accounting Standards, unvested share options that are issuable for little or no consideration are included in the calculation of basic EPS only once the required vesting conditions have been met. [260-10-45-12C, 45-13, 45-61 – 45-61A]

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Partly paid shares

If ordinary shares are not fully paid, then they are treated as a fraction of ordinary shares for the purposes of basic EPS. The fraction is calculated as the degree to which they are entitled to participate in dividends during the period relative to the dividend participation rights of a fully paid ordinary share. [IAS 33.A15]

Ordinary shares subject to recall

If ordinary shares are subject to recall, then they are not considered as outstanding and are excluded from the calculation of basic EPS until the date on which they are no longer subject to recall. In our view, shares that are subject to repurchase due to a written put option or a forward purchase contract should be excluded from the basic EPS calculation, similar to shares subject to recall. However, the calculation of diluted EPS may require adjustment for the shares subject to recall, the written put or the forward (see below). [IAS 33.24, A13–A14]

Diluted EPS

Diluted EPS is calculated by adjusting the profit or loss attributable to ordinary equity holders of the parent entity (the numerator) and the weighted-average number of shares outstanding (denominator) used in the basic EPS calculation for the effects of all dilutive potential ordinary shares (see below) that were outstanding during the reporting period. [IAS 33.30–31]

The effects of potential ordinary shares are reflected in diluted EPS only when they are dilutive – i.e. when inclusion in the calculation would decrease EPS, or increase the loss per share, from continuing operations. [IAS 33.41]

When considering whether potential ordinary shares are dilutive or anti-dilutive, and therefore whether to include them in the diluted EPS calculation, each issue or series of potential ordinary shares is considered separately. [IAS 33.42, 44]

Partially paid shares

Like IFRS Accounting Standards, if common shares are not fully paid, then they are treated as a fraction of common shares for the purposes of basic EPS. The fraction is calculated as the degree to which they are entitled to participate in dividends during the period relative to the dividend participation rights of a fully paid common share, like IFRS Accounting Standards. [260-10-55-23]

Common shares subject to recall

Like IFRS Accounting Standards, if common shares are subject to recall, then they are not considered as outstanding and are excluded from the calculation of basic EPS until the date on which they are no longer subject to recall. Unlike IFRS Accounting Standards, mandatorily redeemable common shares and the shares underlying a forward purchase contract are only excluded from the denominator of basic (and diluted; see 'Diluted EPS' below) EPS calculations if the instrument requires physical settlement by repurchase of a fixed number of common shares, in exchange for cash. Also, unlike IFRS Accounting Standards, shares underlying written put options are not excluded from the basic EPS calculation. In addition, if the (underlying) shares are entitled to non-forfeitable dividends, they are participating securities and the two-class method is used, which may give rise to differences from IFRS Accounting Standards in practice. [260-10-45-13, 45-35, 480-10-45-4]

Diluted EPS

Like IFRS Accounting Standards, diluted EPS is calculated by adjusting income available to common shareholders (the numerator) and the weighted-average number of shares outstanding (denominator) used in the basic EPS calculation for the effects of all dilutive potential common shares (see below) that were outstanding during the reporting period. [260-10-45-16]

Like IFRS Accounting Standards, potential common shares are reflected in diluted EPS only when they are dilutive – i.e. when inclusion in the calculation would decrease EPS, or increase the loss per share, from continuing operations. [260-10-10-2, 45-17]

Like IFRS Accounting Standards, when considering whether potential common shares are dilutive or anti-dilutive, and therefore whether to include them in the diluted EPS calculation, each issue or series of issues of potential common share is considered separately. [260-10-45-17]

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Dilutive potential ordinary shares are determined independently for each period presented. The number of dilutive potential ordinary shares included in the annual (or year-to-date) period is not equal to a weighted average of the dilutive potential ordinary shares included in each interim computation. IFRS Accounting Standards do not provide specific guidance on the exclusion of potential common shares when there is a loss from continuing operations for the year-to-date period. [IAS 33.37]

Contingently issuable shares are determined independently for each period presented, not a weighted average of dilutive potential ordinary shares included in each interim period. [IAS 33.52]

Adjustments to basic EPS

Earnings

To calculate diluted earnings, subject to the exception mentioned below in relation to certain share-based payment costs, the numerator used for the calculation of basic EPS is adjusted for the post-tax effect of any dividends, interest and other items related to the dilutive potential ordinary shares that are deducted in arriving at profit or loss attributable to ordinary equity holders, and any other changes in income or expense that would result from the assumed conversion of dilutive potential ordinary shares. For further discussion of adjustments to the diluted EPS numerator, see below (Contracts that may be settled in ordinary shares or cash). [IAS 33.33–35]

In our view, the numerator should not be adjusted for equity-settled share-based payment costs when calculating diluted EPS. However, if there is a remeasurement expense from a liability of a cash-settled share-based payment that may also be settled in shares, then the numerator is adjusted for that amount when calculating diluted earnings. [IAS 33.58–59]

Unlike IFRS Accounting Standards, the calculation of diluted EPS for year-to-date (including annual) periods is based on the weighted average of the number of incremental shares included in each interim period for that year-to-date period, considering previously anti-dilutive instruments in prior interim periods of loss and their dilution in the year-to-date period. Therefore, if there was a loss from continuing operations in an interim period, shares that were consequently excluded in that interim period as anti-dilutive are included in the year-to-date period if they are dilutive. When there is a loss from continuing operations for the current year-to-date period, potential common shares are not included if the effect is anti-dilutive. [260-10-55-3 – 55-3B]

Unlike IFRS Accounting Standards, the number of contingent shares included in the computation of diluted EPS for year-to-date (including annual) periods is based on the weighted average of the incremental contingent shares included in each interim period for that year-to-date period. Prior-period assumptions about the contingency are not revisited for changes in the current interim period. [260-10-45-49]

Adjustments to basic EPS

Earnings

Like IFRS Accounting Standards, to calculate diluted earnings for convertible securities, the numerator used for the calculation of basic EPS is adjusted for the post-tax effect of any dividends, interest and income or expense items related to the dilutive potential common shares that were outstanding during the period. This is referred to as the 'if-converted' method under US GAAP. For further discussion of adjustments to the diluted EPS numerator, see below (Contracts that may be settled in common shares or cash). [260-10-45-40]

Like IFRS Accounting Standards, the numerator is not adjusted for share-based payment costs when calculating diluted EPS. Unlike IFRS Accounting Standards, the numerator is not adjusted for a remeasurement expense from a liability-classified share-based payment expense, unless the award is presumed to be share-settled and share settlement is more dilutive, because the remeasurement is part of the share-based payment cost and has already been deducted from earnings. [260-10-45-45]

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Weighted-average number of shares

The denominator (the weighted-average number of ordinary shares) used for the calculation of basic EPS is adjusted for the weighted-average number of ordinary shares that would be issued on conversion of all the dilutive potential ordinary shares. Dilutive potential ordinary shares are deemed to have been converted into ordinary shares at the beginning of the period or, if later, on the date of the issue of the potential ordinary shares. [IAS 33.36]

Options, warrants and other potential ordinary shares

To calculate diluted EPS, the entity assumes that dilutive share options, warrants and their equivalents are exercised so that ordinary shares are issued. For options, warrants and similar instruments, dilution is computed under the treasury share method, with only the bonus element of the issue reflected in diluted EPS. The treasury share method assumes that the proceeds (exercise price) from exercising the options are used to buy back shares at the average market price of a share during the period. The bonus element is the difference between the number of ordinary shares that would be issued at the exercise of the options and the number of ordinary shares that would have been bought back at the average market price. [IAS 33.45–46]

Options, warrants and other potential ordinary shares issued subject to conditions – e.g. performance-based employee share options – may be contingently issuable potential ordinary shares (see below). Options, warrants and other potential ordinary shares issued subject to only service (time) conditions are treated as potential shares that are outstanding from grant date and are considered in the diluted EPS calculation. [IAS 33.48]

In applying the treasury share method, an entity adjusts the exercise price of potential ordinary shares to include the fair value of goods or services that will be recognised as a cost in future periods under a share-based payment arrangement. [IAS 33.47A, IE5A]

Weighted-average number of shares

Like IFRS Accounting Standards, the denominator used to calculate basic EPS is adjusted for the shares that would be issued on conversion of the convertible securities or the issue of the dilutive potential common shares. Like IFRS Accounting Standards, conversion is assumed as of the beginning of the period or the date on which the securities were issued, if this is later. [260-10-45-40(c)]

Options, warrants and other potential common shares

Like IFRS Accounting Standards, the entity assumes that dilutive share options, warrants and similar instruments (e.g. forward contracts to issue shares) are exercised at the beginning of the period. Like IFRS Accounting Standards, the effect of dilution is calculated under the treasury stock method for written call options, warrants and similar instruments, with only the incremental shares (under US GAAP, this is also referred to as a 'bonus element' for rights issuances) reflected in diluted EPS. Like IFRS Accounting Standards, the treasury stock method assumes that the proceeds (exercise price) from exercising the option are used to buy back common shares at the average market price during the period. The incremental shares – that is, the number of common shares that would be issued if the option, warrant or equivalent instrument were exercised less the number of common shares assumed repurchased – are added to the denominator. [260-10-45-23]

Like IFRS Accounting Standards, options, warrants and other potential common shares issued subject to conditions – e.g. performance-based employee share options – may be contingently issuable potential common shares (see below). Like IFRS Accounting Standards, share-based payment awards that vest based only on service are considered potential common shares that are outstanding from grant date and are considered in the diluted EPS calculation. [260-10-45-28A, 45-31– 45-32]

Like IFRS Accounting Standards, in calculating diluted EPS under the treasury stock method, an entity adjusts the exercise price of potential common shares to include the fair value of goods and services that will be recognised in future periods. For example, for employee share options that vest on satisfaction of a service condition, an entity adjusts the exercise price of potential common shares to include the average unrecognised compensation cost of the awards. Additionally, US GAAP has more specific guidance on the treatment of estimated forfeitures of share-based payment awards under the treasury stock method than IFRS Accounting Standards, so differences in practice can occur. [260-10-45-29 – 45-29A]

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If an entity has purchased options on its own shares, then these are excluded from diluted EPS. [IAS 33.62]

Written put options and forward purchase contracts are included in diluted EPS if they are dilutive (i.e. they are 'in the money'). If the contracts are in the money during the period, then the potential dilutive effect on EPS is calculated under the reverse treasury method as follows:

- assume that at the beginning of the period sufficient ordinary shares will be issued at the average market price during the period to raise the funds required to satisfy a written put/forward purchase;
- assume that the proceeds from the issue are used to satisfy the written put/forward purchase; and
- include the incremental ordinary shares (i.e. the difference between the number of ordinary shares assumed issued and the number of ordinary shares received from buying back ordinary shares) in the calculation of diluted EPS. [IAS 33.63]

Partly paid shares

To the extent that partly paid shares are not entitled to participate in dividends during the period, they are treated as options or warrants, with the unpaid balance being regarded as the exercise price. [IAS 33.A16]

Contracts that may be settled in ordinary shares or cash

If a contract can be settled in either cash or shares, then it is a potential ordinary share.

If settlement in ordinary shares or cash is at the entity's option, then the entity presumes that the contract will be settled in ordinary shares. If the resulting potential ordinary shares are dilutive, then they are used to calculate diluted EPS. [IAS 33.58]

If a contract that may be settled in ordinary shares or cash is accounted for as an asset or liability, or has an equity component and a liability component, then the numerator should be adjusted for any changes in profit or loss that would have resulted during the period if the contract had been wholly classified as an equity instrument. [IAS 33.59]

Like IFRS Accounting Standards, if an entity has purchased options on its own shares, then these are excluded from diluted EPS. [260-10-45-37]

Like IFRS Accounting Standards, written put options and forward purchase contracts are included in diluted EPS if they are dilutive (i.e. they are 'in the money'). Like IFRS Accounting Standards, if those contracts are in the money during the reporting period, then the potential dilutive effect of a forward purchase contract (other than a forward purchase contract that requires physical settlement by repurchase of a fixed number of common shares in exchange for cash, unlike IFRS Accounting Standards – see 'Basic EPS, Common shares subject to recall' above) or a written put option is calculated under the reverse treasury stock method as follows:

- assume that at the beginning of the period sufficient common shares will be issued at the average market price during the period to raise the funds required to satisfy a written put/forward purchase;
- assume that the proceeds from the issue are used to satisfy the written put/forward purchase; and
- include the incremental common shares (i.e. the difference between the number of common shares assumed issued and the number of common shares received from buying back common shares) in the calculation of diluted EPS. [260-10-45-35]

Partially paid shares

Like IFRS Accounting Standards, any partially paid shares not entitled to participate in dividends during the period are treated as options or warrants, with the unpaid balance being regarded as the exercise price. [260-10-55-23]

Contracts that may be settled in common shares or cash

Like IFRS Accounting Standards, if a contract can be settled in either cash or shares, then it is a potential common share.

Like IFRS Accounting Standards, if settlement in common shares or cash is at the entity's option, then the entity presumes that the contract will be settled in ordinary shares, if this is more dilutive. However, unlike IFRS Accounting Standards, for liability-classified share-based payment awards, past practice or a stated policy of settling in cash may provide a reasonable basis to overcome the presumption of share settlement. [260-10-45-45 – 45-45A]

Like IFRS Accounting Standards, for a share-settleable contract that is reported as an asset or liability, or has an equity component and a liability component, the numerator should be adjusted for changes in income that would have resulted if the contract had been accounted for as an equity instrument. [260-10-45-46]

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IFRS Accounting Standards are not specific about situations in which cash settlement is presumed for an instrument accounted for as equity (or share settlement for an instrument accounted for as an asset or liability).

For contracts that may be settled in ordinary shares or cash at the holder's option, the entity uses the more dilutive of cash settlement and share settlement in calculating diluted EPS. [IAS 33.60]

Convertible securities

Convertible securities are assumed to be converted at the beginning of the period, or date of issue if later. The numerator is adjusted as described above and the shares issuable are included in the denominator, if the effect is dilutive. [IAS 33.33–36, 49]

IFRS Accounting Standards do not provide specific guidance on the diluted EPS treatment of contingently convertible debt securities with a market price trigger – e.g. debt instruments that contain a conversion feature that becomes exercisable on an entity's share price reaching a predetermined price – and practice may vary.

IFRS Accounting Standards do not provide specific guidance on the diluted EPS treatment of convertible debt instruments that require the issuer to settle the principal amount of the instrument in cash on conversion and permit the issuer to settle the intrinsic value of the conversion option by delivering net shares on conversion, so practice may vary.

Contingently issuable shares

Contingently issuable shares are defined as ordinary shares issuable for little or no cash or other consideration on the satisfaction of specified conditions in a contingent share agreement. If the conditions are satisfied at the reporting date, then they are included in diluted EPS (if they are dilutive) from the later of the beginning of the reporting period and the date of the contingent share agreement. If the conditions are not satisfied, then the number of contingently issuable shares included in diluted EPS is based on the number of shares that would be issuable if the reporting date were the end of the contingency period. [IAS 33.5, 52]

Unlike IFRS Accounting Standards, for contracts that may be settled in ordinary shares or cash at the holder's option, share settlement is presumed, if this is more dilutive. However, unlike IFRS Accounting Standards, for liability-classified share-based payment awards, past practice or a stated policy of settling in cash may provide a reasonable basis to overcome the presumption of share settlement. [260-10-45-45 – 45-45A]

Convertible securities

Like IFRS Accounting Standards, convertible securities are assumed to be converted at the beginning of the period, or date of issue if later. The numerator is adjusted as described above and the shares issuable are included in the denominator, if the effect is dilutive, like IFRS Accounting Standards. This is referred to as the 'if-converted' method under US GAAP. [260-10-45-40(c)]

Unlike IFRS Accounting Standards, US GAAP specifies that contingently convertible debt securities with a market price trigger should always be included in diluted EPS computations (if they are dilutive), regardless of whether the market price trigger has been met. That is, the treatment for diluted EPS does not differ from a non-contingently convertible debt security when there is only a contingent market price trigger. [260-10-45-44]

Unlike IFRS Accounting Standards, the if-converted method is used to calculate diluted EPS for all convertible instruments. However, if the principal is required to be settled in cash, then the interest charge is not added back to the numerator. [260-10-45-40(b)]

Contingently issuable shares

Like IFRS Accounting Standards, contingently issuable shares are defined as shares issuable for little or no cash consideration on the satisfaction of certain conditions under a contingent stock agreement. In addition, like IFRS Accounting Standards, if all necessary conditions have been satisfied by the reporting date, then those shares are included in diluted EPS from the later of the beginning of the reporting period and the date of the contingent share agreement. If the conditions are not satisfied, then the number of contingently issuable shares included in diluted EPS is based on the number of shares that would be issuable if the reporting date were the end of the contingency period, like IFRS Accounting Standards. [260-10-20, 45-48]

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Shares awarded as a share-based payment award that vest on satisfaction of a performance condition (see chapter 4.5) are contingently issuable shares for the purpose of computing diluted EPS. [IAS 33.48]

Contingencies related to earnings targets

If shares are contingently issuable based on achieving or maintaining a specified amount of earnings or a similar target (e.g. cost savings), and the entity attains the specified amount of earnings but is also required to maintain the level of earnings for an additional period after the reporting date, then shares are considered only in the calculation of diluted EPS. The number of additional shares included in diluted EPS is based on the number of ordinary shares that would be issued if the amount of earnings at the reporting date were the amount of earnings at the end of the contingency period. [IAS 33.53]

Contingencies related to price levels

If the number of ordinary shares that are contingently issuable depends on the future market price of the ordinary shares and the effect is dilutive, then the calculation of diluted EPS is based on the number of ordinary shares that would be issued if the market price at the reporting date were the market price at the end of the contingency period. As described above, IFRS Accounting Standards do not provide specific guidance on the diluted EPS treatment of contingently convertible debt securities with a market price trigger – e.g. debt instruments that contain a conversion feature that becomes exercisable on an entity's share price reaching a predetermined price – and practice may vary. [IAS 33.54]

Retrospective adjustment

The current- and prior-period figures for basic and diluted EPS are adjusted for transactions that, other than the conversion of potential ordinary shares, adjust the number of ordinary shares outstanding without a corresponding change in resources (e.g. bonus or rights issue, share split or reverse share split). Basic and diluted EPS are also adjusted for a bonus issue, share split or reverse share split that occurs after the reporting date but before the financial statements are authorised for issue. The number of ordinary shares is adjusted as if the event had occurred at the beginning of the earliest period presented. [IAS 33.26–29, 64, A2]

The conversion of potential ordinary shares does not result in a retrospective adjustment to EPS. [IAS 33.26, 65]

Like IFRS Accounting Standards, share-based payment awards that vest on satisfaction of a performance or market condition (see chapter 4.5) are contingently issuable shares for the purpose of computing diluted EPS. [260-10-45-31]

Contingencies related to earnings targets

Like IFRS Accounting Standards, if an issue of common shares is contingent on attaining a specified level of earnings at a future date, then the number of shares included in diluted EPS is based on actual earnings to date, assuming no future earnings at the reporting date. However, US GAAP also clarifies to assume the current amount of earnings will remain unchanged until the end of the agreement, and differences from IFRS Accounting Standards may arise in practice. [260-10-45-51]

Contingencies related to price levels

Like IFRS Accounting Standards, if an issue of common shares is contingent on attaining or maintaining a specified market price of shares at a future date, and the effect is dilutive, then the number of shares included in diluted EPS is based on the number of common shares that would be issued if the market price at the reporting date were the market price at the end of the contingency period. As described above, unlike IFRS Accounting Standards, this guidance does not apply to contingently convertible debt securities with a market price trigger, which are always included in diluted EPS computations (if they are dilutive), regardless of whether the market price trigger has been met. [260-10-45-44, 45-52]

Retrospective adjustment

Like IFRS Accounting Standards, retrospective adjustment of EPS information for transactions that adjust the number of shares without a corresponding change in resources such as share splits, reverse share splits, share dividends and rights issues is required even if these occur after the reporting date but before the financial statements are issued or available to be issued (for certain non-public entities). Like IFRS Accounting Standards, the number of common shares is adjusted as if the event had occurred at the beginning of the earliest period presented. [260-10-55-12 – 55-13]

Like IFRS Accounting Standards, the conversion of potential common shares – e.g. the conversion of convertible debt into common shares – does not result in a retrospective adjustment to EPS. [260-10-45-40(c)]

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IFRS Accounting Standards do not provide specific guidance on the determination of EPS for distributions in which the shareholder can elect to receive either a cash dividend or a share dividend of equal value – i.e. there is no bonus element to the share dividend. In our view, in such cases the entity is exchanging shares and receiving a corresponding amount in resources – i.e. shares are issued as a dividend in exchange for an equal value of cash savings. The shareholder has given up the fair value of the cash dividend; therefore, we believe that there is a corresponding change in resources. As a result, the shares issued would be factored into the calculation of EPS on a prospective basis, with no restatement of prior-period EPS. Conversely, we believe that if the fair value of a share dividend received exceeds the fair value of the cash alternative, then there is a bonus element that would need to be considered and EPS would be restated in prior periods for the bonus element portion.

Diluted EPS is not restated for any subsequent changes in assumptions made in calculating the effects of conversion of potential ordinary shares, such as the average market price or whether contingently issuable shares will be issued. [IAS 33.65]

EPS figures are not adjusted for ordinary share or potential ordinary share transactions that occur after the reporting date, other than those that adjust the number of shares outstanding without a corresponding change in resources. Instead, these events are disclosed in the financial statements. [IAS 33.64, 70]

In certain arrangements, a shareholder makes an election to receive a dividend in cash or in stock of equal value, subject to limitations on the amount of the dividend to be issued in cash and stock. Unlike IFRS Accounting Standards, US GAAP explicitly requires an entity to account for the stock portion of a dividend as a stock issuance, reflected in EPS prospectively.

Like IFRS Accounting Standards, we believe that if the fair value of a dividend received in stock exceeds the fair value of the cash alternative, then there is a bonus element that would need to be considered and EPS for prior periods would be retrospectively adjusted for the bonus element portion. [505-20-15-3A]

Like IFRS Accounting Standards, diluted EPS is not restated for any subsequent changes in assumptions made in calculating the effects of conversion of potential common shares, such as the average market price or whether contingently issuable shares will be issued. [260-10-45-21]

Like IFRS Accounting Standards, EPS figures are not adjusted for common shares or potential common share transactions that occur after the reporting date other than those that adjust the number of shares outstanding without a corresponding change in resources. Instead, these events are disclosed in the financial statements, like IFRS Accounting Standards. [260-10-50-2]

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5.4 Non-current assets held for sale and discontinued operations

(IFRS 5, IFRIC 17)

Overview

- Non-current assets and some groups of assets and liabilities ('disposal groups') are classified as held-for-sale if their carrying amounts will be recovered principally through sale and specific criteria related to their sale are met.
- Non-current assets and some groups of assets and liabilities ('disposal groups') are classified as held-for-distribution when the entity is committed to distributing the asset or disposal group to its owners.
- The classification, presentation and measurement requirements that apply to items that are classified as held-for-sale generally also apply to a non-current asset or disposal group that is classified as held-for-distribution.
- Non-current assets (or disposal groups) held for sale are measured at the lower of their carrying amount and fair value less costs to sell, and are presented separately in the statement of financial position.
- Assets held for sale or distribution are not amortised or depreciated.
- The comparative statement of financial position is not re-presented when a non-current asset or disposal group is classified as held-for-sale.

5.4 Long-lived assets held for sale and discontinued operations

(Subtopic 205-20, Subtopic 360-10)

Overview

- Like IFRS Accounting Standards, long-lived assets (or disposal groups) are classified as held-for-sale if specific criteria related to their sale are met.
- Unlike IFRS Accounting Standards, there is no special designation for assets held for distribution.
- Unlike IFRS Accounting Standards, there is no special designation for assets held for distribution.
- Like IFRS Accounting Standards, long-lived assets (or disposal groups) held for sale are measured at the lower of their carrying amount and fair value less costs to sell, and are presented separately in the statement of financial position.
- Like IFRS Accounting Standards, assets held for sale are not amortised or depreciated. Unlike IFRS Accounting Standards, assets to be distributed to owners continue to be depreciated or amortised.
- Unlike IFRS Accounting Standards, the comparative statement of financial position is re-presented for discontinued operations. Unlike IFRS Accounting Standards, there is no specific guidance for held-for-sale long-lived assets or disposal groups that are not discontinued operations.

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Overview (continued)

- **A 'discontinued operation' is a component of an entity that either has been disposed of or is classified as held-for-sale. Discontinued operations are limited to those operations that are a separate major line of business or geographic area, and subsidiaries acquired exclusively with a view to resale.**
- **Discontinued operations are presented separately in the statement of profit or loss and OCI, and related cash flow information is disclosed.**
- **The comparative statements of profit or loss and OCI and cash flow information is re-presented for discontinued operations.**

Overview (continued)

- **Like IFRS Accounting Standards, a discontinued operation is a component of an entity that has been disposed of or is classified as held-for-sale. Unlike IFRS Accounting Standards, discontinued operations are limited to (1) those operations that represent a strategic shift that has (or will have) a major effect on an entity's operations and financial results; and (2) a business or non-profit activity that, on acquisition, meets the criteria to be classified as held-for-sale.**
- **Like IFRS Accounting Standards, discontinued operations are presented separately in the statements that report profit or loss and cash flows.**
- **Like IFRS Accounting Standards, the comparative statements that report profit or loss and cash flows are re-presented for discontinued operations.**

Held for sale or held for distribution

The classification, presentation and measurement requirements for non-current assets or disposal groups held for sale also apply to those that are held for distribution to owners acting in their capacity as owners. Therefore, in general, the requirements discussed in this chapter in respect of non-current assets and disposal groups that are classified as held-for-sale also apply to those classified as held-for-distribution. [IFRS 5.A, IFRIC 17.3]

A non-current asset or disposal group is classified as held-for-sale if certain criteria are met (see below). [IFRS 5.6–8]

A 'disposal group' is a group of assets to be disposed of together, by sale or otherwise, in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. [IFRS 5.A]

The held-for-sale *classification and presentation* requirements apply to all non-current assets and disposal groups. [IFRS 5.2]

Held for sale

Unlike IFRS Accounting Standards, there is no special designation for assets held for distribution to owners. As a consequence:

- the US GAAP requirements in this chapter apply only to long-lived assets or disposal groups held for sale; and
- long-lived assets or disposal groups to be disposed of in a distribution to owners (e.g. in a spin-off) continue to be classified as held-and-used until their disposal. [360-10-45-15]

Like IFRS Accounting Standards, a long-lived asset or disposal group is classified as held-for-sale if certain criteria are met (see below). [360-10-35-43, 45-9 – 45-11, 45-15]

Like IFRS Accounting Standards, a 'disposal group' is a group of assets to be disposed of together, in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. [205-20-20]

Unlike IFRS Accounting Standards, the held-for-sale *classification and presentation* requirements do not apply to goodwill, servicing assets, certain financial instruments, deferred policy acquisition costs, deferred tax assets, long-lived assets to be distributed to owners and unproved oil and gas properties accounted for under the successful-efforts method, unless those assets are part of a held-for-sale disposal group. [360-10-15-5]

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The held-for-sale *measurement* requirements do not apply to the following: deferred tax assets (see chapter 3.13), employee benefit assets (see chapter 4.4), financial assets in the scope of the financial instruments standard (see chapter 7.1), investment property measured at fair value (see chapter 3.4) and insurance contracts (see chapter 8.1). [IFRS 5.2, 5]

Classification

A non-current asset (or disposal group) is classified as held-for-sale if the following criteria are met:

- the appropriate level of management is committed to a plan to sell the asset (or disposal group); if a plan for sale requires shareholder approval, then management should consider this in determining whether the criterion is met;
- the asset (or disposal group) is available for immediate sale in its present condition, subject only to terms that are usual and customary for sales of such assets (or disposal groups);
- an active programme to locate a buyer and complete the plan to sell the asset (or disposal group) has been initiated;
- the sale of the asset (or disposal group) is highly probable and transfer of the asset (or disposal group) is expected to qualify for recognition as a completed sale within one year;
- the asset (or disposal group) is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and
- actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. [IFRS 5.6–8, IG.Ex1–7, IU 09-13]

A non-current asset (or disposal group) is classified as held-for-distribution if the entity is committed to the distribution, which is when:

- the assets are available for immediate distribution in their present condition; and
- the distribution is highly probable. [IFRS 5.12A]

Like IFRS Accounting Standards, the held-for-sale *measurement* requirements do not apply to the following: deferred tax assets (see chapter 3.13), financial instruments (see chapter 7.1) and deferred insurance policy acquisition costs (see chapter 8.1). Unlike IFRS Accounting Standards, the held-for-sale *measurement* requirements also do not apply to goodwill (see chapters 3.3 and 3.10), equity-method investees, servicing rights, unproved oil and gas properties accounted for under the successful-efforts method and oil and gas properties accounted for under the full-cost method (see chapter 5.11). However, they do apply to employee benefit assets and insurance contracts, unlike IFRS Accounting Standards. [205-20-50-7, 360-10-15-5]

Classification

Like IFRS Accounting Standards, a long-lived asset (or disposal group) is classified as held-for-sale if the following criteria are met:

- management, having the authority to approve the action, commits to a plan to sell the asset (or disposal group); like IFRS Accounting Standards, if a plan for sale requires shareholder approval, then management should consider this in determining whether the criterion is met;
- the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups);
- an active programme to locate a buyer and other actions required to complete the plan to sell the asset (or disposal group) have been initiated;
- the sale of the asset (or disposal group) is probable and transfer of the asset (or disposal group) is expected to qualify for recognition as a completed sale within one year; although 'probable' rather than 'highly probable' is used under US GAAP, these are intended to be the same threshold so differences of interpretation are not expected;
- the asset (or disposal group) is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and
- actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. [360-10-45-9]

Unlike IFRS Accounting Standards, there is no held-for-distribution designation; long-lived assets to be distributed to owners continue to be classified as held-and-used until they are disposed of. [360-10-45-15]

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A non-current asset (or disposal group) can be classified as held-for-sale if the transaction is subject to shareholder approval based on a qualitative analysis of the substantiveness of the approval process. If substantive shareholder approval for a sale is required, then the sale might not be highly probable until shareholder approval is obtained. [IFRS 5.8]

The expectation for the sale to be completed within one year of the classification as held-for-sale may be extended in certain circumstances. [IFRS 5.9]

If an entity has committed to a sale plan involving the loss of control over a subsidiary, then all assets and liabilities of that subsidiary are classified as held-for-sale when the criteria for held-for-sale classification are met. [IFRS 5.8A]

A non-current asset (or disposal group) acquired exclusively with a view to its subsequent disposal is classified as held-for-sale if it meets the held-for-sale criteria or if it is highly probable that it will meet those criteria within a short period after acquisition, usually within three months. In our view, any non-current asset (or disposal group) that satisfies the criteria to be classified as held-for-sale at the date of its acquisition may be assumed to have been acquired exclusively with a view to its subsequent disposal. [IFRS 5.11, BC72]

A non-current asset (or disposal group) that is to be abandoned is not classified as held-for-sale. [IFRS 5.13]

A non-current asset (or disposal group) that is to be exchanged for other non-current assets is classified as held-for-sale, provided that the expected exchange has commercial substance. [IFRS 5.10]

Classification as held-for-sale or held-for-distribution is prohibited when the criteria are met only after the reporting date. Instead, disclosures are required in the notes to the financial statements. [IFRS 5.12, IAS 10.22(c)]

Like IFRS Accounting Standards, if substantive shareholder approval for a sale is required, then the sale might not be probable until shareholder approval is obtained. Unless shareholder approval is perfunctory – e.g. management holds sufficient shares to assure shareholder approval – shareholder approval is deemed to be substantive. [718-10-55-82]

Like IFRS Accounting Standards, the expectation for the sale to be completed within one year of the classification as held-for-sale may be extended in certain circumstances. [360-10-45-11]

Like IFRS Accounting Standards, if an entity has committed to a sale plan involving the loss of control over a subsidiary, then all assets and liabilities of that subsidiary are classified as held-for-sale when the criteria for held-for-sale classification are met. [360-10-45-11]

Like IFRS Accounting Standards, a long-lived asset (or disposal group) acquired exclusively with a view to its subsequent disposal is classified as held-for-sale if it meets the held-for-sale criteria. Like IFRS Accounting Standards, if it is probable that it will meet those criteria within a short period after acquisition (usually within three months), then it is classified as held-for-sale (see chapter 2.6). [360-10-45-12]

Like IFRS Accounting Standards, a long-lived asset (or disposal group) that is to be abandoned is classified as held-and-used and is not classified as held-for-sale. [360-10-45-15]

Unlike IFRS Accounting Standards, a long-lived asset (or disposal group) that is to be exchanged for other non-monetary assets is classified as held-for-sale, provided that the exchange is reciprocal and measured at fair value.

Like IFRS Accounting Standards, classification as held-for-sale is prohibited when the criteria are met only after the reporting date. Instead, disclosures are required in the notes to the financial statements, like IFRS Accounting Standards. [360-10-45-13]

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Measurement

Before classification as held-for-sale or held-for-distribution, non-current assets and the assets and liabilities in a disposal group are measured in accordance with the accounting standards that normally apply to those items. For example, property, plant and equipment is tested for impairment in accordance with the impairment standard. [IFRS 5.18]

On initial classification as held-for-sale or held-for-distribution, the asset (or disposal group) is measured at the lower of its carrying amount and its fair value less costs to sell (or costs to distribute, as applicable). [IFRS 5.15–15A]

Immediately before each subsequent remeasurement of a disposal group, the carrying amounts of liabilities and any assets excluded from the measurement requirements of the held-for-sale standard are remeasured in accordance with other applicable accounting standards. [IFRS 5.19]

The asset (or disposal group) continues to be measured at the lower of carrying amount and fair value less costs to sell. Excluded assets are *measured* using the accounting standards that normally apply to these items, even if such assets are part of a disposal group. However, the disposal group as a whole is measured in a manner consistent with non-current assets that are held for sale. [IFRS 5.4, 15, 19, 23]

The amount of any gain that can be recognised as a result of an increase in fair value less costs to sell before disposal is limited to the cumulative amount of impairment losses recognised in accordance with the held-for-sale standard and previously in accordance with the impairment standard (see chapter 3.10). In our view, impairment losses in relation to goodwill should generally be included in determining the maximum increase. [IFRS 5.20–22]

Measurement

Unlike IFRS Accounting Standards, before classification as held-for-sale, assets in a disposal group that are subject to the measurement requirements of the held-for-sale Codification Subtopic do not require separate testing for impairment. For example, under US GAAP, property, plant and equipment is not tested for impairment in connection with the classification as held-for-sale. Like IFRS Accounting Standards, assets that are excluded from the held-for-sale measurement requirements (see difference in the measurement scope) and liabilities in a disposal group remain accounted for in accordance with the guidance that normally applies to those items.

However, the applicable requirements may differ from IFRS Accounting Standards, and therefore differences in practice may exist. [360-10-15-4, 35-39]

Like IFRS Accounting Standards, on initial classification as held-for-sale, the asset (or disposal group) is measured at the lower of its carrying amount and its fair value less costs to sell. Unlike IFRS Accounting Standards, there is no held-for-distribution designation. [360-10-35-38, 35-43]

Like IFRS Accounting Standards, immediately before each subsequent remeasurement of a disposal group, the carrying amounts of liabilities and any assets excluded from the measurement requirements of the held-for-sale Codification Subtopic are remeasured in accordance with other applicable Codification topics/subtopics. [360-10-35-39]

Like IFRS Accounting Standards, the asset (or disposal group) continues to be measured at the lower of carrying amount and fair value less costs to sell. Like IFRS Accounting Standards, excluded assets are measured using the Codification topics/subtopics that normally apply to these items, even if such assets are part of a disposal group. However, the disposal group as a whole is measured in a manner consistent with non-current assets that are held for sale, like IFRS Accounting Standards. [360-10-35-39 – 35-40]

Like IFRS Accounting Standards, the amount of any gain that can be recognised as a result of an increase in fair value less costs to sell before disposal is limited to the cumulative amount of losses recognised as a result of writing-down the disposal group to fair value less costs to sell. However, unlike IFRS Accounting Standards, this does not include any impairment losses previously recognised in accordance with the impairment Codification Subtopic (see chapter 3.10). [360-10-35-20, 35-26, 35-28, 35-39 – 35-40, 35-43]

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Gains and losses in respect of assets classified as held-for-sale or held-for-distribution are recognised in profit or loss. [IFRS 5.37]

Any gain or loss not recognised before the date of sale is recognised on the derecognition of the non-current asset or disposal group. [IFRS 5.24]

Assets held for sale or distribution are not amortised or depreciated. [IFRS 5.25]

A disposal group continues to be consolidated while it is held for sale or distribution, even if it was acquired exclusively with a view to subsequent disposal. Accordingly, revenue (e.g. from the sale of inventory) and expenses (including interest) continue to be recognised. A disposal group acquired in a business combination is measured at fair value less costs to sell at the date of acquisition. A less detailed method of acquisition accounting (see chapter 2.6) applies because of disclosure exemptions for disposal groups that are newly acquired subsidiaries and are classified as held-for-sale. [IFRS 3.31, 5.16, 33(b), 39]

A disposal group continues to be classified as held-for-sale even if part of the group (e.g. inventory) is sold separately, as long as the remaining items in the group continue to meet the criteria. [IFRS 5.29]

Reclassification as held-for-use and changes in method of disposal

Non-current assets (or disposal groups) are reclassified from held-for-sale or from held-for-distribution to held-for-use if they no longer meet the criteria to be classified as held-for-sale or held-for-distribution. On reclassification as held-for-use, a non-current asset (or disposal group) is remeasured at the lower of its recoverable amount and the carrying amount before the asset (or disposal group) was classified as held-for-sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset not been classified as held-for-sale or held-for-distribution to owners. 'Recoverable amount' is the higher of the asset's fair value less costs of disposal and its value in use (see chapter 3.10). [IFRS 5.26–27, 29]

Like IFRS Accounting Standards, gains and losses in respect of assets classified as held-for-sale are recognised in profit or loss. [360-10-35-40]

Like IFRS Accounting Standards, any gain or loss not recognised before the date of sale is recognised on the derecognition of the asset or disposal group. [360-10-40-5]

Like IFRS Accounting Standards, assets held for sale are not amortised or depreciated. Unlike IFRS Accounting Standards, assets to be distributed to owners continue to be depreciated or amortised. [360-10-35-43, 45-15]

Like IFRS Accounting Standards, a disposal group continues to be consolidated while it is held for sale, even if it was acquired exclusively with a view to subsequent disposal. Therefore, like IFRS Accounting Standards, revenue and expenses continue to be recognised. Like IFRS Accounting Standards, an acquired disposal group is measured at fair value less costs to sell at acquisition. However, unlike IFRS Accounting Standards full acquisition accounting (see chapter 2.6) applies because there are no held-for-sale disclosure exemptions. [360-10-45-12]

Like IFRS Accounting Standards, a disposal group continues to be classified as held-for-sale even if part of the group is sold separately, as long as the remaining assets in the group continue to meet the criteria. [360-10-35-45]

Reclassification as held-and-used

Like IFRS Accounting Standards, long-lived assets (or disposal groups) are reclassified from held-for-sale to held-and-used if they no longer meet the criteria to be classified as held-for-sale. However, unlike IFRS Accounting Standards, on reclassification as held-and-used, a long-lived asset is measured separately at the lower of its fair value at the date of the decision not to sell, and the carrying amount before the asset was classified as held-for-sale adjusted for any depreciation or amortisation that would have been recognised had the asset not been classified as held-for-sale. Additionally, unlike IFRS Accounting Standards, US GAAP is not specific regarding whether the carrying amount is adjusted for impairment losses that would have been recognised had the asset not been classified as held-for-sale. However, because the held-and-used model would apply once the asset has been reclassified, any impairment indicators would warrant an impairment test under the general impairment requirements (see chapter 3.10). [360-10-35-44, 45-6 – 45-7]

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Normally, reversals of impairments of goodwill are prohibited (see chapter 3.10). In our view, reclassification as held-for-use and the requirement to remeasure on reclassification may create one of the rare circumstances in which reversals of goodwill impairment are recognised. This may occur if the recoverable amount of goodwill exceeds its carrying amount as a result of impairment losses recognised in respect of the held-for-sale disposal group that were allocated to goodwill. [IFRS 5.27, IAS 36.124]

Unlike IFRS Accounting Standards, the reclassification as held-and-used cannot include the reversal of goodwill impairment losses, which is consistent with the usual requirements (see chapter 3.10).

Any resulting adjustment is recognised in profit or loss unless the asset was measured at a revalued amount before its classification as held-for-sale, in which case the adjustment is recognised, in whole or in part, as a revaluation increase or decrease (see chapters 3.2 and 3.3). [IFRS 5.28]

Like IFRS Accounting Standards, any resulting adjustment is recognised in profit or loss. Unlike IFRS Accounting Standards, the revaluation of long-lived assets is not permitted and therefore there are no exceptions from recognising adjustments in profit or loss. [360-10-45-7]

When an interest in an equity-accounted investee classified as held-for-sale or held-for-distribution is reclassified as held-for-use, the equity method (see chapter 3.5) is applied retrospectively from the date of its classification as held-for-sale and comparatives are re-presented. [IFRS 5.28, IAS 28.21]

Unlike IFRS Accounting Standards, the equity method of accounting continues to apply as before as long as the investor holds significant influence. Unlike IFRS Accounting Standards, equity-method investees are not classified as held-for-distribution.

If an entity changes the method of disposal of a non-current asset or disposal group – i.e. reclassifies them from held-for-distribution to held-for-sale (or vice versa) without any time lag – then it continues to apply held-for-distribution or held-for-sale accounting. At the time of the change in method, an entity measures the non-current asset or disposal group at the lower of its carrying amount and fair value less costs to sell/distribute and recognises any write-down or subsequent increase in their fair value less costs to sell/distribute. [IFRS 5.26A]

Unlike IFRS Accounting Standards, there is no held-for-distribution designation; long-lived assets to be distributed to owners continue to be classified as held-and-used until they are disposed of. [360-10-45-15]

Presentation

Assets classified as held-for-sale are presented separately from other assets in the statement of financial position. [IFRS 5.38]

Presentation

Like IFRS Accounting Standards, assets classified as held-for-sale are presented separately from other assets in the statement of financial position. [360-10-45-14]

Assets classified as held-for-distribution are presented separately from other assets in the statement of financial position. [IFRS 5.5A, 38]

Unlike IFRS Accounting Standards, there is no held-for-distribution designation; long-lived assets to be distributed to owners continue to be classified as held-and-used until they are disposed of. [360-10-45-15]

The assets within a disposal group are presented separately from other assets in the statement of financial position; similarly, the liabilities within a disposal group classified as held-for-sale are presented separately from other liabilities in the statement of financial position. The assets and liabilities of a disposal group cannot be offset, unless the offsetting requirements apply (see chapter 3.1). [IFRS 5.38, IAS 1.32–33]

Like IFRS Accounting Standards, the assets and liabilities in the disposal group are presented separately from other assets and liabilities in the statement of financial position. Like IFRS Accounting Standards, the assets and liabilities of a disposal group cannot be offset, unless the offsetting requirements apply (see chapter 3.1). [205-20-45-10, 360-10-45-14]

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The major classes of assets and liabilities classified as held-for-sale or held-for-distribution are presented either in the statement of financial position or in the notes to the financial statements. [IFRS 5.5A, 38]

The comparative statement of financial position is not re-presented to reflect the presentation of assets held for sale or held for distribution in the current period. [IFRS 5.40]

Discontinued operations

Classification

A 'discontinued operation' is a component of an entity that either has been disposed of or is held for sale or for distribution to owners, and:

- represents a separate major line of business or geographic area of operations;
- is part of a co-ordinated single plan to dispose of a separate major line of business or geographic area of operations; or
- is a subsidiary acquired exclusively with a view to resale. [IFRS 5.13, 32]

A 'component' of an entity comprises operations and cash flows that can be distinguished clearly, both operationally and for financial reporting purposes, from the rest of the entity. [IFRS 5.31]

Although the accounting standard refers to 'a separate major line of business or geographic area of operations', there is no reference to a strategic shift in operations.

There are no assets that are precluded from designation as a discontinued operation. [IFRS 5.2]

Like IFRS Accounting Standards, the major classes of assets and liabilities classified as held-for-sale are presented either in the statement of financial position or in the notes to the financial statements. Unlike IFRS Accounting Standards, there is no held-for-distribution designation. [360-10-45-14]

Unlike IFRS Accounting Standards, in the period that a discontinued operation (see below) is disposed of or classified as held-for-sale, the statement(s) of financial position is adjusted to reflect that classification for all prior periods presented. There is no specific guidance for held-for-sale long-lived assets or disposal groups that are not discontinued operations, and practice varies. [205-20-45-10]

Unlike IFRS Accounting Standards, US GAAP has additional disclosure requirements for an individually significant component that is not a discontinued operation, but either has been disposed of or is classified as held-for-sale. [360-10-50-3A]

Discontinued operations

Classification

Unlike IFRS Accounting Standards, a discontinued operation is defined as either:

- a component of an entity that has been disposed of, meets the criteria to be classified as held-for-sale or has been abandoned or spun-off; and represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results; or
- a business or non-profit activity that, on acquisition, meets the criteria to be classified as held-for-sale. [205-20-45]

Like IFRS Accounting Standards, a 'component' of an entity comprises operations and cash flows that can be distinguished clearly, both operationally and for financial reporting purposes, from the rest of the entity. [205-20-20]

Although the requirement for there to be a strategic shift that has (or will have) a major effect on an entity's operations and financial results differs from IFRS Accounting Standards, the examples in the discontinued operations Codification Subtopic include the disposal of a major line of business or major geographic area, like IFRS Accounting Standards. [205-20-45-1C]

Unlike IFRS Accounting Standards, oil and gas properties accounted for under the full-cost method are precluded from designation as a discontinued operation. [360-10-15-5]

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Classification as a discontinued operation occurs at the earlier of the dates on which:

- the entity actually has disposed of the operation or, in our view, the distribution to owners has occurred; and
- the operation meets the criteria to be classified as held-for-sale or held-for-distribution to owners, or is a disposal group that has ceased to be used. [IFRS 5.13, 32]

Classification as a discontinued operation is prohibited if the criteria are met only after the reporting date. Instead, disclosures are required in the notes to the financial statements. [IFRS 5.BC66, IAS 10.22(b)]

Measurement

There are no recognition or measurement impacts from classifying an operation as discontinued. However, a discontinued operation will generally include non-current assets (or disposal group/s) held for sale or distribution to owners, the measurement requirements of which are described above.

Presentation

The results of discontinued operations are presented separately from continuing operations, as a single amount in the statement of profit or loss and OCI. An analysis of this single amount is presented either in the statement of profit or loss and OCI or in the notes to the financial statements. [IFRS 5.33–33A]

IFRS Accounting Standards do not provide guidance on allocating interest to discontinued operations.

IFRS Accounting Standards do not provide guidance on allocating general corporate overheads to a discontinued operation, but in our view revenues and expenses should not be presented as discontinued unless they will cease to be earned/incurred on disposal of the discontinued operation.

Like IFRS Accounting Standards, classification as a discontinued operation occurs at the earlier of the dates on which:

- the entity actually has disposed of the operation (including by distribution to owners); and
- the operation meets the criteria to be classified as held-for-sale or is a disposal group that has ceased to be used. [205-20-45-3]

Like IFRS Accounting Standards, classification as a discontinued operation is prohibited if the criteria are met only after the reporting date. Instead, disclosures are required in the notes to the financial statements, like IFRS Accounting Standards. [360-10-45-13]

Measurement

Like IFRS Accounting Standards, there are no recognition or measurement impacts from classifying an operation as discontinued. Like IFRS Accounting Standards, a discontinued operation will generally include long-lived assets (or disposal group(s)) held for sale, the measurement requirements of which are described above. [205-20-45-3]

Presentation

Like IFRS Accounting Standards, the results of discontinued operations are presented separately from continuing operations, as a single amount in the statement that reports profit or loss. An analysis of this single amount is presented either in the statement that reports profit or loss or in the notes to the financial statements, like IFRS Accounting Standards. [205-20-45-3]

Unlike IFRS Accounting Standards, there is a requirement to allocate to a discontinued operation interest on debt that is to be assumed by a buyer and interest on debt that is required to be repaid as a result of the disposal transaction. The allocation to discontinued operations of other interest is permitted but not required, which may result in differences from IFRS Accounting Standards in practice. [205-20-45-6 – 45-7]

US GAAP prohibits the allocation of general corporate overheads to discontinued operations, which is likely to be the same as practice under IFRS Accounting Standards. [205-20-45-9]

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Net cash flow information attributable to operating, investing and financing activities of discontinued operations is required to be disclosed, either in the statement of cash flows or in the notes to the financial statements. Whatever method of presentation is chosen, the total cash flows from each of operating, investing and financing activities, including both continuing and discontinued operations, are disclosed in the statement of cash flows. [IFRS 5.33, IAS 7.10]

The analysis of the results presented in the statement of profit or loss and OCI and cash flow information is not required for a disposal group that is a newly acquired subsidiary that is classified as held-for-sale on acquisition. [IFRS 5.33(b)–(c)]

The comparative statement of profit or loss and OCI and cash flow information are re-presented each period so that the comparative information given in respect of discontinued operations includes all operations classified as discontinued at the current reporting date. [IFRS 5.34]

Reclassification as continuing

If the component ceases to be classified as held-for-sale, then the related operations are reclassified as continuing and comparatives are re-presented consistently. [IFRS 5.36]

Like IFRS Accounting Standards, cash flow information for discontinued operations is required to be disclosed. However, unlike IFRS Accounting Standards, entities disclose either (1) the total operating and total investing cash flows of the discontinued operations; or (2) the depreciation, amortisation, capital expenditure and significant operating and investing non-cash items. [205-20-50]

In addition, unlike IFRS Accounting Standards, for SEC registrants there are three alternatives for presenting this information:

- combine cash flows from discontinued operations with cash flows from continuing operations within each of the operating, investing and financing categories;
- separately identify cash flows from discontinued operations as a line item within each category; or
- present cash flows from discontinued operations separately, with disclosure of operating, investing and financing activities. [2005 AICPA Conf]

Unlike IFRS Accounting Standards, there are no disclosure exemptions for a disposal group that is a newly acquired subsidiary that is classified as held-for-sale on acquisition. [360-10-50]

Like IFRS Accounting Standards, the comparative statements that include profit or loss and cash flow information are re-presented each period so that the comparative information given in respect of discontinued operations includes all operations classified as discontinued at the current reporting date. [205-20-45-3]

Unlike IFRS Accounting Standards, US GAAP requires specific disclosures about entities' continuing involvement with discontinued operations and disposals of individually significant components that do not qualify as discontinued operations. [205-20-50]

Reclassification as continuing

Like IFRS Accounting Standards, if the component ceases to be classified as held-for-sale, then the related operations are reclassified as continuing and comparatives are re-presented consistently. [360-10-35-44, 45-6 – 45-7]

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5.5 Related party disclosures

(IAS 24)

Overview

- 'Related party relationships' are those involving control (direct or indirect), joint control or significant influence.
- Key management personnel and their close family members are parties related to an entity.
- There are no special recognition or measurement requirements for related party transactions.
- The disclosure of related party relationships between a parent and its subsidiaries is required, even if there have been no transactions between them.
- No disclosure is required in the consolidated financial statements of intra-group transactions eliminated in preparing those statements.
- Comprehensive disclosures of related party transactions are required for each category of related party relationship.
- Key management personnel compensation is disclosed in total and is analysed by component.

5.5 Related party disclosures

(Topic 850)

Overview

- Like IFRS Accounting Standards, 'related party relationships' include those involving direct or indirect control (including common control), joint control or significant influence. Unlike IFRS Accounting Standards, entities that are under significant influence of the same third party could be related parties in certain circumstances.
- Like IFRS Accounting Standards, management and management's immediate family members are parties related to an entity.
- Generally, there are no special recognition or measurement requirements for related party transactions; however, unlike IFRS Accounting Standards, certain Codification topics/subtopics have specific guidance.
- Unlike IFRS Accounting Standards, there is no requirement to disclose related party relationships between a parent and its subsidiaries if there have been no transactions between them.
- Like IFRS Accounting Standards, no disclosure is required in the consolidated financial statements of intra-group transactions eliminated in preparing those statements.
- Like IFRS Accounting Standards, comprehensive disclosures of related party transactions are required. However, unlike IFRS Accounting Standards, there is no requirement for the disclosures to be grouped into categories of related parties.
- Unlike IFRS Accounting Standards, management compensation is not required to be disclosed in the financial statements; however, SEC registrants are required to provide compensation information outside the financial statements for specified members of management and the board.

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Overview (continued)

- **In certain cases, government-related entities are allowed to provide less detailed disclosures of related party transactions.**

Scope

Related party disclosure requirements apply to all entities, with a partial exemption for government-related entities (i.e. entities that are controlled, jointly controlled or significantly influenced by a government; see below). [IAS 24.3, 25]

A government-related entity that applies IFRS Accounting Standards is not exempt from providing related party disclosures; however, there is a partial exemption for transactions with a government and other government-related entities. [IAS 24.25–26]

An entity may elect to apply modified disclosure requirements to transactions and outstanding balances, including commitments, with a government that has control, joint control or significant influence over the entity, or another entity that is under control, joint control or significant influence of the same government. [IAS 24.25–26]

The related parties standard does not establish any recognition or measurement requirements for related party transactions. Related party transactions are accounted for in accordance with the requirements of relevant accounting standards.

Identification of related parties

Related party relationships are generally symmetrical – i.e. if B is related to C for the purposes of C's financial statements, then C is related to B for the purposes of B's financial statements.

Overview (continued)

- **Unlike IFRS Accounting Standards, there is no partial disclosure exemption for government-related entities that prepare financial statements in accordance with US GAAP. However, such entities' financial statements will often be prepared in accordance with US governmental accounting standards, rather than in accordance with US GAAP.**

Scope

Like IFRS Accounting Standards, related party disclosure requirements apply to all entities that prepare financial statements in accordance with US GAAP; however, unlike IFRS Accounting Standards, there is no partial exemption for government-related entities. [850-10-15]

Unlike IFRS Accounting Standards, a government-related entity that prepares US GAAP financial statements is not exempt from providing related party disclosures about transactions with other government-related entities. [850-10-15]

Unlike IFRS Accounting Standards, full disclosure requirements apply to all entities that prepare financial statements in accordance with US GAAP. However, financial statements of government-related entities will often be prepared in accordance with US governmental accounting standards, rather than in accordance with US GAAP. [850-10-15-4]

Like IFRS Accounting Standards, US GAAP generally does not establish recognition or measurement requirements for related party transactions, which are accounted for in accordance with the US GAAP requirements relevant to similar transactions with unrelated parties. However, in certain Codification topics/subtopics (e.g. leases) and SEC literature guidance is prescribed for related party transactions, which may result in differences from IFRS Accounting Standards in practice.

Identification of related parties

Like IFRS Accounting Standards, related party relationships are generally symmetrical. [850-10-20]

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IFRS Accounting Standards

The definition of a related party includes relationships involving direct and indirect control (including common control), joint control and significant influence. However, entities are not related parties simply because both are under significant influence of the same third party. [IAS 24.9, 11]

The definition of a related party includes subsidiaries of associates and joint ventures (see chapter 3.5). [IAS 24.9, 12]

Related parties are not restricted to legal entities. [IAS 24.9–10]

The definition of a related party includes key management personnel of the entity or its parent. 'Key management personnel' are those persons who have authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly; and include directors (both executive and non-executive). In our view, the term also includes directors of any of the entity's parents to the extent that they have authority and responsibility for planning, directing and controlling the entity's activities. In our view, an entity's parent includes the immediate, intermediate and ultimate parent. [IAS 24.9]

The definition of a related party includes close members of the family of a person who is a related party. Such family members are those who may be expected to influence, or be influenced by, the related party in their dealings with the entity. [IAS 24.9, IU 05-15]

Entities under the control or joint control of key management personnel (or their close family members) are also related parties of the reporting entity. However, entities are not related parties simply because they have a director or other member of key management personnel in common, or because a member of key management personnel of one entity has significant influence over the other entity. [IAS 24.9, 11]

US GAAP

Like IFRS Accounting Standards, the definition of related parties includes relationships involving direct and indirect control (including common control), joint control and significant influence. Unlike IFRS Accounting Standards, entities that are under significant influence of the same third party could be related parties in certain circumstances. Also unlike IFRS Accounting Standards, principal owners (who are defined as owners of record or known beneficial owners of more than 10 percent of the voting interests of an entity) are related parties to the entity. [850-10-05, 850-10-20]

Like IFRS Accounting Standards, the definition of a related party includes subsidiaries of equity-method investees (see chapter 3.5). [850-10-15-4]

Like IFRS Accounting Standards, US GAAP does not restrict related parties to legal entities. [850-10-05, 850-10-20]

Unlike IFRS Accounting Standards, US GAAP does not use the term 'key management personnel' for identifying related parties, but instead uses the term 'management', which, like IFRS Accounting Standards, includes those individuals who are responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. US GAAP specifies that this normally includes members of the board of directors, the chief executive officer, chief operating officer, vice presidents of principal business functions, and other persons who perform similar policymaking functions. Although the wording of US GAAP is more prescriptive than IFRS Accounting Standards, all of the individuals and entities identified under US GAAP are likely to be related parties under IFRS Accounting Standards. [850-10-05, 850-10-20]

Like IFRS Accounting Standards, the definition of related parties includes those family members whom a principal owner or member of management might control or influence or by whom they might be controlled or influenced because of a family relationship. However, US GAAP refers to these related parties as 'immediate family members' rather than as 'close family members'. [850-10-05, 850-10-20]

Unlike IFRS Accounting Standards, US GAAP does not state that entities under the control or joint control of key management personnel (or their immediate family members) are related parties of the reporting entity. Rather, an analysis of facts and circumstances is required to conclude whether entities under the control, joint control or significant influence of management (or their immediate family) may be related parties of the entity. However, we do not expect significant differences from IFRS Accounting Standards in practice. Like IFRS Accounting Standards, entities are not related parties simply because they have a director or other member of management in common. [850-10-05, 850-10-20]

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A post-employment benefit plan for employees of the reporting entity or any entity that is a related party of the reporting entity is considered to be a related party of the reporting entity. In our view, a multi-employer plan of which a reporting entity is one of the sponsoring entities is related to the reporting entity even if the reporting entity does not have significant influence or control over the multi-employer plan. [IAS 24.9]

Presentation

There are no specific presentation requirements for related party transactions.

Disclosure

All entities

Control relationships

Parent and subsidiary relationships are disclosed regardless of whether there have been any transactions between the parties. A reporting entity discloses the name of its parent and ultimate controlling party, if different. It also discloses the name of its ultimate parent if it is not disclosed elsewhere in information published with the financial statements. In our view, if the ultimate controlling party of the reporting entity is a person or a group of persons, then the identity of that person or the group of persons and that relationship should be disclosed. [IAS 1.138(c), 24.13–15]

If neither the reporting entity's parent nor the ultimate controlling party produces consolidated financial statements available for public use, then a reporting entity discloses the name of the next most senior parent to the reporting entity's parent that produces financial statements available for public use. [IAS 24.13, 16]

Whereas parent and subsidiary relationships are disclosed regardless of whether transactions between the parties occurred (see above), a reporting entity is not required to disclose other relationships with entities in the same group if there have been no transactions with them (see below). [IAS 24.14, 18]

Transactions

Related party transactions that involve a transfer of resources, services or obligations are disclosed regardless of whether a price is charged. [IAS 24.6, 18, 21]

Like IFRS Accounting Standards, trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management, are related parties. Like IFRS Accounting Standards, we believe a multi-employer plan of which a reporting entity is one of the sponsoring entities is related to the reporting entity even if the reporting entity does not have significant influence or control over the multi-employer plan. [850-10-05]

Presentation

Unlike IFRS Accounting Standards, SEC registrants are required to present related party transactions separately on the face of the balance sheet, income statement and statement of cash flows. [S-X Rule 4-08(k)]

Disclosure

All entities

Control relationships

Unlike IFRS Accounting Standards, there is no specific requirement to disclose related party relationships between a parent and its subsidiaries if there have been no transactions between them.

Unlike IFRS Accounting Standards, there is no specific requirement to disclose the name of the parent, ultimate parent or next most senior parent that produces consolidated financial statements.

Unlike IFRS Accounting Standards, if the reporting entity and one or more other entities are under common ownership or management control, and the existence of that control could result in operating results or a financial position of the reporting entity significantly different from those that would have been obtained if the entities were autonomous, then the nature of the control relationship is disclosed even if there are no transactions between the entities. [850-10-50-6]

Transactions

Like IFRS Accounting Standards, related party transactions that involve a transfer of resources, services or obligations are disclosed regardless of whether a price is charged. [850-10-05-5]

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Management compensation

Key management personnel compensation, including non-executive directors, is disclosed in total and analysed into its components (short-term, post-employment, other long-term, termination and share-based benefits). [IAS 19.7, 24.9, 17–17A, 18A]

In addition to key management personnel compensation, a reporting entity also discloses information about other transactions with key management personnel. Such transactions are disclosed as a separate category of related party transactions. [IAS 24.18]

Other related party transactions

Unless the partial exemption for government-related entities is applied, as a minimum, the following disclosures are provided if there have been transactions between related parties:

- the nature of the related party relationship and information about the transactions, including those to which no amounts were ascribed;
- the amount of the transactions;
- outstanding balances, including commitments, and their terms and conditions (including whether outstanding balances are secured);
- the nature of the consideration to be provided and details of guarantees given or received; and
- any allowance for doubtful debts and any amounts written off during the period. [IAS 24.18, 25]

No disclosure is required in the consolidated financial statements in respect of intra-group transactions eliminated in preparing those statements. [IAS 24.4]

Management compensation

Unlike IFRS Accounting Standards, US GAAP does not require the disclosure of management compensation. However, SEC regulations require disclosure (outside the financial statements) of the compensation of certain members of management and the board, as well as other specific disclosures; however, the type and classification of the information required by SEC regulations differs from the requirements under IFRS Accounting Standards.

Like IFRS Accounting Standards, US GAAP requires the disclosure of information about transactions, other than compensation arrangements and other similar transactions in the ordinary course of business, with management. Unlike IFRS Accounting Standards, US GAAP does not require such disclosure as a separate category of related party transactions. [850-10-50]

Other related party transactions

The following disclosures of transactions between related parties are provided for all entities:

- the nature of the relationship(s) and a description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, like IFRS Accounting Standards;
- the amount of the transactions, if any, like IFRS Accounting Standards;
- the effects of any change in the method of establishing the terms of related party transactions from those used in the preceding period, unlike IFRS Accounting Standards;
- amounts due from or to related parties as at each reporting date presented and, if they are not otherwise apparent, the terms and manner of settlement, like IFRS Accounting Standards; and
- the details of guarantees given or received, like IFRS Accounting Standards. [850-10-50, 460-10-50-6]

Unlike IFRS Accounting Standards, there is no specific requirement to disclose allowances for doubtful debts that have been recognised in respect of balances owing from related party transactions.

Like IFRS Accounting Standards, no disclosure is required in the consolidated financial statements in respect of intra-group transactions eliminated in preparing those statements. [850-10-50-1]

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Disclosure is provided separately for each category of related party. [IAS 24.19]

Items of a similar nature may be disclosed in aggregate as long as the aggregation does not obscure the importance of individually significant transactions. [IAS 24.24]

Related party transactions are required to be disclosed regardless of whether they are entered into on terms equivalent to those in an arm's length transaction. A reporting entity may include in its financial statements a statement that related party transactions were made on terms equivalent to those that prevail in an arm's length transaction only if that statement can be substantiated. [IAS 24.21, 23]

Government-related entities

An entity may elect to apply a partial exemption to disclosures about transactions and outstanding balances, including commitments, with a government that has control, joint control or significant influence over the reporting entity or another entity under control, joint control or significant influence of the same government. An entity applying the partial exemption is exempt from disclosing the information set out under 'Other related party transactions' above. Instead, such an entity discloses:

- the name of the government and the nature of its relationship with the reporting entity;
- the nature and amount of individually significant transactions; and
- for other transactions that are collectively (but not individually) significant, a qualitative or quantitative indication of their extent. [IAS 24.25–26]

Although disclosure of related party transactions is required, disclosures of related party transactions are not required to be made for each category of related party relationship, unlike IFRS Accounting Standards. [850-10-50]

Like IFRS Accounting Standards, items of a similar nature may be disclosed in aggregate as long as the aggregation does not obscure the importance of individually significant transactions. [850-10-50-3]

Like IFRS Accounting Standards, entering into related party transactions on terms equivalent to those in an arm's length transaction does not eliminate related party disclosure requirements. Like IFRS Accounting Standards, representations about transactions with related parties, if they are made, should not imply that the related party transactions were consummated on terms equivalent to those that prevail in an arm's length transaction unless such representations can be substantiated. [850-10-50-5]

Government-related entities

Unlike IFRS Accounting Standards, there is no partial exemption for government-related entities that prepare US GAAP financial statements. However, many government-related entities prepare financial statements in accordance with US governmental accounting standards, rather than in accordance with US GAAP. [850-10-15]

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5.6 Investment entity consolidation exception

(IFRS 10)

Overview

- **Only an entity that meets the definition under the consolidation standard can qualify as an 'investment entity'.**
- **The definition of an investment entity requires an entity to meet certain criteria relating to its activities and its measurement and evaluation of the performance of its investments.**
- **In addition, an entity considers 'typical' characteristics in assessing whether it meets the definition of an investment entity.**
- **An investment entity measures its subsidiaries at fair value, with changes in fair value recognised in profit or loss. As an exception, an investment entity consolidates a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities.**
- **An investment entity measures all of its investments in associates and joint ventures at fair value, regardless of whether they provide services that relate to the investment entity's investment activities.**

5.6 Investment company consolidation exception

(Topic 946)

Overview

- **An entity that meets the definition under US GAAP can qualify as an 'investment company', like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, an entity also qualifies as an investment company by virtue of being regulated under the Investment Company Act of 1940.**
- **Like IFRS Accounting Standards, the definition of an investment company requires an entity to meet certain criteria relating to its activities and its evaluation of investments; however, these criteria differ from IFRS Accounting Standards in certain respects.**
- **In addition, an entity considers 'typical' characteristics in assessing whether it meets the definition of an investment company, like IFRS Accounting Standards; however, these characteristics differ from IFRS Accounting Standards in certain respects.**
- **In general, an investment company measures investments in non-investment company subsidiaries at fair value, with changes in fair value recognised in profit or loss, like IFRS Accounting Standards. As an exception, an investment company consolidates an investment in an operating entity that provides services to it (such that the purpose of the investment is to provide services to the investment company, rather than to realise a gain on such an investment) if the investment company holds a controlling financial interest in the operating entity.**
- **In general, an investment company measures investments in non-controlled entities at fair value, with changes in fair value recognised in profit or loss, like IFRS Accounting Standards. As an exception, an investment company applies the equity method to an operating entity that provides services to the investment company and otherwise qualifies for use of the equity method of accounting, unlike IFRS Accounting Standards.**

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Overview (continued)

- **An investment entity prepares a complete set of financial statements in the usual way, including comparative information.**
- **The investment entity consolidation exception is mandatory for the parent of an investment entity that itself meets the definition of an investment entity.**
- **A parent that is not itself an investment entity consolidates all subsidiaries, including those controlled through an investment entity subsidiary.**

Scope

The investment entity consolidation exception is mandatory for an entity that meets the relevant criteria (see below). Under the consolidation exception, an investment entity is required to measure its subsidiaries at FVTPL. However, it does not apply to subsidiaries that are not themselves investment entities and whose main purpose and activities are providing services that relate to the investment entity's investment activities, which continue to be consolidated (see below). [IFRS 10.31–32, B85E]

The investment entity guidance applies to all sectors.

Overview (continued)

- **Unlike IFRS Accounting Standards, an investment company's financial statements include a schedule of investments and financial highlights; a statement of cash flows is not always required. In addition, unlike IFRS Accounting Standards, there is no requirement to present comparative information except for the statement of changes in net assets and financial highlights for registered investment companies.**
- **Unlike IFRS Accounting Standards, consolidation by an investment company of an investment company subsidiary is not precluded.**
- **Unlike IFRS Accounting Standards, for the purpose of consolidating an investment company, a non-investment company parent retains the investment company accounting applied by a subsidiary if that subsidiary meets the definition of an investment company.**

Scope

An entity meets the definition of an investment company either:

- by virtue of being regulated under the Investment Company Act of 1940, unlike IFRS Accounting Standards; or
- by assessing the characteristics of an investment company and determining whether it meets these characteristics, which differ in some respects from IFRS Accounting Standards (see below). [946-10-15-4 – 15-5]

In general, investments in non-investment company subsidiaries are not consolidated, but instead are measured at fair value, with changes in fair value recognised in profit or loss, like IFRS Accounting Standards. Like IFRS Accounting Standards, this consolidation exception for investment companies is mandatory. However, subsidiaries that are operating entities that provide services to the investment company continue to be consolidated; this exception differs in some respects from IFRS Accounting Standards (see below). [810-10-15-12(d), 946-810-45-2 – 45-3]

Unlike IFRS Accounting Standards, the guidance in the investment company Codification Topic generally does not apply to real estate investment trusts. [946-10-15-3]

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Qualifying investment entities

An entity is an 'investment entity' if it meets the following three 'essential' tests.

- It obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services.
- It commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income or both.
- It measures and evaluates the performance of substantially all of its investments on a fair value basis. [IFRS 10.27, B85A–B85M]

An entity considers the following 'typical' characteristics in assessing whether it meets all three essential tests of the definition of an investment entity.

- It has more than one investment.
- It has more than one investor.
- It has investors that are not related parties.
- It has ownership interests in the form of equity or similar interests. [IFRS 10.28, B85N–B85W, IU 03-17]

The absence of one or more of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity, but indicates that additional judgement is required in determining whether the three essential tests are met. [IFRS 10.28, B85N, IU 03-17]

Assessment of investment company status

An investment company has the following fundamental characteristics.

- Like 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; and
  - commits to its investor(s) that its business purpose and only substantive activities are investing the funds solely for returns from capital appreciation, investment income or both.
- The entity or its affiliates do not obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income. Although the precise wording of US GAAP differs from IFRS Accounting Standards, the overall concept is the same. [946-10-15-6]

Unlike IFRS Accounting Standards, under US GAAP managing on a fair value basis is not a fundamental characteristic; rather, it is a 'typical' characteristic to be considered (see below). Although US GAAP does not include measurement of the entity's investments at fair value as a characteristic, an entity that meets the definition of an investment company generally measures investments in subsidiaries at fair value, and therefore we would not generally expect significant differences in practice. [946-10-15-7, 946-320-35-1, 946-325-35-1]

An entity considers the following 'typical' characteristics in assessing whether it meets the definition of an investment company.

- It has more than one investment, like IFRS Accounting Standards.
- It has more than one investor, like IFRS Accounting Standards.
- It has investors that are not related parties of the parent (if there is a parent) or the investment manager, which is broader than IFRS Accounting Standards.
- It has ownership interests in the form of equity or partnership interests, like IFRS Accounting Standards.
- It manages substantially all of its investments on a fair value basis, which is an 'essential' test under IFRS Accounting Standards (see above). [946-10-15-7]

Like IFRS Accounting Standards, the absence of one or more of these typical characteristics does not necessarily disqualify an entity from being classified as an investment company, but indicates that additional judgement is required in making that determination. [946-10-15-8]

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An entity reassesses its status if facts and circumstances indicate that there has been a change in any of the essential elements of the definition of an investment entity or in the typical characteristics. [IFRS 10.29]

When an entity ceases to qualify as an investment entity, the fair value of an investment at the date of the change in status is the investment's initial carrying amount. When an entity qualifies as an investment entity on a change in status, it recognises the difference between the previous carrying amount of an investment and its fair value at the date of the change in status in profit or loss. [IFRS 10.25–26, 30, B100–101]

Essential tests

An investment entity obtains funds from investors to provide those investors with investment management services. As part of its activities, an investment entity is permitted to provide investment-related services to its investors – e.g. investment advisory services, investment management, investment support and administrative services – either directly or through a subsidiary. Even if the investment-related services are substantial and are also provided to third parties, this does not preclude an entity from qualifying as an investment entity. However, if an entity provides investment-related services to third parties, then it needs to assess whether it still qualifies as an investment entity by considering whether its provision of investment-related services to third parties is ancillary to its core investing activities and therefore does not change its business purpose (see below). [IFRS 10.27(a), B85C, BC240F, IU 03-17]

There is no specific restriction on the assets and liabilities that may be held by an investment entity, although significant assets or liabilities that are unrelated to its investment entity activities may raise questions about whether it has the essential elements of an investment entity (see above).

Providing management services or strategic advice to an investee or providing financial support to an investee (e.g. through a loan, capital commitment or guarantee) is prohibited, unless these activities:

- do not represent a separate substantial business activity or a separate substantial source of income for the entity; and
- are undertaken to maximise the investment return from the investee. [IFRS 10.B85D]

An entity is required to reassess its status when:

- there is a subsequent change in the purpose and design of the entity – although this wording differs from IFRS Accounting Standards, we would not generally expect significant differences in practice; or
- the entity is no longer regulated under the Investment Company Act of 1940, unlike IFRS Accounting Standards. [946-10-25-1]

Like IFRS Accounting Standards, the fair value of an investment at the date of the change in status is the investment's initial carrying amount upon ceasing to be an investment company. Unlike IFRS Accounting Standards, when an entity qualifies as an investment company on a change in status, it accounts for the difference between the previous carrying amount of an investment and its fair value at the date of the change in status as a cumulative-effect adjustment to net assets. [946-10-25-2 – 25-3]

Fundamental characteristics

An investment company may provide investing-related services (e.g. investment advisory or transfer agent services) to other entities, directly or indirectly through an investment in an entity that provides those services, as long as those services are not substantive, which is more restrictive than IFRS Accounting Standards. [946-10-55-5]

In addition, an investment company may provide substantive investing-related services, directly or indirectly through an investment in an entity that provides those services, if the substantive services are provided to the investment company only, which is more restrictive than IFRS Accounting Standards. [946-10-55-5]

Unlike IFRS Accounting Standards, an investment company should not have significant assets or liabilities that are unrelated to its investment company activities, unless they relate to permitted investing-related services provided to the investment company. [946-10-55-4]

Like IFRS Accounting Standards, an investment company may provide management services or financial support to an investee as long as they do not represent a separate substantial business activity or separate substantial source of income and are undertaken to maximise returns from capital appreciation, investment income or both. [946-10-55-10]

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An investment entity commits to its investors that its business purpose is to invest for returns solely from capital appreciation and/or investment income. This commitment could, for example, be included in the offering memorandum, investor communications and/or other corporate or partnership documents. [IFRS 10.27(b), B85B]

A documented potential exit strategy is required for substantially all investments that could be held indefinitely. [IFRS 10.B85F, BC247]

An entity is precluded from qualifying as an investment entity if it, or another member of the group containing the entity, obtains, or has the objective of obtaining, other benefits from its investments that are not available to other parties not related to the investee. This is because these benefits indicate that the entity is investing to earn benefits other than capital appreciation and/or investment income. [IFRS 10.B85I]

An investment entity measures and evaluates the performance of 'substantially all' of its investments on a fair value basis. To meet these requirements:

- fair value information is provided to investors; and
- key management personnel use fair value information as the primary basis for evaluating performance and making investment decisions. [IFRS 10.27(c), B85K]

In addition, to meet the performance measurement and evaluation criterion, the entity needs to account for its investments under the fair value model in all instances permitted by other accounting standards, including:

- investment property;
- financial assets; and
- investments in associates and joint ventures. [IFRS 10.27(c), B85K–B85L]

Measurement

An investment entity is generally required to measure its subsidiaries at FVTPL. [IFRS 10.31–32]

Like IFRS Accounting Standards, evidence of the entity's business purpose and substantive activities may, for example, be included in the entity's offering memorandum, publications distributed by the entity, and other corporate or partnership documents that indicate the investment objectives of the entity. [946-10-55-6]

Like IFRS Accounting Standards, there is an exit strategy requirement. However, unlike IFRS Accounting Standards, an exit strategy is not required for investments held only for returns from investment income. [946-10-55-7]

Like IFRS Accounting Standards, an entity cannot be an investment company if the entity or its affiliates (which could differ from IFRS Accounting Standards) obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income. [946-10-55-8]

An investment company typically manages substantially all of its investments on a fair value basis, like IFRS Accounting Standards. This includes an evaluation of whether fair value is a key component of any of the following:

- how the entity evaluates the performance of its investments;
- how the entity transacts with its investors; and
- how asset-based fees are calculated. [946-10-55-27 – 55-29]

Because the precise language under US GAAP differs from IFRS Accounting Standards, it is possible that differences may arise in practice.

Unlike IFRS Accounting Standards, US GAAP does not include measurement of the entity's investments at fair value as a characteristic needed to meet the definition of an investment company. However, an entity that meets the definition of an investment company generally measures its investments at fair value, and therefore we would not generally expect significant differences in practice. [946-10-15-7 – 15-8, 946-320-35-1, 946-325-35-1]

Measurement

In general, investments in non-investment company subsidiaries are measured at fair value, with changes in fair value recognised in profit or loss, like IFRS Accounting Standards. [946-810-45-2, 946-320-35-1]

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As an exception, an investment entity consolidates a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities. [IFRS 10.32, B85E]

An investment entity is required to measure all of its investments in associates and joint ventures at fair value, with changes in fair value recognised in profit or loss, regardless of whether they provide services that relate to the investment entity's investment activities. [IFRS 10.B85L(b)]

Components of the financial statements

An investment entity prepares a complete set of financial statements in the usual way (see chapter 2.1), including comparative information, except that they will not be consolidated financial statements, unless the investment entity has a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities (see above). In addition, although it is not required, many investment entities choose to present a statement of changes in net assets attributable to the holders of redeemable shares/units.

Parent of investment entity

The investment entity consolidation exception is mandatory for the parent of an investment entity that itself meets the definition of an investment entity. [IFRS 10.33]

The consolidation exception is not carried through to the consolidated financial statements of a parent that is not itself an investment entity – i.e. the parent is nevertheless required to consolidate all subsidiaries, including those controlled through an investment entity subsidiary. [IFRS 10.33]

As an exception, an investment company consolidates an investment in an operating entity that provides services to it (such that the purpose of the investment is to provide services to the investment company, rather than to realise a gain on such an investment) if the investment company holds a controlling financial interest in the operating entity. [946-810-45-3]

In general, an investment company measures investments in non-controlled entities at fair value, with changes in fair value recognised in profit or loss, like IFRS Accounting Standards. As an exception, unlike IFRS Accounting Standards, an investment company applies the equity method to an operating entity (see chapter 3.5) that provides services to the investment company and otherwise qualifies for use of the equity method of accounting. [946-323-45-2]

Components of the financial statements

Unlike IFRS Accounting Standards, an investment company prepares the following as a complete set of financial statements:

- a statement of assets and liabilities, including a schedule of investments;
- a statement of operations;
- a statement of cash flows, unless it is exempt;
- a statement of changes in net assets; and
- financial highlights (presented either as a separate schedule or within the notes to the financial statements). [946-205-45-1, 946-205-50-1]

Unlike IFRS Accounting Standards, there is no requirement to present comparative information except for the statement of changes in net assets and financial highlights for registered investment companies. [946-205-45-1]

Parent of investment company

Unlike IFRS Accounting Standards, consolidation by an investment company of an investment company subsidiary is not precluded and practice under US GAAP varies. Further, the SEC staff has provided guidance on scenarios in which consolidation of an investment company by another investment company is most meaningful. [SEC IM Guidance 2014-11]

Unlike IFRS Accounting Standards, for the purpose of consolidating an investment company, a non-investment company parent retains the investment company accounting applied by the subsidiary if that subsidiary meets the definition of an investment company. [810-10-25-15]

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5.7 Non-monetary transactions

(IFRS 15, IAS 16, IAS 20, IAS 38, IAS 40)

Overview

- **If an entity enters into a non-monetary exchange with a customer as part of its ordinary activities, then generally it applies the guidance on non-cash consideration in the revenue standard.**

- **Non-monetary exchanges with non-customers do not give rise to revenue. If a non-monetary exchange of assets with a non-customer has commercial substance, then the transaction gives rise to a gain or loss. The cost of the asset acquired is generally the fair value of the asset surrendered, adjusted for any cash transferred.**

Non-monetary exchanges with customers

If an entity enters into a non-monetary exchange of goods or services with a customer (other than a counterparty in the same line of business – see below) as part of its ordinary activities, then it applies the guidance on non-cash consideration in the revenue standard (see chapter 4.2). [IFRS 15.A]

Sometimes a customer transfers property, plant and equipment to an entity that will use the contributed assets to connect the customer to a network or provide it with ongoing services. If the entity obtains control of the contributed assets, then it applies the guidance on non-cash consideration in the revenue standard (see chapter 4.2).

If an entity enters into a non-monetary exchange with a counterparty in the same line of business to facilitate sales to (potential) customers, then it does not recognise revenue for the transaction and the accounting is the same as for exchanges with non-customers (see below). [IFRS 15.5(d)]

5.7 Non-monetary transactions

(Topic 845, Topic 606, Subtopic 610-20)

Overview

- **If a non-monetary exchange is with a customer because the asset given up or service provided is part of the entity's ordinary activities, then generally it falls under the guidance on non-cash consideration in the revenue Codification Topic, which differs from IFRS Accounting Standards in some respects.**

- **Like IFRS Accounting Standards, if the exchange of non-monetary assets with a non-customer has commercial substance, then the transaction generally gives rise to a gain or loss. However, unlike IFRS Accounting Standards, additional criteria are required to be met before recognition of a gain or loss. Unlike IFRS Accounting Standards, the cost of the asset acquired is generally its fair value, measured at the date of the contract inception.**

Non-monetary exchanges with customers

If a non-monetary exchange with a customer (other than a counterparty in the same line of business – see below) is part of the entity's ordinary activities, then it falls under the guidance on non-cash consideration in the revenue Codification Topic, which differs from IFRS Accounting Standards in some respects (see chapter 4.2). [606 Glossary]

Sometimes a customer transfers property, plant and equipment to an entity that will use the contributed assets to connect the customer to a network or provide it with ongoing services. Like IFRS Accounting Standards, if the entity obtains control of the contributed assets, then it applies the guidance on non-cash consideration in the revenue Codification Topic, which differs from IFRS Accounting Standards in some respects (see chapter 4.2).

Like IFRS Accounting Standards, an exception arises if the exchange is with a counterparty in the same line of business to facilitate sales to (potential) customers. In that case, unlike IFRS Accounting Standards, the transaction is measured at the carrying amount of the asset given up and there is no revenue, gain or loss recognition. [606-10-15-2(e), 845-10-30-16]

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Other non-monetary exchanges

Non-monetary exchanges with non-customers do not give rise to revenue. [IFRS 15.5, A]

If a non-monetary exchange of assets with a non-customer has commercial substance, then the transaction gives rise to a gain or loss. The cost of the asset acquired is generally the fair value of the asset surrendered, adjusted for any cash transferred. [IAS 16.6, 24, 38.45, 40.27]

If a non-monetary exchange of assets lacks commercial substance or if the fair value of neither the asset received nor the asset given up is reliably measurable, then no gain is recognised; instead, the acquired asset is recognised initially at the carrying amount of the asset surrendered. [IAS 16.24, 38.45, 40.27]

An exchange transaction has 'commercial substance' if:

- the configuration of the cash flows (i.e. the amount, timing and uncertainty) of the assets received and transferred is different; or
- the entity-specific value of the portion of the entity's operation affected by the transaction changes as a result of the exchange; and
- the difference in both of the above situations is significant when compared with the fair value of the assets exchanged. [IAS 16.25, 38.46, 40.28]

Other non-monetary exchanges

Like IFRS Accounting Standards, non-monetary exchanges with non-customers do not give rise to revenue. [610-20-05-1]

Like IFRS Accounting Standards, if the exchange of non-monetary assets with a non-customer has commercial substance, then the transaction generally gives rise to a gain or loss. Unlike IFRS Accounting Standards, the cost of the asset acquired is its fair value, measured at the date of the contract inception. Only if an entity cannot make a reasonable estimate of the fair value does it refer to the stand-alone selling price of asset(s) given up. [610-20-25-5, 25-6, 32-2, 32-3, 606-10-32-21, 32-22]

Like IFRS Accounting Standards, if an exchange of non-monetary assets lacks commercial substance, then no gain is recognised; in our experience, the acquired asset is recognised initially at the carrying amount of the asset surrendered. [610-20-25-5 – 25-6]

Like IFRS Accounting Standards, an exchange transaction has 'commercial substance' if the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract. However, unlike IFRS Accounting Standards, there is no alternative criterion based on the value of an entity's operations. Unlike IFRS Accounting Standards, all of the following criteria must also be met before income can be recognised:

- the contract is approved and the parties are committed to their obligations;
- rights to goods or services and payment terms can be identified; and
- collection of consideration is 'probable'. [606-10-25-1, 610-20-25-5]

Unlike IFRS Accounting Standards, if the exchange is with a counterparty in the same line of business to facilitate sales to (potential) customers, regardless of whether the counterparty is considered a customer, the transaction is measured at the carrying amount of the asset given up and there is no gain or loss recognition. [845-10-30-16]

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Assets received from government

If assets are transferred to the entity by the government, then such transfers normally meet the definition of a government grant (see chapter 4.3). [IAS 20.3]

Assets received from owners

Assets or resources transferred to an entity by a shareholder for no consideration are normally equity contributions that are recognised directly in equity (see chapter 7.3). [CF 6.82]

Assets received from government

Unlike IFRS Accounting Standards, US GAAP does not provide specific guidance on assets donated by the government to for-profit entities (see chapter 4.3). If the government is determined to be a customer, the entity applies the non-cash consideration guidance in the revenue Codification Topic, which differs from IFRS Accounting Standards in some respects (see chapter 4.2). [958-605, 606-10-15-2A]

Assets received from owners

Like IFRS Accounting Standards, assets or resources transferred to an entity by a shareholder for no consideration are normally equity contributions that are recognised directly in equity (see chapter 7.3). [845-10-05-4]

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5.8 Accompanying financial and other information

(IAS 1, IFRS Practice Statement 1)

Overview

- **IFRS Accounting Standards do not require supplementary financial and operational information to be presented.**
- **An entity considers its particular legal or regulatory requirements in assessing what information is disclosed in addition to that required by IFRS Accounting Standards.**
- **IFRS Accounting Standards do not contain any requirements for MD&A, either as part of the financial statements or outside the financial statements.**

In addition to disclosing additional information in the financial statements to achieve a fair presentation (see chapter 1.1), many entities provide further information to accompany the financial statements. Accompanying information may be provided either voluntarily or because of regulatory requirements.

5.8 Accompanying financial and other information

(Reg G, Reg S-K, Reg S-X)

Overview

- **Like IFRS Accounting Standards, a financial and operational review is not required. However, unlike IFRS Accounting Standards, SEC registrants are required to include MD&A in their annual and interim reports. Such information is presented outside the financial statements.**
- **Like IFRS Accounting Standards, an entity considers the legal, securities exchange or SEC requirements in assessing the information to be disclosed in addition to US GAAP requirements.**
- **Unlike IFRS Accounting Standards, SEC registrants are required to include MD&A in their annual and interim reports. Although this is not required for non-SEC registrants, sometimes they include MD&A in their annual reports.**

Like IFRS Accounting Standards, in addition to disclosing additional information in the financial statements to achieve a fair presentation (see chapter 1.1), many entities provide further information to accompany the financial statements. Accompanying information may be provided either voluntarily or because of regulatory requirements; in the US, many regulatory requirements relate to the securities exchanges and the SEC.

SEC requirements guide the content of additional information that is required to be included in the financial statements and outside the financial statements in regulatory filings of SEC registrants. Additional information required by the SEC on Form 10-K or 20-F includes, but is not limited to:

- supplementary financial information (e.g. schedule of loans);
- quantitative and qualitative disclosures on market risk (see chapter 7.10);
- the effectiveness of disclosure controls and procedures; and
- certain prescribed financial schedules and exhibits.

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IFRS Accounting Standards	US GAAP
IFRS Accounting Standards are not based on any particular legal or regulatory framework. However, the IASB has published guidance in the form of IFRS Practice Statement 1 *Management Commentary*, which is not an accounting standard and is not mandatory.	Unlike IFRS Accounting Standards, although companies outside the US apply US GAAP and US companies have operations outside the US, US GAAP has been developed to a substantial degree with the US legal and regulatory environment in mind. Unlike IFRS Accounting Standards, SEC registrants are required to include MD&A in their annual reports filed with the SEC. For non-SEC registrants, US GAAP does not provide either mandatory or optional guidance on management commentary; however, some non-SEC registrants include MD&A in their annual reports.
IFRS Accounting Standards do not contain any requirements for MD&A, either as part of the financial statements or outside the financial statements.	Like IFRS Accounting Standards, there is no requirement in US GAAP for MD&A. However, the SEC requires MD&A of financial condition and results of operations and quantitative and qualitative disclosures about market risk to be included as part of a registrant's annual and interim filings; however, MD&A is not part of the financial statements.
IFRS Accounting Standards do not contain any requirement for the financial statements of other entities to be presented, either within or outside the reporting entity's financial statements.	Like IFRS Accounting Standards, there is no requirement in US GAAP for the financial statements of other entities to be presented. However, SEC regulations may require presentation of the financial statements of other related entities. These requirements vary depending on whether an entity is domestic or foreign, the filing is a periodic report (e.g. annual report) or for capital raising, and the significance of the other entity to the reporting entity. Examples of the financial statements that might be required include those of: • significant acquirees; • significant investees; • guarantors; • affiliates whose securities collateralise the registrant's securities; and • entities that have significant restricted net assets.
IFRS Accounting Standards do not prohibit the presentation of subtotals, including certain alternative earnings measures such as EBITDA, in the statement of profit or loss and OCI (see chapter 4.1). IFRS Accounting Standards also do not limit the presentation of alternative earnings measures outside the financial statements.	Like IFRS Accounting Standards, US GAAP does not limit the presentation of information outside the financial statements. However, unlike IFRS Accounting Standards, SEC rules define non-GAAP measures as numerical measures of financial performance, financial position or cash flows that (1) exclude amounts that are included in the most directly comparable measure calculated and presented in accordance with US GAAP, or (2) include amounts that are excluded from the most directly comparable measure calculated and presented in accordance with US GAAP. SEC regulations prohibit the presentation of non-GAAP measures in the financial statements, with a narrow exception for certain voluntarily disclosed non-GAAP segment profit or loss measures (see chapter 5.2). Further, SEC regulations require non-GAAP measures to be reconciled to the most directly comparable US GAAP measure. In addition, management should disclose why the measure is useful to investors (see chapter 4.1), unlike IFRS Accounting Standards. [Reg G, S-K]

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Certain disclosures required by specific accounting standards may be presented outside the financial statements with a cross-reference to those disclosures from the financial statements, as long as the accompanying information is available to users of the financial statements on the same terms as the financial statements and at the same time. In our view, if such information is presented outside the financial statements, then it should be marked clearly as being part of the disclosures required by IFRS Accounting Standards and cross-referenced to the financial statements.
[IFRS 4.IG62, 7.B6, 14.31, IAS 34.16A]

Forthcoming requirements

A new presentation and disclosure standard is effective for annual periods beginning on or after 1 January 2027; early adoption is permitted. [IFRS 18.C1]

The new accounting standard defines 'management-defined performance measures' (MPMs) and requires such measures to be disclosed in a single note to the financial statements. MPMs capture some, but not all, non-GAAP measures. An entity needs to assess public communications outside the financial statements to identify subtotals of income and expenses that may meet the definition of an MPM. [IFRS 18.117–120, BC364]

For further discussion, see chapter 4.1A.

Unlike IFRS Accounting Standards, SEC Regulation S-K requires quantitative and qualitative disclosure about market risk related to certain financial instruments in MD&A, which is not part of the financial statements and is expressly subject to the statutory safe harbour provisions of the Securities Act and the Exchange Act. Unlike IFRS Accounting Standards, all information that is a part of the financial statements is included within the financial statements.

Forthcoming requirements

There are no forthcoming requirements under US GAAP.

Unlike IFRS Accounting Standards, US GAAP does not include the concept of MPMs. Instead, SEC regulations define non-GAAP measures and prohibit SEC registrants from presenting them in the financial statements, with a narrow exception for certain voluntarily disclosed non-GAAP segment profit or loss measures (see chapter 5.2).
[Reg G, Reg S-K Rule 10(e)]

For further discussion, see chapter 4.1A.

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5.9 Interim financial reporting

(IAS 34, IFRIC 10)

Overview

- **Interim financial statements contain either a complete or a condensed set of financial statements for a period shorter than a financial year.**
- **At least the following are presented in condensed interim financial statements: condensed statement of financial position, condensed statement of profit or loss and OCI, condensed statement of changes in equity, condensed statement of cash flows, and selected explanatory notes.**
- **Other than income tax, items are recognised and measured as if the interim period were a discrete stand-alone period.**
- **Income tax expense for an interim period is based on an estimated average annual effective income tax rate.**
- **The accounting policies applied in the interim financial statements are generally those that will be applied in the next annual financial statements.**

Scope

An entity is not required to prepare interim financial statements in accordance with the interim reporting standard in order for its annual financial statements to comply with IFRS Accounting Standards. [IAS 34.1]

5.9 Interim financial reporting

(Topic 270, Subtopic 740-270)

Overview

- **Like IFRS Accounting Standards, interim financial statements contain either a complete or a condensed set of financial statements for a period shorter than a financial year.**
- **Like IFRS Accounting Standards, at least the following are presented in condensed interim financial statements: condensed statement of financial position, condensed statement of comprehensive income, condensed statement of cash flows, and selected explanatory notes. Changes in equity may be presented either in a separate statement (like IFRS Accounting Standards) or in the notes to the financial statements (unlike IFRS Accounting Standards).**
- **Unlike IFRS Accounting Standards, each interim period is viewed as an integral part of the annual period to which it relates.**
- **Like IFRS Accounting Standards, income tax expense for an interim period is based on an estimated average annual effective income tax rate. However, US GAAP has more detailed guidance than IFRS Accounting Standards.**
- **Like IFRS Accounting Standards, the accounting policies applied in the interim financial statements are generally those that will be applied in the next annual financial statements.**

Scope

Like IFRS Accounting Standards, the interim reporting Codification Topic does not mandate that interim financial statements be presented in order for the annual financial statements to comply with US GAAP. However, SEC regulations require US domestic registrants to prepare and file interim financial statements, on a quarterly basis.

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Sometimes a *complete* set of financial statements is published for an interim period, prepared in accordance with IFRS Accounting Standards. The form and content of those financial statements comply with the requirements of full IFRS Accounting Standards for annual financial statements (see chapter 2.2), although the recognition and measurement requirements of the interim reporting standard still apply, as well as the requirements for the presentation of comparatives. However, more commonly entities prepare a condensed set of financial statements in accordance with the interim reporting standard. [IAS 34.1–3, 7, 9, 19]

Form and content of condensed interim financial statements

Condensed interim financial statements include at least:

- a condensed statement of financial position as at the end of the current interim period and at the end of the immediately preceding financial year;
- a condensed statement of profit or loss and OCI for the current interim period and cumulatively for the year to date, and for the comparable interim periods (current and cumulative) of the immediately preceding financial year;
- a condensed statement of cash flows, cumulatively for the current year to date and for the comparable year-to-date period of the immediately preceding financial year;
- a condensed statement of changes in equity, cumulatively for the current year to date and for the comparable year-to-date period of the immediately preceding financial year; and
- certain explanatory notes. [IAS 34.8, 20]

Condensed interim financial statements include, at a minimum, each of the headings and subtotals that were included in the most recent annual financial statements. Additional line items are included if their omission would make the financial statements misleading. The objective is to ensure that the condensed financial statements include all information that is relevant to an understanding of an entity's financial position and performance as well as its ability to generate cash flows and its needs to use those cash flows. A three-line presentation in the condensed statement of cash flows – i.e. showing only a total for cash flows from each operating, investing and financing activity – would not generally meet these requirements. [IAS 34.10, 25, IU 07-14]

Sometimes a *complete* set of financial statements is published for an interim period, prepared in accordance with US GAAP. Like IFRS Accounting Standards, the form and content of those financial statements comply with the requirements of US GAAP for annual financial statements (see chapter 2.2). Like IFRS Accounting Standards, the recognition and measurement requirements of the interim reporting Codification Topic apply, as well as the requirements for the presentation of comparatives. More commonly, like IFRS Accounting Standards, condensed financial statements are prepared. [270-10-50, S-X Rule 10-01]

Form and content of condensed interim financial statements

Like IFRS Accounting Standards, condensed interim financial statements for SEC registrants include at least:

- a condensed statement of financial position as at the end of the current interim period and at the end of the immediately preceding financial year;
- a condensed statement of comprehensive income, for the current interim period and cumulatively for the year to date, and for the comparable interim periods (current and cumulative) of the immediately preceding financial year;
- a condensed statement of cash flows, cumulatively for the current year to date and for the comparable year-to-date period of the immediately preceding financial year; and
- certain explanatory notes. [270-10-50, S-X Rule 10-01]

However, SEC registrants may present an analysis of the changes in equity for the current and comparative year-to-date periods, with subtotals for each interim period, in a separate statement (like IFRS Accounting Standards) or in the notes to the financial statements (unlike IFRS Accounting Standards). Unlike IFRS Accounting Standards, US GAAP does not address whether this analysis may be presented in a condensed format. [S-X Rule 10-01(a)(7)]

Unlike IFRS Accounting Standards, the most recent annual financial statements do not establish a minimum requirement for the headings and subtotals to be included in the interim financial statements. SEC registrants are permitted to present only major captions, subject to limitations. Unlike IFRS Accounting Standards, the statement of cash flows may be abbreviated, starting with a single figure of net cash flows from operating activities and showing cash changes from investing and financing activities individually only when they exceed 10 percent of the average of net cash flows from operating activities for the most recent three years. [S-X Rule 10-01(a)]

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Basic and diluted EPS are presented in the condensed interim statement of profit or loss and OCI for each class of ordinary shares of the parent entity, with equal prominence (see chapter 5.3). The interim reporting standard does not specify the component(s) of earnings for which basic and diluted EPS should be presented in condensed interim financial statements. However, if a discontinued operation is reported, then EPS amounts for continuing operations may be material to an understanding of the interim period, in which case they are disclosed in addition to EPS for total operations in the condensed interim financial statements. [IAS 34.11–11A, 15]

Entities with highly seasonal activities are encouraged to supplement the required disclosures with information for the 12-month period ending on the interim reporting date, as well as comparatives. [IAS 34.21]

An entity provides explanatory notes, including a description of any transactions and events that are significant to an understanding of the changes in its financial position and performance since the last annual reporting date. Entities are not required to repeat or provide insignificant updates to information already reported in the most recent annual financial statements. [IAS 34.15–16A, IU 07-09]

Certain disclosures, if they are not included in the notes to interim financial statements, may be incorporated by cross-reference from the interim financial statements to another part of the interim financial report that is available to users of the interim financial statements on the same terms and at the same time as the interim financial statements. [IAS 34.16A]

Recognition and measurement in condensed interim financial statements

Generally, items are required to be recognised and measured as if the interim period were a discrete stand-alone period. However, the tax charge is based on the expected weighted-average effective rate for the full year. [IAS 34.29–30]

Like IFRS Accounting Standards, both basic and diluted EPS are presented in the condensed interim statement of comprehensive income for each class of common shares, with equal prominence (see chapter 5.3). Unlike IFRS Accounting Standards, US GAAP requires presentation of basic and diluted EPS for both continuing operations and net income in the statement that reports profit or loss, for each class of common shares, with equal prominence. [270-10-50-1]

Like IFRS Accounting Standards, US GAAP encourages entities that are subject to significant seasonal variations to supplement their required disclosures with information for the 12-month period ending on the interim reporting date, as well as comparatives. [270-10-45-11]

Like IFRS Accounting Standards, an entity provides explanatory notes, including a description of any transactions and events that may be significant to an understanding of the current interim period. Entities are not required to repeat or provide insignificant updates to information already reported in the most recent annual financial statements, like IFRS Accounting Standards. [270-10-50]

Unlike IFRS Accounting Standards, disclosures related to the interim financial statements cannot be provided elsewhere in the interim financial report and cross-referenced in the interim financial statements. [17 CFR 240.12b-23]

Recognition and measurement in condensed interim financial statements

Unlike IFRS Accounting Standards, US GAAP is based on the notion that each interim period is an integral part of an annual period. Accordingly, although the results of each interim period are generally based on the accounting policies and practices used by an entity in preparing its annual financial statements, US GAAP allows for certain modifications at interim reporting dates so that the reported results for the interim period may relate better to the results of operations for the annual period – e.g. lower of cost and market adjustments for inventory (see chapter 3.8). The tax charge is based on the estimated annual effective rate, like IFRS Accounting Standards. [270-10-45, 270-740]

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The conditions for recognising expenses and provisions are the same for interim financial statements as for annual financial statements. Therefore, losses, expenses and income are recognised as they are incurred and may not be anticipated (see chapter 3.12). Similarly, costs and income that are incurred or earned unevenly during the financial year are anticipated or deferred at the end of the interim reporting period only if it would also be appropriate to anticipate or defer that type of cost or income at the annual reporting date. [IAS 34.37, 39]

An entity is prohibited from reversing an impairment loss recognised in a previous interim period in respect of goodwill. This specific prohibition is not applied by analogy to other transactions and events. [IFRIC 10.8]

Assets measured at fair value

The carrying amount of assets that are measured at fair value (e.g. investment property) is determined at the interim reporting date. The fair value assessment may involve a higher degree of estimation than is used for the annual financial statements. [IAS 34.IE.C7]

Income tax expense

The income tax expense or benefit for an interim period comprises both current tax and deferred tax.

The income tax expense recognised in each interim period is based on the best estimate of the weighted-average annual rate expected for the full year applied to the pre-tax income of the interim period. [IAS 34.30(c), IE.B12–B16]

The effective rate applied to the interim period reflects enacted or substantively enacted changes in tax rates (see chapter 3.13). [IAS 34.IE.B13]

An adjustment to current tax relating to prior periods is treated as a change in estimate, unless there is an indication that it is the result of an error. In our view, the related tax charge or credit should be recognised in full in the interim period in which it becomes probable that such an adjustment is required.

Like IFRS Accounting Standards, under US GAAP recognition of expenses and income is generally the same for interim financial statements as for annual financial statements. However, unlike IFRS Accounting Standards, US GAAP permits certain principles and practices used in the preparation of the annual financial statements to be modified for the purposes of interim financial statements. For example, US GAAP provides specific guidance related to determining inventory costs in interim periods. [270-10-45]

Like IFRS Accounting Standards, an entity is prohibited from reversing an impairment loss recognised in a previous interim period in respect of goodwill. Unlike IFRS Accounting Standards, US GAAP also precludes the reversal of an impairment loss recognised on long-lived assets in a previous interim period. [350-20-35-13, 360-10-35-20]

Assets measured at fair value

Like IFRS Accounting Standards, the carrying amount of assets that are measured at fair value is determined at the interim reporting date. The fair value assessment for the purposes of interim financial statements is generally the same as is used for the annual financial statements, which may be stricter than the requirement under IFRS Accounting Standards. Additionally, differences exist between IFRS Accounting Standards and US GAAP in respect of the assets that are measured at fair value, which are discussed in other chapters of this publication (e.g. property, plant and equipment in chapter 3.2). [270-10-45-2]

Income tax expense

Like IFRS Accounting Standards, the income tax expense or benefit for an interim period comprises both current tax and deferred tax. [740-270-25]

Like IFRS Accounting Standards, income tax expense recognised in each interim period is based on the best estimate of the effective tax rate expected to be applicable for the full year applied to the pre-tax income of the interim period. [740-270-25]

Unlike IFRS Accounting Standards, the effective rate applied to the interim period reflects only enacted tax rates (see chapter 3.13). [740-270-25]

Like IFRS Accounting Standards, an adjustment to current tax relating to prior periods is recognised in full in the interim period in which it is determined that such an adjustment is required, unless it is the result of an error. [740-270-25]

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In our view, if a change in tax rate is enacted or substantively enacted in an interim period, then an entity should develop an accounting policy, to be applied consistently, to either:

- recognise the effect of the change immediately in the interim period in which the change occurs; or
- spread it over the remainder of the annual reporting period via an adjustment to the estimated annual effective income tax rate.

We believe that whether the change in tax rate is triggered by a one-off event may be a relevant consideration in developing an accounting policy that results in information that is reliable and relevant to users of financial statements (see chapter 2.8). [IAS 34.30(c), IE.B19]

Anticipated tax benefits from tax credits are generally reflected in computing the estimated annual effective tax rate when the credits are granted and calculated on an annual basis. However, if the credits relate to a one-off event, then they are recognised in the interim period in which the event occurs. [IAS 34.IE.B19]

There are no specific criteria in addition to the general criteria for the recognition of a deferred tax asset in an interim period to be applied under IFRS Accounting Standards.

If different income tax rates apply to different categories of income (e.g. capital gains) or to different tax jurisdictions, then a separate rate is applied to each category in the interim period, to the extent practicable. However, a weighted-average rate across jurisdictions and income categories may be used if it is a reasonable approximation of the effect of using more specific rates. [IAS 34.IE.B14]

Unlike IFRS Accounting Standards, if a change in tax rate is enacted in an interim period, an entity is required to:

- recognise the effect of the change on deferred tax immediately in the interim period in which the change occurs;
- spread the effect of the change on current taxes for the current year over the remainder of the annual reporting period via an adjustment to the estimated annual effective tax rate; and
- recognise the effect of the change on current taxes for a prior year immediately in the interim period in which the change occurs. [740-270-25]

Like IFRS Accounting Standards, anticipated tax benefits from tax credits are generally reflected in computing the estimated annual effective tax rate when the credits are granted and calculated on an annual basis. However, if the credits relate to a significant unusual or infrequent item reported separately or reported net of the related tax effect, then they are recognised in the interim period in which the event occurs, like IFRS Accounting Standards. However, because more guidance exists under US GAAP, differences from IFRS Accounting Standards may arise in practice. [740-270-30]

In addition to applying the general criteria for the recognition of a deferred tax asset at each interim reporting date (see chapter 3.13), the tax benefits need to be expected to be (1) realised during the annual reporting period; or (2) recognisable as a deferred tax asset at the annual reporting date, unlike IFRS Accounting Standards. Subject to these limitations, the estimated tax benefit of the loss is considered in determining the estimated effective tax rate for the year, like IFRS Accounting Standards. Because of the greater level of detail under US GAAP, differences from IFRS Accounting Standards may arise in practice. [740-270-30]

Unlike IFRS Accounting Standards, the estimated annual effective tax rate is used to allocate expected annual income tax expense to interim periods. Generally, the expected annual effective tax rate includes the expected benefits from tax credits, statutory depletion, tax planning strategies, capital gain rates and alternative tax systems. An entity with multiple jurisdictions generally computes one overall effective rate; however, the ordinary income or loss and related tax or benefit in a jurisdiction is excluded if the entity anticipates an ordinary loss for which no benefit can be recognised in that jurisdiction or if the entity is unable to make an estimate of ordinary income or the related tax for the jurisdiction. [740-270-30]

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Management's estimate of the recoverability of unused tax losses may change during an interim period. In our view, an entity should develop an accounting policy, to be applied consistently, to either:

- recognise such a change in full in the interim period in which the change occurs; or
- reflect the change in calculating the expected annual effective tax rate.

In developing an accounting policy, an entity considers relevant factors. For example, if the change in estimate is triggered by a one-off event (e.g. receiving a one-off tax relief in the form of additional tax deductions), then an entity may determine that it is more appropriate to reflect the change in full in the interim period in which the event occurs.

We believe that an entity should follow the same approach in developing an accounting policy for recognising changes in estimate of the recoverability of deductible temporary differences.

Other expenses

Advertising expenses are generally expensed when they are incurred. [IAS 2.16, 16.19(b), 38.69(c), SIC-32.8–9]

Accounting policies

The accounting policies followed in the interim financial statements are generally the same as those applied in the previous annual financial statements, except for changes in accounting policies made during the current financial year. [IAS 34.28]

Any new or revised accounting standard is applied to all interim periods within the annual period in which it is first adopted, unless the transitional requirements of the accounting standard permit or require a different transition. [IAS 34.43]

Changes in accounting policy adopted after the first interim period are normally presented by restating the financial statements for the prior interim periods of the current annual reporting period as well as the comparative interim periods presented. [IAS 34.43–45]

Unlike IFRS Accounting Standards, the effect of a change in a valuation allowance is recognised in interim periods as follows.

- The effect of a change expected to be necessary at the end of the year for deductible temporary differences and carry-forwards originating during the year is generally included in the estimated annual effective tax.
- The effect of a change in the estimate of the beginning-of-year valuation allowance as the result of a change in judgement about realisability in future years is recognised in the interim period in which the change occurs.
- The tax benefit of a change in the beginning-of-year valuation allowance as a result of ordinary income in the current year is generally included in the estimated annual effective tax rate and allocated to items other than continuing operations only if the event that is not part of continuing operations causes the change in valuation allowance. [740-270-25-7, 30-7, 30-11]

Because there is a greater level of detail under US GAAP, particularly regarding special deduction items, differences from IFRS Accounting Standards may arise in practice.

Other expenses

Unlike IFRS Accounting Standards, the guidance on interim reporting may support a policy under which advertising expenses are accrued and deferred beyond the interim period in which the expenditure is made. [270-10-45-9(d)]

Accounting principles

Like IFRS Accounting Standards, the accounting principles (policies) followed in the interim report are generally the same as those applied in the previous annual financial statements, except for changes in accounting principles made during the current financial year. [270-10-45]

Like IFRS Accounting Standards, any new Codification requirement is applied to all interim periods within the annual period in which it is first adopted, unless the transitional requirements of the Codification topic/subtopic permit or require a different transition. [270-10-45-13, 45-15]

Like IFRS Accounting Standards, changes in accounting policies are reported through retrospective application to the financial statements for prior interim periods of the current annual reporting period as well as the comparative interim periods presented, unless specific guidance requires or permits adoption as of the beginning of an interim period other than the first interim period of the annual reporting period. [270-10-45-17]

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Operating segments

The following segment information is disclosed in interim periods by an entity that is required to disclose segment information in its annual financial statements (see chapter 5.2):

- a measure of segment profit or loss;
- if included in the measure of segment profit or loss reviewed by, or otherwise provided regularly to, the CODM:
  - revenues from external customers; and
  - inter-segment revenues;
- a measure of total assets and/or total liabilities for a particular reportable segment if:
  - the related amounts are regularly provided to the CODM; and
  - there has been a material change in the total assets or total liabilities for that segment from the related amounts disclosed in the last annual financial statements;
- any change in the basis of segmentation or the basis of measuring segment profit or loss; and
- a reconciliation of the total of the reportable segments' measures of profit or loss to the entity's profit or loss before income tax and discontinued operations. [IAS 34.16A(g)]

Financial instruments

An entity includes in the notes to its interim financial statements certain disclosures about the fair value of financial instruments that are required by other accounting standards. [IAS 34.16A(j), IFRS 7.25–26, 28–30, 13.91–93(h), 94–96, 98–99]

Operating segments

Unlike IFRS Accounting Standards, US GAAP requires an entity to disclose in interim periods nearly all the segment disclosures that are required on an annual basis (see chapter 5.2). [280-10-50-32 – 50-33]

Financial instruments

An entity includes in the notes to its interim financial statements certain disclosures about the fair value of financial instruments that are required by other Codification topics; however, these disclosure requirements differ in certain respects from IFRS Accounting Standards. [820-10-50-2]

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Revenue from contracts with customers

An entity discloses in its interim financial statements the following information about revenue from contracts with customers (see chapter 4.2):

- a disaggregation into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors; and
- sufficient information about the relationship between the disclosure of disaggregated revenue and revenue information that is disclosed for each reportable segment (if the entity applies the operating segments standard).

Other annual disclosures about revenue are typically not required for interim financial reporting. [IAS 34.16A(l), IFRS 15.114–115, B87–B89]

Revenue from contracts with customers

For public entities, the disclosure requirements for interim financial statements relating to revenue from contracts with customers under US GAAP are generally more detailed than under IFRS Accounting Standards. Under US GAAP, public entities are required to disclose (see chapter 4.2):

- a disaggregation of revenue for the period;
- opening and closing balances of contract assets, contract liabilities and receivables;
- revenue recognised in the current period that was included in the opening contract liability balance;
- revenue from performance obligations satisfied (or partially satisfied) in previous periods; and
- information about the entity's remaining performance obligations. [270-10-50-1A]

For non-public entities, unlike IFRS Accounting Standards, there are no required disclosures relating to revenue from contracts with customers for interim financial statements.

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5.10 Disclosure of interests in other entities

(IFRS 12)

Overview

- **A single accounting standard deals with the disclosure of information about an entity's interests in other entities.**
- **An entity discloses information that helps users of its financial statements to understand the composition of the group and the interests of NCI in the group's activities and cash flows.**
- **An entity discloses information that helps users of its financial statements to evaluate the nature, extent and financial effects of its interests in joint arrangements and associates and the risks associated with them.**
- **Disclosures are required about an entity's involvement with both consolidated and unconsolidated 'structured entities'.**
- **An investment entity discloses information about the nature of its involvement with investees.**

Objective of disclosures

A single accounting standard deals with the disclosure of information about an entity's interests in other entities. [IFRS 12]

5.10 Disclosure of interests in other entities

(Topic 320, Topic 808, Topic 810, Topic 946)

Overview

- **Unlike IFRS Accounting Standards, there is no single Codification Topic under US GAAP that deals with the disclosure of information about an entity's interests in other entities.**
- **In general, the disclosure requirements related to the composition of the group and the interests of NCI in the group's activities and cash flows are not as extensive as under IFRS Accounting Standards.**
- **Unlike IFRS Accounting Standards, US GAAP does not explicitly require disclosure about an entity's interests in joint arrangements except for collaborative arrangements. While disclosures are required about corporate joint ventures and other equity-method investees that are material in aggregate, the overall approach to disclosure may result in differences from IFRS Accounting Standards in practice.**
- **Disclosures are required about an entity's involvement with both consolidated and unconsolidated 'variable interest entities', which may be different from 'structured entities' under IFRS Accounting Standards. In addition, certain of the disclosure requirements are more extensive than IFRS Accounting Standards.**
- **The disclosures required by investment companies in respect of investees are more extensive than IFRS Accounting Standards.**

Objective of disclosures

Unlike IFRS Accounting Standards, there is no single Codification Topic under US GAAP that deals with the disclosure of information about an entity's interests in other entities. Instead, relevant disclosures are included in the Codification Topic relevant to each type of investee and to participants in collaborative arrangements.

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An entity discloses the significant judgements and assumptions that it has made in determining the nature of its interest in another entity or arrangement. The accounting standard also requires extensive disclosures for interests in other entities. For the purpose of these disclosures, an 'interest in another entity' refers to contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. However, an interest in another entity does not exist solely as a result of a typical customer-supplier relationship. [IFRS 12.A, 2]

Significant judgements and assumptions

An entity discloses information about the significant judgements and assumptions that management has made in determining whether it has control, joint control or significant influence over another entity/arrangement, and in determining whether a joint arrangement structured through a separate vehicle is a joint venture or joint operation (see chapter 3.6). An investment entity discloses information about the significant judgements and assumptions that it has made in determining that it is an investment entity (see chapter 5.6). [IFRS 12.7–9A]

Aggregation

The disclosures may be aggregated for interests in similar entities, with the method of aggregation being disclosed. A quantitative and qualitative analysis, taking into account the different risk and return characteristics of each entity, is made to determine the aggregation level. [IFRS 12.B2–B6]

However, in respect of the disclosure of summarised financial information for interests in *material* joint ventures and associates (see below), the disclosures need to be provided for each investee – i.e. they cannot be aggregated. [IU 01-15]

Interests in consolidated subsidiaries

An entity discloses information that helps users of its financial statements to understand the composition of the group and the interests of NCI in the group's activities and cash flows. This includes:

- the nature and extent of significant restrictions on its ability to access or use assets, or to settle liabilities of the group;
- the consequences of changes in its ownership interests in a subsidiary while retaining control;
- the consequences of losing control of a subsidiary; and

Unlike IFRS Accounting Standards, there is no overall concept of 'interests in other entities' that is applied consistently. Rather, disclosure requirements apply by type of investee and to participants in collaborative arrangements.

Significant judgements and assumptions

Like IFRS Accounting Standards, US GAAP requires disclosure of the significant judgements and assumptions that an entity has made in determining whether to consolidate a VIE. Unlike IFRS Accounting Standards, there are no similar disclosures for equity-method investees and investments in joint ventures (see chapter 3.6). [810-10-50-3]

Unlike IFRS Accounting Standards, because the scope of investment companies defines which entities are required to apply the guidance in that Codification Topic, US GAAP does not specifically require an entity to disclose information about significant judgements and assumptions made in determining that it is an investment company (see chapter 5.6). However, the entity is required to disclose its status as an investment company and the reasons for any change in status. [946-10-50-1 – 50-3]

Aggregation

Except in relation to interests in equity-method investees and investments in joint ventures (see below), there is no specific guidance on the level of aggregation required in respect of investees, unlike IFRS Accounting Standards. Instead, an entity follows the general materiality guidelines (see chapter 1.2).

Interests in consolidated subsidiaries

Like IFRS Accounting Standards, an entity discloses information about the consequences of changes in its ownership interests in a subsidiary while retaining control, and the consequences of losing control of a subsidiary. However, in general the disclosure requirements are not as extensive as under IFRS Accounting Standards. [810-10-50-1A(d), 50-1B]

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- the nature of, and changes in, the risks associated with the interests in consolidated structured entities. [IFRS 12.10]

An entity's disclosures for each of its subsidiaries that has material NCI include summarised financial information about the subsidiary. [IFRS 12.12, B10–B11, IU 01-15]

Interests in joint arrangements and associates

An entity discloses information that helps users of its financial statements to evaluate the nature and effects of its interests in joint arrangements (see chapter 3.6) and associates (see chapter 3.5). This includes:

- the nature, extent and financial effects of its interests in such investees, including the nature and effects of contractual relationships with the other investors with joint control or significant influence; and
- the nature of, and changes in, the risks associated with its interests in such investees. [IFRS 12.20]

An entity's disclosures for each material joint venture and associate include summarised financial information about the investee. [IFRS 12.21(b), B12–B13]

Structured entities

A 'structured entity' is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity (see chapter 2.5). [IFRS 12.A, B21]

In respect of *consolidated* structured entities, an entity discloses the terms of any contractual arrangements with consolidated structured entities that could require the parent or its subsidiaries to provide financial support. This includes events or circumstances that could expose the entity to loss. [IFRS 12.14]

Unlike IFRS Accounting Standards, US GAAP does not explicitly require disclosure of summarised financial information about its subsidiaries with material NCI.

Interests in equity-method investees, investments in joint ventures and participation in collaborative arrangements

An entity may be required to make specific disclosures about its interests in entities that would be classified as joint arrangements (see chapter 3.6) and associates (see chapter 3.5) under IFRS Accounting Standards, and a participant in a collaborative arrangement (see chapter 3.6) discloses its rights and obligations under the arrangement. However, unlike IFRS Accounting Standards, there is no single Codification Topic and the disclosures vary by type of investee or participation. [808-10-50-1(b)]

An entity discloses summarised financial information about corporate joint ventures and other equity-method investees that are material in aggregate. For equity-method investees, an entity considers the extent of disclosures required based on the significance of the investee to the investor. This difference in approach may result in differences from IFRS Accounting Standards in practice. [323-10-50-2, 50-3(c)]

Variable interest entities

US GAAP has no concept of structured entities. Instead, a VIE is an entity that has certain characteristics, which are discussed in chapter 2.5.

Like IFRS Accounting Standards, US GAAP contains extensive disclosure requirements for VIEs that an entity is involved with or consolidates. These disclosures include the terms of any contractual arrangements with consolidated VIEs that could require the parent or its subsidiaries to provide financial support, including events or circumstances that could expose the reporting entity to a loss. In general, we would expect the disclosures under US GAAP for involvement with a VIE to be similar to those provided under IFRS Accounting Standards for involvement with a structured entity. [810-10-50-3, 50-5A]

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An entity discloses general information about its involvement with *unconsolidated* structured entities including, but not limited to, the nature, purpose, size and activities of the structured entity and how the structured entity is financed. More specific disclosures are required if an entity has an interest in an unconsolidated structured entity at the reporting date – e.g. a contract to provide management services. [IFRS 12.24–31]

Investment entities

An investment entity (see chapter 5.6) discloses the following in respect of unconsolidated subsidiaries:

- the nature and extent of any significant restrictions on the ability of such investees to pay cash dividends to the investment entity or to repay loans or advances made by the investment entity;
- any commitment or intention to provide financial or other support to such investees; and
- the type and amount of financial or other support provided during the reporting period without a contractual obligation to do so, including the reasons for providing support. [IFRS 12.19D–19E]

For an unconsolidated subsidiary that is a structured entity, an investment entity discloses:

- contractual arrangements that could require the investment entity or its unconsolidated subsidiaries to provide financial support, including events or circumstances that could expose the investment entity to loss; and
- information about financial or other support provided during the reporting period without a contractual obligation to do so, including the relevant factors in deciding to provide support. [IFRS 12.19F–19G]

An entity that holds a significant variable interest in a VIE that it does not consolidate is required to disclose the nature of its involvement with the VIE and when the involvement began, the nature, purpose, size and activities of the VIE, and the entity's maximum exposure to loss as a result of its involvement with the VIE. [810-10-50-4]

Investment companies

The disclosures required by investment companies (see chapter 5.6) in respect of investees are more extensive than IFRS Accounting Standards and focus on the structure of the investment company and its investments. [946-235-50]

Like IFRS Accounting Standards, an investment company discloses financial support that the investment company has provided or is contractually required to provide to its investees, including the type, amount and primary reasons for providing (or being required to provide) such financial support. These include situations in which the investment company assisted the investee in obtaining financial support. [946-20-50-15 – 50-16]

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5.11 Extractive activities

(IFRS 6, IFRIC 20)

Overview

- IFRS Accounting Standards provide specialised extractive industry guidance only in respect of expenditure incurred on the E&E of mineral resources after obtaining a legal right to explore and before being able to demonstrate technical feasibility and commercial viability.
- There is no industry-specific guidance on the recognition or measurement of pre-exploration expenditure or development expenditure. Pre-E&E expenditure is generally expensed as it is incurred.
- Entities identify and account for pre-exploration expenditure, E&E expenditure and development expenditure separately.
- Each type of E&E cost may be expensed as it is incurred or capitalised, in accordance with the entity's selected accounting policy.
- Capitalised E&E costs are classified as either tangible or intangible assets, according to their nature.

5.11 Extractive activities

(Topic 930, Topic 932)

Overview

- Unlike IFRS Accounting Standards, US GAAP provides detailed guidance on the accounting and reporting by oil- and gas-producing entities for expenditure incurred before, during and after E&E activities. US GAAP does not contain extensive authoritative guidance for other extractive industries. SEC guidelines are used for other extractive industries.
- Unlike IFRS Accounting Standards, there is industry-specific guidance on the recognition and measurement of pre-exploration expenditure and development expenditure for oil- and gas-producing entities. For other extractive industries, pre-E&E expenditure is generally expensed as it is incurred, like IFRS Accounting Standards.
- Unlike IFRS Accounting Standards, the accounting for oil- and gas-producing activities covers pre-exploration expenditure, E&E expenditure and development expenditure. Other extractive industries account for pre-exploration and E&E separately from development expenditure.
- Unlike IFRS Accounting Standards, all costs related to oil- and gas-producing activities are accounted for under either the successful-efforts method or the full-cost method, and the type of E&E costs capitalised under each method differs. For other extractive industries, E&E costs are generally expensed as they are incurred unless an identifiable asset is created by the activity.
- Like IFRS Accounting Standards, in extractive industries (other than oil- and gas-producing industries), capitalised costs are classified as either tangible or intangible assets, according to their nature. Unlike IFRS Accounting Standards, oil- and gas-producing entities do not segregate capitalised E&E costs into tangible and intangible components; all capitalised costs are classified as tangible assets.

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Overview (continued)

- **The test for recoverability of E&E assets can combine several CGUs, as long as the combination is not larger than an operating segment.**

- **Stripping costs incurred during the production phase of surface mining are included in the cost of inventory extracted during the period, if appropriate, or are capitalised as a non-current asset if they improve access to the ore body.**

Scope

IFRS Accounting Standards provide specific extractive industry guidance only for the recognition, measurement and disclosure of expenditure incurred on the E&E of mineral resources. There is limited relief from the requirement to select accounting policies in accordance with the hierarchy for their selection (see chapter 2.8), and from the general requirements for impairment testing. However, no such relief is provided for either pre-exploration activities or development activities; therefore, these activities need to comply fully with the general requirements in IFRS Accounting Standards, including the hierarchy for the selection of accounting policies (see chapter 2.8). [IFRS 6.3–4, 7, 18, IU 01-06]

IFRS Accounting Standards provide no specific guidance or exemptions for pre-exploration or development activities, which are excluded from the scope of the mineral resources standard. [IFRS 6.5]

The mineral resources standard cannot be applied to other research-type activities by analogy.

Overview (continued)

- **Unlike IFRS Accounting Standards, the test for recoverability is usually conducted at the oil and gas field level under the successful-efforts method, or by geographic region under the full-cost method. For other extractive industries, the test for recoverability is generally at the mine or group of mines level, which may differ from IFRS Accounting Standards.**

- **Unlike IFRS Accounting Standards, the guidance on production stripping applies to all extractive activities other than oil and gas. Unlike IFRS Accounting Standards, stripping costs incurred during the production phase of a mine are included in the cost of inventory extracted during the period.**

Scope

Unlike IFRS Accounting Standards, US GAAP provides detailed guidance on the accounting and reporting by oil- and gas-producing entities for expenditure that occurs before, during and after E&E activities. US GAAP does not contain a significant amount of guidance for other extractive industries (e.g. mining entities). However, for SEC registrants the definition of oil and gas activities includes bitumen extracted from oil sands, as well as oil and gas extracted from coal and shales. [930, 932, 932-10-S99-1]

Unlike IFRS Accounting Standards, US GAAP includes specific guidance on both pre-exploration and development activities by oil- and gas-producing entities. For other extractive industries, US GAAP does not contain specific guidance for pre-exploration activities. Costs incurred during development activities are capitalised and amortised or depleted, which may differ from IFRS Accounting Standards.

Like IFRS Accounting Standards, the industry-specific guidance for oil- and gas-producing entities cannot be applied to other research-type activities by analogy. However, because US GAAP contains little authoritative guidance for extractive industries other than the oil and gas industry, those in other extractive industries generally look to industry practice and may, in some circumstances, look to the guidance for the oil and gas industry when authoritative guidance does not exist. [932-10-05-3]

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Recognition and measurement

For each type of E&E expenditure, an entity chooses an accounting policy, to be applied consistently, to either immediately expense the expenditure or capitalise it as an E&E asset. The policy of expense or capitalisation reflects the extent to which the type of E&E expenditure can be associated with finding specific mineral resources. [IFRS 6.9]

An entity chooses an accounting policy, to be applied consistently, to either expense administrative and other general overhead costs, or capitalise those costs associated with finding specific mineral resources in the initial recognition and measurement of an E&E asset. [IFRS 6.BC28]

Capitalised E&E assets are classified as tangible or intangible assets depending on their nature. The subsequent accounting for these assets is consistent with their classification. [IFRS 6.15]

Recognition and measurement

Unlike IFRS Accounting Standards, an oil and gas entity has a choice of applying either the successful-efforts or the full-cost method to all oil and gas expenditure, which includes E&E expenditure.

- Under the successful-efforts method, geological and geophysical activities, costs of carrying and retaining undeveloped properties and costs associated with exploratory dry holes are recognised as an expense as they are incurred. The costs of drilling exploratory and exploratory-type stratigraphic test wells are capitalised, pending determination of whether the well can produce proved reserves. If it is determined that the well will not produce proved reserves, then the capitalised costs, net of any salvage value, are expensed.
- Under the full-cost method, all costs associated with the exploration of properties are capitalised within an appropriate cost centre at the geographic level (full-cost pool), which generally covers an entire country. For SEC registrants, the geographic cost centres are required to be by country. [932-10-S99-1, 932-360-25-3 – 25-4, 25-7 – 25-10, 932-720-25-1]

Under the full-cost method, all costs (internal and external) that are directly identified with the acquisition of property, E&E costs and development activities undertaken by the entity generally qualify for capitalisation, which may differ from the policy adopted under IFRS Accounting Standards. However, entities using the successful-efforts method are limited to capitalising only those costs that are directly related to activities whose direct costs are capitalisable, which generally excludes most internal costs, unlike IFRS Accounting Standards. Unlike IFRS Accounting Standards, costs related to general overhead or similar activities are expensed as they are incurred under both the successful-efforts and full-cost methods. Costs related to production are capitalised to inventory. For other extractive industries, E&E costs are generally expensed as they are incurred, unless an identifiable asset is created by the activity. [932-10-S99-1, 932-360-25-3]

Unlike IFRS Accounting Standards, an oil and gas entity does not segregate capitalised E&E costs into tangible and intangible components. All capitalised costs are classified as tangible assets. For extractive activities other than oil and gas, capitalised costs are classified as tangible or intangible assets depending on their nature, like IFRS Accounting Standards. [932-350-50-1]

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E&E expenditure and pre-E&E expenditure that is not recognised as an E&E asset is expensed as it is incurred. [IFRS 6.9]

Subsequent measurement

After recognition, an entity applies either the cost model or the revaluation model, as appropriate, to each of tangible and intangible E&E assets. The criteria for the revaluation of intangible assets are particularly strict (see chapter 3.3), and in effect rule out the revaluation of intangible E&E assets. In our experience, tangible E&E assets are rarely revalued. [IFRS 6.12]

Cost model

Tangible assets that are used for E&E (and intangible assets with a finite life that are used for E&E) are depreciated (amortised) over their useful lives. The depreciable amount of a tangible asset (or an intangible asset with a finite useful life) is its cost less its residual value. The residual value of a tangible asset is the amount that an entity could receive from its disposal at the reporting date if the asset were already of the age and in the condition that it will be in at the time of the expected disposal (see chapter 3.2). The residual value of an intangible asset with a finite useful life is assumed to be zero unless certain criteria are met (see chapter 3.3). [IAS 16.6, 53, 38.100]

Both tangible and intangible E&E assets are tested for impairment in some circumstances (see below). [IAS 36.2]

Revaluation model

If an entity elects to apply the revaluation model, then the model applied is consistent with the classification of the assets as tangible or intangible. Tangible E&E assets are revalued using the property, plant and equipment model (see chapter 3.2) and intangible E&E assets using the intangible asset model (see chapter 3.3). [IAS 16.31, IAS 38.75]

Both revaluation models apply the guidance in the fair value standard in measuring fair value (see chapter 2.4).

Unlike IFRS Accounting Standards, an entity using the full-cost method capitalises pre-E&E (pre-licence) expenditure. An entity using the successful-efforts method expenses pre-E&E (pre-licence) expenditure, like IFRS Accounting Standards. Like IFRS Accounting Standards, extractive industries other than oil and gas expense E&E expenditure as it is incurred unless an E&E asset is recognised, although the circumstances under which an E&E asset is recognised could differ from practice under IFRS Accounting Standards. [932-10-S99-1, 932-360-25-3]

Subsequent measurement

Unlike IFRS Accounting Standards, an entity applies the cost model to its tangible and intangible E&E assets; a revaluation model is not permitted.

Cost model

Like IFRS Accounting Standards, tangible assets that are used for E&E (and intangible assets with a finite life that are used for E&E) are depreciated (amortised) over their useful lives. These assets normally are depreciated using a units-of-production method, which may result in differences from IFRS Accounting Standards in practice. Like IFRS Accounting Standards, the depreciable amount of a tangible asset (or an intangible asset with a finite useful life) is cost less salvage value (residual value). US GAAP does not define 'salvage value' for depreciable tangible assets or prescribe a method for measuring salvage value (see chapter 3.2). Therefore, differences from IFRS Accounting Standards may arise in practice. The residual value of an intangible asset with a finite useful life is assumed to be zero unless certain criteria are met, like IFRS Accounting Standards (see chapter 3.3). [350-30-35-8, 932-360-35-3 – 35-5]

Like IFRS Accounting Standards, tangible and intangible E&E assets are tested for impairment in some circumstances (see below). [932-360-35-8 – 35-9]

Revaluation model

Unlike IFRS Accounting Standards, entities are not permitted to use the revaluation model under US GAAP.

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Depletion, depreciation and amortisation (DD&A)

The depreciation and amortisation of assets is calculated separately for each significant component of an asset. [IAS 16.43]

IFRS Accounting Standards do not specify the method or the reserve base to be used to calculate DD&A. An entity applies judgement to ensure that its calculation most closely reflects the pattern in which the future economic benefits associated with the asset are expected to be consumed. The units-of-production method may better reflect this pattern than the straight-line method. [IAS 16.62, 38.97–98]

Decommissioning and environmental obligations

IFRS Accounting Standards do not distinguish between decommissioning and environmental obligations, and the same accounting requirements apply.

Decommissioning and environmental provisions are discussed in chapter 3.12.

Impairment

E&E assets are assessed for impairment only when the facts and circumstances suggest that the carrying amount of an E&E asset may exceed its recoverable amount, and on the transfer of E&E assets to development assets. Unlike other assets, there is no requirement to assess whether an indication of impairment exists at each reporting date until an entity has sufficient information to reach a conclusion about commercial viability and the feasibility of extraction. [IFRS 6.17–18, BC39]

The mineral resources standard provides industry-specific examples of facts and circumstances that, if one or more are present, indicate that an entity should test an E&E asset for impairment. These indications include:

- the entity's right to explore in the specific area has expired or will expire in the near future, and is not expected to be renewed;
- substantive expenditure on further E&E activities in the specific area is neither budgeted nor planned;

Depletion, depreciation and amortisation

Unlike IFRS Accounting Standards, under the full-cost method capitalised costs in a cost pool are depleted on a group basis. Unlike IFRS Accounting Standards, under the successful-efforts method all capitalised costs at the oil and gas field level are depleted based on proved reserves for that field. Unlike IFRS Accounting Standards, for other extractive industries US GAAP does not require depletion to be calculated separately for each significant component of an asset. [932-360-35-3 – 35-5, 932-10-S99-1]

Unlike IFRS Accounting Standards, the reserve base used to calculate DD&A is defined as proved reserves. Like IFRS Accounting Standards, an entity applies judgement to ensure that its calculation most closely reflects the pattern in which the future economic benefits associated with the asset are expected to be consumed. Like IFRS Accounting Standards, the units-of-production method may better reflect this pattern than the straight-line method, and is the most commonly used method. [932-360-35-3]

Asset retirement (decommissioning) and environmental obligations

Unlike IFRS Accounting Standards, asset retirement (decommissioning) obligations are distinguished from environmental obligations. Under US GAAP, asset retirement obligations arise due to the 'normal' operation of an asset, whereas environmental obligations arise from the 'improper' operation of an asset. [410-20-15-2 – 15-3]

Decommissioning and environmental provisions are discussed in chapter 3.12.

Impairment

US GAAP includes specific guidance on how unproved properties should be assessed for impairment, which differs from IFRS Accounting Standards. In addition, unlike IFRS Accounting Standards, entities using the full-cost method perform a limitation calculation on capitalised costs each reporting period (see below). Otherwise, unlike IFRS Accounting Standards, there are no indications of impairment written specifically for extractive industries under US GAAP. [360-10-35-21, 932-10-S99-1, 932-360-35-8 – 35-14]

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- the entity has not discovered commercially viable quantities of mineral resources as a result of E&E activities in the area to date, and the entity has decided to discontinue such activities in the specified area; and
- even if the development is likely to proceed, the entity has sufficient data indicating that the carrying amount of the E&E asset is unlikely to be recovered in full from successful development or by sale. [IFRS 6.19–20]

An entity is permitted to aggregate CGUs to form a group of units for the purposes of impairment testing of E&E assets, but the grouping cannot be at a level of aggregation that is larger than that of the operating segment to which the CGU belongs (see chapter 5.2). [IFRS 6.21]

The general impairment standard is applied to measure, present and disclose the impairment of E&E assets (see chapter 3.10). [IFRS 6.18]

Unlike IFRS Accounting Standards, the test for recoverability under the successful-efforts method is generally at the field level, which is usually the lowest level of separate cash flows; under the full-cost method, the test for recoverability is at the 'geographic' level (usually country), which may result in differences from IFRS Accounting Standards in practice. For other extractive industries, the test for recoverability is generally at the mine or group of mines level, which may differ from IFRS Accounting Standards in practice. [932-10-S99-1, 932-360-35-8]

Except when the full-cost method is applied (see below), the general impairment guidance is applied to measure, present and disclose the impairment assets arising from extractive activities, which differs from IFRS Accounting Standards (see chapter 3.10).

Unlike IFRS Accounting Standards, entities using the full-cost method perform a limitation calculation on capitalised costs each reporting period ('ceiling test'). An impairment loss is recognised when the carrying amount of a cost centre is not recoverable and exceeds the limitation on capitalised costs (the 'ceiling'). The limitation on capitalised costs is the sum of:

- the present value of estimated future net revenues computed by applying the current prices of oil and gas reserves (with consideration of price changes only to the extent provided by contractual arrangements) to estimated future production of proved oil and gas reserves as at the date of the latest statement of financial position presented, less estimated future expenditure (based on current costs) to be incurred in developing and producing the proved reserves computed using a discount factor of 10 percent and assuming continuation of existing economic conditions; plus
- the cost of properties not being amortised; plus
- the lower of cost and the estimated fair value of unproven properties included in the costs being amortised; less
- income tax effects related to differences between the carrying amount and tax basis of the properties referred to in the previous two bullets. [932-10-S99-1]

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Partial or full reversals of impairments of assets, other than impairments of goodwill, are recognised if there is an indication that a previously recognised impairment loss has reversed and the recoverable amount of the impaired asset has subsequently increased (see chapter 3.10). [IAS 36.110]

Change in accounting policy

An entity may change its existing accounting policy for E&E expenditure under IFRS Accounting Standards only if the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs, judged by the criteria for voluntary changes in accounting policies (see chapter 2.8). [IFRS 6.13]

Stripping costs

There is no specific guidance on accounting for stripping costs in surface mining activities in the pre-production phase. In our experience, costs are generally capitalised and amortised under a units-of-production method.

There is specific guidance on the accounting for stripping costs for surface mining activities in the production phase. Such costs that give rise to benefits in the form of inventory produced are accounted for in accordance with the inventory standard. However, production stripping costs that improve access to ore to be mined in the future are recognised as a non-current asset if, and only if, all of the following criteria are met.

- It is probable that the future economic benefit will flow to the entity.
- The entity can identify the component of the ore body to which access has been improved.
- The costs related to the stripping activity associated with that component can be measured reliably. [IFRIC 20.6, 8–9]

If the costs of the stripping activity asset vs inventory produced are not separately identifiable, then costs are allocated based on a relevant production method. [IFRIC 20.13]

Unlike IFRS Accounting Standards, impairment losses are not reversed under US GAAP (see chapter 3.10). [360-10-35-20]

Change in accounting principle

Unlike IFRS Accounting Standards, US GAAP establishes the successful-efforts method as the preferred method, and therefore an entity is allowed to change from full-cost to successful-efforts with reference to the Codification topic to support its preferability (see chapter 2.8). However, a change from the successful-efforts to the full-cost method would require demonstration that the change is preferable in the entity's circumstances (see chapter 2.8). [932-10-S99-3]

Stripping costs

Like IFRS Accounting Standards, there is no specific guidance on accounting for stripping costs in surface mining and other extractive activities in the pre-production phase. Generally, practice is to capitalise and amortise the costs under a units-of-production method, like practice under IFRS Accounting Standards.

Unlike IFRS Accounting Standards, US GAAP guidance on stripping costs applies to all extractive activities other than oil and gas. Unlike IFRS Accounting Standards, stripping costs incurred during the production phase of a mine are accounted for as variable production costs included in the costs of inventory extracted during the period. [930-330-25-1]

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Any stripping activity (non-current) asset recognised is accounted for as part of an existing asset, and measured at cost or revalued amount less depreciation, amortisation and impairment losses, in line with the accounting for the asset of which it is a part. Depreciation or amortisation is calculated based on the expected useful life of the identified component of the ore body that becomes more accessible as a result of the stripping activity under a units-of-production method unless another method is more appropriate. [IFRIC 20.14–15]

Other

There is no specific guidance on the accounting for farm-ins, and the general principles of other accounting standards apply in determining whether the arrangement constitutes a business combination, investment in an associate, joint venture or asset acquisition.

There is no specific guidance on the accounting for farm-outs. Depending on the nature of the entity's interest in the venture (e.g. a joint venture or an interest in a licence), the general principles of other accounting standards apply in determining whether the entity has disposed of an interest and a gain or loss should be recognised.

There are no specific requirements in IFRS Accounting Standards on the disclosure of information about reserves. However, IFRS Accounting Standards require an entity to provide additional disclosures when compliance with the specific requirements in IFRS Accounting Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance. [IAS 1.17(c)]

There is no specific guidance on the accounting for overlifts and underlifts. Therefore, an entity applies the general principles of the revenue standard (see chapter 4.2) – i.e. it recognises revenue based on the amount of output that it has received and sold to its customers in each period, rather than based on the amount of output to which is it entitled. [IU 03-19]

There is no specific guidance on the taxes and other fiscal features that are prevalent in the oil and gas industry. Therefore, differences in the classification as income taxes or operating expenses of a number of petroleum taxes arise in practice.

Other

Unlike IFRS Accounting Standards, US GAAP contains specific guidance on the accounting for farm-ins. The costs incurred to perform the functions required by the farm-in agreement generally become part of the cost basis of the performing party's interest obtained in the farm-in agreement. [932-360-55-5]

Unlike IFRS Accounting Standards, US GAAP contains specific guidance on the accounting for farm-outs. The assignor's cost in the original interest generally becomes the cost of the interest retained. No gain or loss is typically recognised as a result of the assignment of the interest to the counterparty to the agreement. [932-360-55-3]

Unlike IFRS Accounting Standards, US GAAP requires oil and gas entities that are issuers to follow SEC guidelines for the measurement of reserves. SEC guidelines allow oil and gas entities to report proved, probable and possible reserves in the forepart of their filings with the SEC. However, US GAAP only allows the disclosure of proved reserves for financial reporting purposes and requires supplemental disclosures of standardised measurements of oil and gas reserves. [932-235-50-29 – 50-36]

Like IFRS Accounting Standards, there is no specific guidance on the accounting for overlifts and underlifts. Therefore, an entity applies the general principles of the revenue Codification Topic (see chapter 4.2) – i.e. it recognises revenue based on the amount of output that it has received and sold to its customers in each period, rather than based on the amount of output to which is it entitled. [606-10-25]

Like IFRS Accounting Standards, there is no specific guidance on the taxes and other fiscal features that are prevalent in the oil and gas industry. The recognition and presentation of taxes are governed by other applicable US GAAP, which may result in differences from IFRS Accounting Standards in practice.

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5.12 Service concession arrangements

(IFRIC 12, SIC-29)

Overview

- The interpretation on service concession arrangements provides guidance on the accounting by private sector entities (operators) for public-to-private service concession arrangements. The guidance applies only to service concession arrangements in which the public sector (the grantor) controls or regulates:
  - the services provided with the infrastructure;
  - to whom the operator should provide the services;
  - the prices charged to end users; and
  - any significant residual interest in the infrastructure.
- Legal ownership of the infrastructure during the term of the arrangement is not relevant in determining whether an arrangement is in the scope of the interpretation on service concession arrangements.
- For service concession arrangements in the scope of the guidance, the operator does not recognise public service infrastructure as its property, plant and equipment if the infrastructure is existing infrastructure of the grantor, or if the infrastructure is built or acquired by the operator as part of the service concession arrangement.
- If the grantor provides other items to the operator that the operator may retain or sell at its discretion and those items form part of the consideration for the services provided, then the operator accounts for the items as part of the transaction price as defined in the revenue standard.

5.12 Service concession arrangements

(Topic 853, Topic 980)

Overview

- US GAAP provides limited guidance on the accounting by operators for service concession arrangements. Unlike IFRS Accounting Standards, the guidance applies only to service concession arrangements that are not regulated operations. Like IFRS Accounting Standards, the guidance applies only to service concession arrangements in which the public sector (the grantor) controls:
  - the services provided with the infrastructure;
  - to whom the operator must provide those services;
  - the price charged for the services; and
  - any residual interest in the infrastructure at the end of the term of the arrangement.
- Unlike IFRS Accounting Standards, some entities choose to account for a service concession arrangement as a lease if the operator is the legal owner of the infrastructure during the term of the arrangement.
- Like IFRS Accounting Standards, for service concession arrangements in the scope of the guidance, the operator does not recognise public service infrastructure as its property, plant and equipment.
- Like IFRS Accounting Standards, if the grantor provides other items to the operator that the operator may retain or sell at its discretion and those items form part of the consideration for the services provided, then the operator accounts for the items as part of the transaction price under the revenue Codification Topic.

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Overview (continued)

- The operator recognises and measures revenue for providing construction or upgrade services, and revenue for other services, in accordance with the revenue standard.
- The operator recognises a contract asset during the construction or upgrade phase.
- The operator recognises a financial asset to the extent that it has an unconditional right to receive cash (or another financial asset), irrespective of the use of the infrastructure.
- The operator recognises an intangible asset to the extent that it has a right to charge for use of the infrastructure.
- Any financial asset recognised is accounted for in accordance with the financial instruments standard, and any intangible asset in accordance with the intangible assets standard. There are no exemptions from these accounting standards for operators.
- The operator recognises and measures obligations to maintain or restore infrastructure, except for any construction or upgrade element, in accordance with the provisions standard.
- The operator generally capitalises attributable borrowing costs incurred during construction or upgrade periods to the extent that it has a right to receive an intangible asset. Otherwise, the operator expenses borrowing costs as they are incurred.

Overview (continued)

- Like IFRS Accounting Standards, the operator recognises and measures revenue for providing construction or upgrade services, and revenue for other services, in accordance with the revenue Codification Topic.
- Unlike IFRS Accounting Standards, further evaluation of the construction activities is required to determine the appropriate classification of the resulting asset.
- Like IFRS Accounting Standards, the operator recognises a receivable to the extent that it has an unconditional right to receive cash (or another financial asset), irrespective of the use of the infrastructure.
- Unlike IFRS Accounting Standards, the operator recognises a contract asset to the extent that it does not have an unconditional right to receive cash (or another financial asset).
- Any financial asset recognised is accounted for in accordance with the relevant financial instruments Codification Topics, which differ in certain respects from IFRS Accounting Standards. Unlike IFRS Accounting Standards, an intangible asset is never recognised.
- Unlike IFRS Accounting Standards, the operator recognises revenue and costs related to maintenance activities in accordance with the revenue Codification Topic and related cost guidance.
- Like IFRS Accounting Standards, the operator capitalises interest costs when it concludes that the construction service gives rise to a qualifying asset and it has net accumulated expenditures on the qualifying asset. Otherwise, the operator expenses interest costs as they are incurred.

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Scope

The interpretation on service concession arrangements provides guidance to private sector entities on certain recognition and measurement issues that arise in accounting for public-to-private service concession arrangements; it does not address the accounting by the public sector. [IFRIC 12.4–9]

Legal ownership of the infrastructure during the term of the arrangement is not relevant in determining whether an arrangement is in the scope of the interpretation on service concession arrangements. [IFRIC 12.5, BC20–BC21]

Service concession arrangements in the scope of this interpretation are scoped out of the leasing standard (see chapter 5.1). [IFRS 16.3(c)]

'Public-to-private service concession arrangements' are arrangements in which the public sector (the grantor) controls or regulates:

- what services the operator should provide with the infrastructure (control of services);
- to whom it should provide them (control of services);
- the price at which services are charged (control of pricing); and
- through ownership, beneficial entitlement or otherwise, any significant residual interest in the infrastructure at the end of the term of the arrangement (control of the residual interest). [IFRIC 12.5]

Scope

Like IFRS Accounting Standards, US GAAP provides guidance on the accounting by operators for service concession arrangements; it does not address the accounting by the public sector, like IFRS Accounting Standards.

Unlike IFRS Accounting Standards, the service concession arrangements guidance is limited and focuses on the Codification topics that do not apply. The guidance excludes service concession arrangements from the scope of the leases Codification Topic and prohibits the recognition of the infrastructure as property, plant and equipment of the operator. Other accounting aspects of a service concession arrangement are dealt with under other existing US GAAP requirements. [853-10-25]

Unlike IFRS Accounting Standards, there is diversity in practice over whether legal ownership of the infrastructure during the term of the arrangement is relevant in determining whether the service concession arrangements Codification Topic applies. In our view, an entity should elect an accounting policy and apply it consistently.

- *Legal ownership relevant:* If the operator is the legal owner of the infrastructure during the term of the arrangement, then the infrastructure is the operator's rather than the grantor's. In this case, the leases Codification Topic applies (see chapter 5.1).
- *Legal ownership not relevant:* Regardless of whether the operator is the legal owner of the infrastructure during the term of the arrangement, the arrangement is in the scope of the service concession arrangements Codification Topic if the criteria below are met.

Like IFRS Accounting Standards, arrangements in the scope of the service concession arrangements Codification Topic are scoped out of the leases Codification Topic (see chapter 5.1). [853-10-25-2]

Like IFRS Accounting Standards, an arrangement is in the scope of the service concession arrangements Codification Topic when the grantor controls or has the ability to modify or approve:

- the services that the operator must provide with the infrastructure;
- to whom it must provide them;
- at what price the services are provided; and
- through ownership, beneficial entitlement or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement. [853-10-15-3]

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Typically, a public-to-private service concession arrangement will involve most of the following:

- infrastructure used to deliver public services;
- a contractual agreement between the grantor and the operator;
- supply of services by the operator;
- payments to the operator over the term of the arrangement; and
- return of the infrastructure to the grantor at the end of the arrangement. [IFRIC 12.3]

The operator's rights over the infrastructure

The operator does not recognise public service infrastructure as its property, plant and equipment, because the operator is considered to have a right of access rather than a right of use. This requirement applies to existing infrastructure of the grantor and to infrastructure that the operator constructs or acquires for the purposes of the concession. [IFRIC 12.11]

Identity of the customer in the arrangement

The operator determines the identity of the customer in a service concession arrangement based on the terms of the arrangement. The grantor is usually the customer for the construction or upgrade service. However, the customer for the operation services can be the grantor or the users of the infrastructure. This identification generally depends on the type of concession – i.e. the nature of the consideration (see below). If the operator receives a financial asset, then the grantor is also the customer for the operation services. However, if the operator receives an intangible asset, then the users of the infrastructure are typically the customers for the operation services. [IFRIC 12.IE1, IE11, IE23, BC32]

Recognition of construction/upgrade revenue

The operator recognises revenue and costs related to construction and upgrade services in accordance with the revenue standard – i.e. when (or as) it satisfies its performance obligation by transferring control over goods or services to a customer (see chapter 4.2). [IFRIC 12.13–15, IFRS 15.31]

If a service concession arrangement includes more than one performance obligation to the same customer, then the operator allocates the total consideration to which it expects to be entitled over the concession period to each of the performance obligations based on their relative stand-alone selling prices (see chapter 4.2). [IFRS 15.74]

Unlike IFRS Accounting Standards, service concession arrangements that are regulated operations are excluded from the scope of the service concession arrangements Codification Topic and accounted for under the specific Codification Topic for regulated operations. [853-10-15-4]

The operator's rights over the infrastructure

Like IFRS Accounting Standards, the operator does not recognise public service infrastructure as its property, plant and equipment, because it does not control the infrastructure. This requirement applies to existing infrastructure of the grantor and to infrastructure that is the subject of a service concession arrangement, like IFRS Accounting Standards. [853-10-25-2]

Identity of the customer in the arrangement

Unlike IFRS Accounting Standards, US GAAP specifies that the grantor, rather than third party users, is the customer in a service concession arrangement, for both operation and construction/upgrade services. This conclusion then determines the following.

- The pattern of revenue recognition by the operator under the revenue Codification Topic, which may be substantially the same as under IFRS Accounting Standards (see chapter 4.2).
- The accounting for payments made by the operator to the grantor for its rights under the arrangement. There are no defined accounting models in the service concession arrangements Codification Topic; however, because the grantor is the customer and this is therefore a payment to a customer, differences from IFRS Accounting Standards may arise. [853-10-25-1]

Recognition of construction/upgrade revenue

Like IFRS Accounting Standards, the operator recognises revenue and costs related to construction and upgrade services in accordance with the revenue Codification Topic – i.e. when (or as) it satisfies its performance obligation by transferring control over goods or services to a customer (see chapter 4.2).

Like IFRS Accounting Standards, if a service concession arrangement includes more than one performance obligation (the customer is the grantor in all cases), then the operator allocates the total consideration to which it expects to be entitled over the concession period to each of the performance obligations based on their relative stand-alone selling prices (see chapter 4.2).

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Consideration receivable for construction/upgrade revenue

The operator recognises consideration received or receivable for providing construction or upgrade services as:

- a financial asset to the extent that it has an unconditional right to receive cash (or another financial asset), irrespective of use of the infrastructure; and/or
- an intangible asset to the extent that its consideration is dependent on use of the infrastructure. [IFRIC 12.15–17]

Regardless of the nature of the consideration (i.e. financial asset, intangible asset or both) the operator recognises a contract asset (see chapter 4.2) during the construction or upgrade period. [IFRIC 12.19]

Borrowing costs

If the operator receives a right to charge for use of the public service infrastructure, then the operator is generally required to capitalise attributable borrowing costs for qualifying assets incurred during the construction or upgrade phase (see chapter 4.6). Otherwise, the operator expenses borrowing costs as they are incurred. [IAS 23.8, 10, IFRIC 12.22, BC58]

Items provided by the grantor

If the grantor provides items to the operator that the operator may retain or sell at its discretion ('keep or deal' items) and those items form part of the consideration for the services provided, then the operator accounts for the items as part of the transaction price as defined in the revenue standard (see chapter 4.2). [IFRIC 12.27]

Operation revenue

The operator recognises and measures revenue related to operation services in accordance with the revenue standard – i.e. when it satisfies its performance obligation to transfer those services to a customer, at the amount that reflects the consideration to which it expects to be entitled (see chapter 4.2). [IFRIC 12.20, IFRS 15.31, 46]

Consideration receivable for construction/upgrade revenue

The operator recognises consideration received or receivable for providing construction or upgrade services as:

- a receivable (financial asset) to the extent that it has an unconditional right to receive the consideration (cash or another financial asset) irrespective of use of the infrastructure, like IFRS Accounting Standards; and/or
- a contract asset under the revenue Codification Topic in all other circumstances, unlike IFRS Accounting Standards. [606-10-45-4]

Interest costs

Like IFRS Accounting Standards, the operator capitalises interest costs (borrowing costs) when it concludes that the construction service gives rise to a qualifying asset and it has net expenditure on the qualifying asset (see chapter 4.6). Otherwise, the operator expenses interest costs as they are incurred. [835-20-15-5]

Items provided by the grantor

Like IFRS Accounting Standards, if the grantor provides items to the operator that the operator may retain or sell at its discretion and those items form part of the consideration for the services provided, then the operator accounts for the items as part of the transaction price under the revenue Codification Topic; such non-cash consideration is measured at contract inception, which differs from IFRS Accounting Standards (see chapter 4.2). The items received are recognised as assets of the operator in the usual way (e.g. as property, plant and equipment), which may differ from IFRS Accounting Standards.

Operation revenue

Like IFRS Accounting Standards, the operator recognises and measures revenue related to operation services in accordance with the revenue Codification Topic (see chapter 4.2).

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Maintenance obligations

The operator recognises and measures contractual obligations to maintain or restore infrastructure in accordance with the provisions standard (see chapter 3.12), except for any upgrade element for which the operator recognises revenue and costs in accordance with the revenue standard (see chapter 4.2). [IFRIC 12.21, IE19–IE20, IE35–IE36]

Subsequent accounting for financial and intangible assets

The operator measures a financial asset at amortised cost, FVOCI or FVTPL (see chapter 7.4). [IFRIC 12.23–24]

The operator amortises an intangible asset over its useful life under the straight-line method or another method consistent with how the benefits from the intangible asset are expected to be consumed. The use of the revenue-based method is allowed only when revenue and the consumption of economic benefits of the intangible asset are 'highly correlated' or the intangible right is expressed as a measure of revenue (see chapter 3.3). In our view, amortisation should begin when the asset is available for use – i.e. when the operator is able to charge the public for use of the infrastructure. [IFRIC 12.26, IAS 38.97–98C]

Maintenance obligations

Unlike IFRS Accounting Standards, the operator recognises revenue and costs related to maintenance activities in accordance with the revenue Codification Topic and related cost guidance (see chapter 4.2). These activities may be routine and indistinguishable from operations and not specifically identified in the contract, or major maintenance projects that are specifically identified in the contract.

Subsequent accounting for financial and intangible assets

Unlike IFRS Accounting Standards, the operator classifies a financial asset arising from the service concession arrangement as a receivable measured at amortised cost (see chapter 7.4). [310-10-15-2]

Unlike IFRS Accounting Standards, an intangible asset is not recognised for service concession arrangements under US GAAP.

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5.13 Common control transactions and Newco formations

Overview

- In our view, the acquirer in a common control transaction has a choice of applying either book value accounting or acquisition accounting in its consolidated financial statements.
- The transferor losing control in a common control transaction that is not a demerger applies the general guidance on loss of control in its consolidated financial statements.
- In our view, the transferor in a common control transaction that is a demerger has a choice of applying either book value accounting or fair value accounting in its consolidated financial statements.
- Newco formations generally fall into one of two categories: to effect a business combination involving a third party, or to effect a restructuring among entities under common control.
- In a Newco formation to effect a business combination involving a third party, acquisition accounting generally applies.
- In a Newco formation to effect a restructuring among entities under common control, in our view it is first necessary to determine whether there has been a business combination. If there has been, then the same accounting choices are available as for common control transactions in consolidated financial statements.

5.13 Common control transactions and Newco formations

(Subtopic 805-50)

Overview

- Unlike IFRS Accounting Standards, the acquirer in a common control transaction applies book value accounting in its consolidated financial statements.
- Like IFRS Accounting Standards, the transferor losing control in a common control transaction that is not a spin-off applies the general guidance on loss of control in its consolidated financial statements.
- Unlike IFRS Accounting Standards, the transferor in a common control transaction that is a spin-off applies book value accounting in its consolidated financial statements.
- The formation of a Newco is often to effect a business combination or a restructuring among entities under common control, like IFRS Accounting Standards.
- Like IFRS Accounting Standards, in a Newco formation to effect a business combination, acquisition accounting generally applies.
- In a Newco formation to effect a restructuring among entities under common control, the transaction is accounted for using book values, which may result in differences from IFRS Accounting Standards.

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This chapter deals with business combinations among entities under common control. It does not deal with the wider issue of common control transactions in general – e.g. the transfer of a single item of property, plant and equipment between fellow subsidiaries.

The accounting issues dealt with in this chapter are not explicitly covered in IFRS Accounting Standards.

Common control transactions

A business combination involving entities or businesses under common control is exempt from the scope of the business combinations standard (see chapter 2.6). [IFRS 3.2]

A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the combination and that control is not transitory. The concept of control is discussed in chapter 2.5. [IFRS 3.B1]

A group of individuals is regarded as controlling an entity if, as a result of contractual arrangements, they exercise control. In our view, the requirement for there to be a contractual arrangement should be applied strictly and is not overcome by an established pattern of voting together. In our view, a transfer of a business between entities jointly controlled by the same parties both before and after the combination is a transaction under common control (see chapter 3.6). [IFRS 3.B2]

This chapter deals with business combinations among entities under common control. It does not deal with the wider issue of common control transactions in general – e.g. the transfer of a single item of property, plant and equipment between fellow subsidiaries.

Unlike IFRS Accounting Standards, there is specific guidance in US GAAP on common control transactions and, to a limited extent, Newco formations; this guidance does not apply to the initial measurement by a primary beneficiary of a VIE (see chapter 2.5) if the primary beneficiary of a VIE and the VIE are under common control. [805-50-15-6A]

Common control transactions

Like IFRS Accounting Standards, a business combination involving entities or businesses under common control is exempt from acquisition accounting under the business combinations Codification Topic (see chapter 2.6). [805-10-15-4]

Like IFRS Accounting Standards, a business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the combination. However, unlike IFRS Accounting Standards, US GAAP does not discuss the impact of transitory control, so differences from IFRS Accounting Standards may arise in practice. The concept of control, which differs in some respects from IFRS Accounting Standards, is discussed in chapter 2.5. [805-10-15-4]

Although US GAAP does not have an authoritative definition of common control, the SEC Staff has indicated that common control exists between (or among) separate entities only in the following situations.

- An individual or enterprise holds more than 50 percent of the voting ownership interest of each entity.
- Immediate family members hold more than 50 percent of the voting ownership interest of each entity (with no evidence that those family members will vote their shares in any way other than in concert).
- 'Immediate family members' include a married couple and their children, but not the married couple's grandchildren.
- Entities might be owned in varying combinations among living siblings and their children. These situations would require careful consideration regarding the substance of the ownership and voting relationships.
- A group of shareholders holds more than 50 percent of the voting ownership interest of each entity, and contemporaneous written evidence of an agreement to vote a majority of the entities' shares in concert exists. [EITF 02-5]

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It is not necessary that an individual, or a group of individuals acting together under a contractual arrangement to control an entity, be subject to the financial reporting requirements of IFRS Accounting Standards. Also, the entities are not required to be part of the same consolidated financial statements. [IFRS 3.B3]

The extent of NCI in each of the combining entities before and after the business combination is not relevant in determining whether the combination involves entities under common control. [IFRS 3.B4]

In our view, the common control exemption in accounting for business combinations may also be applied to the transfer of investments in equity-accounted investees between investors under common control. If an entity does not apply the common control exemption, then it applies acquisition accounting under the investments in associates and joint ventures standard (see chapter 3.5).

Consolidated financial statements of the acquirer

In our view, the acquirer in a common control transaction should choose an accounting policy in respect of its consolidated financial statements, to be applied consistently to all similar common control transactions, to use:

- 'book value (carry-over basis) accounting' on the basis that the investment has simply been moved from one part of the group to another; or
- 'acquisition accounting' on the basis that the acquirer is a separate entity in its own right and should not be confused with the economic group as a whole.

Book value accounting

In our view, the acquirer in its consolidated financial statements has a choice, to be applied consistently, in respect of whose book values are used: the ultimate parent, any intermediate parent, the transferor or the entity transferred.

In our view, the acquirer is permitted, but not required, to re-present its comparatives and adjust its current year before the date of the transaction as if the combination had occurred before the start of the earliest period presented. However, this restatement should not, in our view, extend to periods during which the entities were not under common control. The chosen accounting policy regarding comparative information should be applied consistently to all similar common control transactions.

In our view, to the extent that the common control transaction involves transactions with NCI, the changes in NCI should be accounted for as acquisitions and/or disposals of NCI on the date when the changes occur (see chapter 2.5).

Like IFRS Accounting Standards, it is not necessary that an individual, or a group of individuals acting together under a contractual arrangement to control an entity, be subject to the financial reporting requirements of US GAAP. Also, the entities are not required to be part of the same consolidated financial statements, like IFRS Accounting Standards.

Like IFRS Accounting Standards, the extent of NCI in each of the combining entities before and after the business combination is not relevant in determining whether the combination involves entities under common control. [805-50-15-6]

Unlike IFRS Accounting Standards, there is no policy choice, and the common control exemption in accounting for business combinations also applies to the transfer of investments in equity-method investees between investors under common control.

Consolidated financial statements of the acquirer

Unlike IFRS Accounting Standards, the acquirer in a common control transaction applies book value accounting in all cases. [805-50-30-5]

Book value accounting

Unlike IFRS Accounting Standards, the acquirer in its consolidated financial statements uses the book values of the ultimate parent. [805-50-30-5]

Unlike IFRS Accounting Standards, the acquirer is generally required to restate its comparatives and adjust its current year before the date of the transaction as if the combination had occurred before the start of the earliest period presented. However, this restatement does not extend to periods during which the entities were not under common control, like IFRS Accounting Standards. [805-50-45-2, 45-5]

To the extent that the common control transaction involves transactions with NCI, the changes in NCI are accounted for as acquisitions and/or disposals of NCI on the date when the changes occur (see chapter 2.5), like IFRS Accounting Standards.

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Acquisition accounting

In our view, in applying acquisition accounting to a common control transaction, the acquisition accounting methodology in the business combinations standard should be applied in its *entirety* by analogy (see chapter 2.6).

However, to the extent that the acquisition accounting gives rise to an apparent gain on a bargain purchase, in our view such amount should be recognised in equity as a capital contribution from the shareholders of the acquirer.

Consolidated financial statements of the transferor

The consolidated financial statements standard does not contain a scope exception when an intermediate parent loses control of a business in a common control transaction. Therefore, the transferor in a common control transaction applies the general guidance on loss of control, and calculates the gain or loss on disposal with reference to the fair value of the consideration received (see chapter 2.5). [IFRS 10.B98]

The requirements of the held-for-sale standard apply to the transferor in a common control transaction, regardless of whether the disposal occurs through non-reciprocal distribution of the shares in a subsidiary (a demerger or spin-off) or a sale (see chapter 5.4).

In our view, a demerger that is a common control transaction may be accounted for on either a fair value basis, in which case a gain or loss is recognised in profit or loss, or a book value basis, in which case no gain or loss is recognised.

Transactions involving a Newco

Although it is not a term that is defined in IFRS Accounting Standards, in practice a 'Newco' is a new entity. However, a Newco can also be an existing entity that is itself not a business under the business combinations standard.

A 'Newco formation' is a transaction that involves the formation of a new entity for the purpose of effecting a business combination or a transaction that purports to be a business combination.

Newco formations generally fall into two categories. They are either used to effect a business combination involving a third party, or in a restructuring among entities under common control.

Acquisition accounting

Unlike IFRS Accounting Standards, acquisition accounting is not permitted. [805-50-30-5]

Consolidated financial statements of the transferor

Like IFRS Accounting Standards, the transferor in a common control transaction generally applies the general guidance on loss of control in its consolidated financial statements (see chapter 2.5). However, in our view any difference between the carrying amount of net assets transferred and proceeds received should be recognised by the transferor as an equity transaction, unlike IFRS Accounting Standards. [805-50]

Unlike IFRS Accounting Standards, the requirements of the held-for-sale guidance apply to the transferor in a common control transaction only if the disposal occurs through a sale (see chapter 5.4).

Unlike IFRS Accounting Standards, a spin-off that is a common control transaction is accounted for on a book value basis in all cases; accordingly, no gain or loss is recognised. [810-10-40-5, 845-10-30-10]

Transactions involving a Newco

Although it is not a term that is defined in US GAAP, in practice a 'Newco' may be a new entity. However, judgement is required and a Newco may also be an existing entity that is itself not a business under the business combinations Codification Topic. We would not generally expect significant differences in practice.

A 'Newco formation' often involves the formation of a new entity for the purpose of effecting a business combination or a transaction that purports to be a business combination, like IFRS Accounting Standards.

A Newco formation often involves a business combination or a restructuring amongst entities under common control, like IFRS Accounting Standards.

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If a Newco is used to effect a business combination involving a third party, then acquisition accounting generally applies.

In a Newco formation used in a restructuring among entities under common control, in our view it is necessary to determine whether there has been a business combination – i.e. whether it is possible to identity an acquirer and an acquiree. If there has been a business combination, then the guidance on accounting for common control transactions in the consolidated financial statements of the acquirer applies (see above). However, if only one business is put under Newco, then there is no business combination and book value accounting applies to the business transferred.

Legal mergers and amalgamations following a Newco formation

For the purposes of the discussion that follows, a 'merger' is a transaction that involves the combination of two or more entities in which one of the legal entities survives and the other ceases to exist, or in which both existing entities cease to exist and a new legal entity comes into existence (often referred to as an 'amalgamation').

In our view, when a legal merger or amalgamation follows a Newco formation to effect a business combination involving a third party, the surviving/emerging entity has a choice over which entity's financial statements continue after the transaction:

- the consolidated financial statements of Newco, on the basis that Newco was the acquirer in the business combination and therefore the newly merged entity should be a continuation of Newco consolidated; or
- the consolidated financial statements of the acquiree in the business combination, on the basis that the acquiree continues to reflect the operations of the merged entity; from the acquiree's point of view, there has simply been a change in shareholding.

Like IFRS Accounting Standards, if a Newco formation is used to effect a business combination, then acquisition accounting generally applies. However, because there is more informal guidance under US GAAP, differences in practice from IFRS Accounting Standards may arise if the Newco is not considered substantive.

A Newco formed in a restructuring among entities under common control is accounted for using the book values of the ultimate parent, which may give rise to differences from IFRS Accounting Standards in practice. In addition, unlike IFRS Accounting Standards, there is specific guidance when common control did not exist for the entire period for which the Newco's financial statements are being presented; in this case, the entity that was under common control the longest is generally considered to be the predecessor. [SEC FRM 1170, Reg C Rule 405]

Legal mergers following a Newco formation

For the purposes of the discussion that follows, a 'merger' is a transaction that involves the combination of two or more entities in which one of the legal entities survives and the other ceases to exist, or in which both existing entities cease to exist and a new legal entity comes into existence.

When a legal merger follows a Newco formation to effect a business combination, determining the basis of the surviving/emerging entity's consolidated financial statements requires judgement, so differences from IFRS Accounting Standards may arise in practice.

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7 Financial instruments

7.1 Scope and definitions

(IAS 32, IFRS 9)

Overview

- The financial instruments standards apply to all financial instruments, except for those specifically excluded from their scope.
- Financial instruments include a broad range of financial assets and financial liabilities. They include both primary financial instruments (e.g. cash, receivables, debt and shares in another entity) and derivative financial instruments (e.g. options, forwards, futures, interest rate swaps and currency swaps).
- A 'financial instrument' is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.
- A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due. Certain financial guarantee contracts are in the scope of IFRS 9, the financial instruments standard.
- A loan commitment is a firm commitment to provide credit under pre-specified terms and conditions. Loan commitments are fully or partially in the scope of the financial instruments standard.

7.1 Scope and definitions

(Subtopic 320-10, Topic 321, Topic 326, Subtopic 505-10, Subtopic 815-10, Subtopic 820-10, Subtopic 825-10, Topic 860, Subtopic 946-320)

Overview

- Like IFRS Accounting Standards, the financial instruments standards apply to all financial instruments, except for those specifically excluded from their scope.
- Like IFRS Accounting Standards, financial instruments include a broad range of financial assets and financial liabilities. They include both primary financial instruments (e.g. cash, receivables, debt and shares in another entity) and derivative financial instruments (e.g. options, forwards, futures, interest rate swaps and currency swaps).
- Like IFRS Accounting Standards, a 'financial instrument' is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.
- Unlike IFRS Accounting Standards, US GAAP does not define a financial guarantee contract. Instead, US GAAP provides guidance on when to account for a financial guarantee contract as a derivative or as a guarantee.
- Like IFRS Accounting Standards, a loan commitment is a legally binding commitment to provide credit under pre-specified terms and conditions. Certain loan commitments are in the scope of the financial instruments standards.

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Overview (continued)

- **A contract to buy or sell a non-financial item may be required to be accounted for as a derivative, even though the contract itself is not a financial instrument.**

Scope

The financial instruments standards apply to all financial instruments, except for those specifically excluded from their scope.

Financial instruments include a broad range of financial assets and financial liabilities. They include both primary financial instruments (e.g. cash, receivables, debt and shares in another entity) and derivative financial instruments (e.g. options, forwards, futures, interest rate swaps and currency swaps).

Definitions

A 'financial instrument' is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. [IAS 32.11]

A 'financial asset' is any asset that is:

- cash;
- a contractual right:
  - to receive cash or another financial asset; or
  - to exchange financial assets or financial liabilities under potentially favourable conditions;
- an equity instrument of another entity; or
- a contract that will or may be settled in the entity's own equity instruments and is:
  - a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
  - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. [IAS 32.11]

Overview (continued)

- **Like IFRS Accounting Standards, a contract to buy or sell a non-financial item may be required to be accounted for as a derivative, even though the non-financial item itself may be outside the scope of the financial instruments standards.**

Scope

Like IFRS Accounting Standards, the financial instruments standards apply to all financial instruments, except for those specifically excluded from their scope.

Like IFRS Accounting Standards, financial instruments include a broad range of financial assets and financial liabilities. They include both primary financial instruments (e.g. cash, receivables, debt and shares in another entity) and derivative financial instruments (e.g. options, forwards, futures, interest rate swaps and currency swaps).

Definitions

Like IFRS Accounting Standards, a 'financial instrument' is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. [825-10-20]

Like IFRS Accounting Standards, a 'financial asset' is any asset that is:

- cash;
- a contractual right:
  - to receive cash or another financial asset; or
  - to exchange financial assets or financial liabilities under potentially favourable conditions; or
- an equity instrument of another entity. [825-10-20]

Unlike IFRS Accounting Standards, the definition of a financial asset does not address contracts that will or may be settled in the entity's own equity instruments.

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A 'financial liability' is:

- a contractual obligation:
  - to deliver cash or another financial asset to another entity; or
  - to exchange financial instruments under potentially unfavourable conditions; or
- a contract that will or may be settled in the entity's own equity instruments and is:
  - a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
  - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. [IAS 32.11]

An 'equity instrument' is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. [IAS 32.11]

There is no definition of a 'security' under IFRS Accounting Standards because the financial instruments standards apply to all financial instruments in their scope, irrespective of whether the financial instrument is a security.

Scope exemptions

The exemptions from IFRS 9, the financial instruments standard, are outlined below. [IFRS 9.2.1–2.7]

Like IFRS Accounting Standards, a 'financial liability' is a contractual obligation:

- to deliver cash or another financial instrument to another entity; or
- to exchange financial instruments under potentially unfavourable conditions. [825-10-20]

Unlike IFRS Accounting Standards, the definition of a financial liability does not address contracts that will or may be settled in the entity's own equity instruments. The guidance on such contracts is described in chapter 7.3.

Like IFRS Accounting Standards, an 'equity instrument' is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. However, US GAAP differs from IFRS Accounting Standards in some respects regarding what is considered a residual interest (see chapter 7.3). [505-10-05-3]

Unlike IFRS Accounting Standards, US GAAP defines a 'security' because certain accounting requirements apply only to instruments that meet the definition of a security. A 'security' is defined as a share, participation or other interest in property or in an entity of the issuer or an obligation of the issuer that:

- either is represented by an instrument issued in bearer or registered form or, if it is not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer;
- is of a type commonly dealt in on securities exchanges or markets or, if it is represented by an instrument, is commonly recognised in any area in which it is issued or dealt in as a medium for investment; and
- either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests or obligations. [320-10-20]

Scope exemptions

The exemptions from the recognition and measurement requirements for financial instruments, which are the subject of this chapter, are outlined below and differ in certain respects from IFRS Accounting Standards.

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Investments in subsidiaries, associates and joint ventures except for:

- investments in associates and joint ventures held by venture capital and similar organisations that have elected to account for those investments at FVTPL (see chapter 3.5);
- investments in subsidiaries, associates and joint ventures held by an investment entity. These investments are measured at FVTPL under the financial instruments standard. However, this exception does not apply to subsidiaries that are not themselves investment entities and whose main purpose and activities are to provide services that relate to the investment entity's investment activities (for a full discussion of the investment entity consolidation exception, see chapter 5.6); and
- derivatives on an interest in a subsidiary, associate or joint venture unless the derivative meets the definition of an equity instrument of the entity. [IFRS 9.2.1(a), 10.31–32, B85L, IAS 28.12–14A, 18–19]

Rights and obligations under leases, which are accounted for under the leasing standard (see chapter 5.1), except for the following:

- derecognition of lease receivables;
- derecognition of lease payables;
- impairment (expected credit losses) of lease receivables; and
- derivatives embedded in leases. [IFRS 9.2.1(b)]

Employers' rights and obligations under employee benefit plans are accounted for under the employee benefits standard (see chapter 4.4). [IFRS 9.2.1(c)]

Issued financial instruments, or portions thereof, classified as equity (see chapter 7.3). [IFRS 9.2.1(d)]

Like IFRS Accounting Standards, investments in subsidiaries and equity-method investees, except:

- equity-method investments that an investor irrevocably elects to account for at fair value under the fair value option, regardless of whether the investor is a venture capital or similar organisation, unlike IFRS Accounting Standards (see chapter 3.5);
- investments in subsidiaries held by investment companies. These investments are measured at FVTPL, like IFRS Accounting Standards. However, this exception does not apply to subsidiaries that provide permitted investment-related services solely to the investment company. For a full discussion of the investment company consolidation exception, see chapter 5.6; and
- like IFRS Accounting Standards, certain derivatives on an entity's interest in subsidiaries and joint ventures, depending on specific facts and circumstances. [480-10, 810-10-45-14, 815-10, 825-10-15-4, 946-320-35-1, 946-810-45-2 – 45-3]

Rights and obligations under leases (which are accounted for under the leases Codification Topic – see chapter 5.1), except:

- derecognition of the financial asset component of a net investment in a lease, like IFRS Accounting Standards;
- impairment (expected credit losses) of net investment in a lease, which includes the financial asset component (i.e. lease receivable), like IFRS Accounting Standards; as well as the non-financial asset component (i.e. the unguaranteed residual value), unlike IFRS Accounting Standards; and
- derivatives embedded in leases, which are accounted for separately if they are not clearly and closely related to the lease agreement (host), like IFRS Accounting Standards. However, because the bifurcation guidance differs from IFRS Accounting Standards, differences may arise in practice. [326-20-55-8, 815-10-15-79 – 15-81, 842-30-35-3, 860-10-55-6]

Unlike IFRS Accounting Standards, a lease liability is derecognised in accordance with the guidance in the leases Codification Topic (see chapter 5.1). [842-20-40-1]

Like IFRS Accounting Standards, employers' rights and obligations under employee benefit plans, which are accounted for under the employee benefits Codification Topics (see chapter 4.4), although these requirements differ in certain respects from IFRS Accounting Standards. [825-10-15-5c]

Like IFRS Accounting Standards, issued financial instruments, or portions thereof, classified as equity. However, the determination of which instruments are considered own equity differs in certain respects from IFRS Accounting Standards (see chapter 7.3). [815-10-15-74 – 15-78]

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The following rights and obligations.

- Those arising under an insurance contract as defined in the insurance contracts standard (see chapter 8.1), other than:
  - an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract unless an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts. Then the issuer may elect on a contract-by-contract basis to apply either the financial instruments standard or the insurance contracts standard to such contracts;
  - a derivative that is embedded in a contract in the scope of the insurance contracts standard if the derivative is not itself a contract in the scope of the insurance contracts standard;
  - investment components that are separated from insurance contracts if the insurance contracts standard requires such separation;
  - an issuer's rights and obligations that are financial instruments arising under issued credit card contracts, or similar contracts that provide credit or payment arrangements, that meet the definition of an insurance contract but are excluded from the scope of the insurance contracts standard. However, if the insurance coverage is a contractual term of the financial instrument, then the entity separates the insurance coverage component and applies the insurance contracts standard to it; and
  - an entity's rights and obligations that are financial instruments arising under issued insurance contracts that limit the compensation for insured events to the amount otherwise required to settle the policyholder's obligation created by the contract, if the entity elects to apply the financial instruments standards instead of the insurance contracts standard. One of the examples is a loan with a waiver on death. The election to apply the financial instrument standards or the insurance contracts standard is made for each portfolio of insurance contracts and is irrevocable.
- Those arising under a contract that is in the scope of the insurance contracts standard because it contains a discretionary participation feature. [IAS 32.4(d), IFRS 7.3(d), 9.2.1(e), 17.7(h), 8A]

A forward contract between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination at a future date if certain conditions are met. This scope exclusion does not apply to option contracts, whether or not they are currently exercisable, that on exercise will result in obtaining control of an entity. It also does not apply by analogy to contracts to acquire investments in associates and similar transactions such as investments in joint ventures. [IFRS 9.2.1(f), BCZ2.40–BCZ2.42]

Unlike IFRS Accounting Standards, insurance contracts issued by an insurance company that are subject to the specialised insurance accounting Codification Topic (see chapter 8.1). See the section below on financial guarantee contracts for guidance for financial guarantee contracts not subject to the insurance Codification Topic. Also unlike IFRS Accounting Standards, an insurance company may make an irrevocable election on a contract-by-contract basis to account for an issued insurance contract at FVTPL if the contract is not a financial instrument (because it requires or permits the insurer to provide goods or services rather than a cash settlement) and it permits the insurer to settle by paying a third party to provide goods or services. Like IFRS Accounting Standards, the guidance in chapter 7.2 applies to a derivative that is embedded in an insurance contract issued by an insurance company. For SEC filers, for requirements related to the financial services – insurance Codification Topic, including certain contracts or contract features that are embedded derivatives under IFRS Accounting Standards but may be accounted for as market risk benefits, see chapter 8.1. [815-10-15-52 – 15-58, 825-10-15-4]

Like IFRS Accounting Standards, forward contracts between an acquirer and a seller to enter into a business combination at a future date. Like IFRS Accounting Standards, this scope exception does not apply by analogy to contracts to acquire an ownership interest in an entity that will not result in a business combination. [321-10-15, 815-10-15-74(c), 15-141]

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Contracts and obligations under share-based payment transactions, which are generally accounted for under the share-based payment standard (see chapter 4.5). [IFRS 9.2.1(h)]

Rights and obligations in the scope of the revenue standard except for those that the revenue standard specifies are accounted for under the financial instruments standard (see chapter 4.2). [IFRS 9.2.1(j), 2.2]

Financial guarantee contracts

A 'financial guarantee contract' is a contract that requires an issuer to make specified payments to reimburse a holder for a loss that it incurs because a specified debtor fails to make payments when it is due in accordance with the original or modified terms of a debt instrument. [IFRS 9.A]

Like IFRS Accounting Standards, contracts and obligations under share-based payment transactions, which are generally accounted for under the share-based payment Codification Topic (see chapter 4.5). However, the scope of the share-based payment Codification Topic differs in certain respects from IFRS Accounting Standards. [815-10-15-74(b)]

Like IFRS Accounting Standards, rights and obligations in the scope of the revenue Codification Topic except for those that the revenue Codification Topic specifies are accounted for under the financial instruments standards (see chapter 4.2). [606-10-15-2(c)]

Financial guarantee contracts

Unlike IFRS Accounting Standards, US GAAP does not define a financial guarantee contract. Instead, US GAAP provides guidance on when to account for a financial guarantee contract as a derivative or as a guarantee.

Like IFRS Accounting Standards, financial guarantee contracts issued are first analysed to determine if the contract is in the scope of the derivatives Codification Topic. To qualify for the scope exception from derivative accounting, the contract must meet all of the following conditions:

- provide for payments to be made solely to reimburse the guaranteed party for failure of the debtor to satisfy its required payment obligations under a non-derivative contract;
- provide payment only if the debtor's obligation is past due; and,
- provide payment only if the guaranteed party is exposed to the risk of non-payment at inception of the guarantee arrangement and throughout its life. [815-10-15-58]

If an issued financial guarantee contract is eligible for the scope exception from derivative accounting, then it is accounted for under the guarantees Codification Topic and the credit impairment Codification Topic. [460-10-15-4, 326-20-15-2(c)]

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If the issuer applies the financial instruments standard to a financial guarantee contract, then it measures the financial guarantee contract:

- initially at fair value; and
- subsequently, generally, at the higher of:
  - the amount of expected credit loss allowance determined in accordance with the financial instruments standard (see chapter 7.8); and
  - the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of the revenue standard (see chapter 4.2). [IFRS 9.4.2.1(c), B2.5(a)]

In our view, the holder of a financial guarantee contract should determine whether the guarantee is an integral element of the guaranteed debt instrument. If the guarantee is an integral element of the debt instrument, then in our view the effect of the protection should be considered when measuring the debt instrument.

Loan commitments

In our view, an arrangement is a loan commitment fully or partially in the scope of the financial instruments standard if:

- it is a financial instrument; and
- it is a firm commitment to provide credit under pre-specified terms and conditions. [IFRS 9.2.1, BCZ2.2]

The following loan commitments are measured at FVTPL:

- loan commitments designated as a financial liability at FVTPL;
- all loan commitments in a particular class if an entity has a past practice of selling the assets resulting from such loan commitments shortly after origination, which are accounted for as derivatives; and
- loan commitments that can be settled net in cash or by delivering or issuing another financial instrument, which are accounted for as derivatives. [IFRS 9.2.1(g), 2.3]

A commitment to provide a loan at a below-market interest rate is measured at the higher of:

When the issuer is required to apply the guarantees Codification Topic to a financial guarantee contract, a liability for the non-contingent obligation of the contract is recognised initially at fair value, like IFRS Accounting Standards. Subsequent to initial recognition, the issuer will typically reduce the non-contingent obligation, by a credit to earnings, as the guarantor is released from the risk under the guarantee, unlike IFRS Accounting Standards. The release from risk is generally recognised over the term of the guarantee under one of the following methods:

- only on expiry or settlement of the guarantee;
- by a systematic and rational amortisation method; or
- as the fair value of the guarantee changes. [460-10-25-2, 30-2, 35-1 – 35-2]

At inception of the guarantee, a separate liability for the off-balance sheet credit risk is recognised for expected credit losses related to the contingent obligation, unlike IFRS Accounting Standards (see chapter 7.8). [460-10-25-3, 30-5, 35-4, 326-20-30-11]

Like IFRS Accounting Standards, the holder of a financial guarantee contract needs to determine whether the guarantee is embedded in the underlying loan or debt instrument, or whether the contract is freestanding and accounted for separately. Like IFRS Accounting Standards, if the holder determines that the guarantee is not a freestanding contract, then the guarantee is considered in estimating expected credit losses on the underlying instrument. [326-20-30-12]

Loan commitments

Under US GAAP, loan commitments are legally binding commitments to extend credit to a counterparty under pre-specified terms and conditions and are generally in the scope of the financial instruments standards. The definition differs from IFRS Accounting Standards in some respects and differences in practice may exist.

The following loan commitments are measured at FVTPL:

- loan commitments designated as a financial liability at FVTPL, like IFRS Accounting Standards; and
- loan commitments accounted for as derivatives, like IFRS Accounting Standards. However, only issued commitments to originate mortgage loans to be held for sale are treated as derivatives, unlike IFRS Accounting Standards. [815-10-15-69 – 15-71, 825-10-15-4]

Unlike IFRS Accounting Standards, there is no specific guidance for loan commitments to provide a loan at below-market interest rates.

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- the amount of expected credit loss allowance determined in accordance with the financial instruments standard; and
- the amount initially recognised less the cumulative amount of income recognised in accordance with the principles of the revenue standard. [IFRS 9.2.1(g), 2.3(c), 4.2.1(d)]

Other loan commitments are excluded from the scope of the financial instruments standard, except for the following:

- loan commitments issued are subject to the expected credit loss requirements (see chapter 7.8); and
- all loan commitments are subject to its derecognition requirements. [IFRS 9.2.1(g)]

Purchases and sales of non-financial items

A contract to buy or sell a non-financial item generally meets the definition of a derivative, and is in the scope of the financial instruments standard, if it can be settled net in cash or another financial instrument (see below). However, contracts that are entered into and continue to be held for the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements are exempt from being accounted for as derivatives (the 'normal sales and purchases' or 'own use' exemption).

A commitment to buy or sell a non-financial item is considered settled net in cash or another financial instrument when:

- the terms of the contract permit either party to settle net;
- the entity has a past practice of settling similar contracts net (including entering into offsetting contracts);
- for similar contracts, the entity has a past practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating profit from short-term fluctuations in price or dealers' margin; or
- the non-financial item that is subject to the contract is readily convertible into cash. [IFRS 9.2.6]

Like IFRS Accounting Standards, all other loan commitments are excluded from the scope of the financial instruments standards, except that:

- certain loan commitments issued are in the scope of the credit impairment Codification Topic when the entity has a present obligation to extend credit and cannot unconditionally cancel the commitment; and
- all loan commitments are subject to the derecognition requirements under the extinguishments of liabilities Codification Topic. [326-20-15-2(c), 30-11, 35-3, 405-20-15-2, 40-1]

Purchases and sales of non-financial items

Like IFRS Accounting Standards, a contract to buy or sell a non-financial item generally meets the definition of a derivative, and is in the scope of the derivatives Codification Topic, if the terms of the contract permit or require net settlement, or the non-financial item that is the subject of the contract is readily convertible into cash. Unlike IFRS Accounting Standards, net settlement may be made in cash or by delivery of any other asset, whether or not that asset is readily convertible to cash. Like IFRS Accounting Standards, contracts for the delivery of a non-financial item for use or sale in the normal course of business are generally exempt from being accounted for as derivatives (the 'normal purchases and normal sales' scope exception), but unlike IFRS Accounting Standards certain additional conditions have to be met:

- it is at normal terms for normal quantities;
- the contract has a price based on an underlying that is clearly and closely related;
- it is probable at inception and throughout the contract that the contract will not settle net and will result in physical delivery; and
- there is contemporaneous documentation. [815-10-15-22 – 15-39, 15-83 – 15-101]

A contract to buy or sell a non-financial item is considered settled net in cash or another asset when any of the following are met, which differs from IFRS Accounting Standards in some respects and differences in practice may arise:

- the terms implicitly or explicitly require or permit net settlement;
- there is a market mechanism that facilitates net settlement of the contract, meaning the contract is readily settleable net by a means outside the contract (including entering into offsetting contracts); or
- an asset is delivered that puts the recipient in a position not substantially different from net settlement. [815-10-15-83(c), 15-99, 15-110]

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A contract that can be settled net in cash or one with the underlying item readily convertible into cash may qualify as a contract entered into and held in accordance with the entity's expected purchase, sale or usage requirements as long as the entity has no past practice of settling similar contracts net or trading the underlying. [IFRS 9.2.4]

In our view, 'past practice' should be interpreted narrowly. Infrequent historical incidences of net settlement in response to events that could not have been foreseen at inception of a contract would not taint an entity's ability to apply the own use exemption to other contracts.

A written option, under which an entity might be required to purchase or sell a commodity or other non-financial asset that can be settled net in cash or another financial instrument, can never qualify for the own use exemption. Sometimes forward contracts, which may qualify for the own use exemption, are combined with written options in one contract. In our view, in such cases the contract may be split so that the forward element may qualify as own use even though the written option component will not. [IFRS 9.2.7]

If a contract to buy or sell a non-financial item contains an embedded derivative, then an entity determines whether the embedded derivative should be separated from the host contract and accounted for separately. If the embedded derivative is accounted for separately, then in our view the host contract might still qualify for the own use exemption. [IFRS 9.4.3.1, 4.3.3]

An entity may designate a contract to buy or sell a non-financial item that may be settled net in cash or another financial instrument as at FVTPL if such designation eliminates or significantly reduces a recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise. [IFRS 9.2.4–2.6]

Like IFRS Accounting Standards, a contract that can be settled net in cash or one with the underlying item readily convertible into cash may qualify for the normal purchases and normal sales scope exception. [815-10-15-22 – 15-39, 15-83(c), 15-99]

To assess whether it is probable at inception and throughout the contract that the contract will not net settle and will result in physical delivery, an entity should consider its prior practices with regard to such contracts. Like IFRS Accounting Standards, 'past practice' of net settlements should be interpreted narrowly. [815-10-15-83(c), 15-99]

Unlike IFRS Accounting Standards, the normal purchase/normal sale scope exception cannot generally be applied to contracts with optionality features over quantity (which includes both purchased and written options). However, despite the above prohibitions, certain power purchase and sales agreements may still qualify for the exception even if they are written options and/or even if the entity has a past practice of net settling such contracts, unlike IFRS Accounting Standards. Additionally, contracts that qualify as 'requirements contracts' may include optionality related to quantity and still be eligible for the normal purchase/normal sale scope exception. [815-10-15-40, 15-42 – 15-51, 15-92, 55-5 – 55-7]

Unlike IFRS Accounting Standards, a contract to buy or sell a non-financial item cannot be separated into one or more components, such that one component qualifies for the normal purchase/normal sale scope exception under the derivatives Codification Topic while one or more other components do not qualify for the scope exception. [815-10-15-41 – 15-44]

Unlike IFRS Accounting Standards, contracts to buy or sell a non-financial item are not eligible to be accounted for at FVTPL under the fair value option of the financial instruments Codification Topic. However, there is a similar accounting outcome if an entity does not contemporaneously document the normal purchases and normal sales election. [815-10-15-22 – 15-39, 825-10-15-4]

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Forthcoming requirements

Nature-dependent electricity contracts

Amendments to the financial instruments standards are effective for annual periods beginning on or after 1 January 2026; early adoption is permitted. [IFRS 9.7.1.15]

The amendments apply to certain nature-dependent electricity contracts (NDE contracts) to sell or buy renewable electricity. These contracts are often structured as power purchase agreements. [IFRS 9.2.3A]

Under the amendments, an entity purchasing electricity is eligible to apply the own use exemption, subject to certain conditions, even if it sells some electricity delivered under the contract. [IFRS 9.B2.7]

Contracts that have a variable specific to a party to the contract

There are no forthcoming requirements under IFRS Accounting Standards.

Contracts (and embedded features) that have a non-financial variable specific to a party to the contract are not accounted for as derivatives (see chapter 7.2). However, such contracts are accounted for as financial instruments when they meet the scoping requirements.

Forthcoming requirements

Nature-dependent electricity contracts

There are no forthcoming requirements under US GAAP.

The normal purchases and normal sales scope exception may apply to all contracts to sell or buy electricity. Unlike IFRS Accounting Standards, there are no separate requirements for the normal purchases and normal sales scope exception specific to nature-dependent electricity contracts to sell or buy renewable energy.

Contracts that have a variable specific to a party to the contract

Amendments to the derivatives and hedging Codification Topic are effective for annual periods beginning after 15 December 2026; early adoption is permitted. See appendix.

The amendments add a scope exception from derivative accounting for contracts (and embedded features) that are not exchange-traded if the underlying is based on the operations or activities specific to one of the parties to the contract. However, the scope exception does not apply to:

- underlyings that are based on a market rate, market price or market index;
- underlyings that are based on the price or performance of a financial asset or financial liability of one of the parties to the contract;
- contracts involving an entity's own equity that are subject to the own equity scope exception (see chapter 7.3); or
- call options and put options on debt instruments that are subject to a separate analysis (see chapter 7.2).

Like IFRS Accounting Standards, some of these contracts may be accounted for as financial instruments when they meet the scoping requirements.

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7.2 Derivatives and embedded derivatives

(IAS 32, IFRS 9, IFRIC 9)

Overview

- A 'derivative' is a financial instrument or other contract in the scope of the financial instruments standards:
  - the value of which changes in response to some underlying variable;
  - that has an initial net investment smaller than would be required for other instruments that have a similar response to changes in market factors; and
  - that will be settled at a future date.

- An 'embedded derivative' is a component of a hybrid contract that affects the cash flows of the hybrid contract in a manner similar to a stand-alone derivative instrument.

- A hybrid instrument also includes a non-derivative host contract that may be a financial or a non-financial contract. The requirements on separation of embedded derivatives do not apply when the host contract is a financial asset in the scope of IFRS 9, the financial instruments standard.

- An embedded derivative is not accounted for separately from the host contract if it is closely related to the host contract or if the entire contract is measured at FVTPL. In other cases, an embedded derivative is accounted for separately as a derivative.

7.2 Derivatives and embedded derivatives

(Subtopic 470-20, Subtopic 815-10, Subtopic 815-15)

Overview

- A 'derivative' is a financial instrument or other contract in the scope of the financial instruments Codification Topics:
  - that has one or more underlyings, and one or more notional amounts or payment provisions or both, unlike IFRS Accounting Standards;
  - that has an initial net investment smaller than would be required for other instruments that would be expected to have a similar response to changes in market factors, like IFRS Accounting Standards; and
  - that, unlike IFRS Accounting Standards:
    - requires or permits net settlement;
    - can readily be settled net through a market mechanism outside the contract; or
    - provides for delivery of an asset that is readily convertible into cash.

- Like IFRS Accounting Standards, an 'embedded derivative' is one or more implicit or explicit terms in a host contract that affect the cash flows of the contract in a manner similar to a stand-alone derivative instrument.

- Like IFRS Accounting Standards, a 'host contract' may be a financial or a non-financial contract. However, unlike IFRS Accounting Standards, the US GAAP guidance on separation of embedded derivatives also applies to all hybrid contracts with financial asset hosts.

- Like IFRS Accounting Standards, an embedded derivative is not accounted for separately from the host contract if it is clearly and closely related to the host contract or if the entire contract is measured at FVTPL. However, the US GAAP guidance on the term 'clearly and closely related' differs from IFRS Accounting Standards in certain respects. In other cases, an embedded derivative is accounted for separately as a derivative, like IFRS Accounting Standards.

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Derivatives

Definition

A 'derivative' is a financial instrument or other contract in the scope of the financial instruments standards that has all of the following features:

- its value changes in response to some underlying variable (e.g. an interest rate), provided that in the case of a non-financial variable it is not specific to a party to the contract;
- it has an initial net investment smaller than would be required for other instruments that would be expected to have a similar response to changes in market factors; and
- it will be settled at a future date. [IFRS 9.A]

A derivative usually has a notional amount. However, in our view contracts without notional amounts or with variable notional amounts may also meet the definition of a derivative. A contract to pay or receive a fixed amount on the occurrence or non-occurrence of a future event meets the definition of a derivative, provided that this future event depends on a financial variable or a non-financial variable that is not specific to a party to the contract. [IFRS 9.BA.1]

Exemptions from derivative treatment

Regular-way contracts

'Regular-way contracts' are contracts to buy or sell financial assets that will be settled within the timeframe established by regulation or convention in the market concerned. Regular-way contracts are not treated as derivatives between the date from which the entity is committed (trade date) and the date on which the financial asset is actually transferred (settlement date). [IFRS 9.A, 3.1.2, B3.1.3–B3.1.6]

Derivatives on own equity

Derivatives on own equity are excluded from derivative treatment if they meet the definition of an equity instrument (see chapter 7.3). [IFRS 9.2.1(d)]

Derivatives

Definition

A 'derivative' is a financial instrument or other contract in the scope of the financial instruments Codification Topics that has all of the following features:

- (1) one or more underlyings *and* (2) one or more notional amounts or payment provisions or both, unlike IFRS Accounting Standards;
- an initial net investment smaller than would be required for other instruments that would be expected to have a similar response to changes in market factors, like IFRS Accounting Standards; and
- unlike IFRS Accounting Standards:
  - requires or permits net settlement;
  - can readily be settled net through a market mechanism outside the contract; or
  - provides for delivery of an asset that is readily convertible into cash. [815-10-15-83]

Unlike IFRS Accounting Standards, a contract must have either a notional amount or a payment provision to meet the definition of a derivative. Like IFRS Accounting Standards, a contract to pay or receive a fixed amount on the occurrence or non-occurrence of a future event meets the definition of a derivative if the other requirements – e.g. initial net investment feature – are met. Unlike IFRS Accounting Standards, if the future event is dependent on a non-financial variable, then there are no restrictions on such a variable. [815-10-15-88(h)]

Exemptions from derivative treatment

Regular-way contracts

Like IFRS Accounting Standards, 'regular-way contracts' are contracts to buy or sell securities that will be settled within the timeframe established by regulation or convention in the market concerned. Like IFRS Accounting Standards, US GAAP exempts regular-way securities trades from being accounted for as derivatives between trade date and settlement date. [815-10-15-15 – 15-21]

Derivatives on own equity

Like IFRS Accounting Standards, some derivatives on own equity are excluded from derivative treatment. However, the situations in which this exception from derivative accounting is applied differ in certain respects from IFRS Accounting Standards (see chapter 7.3). [815-10-15-74 – 15-78]

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Embedded derivatives

Definition

An 'embedded derivative' is a component of a hybrid contract that also includes a non-derivative host, such that some of the cash flows of the combined instrument are affected in a manner similar to a stand-alone derivative instrument. An embedded derivative causes modifications to some or all of the cash flows that would otherwise be required by the contract, according to a specified financial variable or non-financial variable that is not specific to a party to the contract. [IFRS 9.4.3.1]

When to separate

Derivatives embedded in a hybrid contract (other than a financial asset in the scope of the financial instruments standard), including leases and insurance contracts, are accounted for separately as a stand-alone derivative if the following conditions are met:

- the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- the hybrid instrument is not measured at fair value with changes in fair value recognised in profit or loss. [IFRS 9.4.3.3, B4.3.1]

When a contract contains a host that is a financial asset in the scope of the financial instruments standard, the entire contract, including all embedded features, is assessed for classification under that accounting standard. In other words, these requirements apply to embedded derivative features with host contracts that are either:

- financial liabilities; or
- not in the scope of the financial instruments standard. [IFRS 9.4.3.2–9.4.3.3]

Embedded derivatives

Definition

Like IFRS Accounting Standards, an 'embedded derivative' is one or more implicit or explicit terms in a host contract that affect the cash flows of the contract in a manner similar to a stand-alone derivative instrument. [815-10-20]

When to separate

Like IFRS Accounting Standards, derivatives embedded in a host contract, including leases and insurance contracts, are accounted for separately as a stand-alone derivative if the following conditions are met:

- their economic characteristics and risks are not clearly and closely related to those of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in profit or loss. [815-15-25-1]

Unlike IFRS Accounting Standards, the US GAAP guidance on separation of embedded derivatives also applies to all contracts with financial asset hosts.

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Determining whether an embedded derivative is closely related to the host contract requires consideration of the nature – i.e. the economic risks and characteristics – of the host contract and the nature of the underlying of the derivative. If the natures of both the underlying and the host contract are similar, then they are generally closely related. [IFRS 9.4.3.3, B4.3.5–B4.3.8]

Nature of the host contract

Evaluating whether an embedded derivative is closely related to its host contract involves identifying the nature of the host contract. The nature of a host financial instrument – i.e. debt or equity – is not always obvious. A debt host contract has the economic characteristics and risks of a debt instrument, is not an equity instrument and meets the definition of a financial instrument, whereas an equity host contract has no stated or predetermined maturity and gives the holder a residual interest in the net assets of an entity. [IFRS 9.B4.3.2]

Specific examples

An embedded derivative in which the underlying is an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing host debt or insurance contract is closely related to the host contract unless the hybrid contract can be settled in such a way that the holder would not recover substantially all of its recognised investment, or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice the market return of a contract with the same terms as the host contract. [IFRS 9.B4.3.8(a)]

Like IFRS Accounting Standards, determining whether an embedded derivative is clearly and closely related to the host contract requires consideration of the nature of the host contract and the nature of the underlying of the derivative. If the natures of both the underlying and the host contract are similar, then they are generally clearly and closely related. However, the US GAAP guidance on the term 'clearly and closely related' differs from IFRS Accounting Standards in certain respects. [815-15-25-1, 25-16 – 25-51A]

In addition, the determination of whether an embedded derivative is clearly and closely related to the host contract, the definition of a derivative and the circumstances in which hybrid instruments are measured at fair value with changes in fair value recognised in profit or loss differ in certain respects from IFRS Accounting Standards.

Nature of the host contract

Like IFRS Accounting Standards, if the host contract encompasses a residual interest in an entity, then its economic characteristics and risks may be considered those of an equity interest. US GAAP provides additional guidance to analyse the nature of a host contract in a hybrid financial instrument issued in the form of shares (e.g. convertible preferred stock), which may give rise to differences from IFRS Accounting Standards. Under US GAAP, to determine the nature of the host contract, an entity has to (1) consider all stated and implied substantive terms and features of the hybrid financial instrument, (2) determine whether those terms and features are debt-like or equity-like and (3) weigh those terms and features on the basis of the relevant facts and circumstances. [815-15-25-17C – 25-17D]

Specific examples

Like IFRS Accounting Standards, an embedded derivative in which the only underlying is an interest rate or interest rate index that alters net interest payments that would otherwise be paid or received on an interest-bearing host debt contract is clearly and closely related to the host contract unless the combined instrument can be settled in such a way that the holder would not recover substantially all of its recognised investment, or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract. However, because US GAAP has more guidance, differences from IFRS Accounting Standards may arise in practice. [815-15-25-26 – 25-39]

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An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the contract is issued, and the cap or floor is not leveraged in relation to the host contract. [IFRS 9.B4.3.8(b)]

An embedded foreign currency derivative that provides a stream of principal or interest payments that are denominated in a foreign currency and is embedded in a host debt instrument (e.g. a dual-currency bond) is closely related to the host debt instrument. Such a derivative is not separated from the host instrument because foreign currency gains and losses on monetary items are recognised in profit or loss. [IFRS 9.B4.3.8(c), IAS 21.28]

An insurance contract or a contract that is not a financial instrument and that is denominated in a foreign currency gives rise to an embedded derivative that is not closely related, unless it is not leveraged and does not contain an option feature, and the payments required under the contract are denominated in one of the following currencies:

- the functional currency of one of the substantial parties to the contract;
- the currency in which the price of the related goods or services being delivered under the contract is routinely denominated in commercial transactions around the world; or
- the currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place. [IFRS 9.B4.3.8(d)]

Unlike IFRS Accounting Standards, an embedded floor or cap on the interest rate on a hybrid instrument is clearly and closely related to the host contract unless the feature could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract. [815-15-25-26, 25-32]

Like IFRS Accounting Standards, financial instruments that are monetary items and have principal payments, interest payments or both that are denominated in a foreign currency are not considered to include embedded foreign currency derivative components. Also like IFRS Accounting Standards, such component instruments are not separated from the host instrument because foreign currency gains and losses on such instruments are recognised in profit or loss. [815-15-15-10, 830-20-35-1]

A contract that is not a financial instrument, and that is denominated in a foreign currency, gives rise to an embedded derivative that is not clearly and closely related unless the payments required under the contract are denominated in one of the following currencies:

- the functional currency of one of the substantial parties to the contract, like IFRS Accounting Standards;
- the currency in which the price of the related goods or services being delivered under the contract is routinely denominated in commercial transactions around the world, like IFRS Accounting Standards;
- a currency that a substantial party to the contract uses as if it were its functional currency due to the primary economic environment of that substantial party being highly inflationary, unlike IFRS Accounting Standards; or
- a currency that is the local currency of any substantial party to the contract, unlike IFRS Accounting Standards. [815-15-15-10 – 15-19]

For an insurance contract in which losses are denominated in either (1) the functional currency of one of the parties to that contract (like IFRS Accounting Standards) or (2) the local currency of the country in which the loss is incurred, during the period between inception of the contract and the loss occurrence date (unlike IFRS Accounting Standards), there is no embedded foreign currency derivative that requires separate accounting. [815-15-15-20 – 15-21, 55-1 – 55-4]

Unlike IFRS Accounting Standards, a foreign currency option feature embedded in a contract that is not a financial instrument that is denominated in a foreign currency does not require bifurcation as long as the option feature does not contain leverage and does not represent a written option or net written option. [815-15-15-15]

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Embedded put and call options

A call, put or prepayment option embedded in a host financial liability or host insurance contract is closely related to the host contract in either of the following scenarios.

- The exercise price of the option is approximately equal on each exercise date to the amortised cost of the host financial liability or the carrying amount of the host insurance contract.
- The exercise price of the prepayment option reimburses the lender for an amount up to the approximate present value of lost interest for the remaining term of the host contract. This exception is conditional on the exercise price compensating the lender for loss of interest by reducing the economic loss from reinvestment risk. [IFRS 9.4.3.3, B4.3.5(e), BCZ4.97]

However, in our view if the call, put or prepayment option is contingently exercisable, then the evaluation of whether it should be bifurcated should also consider the nature of the contingency. Accordingly, we believe that a contingent call, put or prepayment option with an exercise price approximately equal to the amortised cost of the host financial liability at each exercise date should not be bifurcated from the host contract if and only if the underlying contingent event that triggers exercisability of the option:

- is a non-financial variable that is specific to a party to the contract; or
- has economic characteristics and risks that are closely related to those of the host financial liability – e.g. based on the interest rate or credit risk of the host financial liability.

Reassessment of separation

The assessment of whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative is made at inception of the contract – i.e. when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows under the contract, in which case it is required. [IFRS 9.B4.3.11]

Embedded put and call options

US GAAP provides the following decision sequence to determine whether an embedded call or put options is 'clearly and closely related' to a debt host, which differs from IFRS Accounting Standards.

- *Step 1:* Is the amount paid on settlement (payoff) adjusted based on changes in an index? If yes, then continue to Step 2. If no, then continue to Step 3.
- *Step 2:* Is the payoff indexed to an underlying other than interest rate or credit risk? If yes, then the embedded feature is not clearly and closely related to the debt host contract and further analysis is not required. If no, then that embedded feature is analysed further under Steps 3 and 4.
- *Step 3:* Does the debt involve a substantial premium or discount? If yes, then continue to Step 4. If no, then further analysis of the contract under the interest rate-related underlyings guidance of the embedded derivatives Codification Subtopic is required, if applicable.
- *Step 4:* Does a contingently exercisable call (put) option accelerate the repayment of the contractual principal amount? If yes, then the call (put) option is not clearly and closely related to the debt instrument. If it is not contingently exercisable, then further analysis of the contract under the interest rate-related underlyings guidance of the embedded derivatives Codification Subtopic is required, if applicable. [815-15-25-42]

Reassessment of separation

Unlike IFRS Accounting Standards, the evaluation of whether there is an embedded derivative that requires separation is made throughout the life of the contract except (1) when otherwise limited by the derivatives Codification Topic – e.g. the evaluation is required only at inception of a contract that is not a financial instrument for embedded foreign currency derivatives that meet one of the above exemptions from separation – or (2) for the purposes of the clearly and closely related guidance, where such evaluation is at inception and thereafter only if contractual terms of the hybrid have changed. [815-15-15-10]

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Accounting for separable embedded derivatives

Separable embedded derivatives are measured at fair value, with all changes in fair value recognised in profit or loss unless they form part of a qualifying cash flow or net investment hedging relationship (see chapter 7.9). If an entity is unable to reliably measure the fair value of an embedded derivative on the basis of its terms and conditions, then the fair value of the embedded derivative is the difference between the fair value of the hybrid contract and the fair value of the host. If the entity is unable to measure the fair value of the embedded derivative under this method, then the hybrid contract is designated as at FVTPL in its entirety. [IFRS 9.4.3.6, 9.4.3.7, 9.5.7.1, B4.3.1]

The initial bifurcation of a separable embedded derivative does not result in any gain or loss being recognised. [IFRS 9.B4.3.3, IGC.1–IGC.2]

The initial carrying amount of the host instrument is the residual amount after separating the embedded derivative at its fair value. [IFRS 9.4.3.7, B4.3.3]

Multiple embedded derivatives in a single hybrid contract that relate to the same risk exposures or that are not readily separable and independent of each other are treated as a single compound derivative. In other cases, multiple embedded derivatives in a single hybrid contract are accounted for separately. [IFRS 9.B4.3.4]

Accounting for separable embedded derivatives

Like IFRS Accounting Standards, separable embedded derivatives are required to be measured at fair value, with all changes in fair value recognised in profit or loss unless they form part of a qualifying cash flow or net investment hedging relationship (see chapter 7.9). Unlike IFRS Accounting Standards, if an entity is unable to reliably identify and measure the fair value of an embedded derivative, then it measures the entire hybrid instrument at FVTPL. There is no alternative measurement method for the separable embedded derivative under US GAAP. [815-15-25-52 – 25-53, 30-2]

Like IFRS Accounting Standards, the initial bifurcation of a separable embedded derivative does not result in any gain or loss being recognised. [815-15-30-2]

The carrying amount of the host contract on initial recognition is the difference between the basis of the hybrid instrument and the fair value of the embedded derivative, like IFRS Accounting Standards. [815-15-30-2]

Unlike IFRS Accounting Standards, if a single host contract has more than one embedded derivative each of which would warrant separate accounting as a derivative, then those individual embedded derivatives are always bundled together as a single, compound embedded derivative instrument and accounted for separately from the host contract. Therefore, an entity cannot embed a compound derivative in a hybrid instrument and separate that compound derivative into multiple derivatives based on the dissimilar components representing different risks, unlike IFRS Accounting Standards. [815-15-25-7 – 25-8]

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Forthcoming requirements

There are no forthcoming requirements under IFRS Accounting Standards.

Contracts (and embedded features) that have a non-financial variable specific to a party to the contract are not accounted for as derivatives. However, such contracts are accounted for as financial instruments when they meet the scoping requirements (see chapter 7.1).

Forthcoming requirements

Amendments to the derivatives and hedging Codification Topic are effective for annual periods beginning after 15 December 2026; early adoption is permitted. See appendix.

The amendments add a scope exception from derivative accounting for contracts (and embedded features) that are not exchange-traded if the underlying is based on operations or activities specific to one of the parties to the contract. However, the scope exception does not apply to:

- underlyings that are based on a market rate, market price, or market index;
- underlyings that are based on the price or performance of a financial asset or financial liability of one of the parties to the contract;
- contracts involving an entity's own equity that are subject to the own equity scope exception (see chapter 7.3); or
- call options and put options on debt instruments that are subject to a separate analysis (see above).

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7.3 Equity and financial liabilities

(IAS 1, IAS 32, IFRS 9, IFRIC 17)

Overview

- **An instrument, or its components, is classified on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.**
- **A financial instrument is a financial liability if it contains a contractual obligation to transfer cash or another financial asset.**
- **A financial instrument is also classified as a financial liability if it is a derivative that will or may be settled in a variable number of the entity's own equity instruments or a non-derivative that comprises an obligation to deliver a variable number of the entity's own equity instruments.**
- **An obligation for an entity to acquire its own equity instruments gives rise to a financial liability, unless certain conditions are met.**

7.3 Equity and financial liabilities

(Topic 815, Subtopic 470-10, Subtopic 470-20, Subtopic 480-10, Subtopic 505-10, Subtopic 505-20, Subtopic 505-30, Subtopic 810-10, Subtopic 815-40, CON8)

Overview

- **An instrument, or its components, is classified on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the applicable Codification topics/subtopics, which may result in differences from IFRS Accounting Standards.**
- **Like IFRS Accounting Standards, financial instruments that can oblige the issuer to settle in cash or by delivering another financial asset are classified as liabilities. Unlike IFRS Accounting Standards, certain securities with redemption features that are outside the control of the issuer that would not otherwise be classified as liabilities are presented as 'temporary equity'.**
- **Like IFRS Accounting Standards, a financial instrument is a financial liability if the monetary value of the obligation is based solely or predominantly on a fixed monetary amount known at inception that will or may be settled in a variable number of the entity's own equity instruments. Unlike IFRS Accounting Standards, a financial instrument that is an outstanding share that only conditionally obliges settlement in a variable number of shares is equity if other criteria are met. Unlike IFRS Accounting Standards, a financial instrument that is predominantly indexed to the entity's own stock and is settleable in a variable number of shares is equity if other criteria are met.**
- **Unlike IFRS Accounting Standards, an obligation for an entity to acquire its own equity instruments creates a financial liability only if it has certain characteristics.**

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Overview (continued)

- As an exception to the general principle, certain puttable instruments and instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation are classified as equity instruments if certain conditions are met.
- The contractual terms of preference shares and similar instruments are evaluated to determine whether they have the characteristics of a financial liability.
- The components of compound financial instruments, which have both liability and equity characteristics, are accounted for separately.
- A non-derivative contract that will be settled by an entity delivering its own equity instruments is an equity instrument if, and only if, it will be settled by delivering a fixed number of its own equity instruments.
- A derivative contract that will be settled by the entity delivering a fixed number of its own equity instruments for a fixed amount of cash is an equity instrument. If such a derivative contains settlement options, then it is an equity instrument only if all settlement alternatives lead to equity classification.

Overview (continued)

- Unlike IFRS Accounting Standards, the accounting for a puttable instrument depends on whether the entity is publicly or privately held and on whether it is conditionally or unconditionally puttable. Like IFRS Accounting Standards, certain instruments that can be required to be redeemed only in the event of the liquidation of the issuer are equity; however, the conditions for such treatment differ from IFRS Accounting Standards.
- Like IFRS Accounting Standards, an instrument issued in the legal form of a preferred share and similar instruments may be, in whole or in part, a liability based on an analysis of the contractual terms of the instrument. However, differences between IFRS Accounting Standards and US GAAP exist in treating preferred shares as liability, equity or temporary equity.
- Unlike IFRS Accounting Standards, instruments with characteristics of both liability and equity are not always split between their liability and equity components; and when they are, the basis of separation may differ from IFRS Accounting Standards.
- Unlike IFRS Accounting Standards, a non-derivative contract in the form of a share that the issuer must or may settle by issuing a variable number of its equity shares is recorded as equity, unless it is known at inception that the monetary value of the obligation is based solely or predominantly on a fixed monetary amount; will vary based on something other than the fair value of the issuer's equity shares; or will vary inversely related to changes in the fair value of the issuer's equity shares.
- Instruments indexed to an entity's own stock that will be settled by the entity delivering a fixed number of own equity instruments for a fixed amount of cash may meet the definition of equity; however, the criteria for determining whether they meet the definition of equity or liability differ from IFRS Accounting Standards. Additionally, US GAAP contains more guidance on what constitutes 'indexed to an entity's own stock'. Also, instruments indexed to an entity's own stock may be treated as equity if they can be net share-settled where certain criteria are met, unlike IFRS Accounting Standards.

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Overview (continued)

- **Incremental costs that are directly attributable to issuing or buying back own equity instruments are recognised directly in equity.**
- **Treasury shares are presented as a deduction from equity.**
- **Gains and losses on transactions in an entity's own equity instruments are reported directly in equity.**
- **Dividends and other distributions to the holders of equity instruments, in their capacity as owners, are recognised directly in equity.**
- **Non-redeemable NCI are classified within equity, but separately from equity attributable to shareholders of the parent.**

Overview (continued)

- **Like IFRS Accounting Standards, incremental costs that are directly attributable to issuing or buying back an entity's own equity instruments are recognised directly in equity.**
- **Like IFRS Accounting Standards, treasury shares are presented as a deduction from equity.**
- **Like IFRS Accounting Standards, gains and losses on transactions in own equity instruments are reported directly in equity.**
- **Like IFRS Accounting Standards, dividends and other distributions to the holders of equity instruments, in their capacity as owners, are recognised directly in equity.**
- **Like IFRS Accounting Standards, non-redeemable NCI are classified within equity, but separately from equity attributable to shareholders of the parent.**

Classification as a financial liability or equity

General principles

An instrument is a financial liability if it is:

- a contractual obligation:
  - to deliver cash or another financial asset to another entity; or
  - to exchange financial assets or financial liabilities with another entity under potentially unfavourable conditions (for the issuer of the instrument); or
- a contract that will or may be settled in the entity's own equity instruments and is:
  - a non-derivative that comprises an obligation for the entity to deliver a variable number of its own equity instruments; or
  - a derivative that will or may be settled other than by the entity exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments. [IAS 32.11]

Classification as a financial liability or equity

General principles

Although there are requirements for certain types of instruments that result in the same classification as IFRS Accounting Standards, there are many requirements under US GAAP that result in a different treatment from IFRS Accounting Standards. Therefore, many instruments that are liabilities under IFRS Accounting Standards could be classified as equity or 'temporary equity' (which is between total liabilities and equity) under US GAAP and certain instruments that are equity under IFRS Accounting Standards could be classified outside equity under US GAAP (i.e. as temporary equity or as a liability).

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If an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, then the obligation meets the definition of a financial liability regardless of the financial ability of the issuer to settle the contractual obligation or the probability of settlement. [IAS 32.19, IU 11-06]

An obligation for an entity to acquire its own equity instruments (e.g. a forward contract to buy its own shares or a written put option on own shares) gives rise to a financial liability, unless they meet the conditions set out below in the sections on 'puttable instruments' and 'obligations arising on liquidation' to be classified as equity. This is the case even if the contract itself is an equity instrument. [IAS 32.23]

Under US GAAP, financial liabilities include:

- contractual obligations to transfer cash or other assets on fixed or determinable dates, like IFRS Accounting Standards;
- mandatorily redeemable shares issued by a public entity that embody an unconditional obligation requiring the issuer to redeem it by transferring assets at a specified or determinable date (or dates) or on an event that is certain to occur, like IFRS Accounting Standards;
- shares issued by a public or non-public entity that are mandatorily redeemable on fixed dates for amounts that are either fixed or determinable with reference to an interest rate, currency or other external index, like IFRS Accounting Standards;
- an instrument that is not itself an outstanding share that, at inception, embodies an obligation for the issuer to repurchase its own equity shares, or is indexed to such an obligation, and requires or may require the issuer to settle the obligation by transferring assets (e.g. a forward purchase contract or written put option on the issuer's equity shares that is to be physically settled or net cash-settled), like IFRS Accounting Standards; and
- like IFRS Accounting Standards, an instrument that embodies an unconditional obligation or, for an instrument that is not itself an outstanding share, that embodies a conditional obligation that the issuer must or may settle by issuing a variable number of its equity shares, if at inception the monetary value of the obligation is based solely or predominantly on:
  - a fixed monetary amount known at inception (e.g. a payable to be settled with a variable number of the issuer's equity shares);
  - variations in something other than the fair value of the issuer's equity shares (e.g. a financial instrument indexed to the S&P 500 and to be settled with a variable number of the issuer's equity shares); or
  - variations inversely related to changes in the fair value of the issuer's equity shares (e.g. a written put option that could be net share-settled). [470-10, 480-10-20, 480-10-25-8, 25-14]

Because IFRS Accounting Standards do not have such prescriptive guidance, differences from IFRS Accounting Standards may arise in practice.

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In general, an 'equity instrument' is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. [IAS 32.11]

An equity instrument is an instrument that meets both of the following conditions.

- There is *no contractual obligation* to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavourable conditions (for the issuer of the instrument).
- If the instrument will or may be settled in the issuer's own equity instruments, then it is either:
  - a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or
  - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

  [IAS 32.11, 16]

An obligation may arise from a requirement to repay the principal or to pay interest or dividends. A perpetual instrument with an obligation to pay dividends or interest is a liability and the principal is assumed to be equal to the net present value of the perpetual dividend or interest obligation. [IAS 32.AG6]

Instruments or components of instruments are either a liability or equity; there is no midway classification between liabilities and equity. [IAS 32.15–16]

The classification of an instrument as either a financial liability or equity is made on initial recognition. However, a reclassification may be required if:

- an entity amends the contractual terms of an instrument;
- the effective terms of an instrument change without any amendment of the contractual terms;
- there is a relevant change in the composition of the reporting entity; or
- in the case of puttable instruments and instruments that impose on the entity an obligation only on liquidation, if certain conditions are met. [IAS 32.15, 16E]

Like IFRS Accounting Standards, in general an 'equity instrument' is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. However, application of the Codification topics/subtopics results in differences from IFRS Accounting Standards for certain instruments.

Unlike IFRS Accounting Standards, the liability classification is based on a requirement to repay the principal; a requirement to pay interest or dividends may not result in the entire instrument being classified as a liability because it is only one factor to consider in determining its classification.

Unlike IFRS Accounting Standards, SEC registrants present in temporary equity redeemable preferred shares and redeemable NCI that would otherwise be equity (see above), and other redemption features that are bifurcated and accounted for separately, whose redemption is outside the control of the issuer. [480-10-S99]

Like IFRS Accounting Standards, the classification of an instrument as either a financial liability or equity is made on initial recognition. However, unlike IFRS Accounting Standards, the classification of certain contracts – including those that are indexed to, and potentially settled in, an entity's own stock – is reassessed at each balance sheet date. If the classification changes as a result of events during the period, then the contract is reclassified as of the date of the event that caused the reclassification. Like IFRS Accounting Standards, a reclassification may also be required if an entity amends the contractual terms of an instrument. [480-10-25-5, 25-7; 815-40-35-8]

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Contingent settlement provisions

An instrument that contains contingent settlement provisions is a financial liability because the issuer does not have the unconditional right to avoid making payments unless one of the following applies:

- the part of the contingent settlement provision that could require settlement in cash or another financial asset is not genuine; or
- the issuer can be required to settle in cash or another financial asset only in the event of its own liquidation. [IAS 32.25]

Puttable instruments

A 'puttable instrument' is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the holder. Puttable instruments are generally classified as financial liabilities of the issuer, unless certain conditions are met (see below). [IAS 32.16A]

A puttable instrument is classified as equity if all of the following conditions are met:

- the instrument entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation;
- the instrument belongs to a class of instruments that is subordinated to all other classes of instruments issued by the entity. In determining whether an instrument is in the most subordinated class, an entity evaluates the instrument's claim on liquidation as if it were to liquidate on the date when it classifies the instrument;
- all financial instruments in this most subordinated class of instruments have identical features (i.e. no instrument holder in that class can have preferential terms or conditions);
- apart from the contractual obligation to repurchase or redeem the instrument, the instrument does not include any other contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; and
- the total expected cash flows attributable to the instrument over its life are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity. Profit or loss and the change in recognised net assets are measured in accordance with IFRS Accounting Standards for this purpose. [IAS 32.16A, AG14A–AG14E]

Contingent settlement provisions

Unlike IFRS Accounting Standards, US GAAP has specific guidance on conditional (contingent) obligations to determine if the instruments should be presented as equity. Examples include the following.

- Conditionally redeemable shares are not liabilities unless and until they become mandatorily redeemable, unlike IFRS Accounting Standards. Also, SEC registrants present certain conditionally redeemable shares in temporary equity, unlike IFRS Accounting Standards.
- Instruments are not liabilities if the settlement in cash or another financial asset can be required only in the event of the liquidation of the issuer, like IFRS Accounting Standards. [480-10-25-4, 25-5]

Puttable instruments

Unlike IFRS Accounting Standards, if the puttable instruments are in the form of shares (i.e. the put option is embedded in the share) but they do not meet the definition of mandatorily redeemable shares (see above), then:

- they are classified as temporary equity by SEC registrants; and
- they may be classified as equity by non-SEC registrants. [480]

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In addition to the above conditions to be met by the instrument, the issuer has no other financial instrument or contract that has:

- total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity; and
- the effect of substantially restricting or fixing the residual return to the puttable instrument holders. [IAS 32.16B]

Obligations arising only on liquidation

Some financial instruments include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets only on liquidation. The obligation arises because liquidation either is certain to occur and is outside the control of the entity – e.g. a limited-life entity – or is uncertain to occur but is at the option of the instrument holder. Such instruments are classified as equity if certain conditions are met (see below). [IAS 32.16C]

As an exception to the definition of a financial liability, an instrument (or a component of an instrument) that includes such an obligation is classified as equity if it has all of the following features:

- the instrument entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation;
- the instrument belongs to a class of instruments that is subordinated to all other classes of instruments issued by the entity. In determining whether an instrument is in the most subordinated class, an entity evaluates the instrument's claim on liquidation as if it were to liquidate on the date when it classifies the instrument; and
- all financial instruments in this most subordinated class of instruments have an identical contractual obligation for the entity to deliver a pro rata share of its net assets on liquidation. [IAS 32.16C, AG14B]

In addition to the instrument having all of the above features to be classified as an equity instrument, the issuer should have no other financial instrument or contract that has:

- total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity; and
- the effect of substantially restricting or fixing the residual return to the instrument holders. [IAS 32.16D]

Obligations arising only on liquidation

Like IFRS Accounting Standards, certain instruments that can be required to be redeemed only in the event of the liquidation of the issuer are treated as equity. However, the conditions for such treatment differ from IFRS Accounting Standards. [480]

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Impact of share settlement

If a non-derivative contract comprises a contractual obligation to deliver a variable number of the entity's own equity instruments, then it is a liability. [IAS 32.11, 16(b)(i), 21, AG27(d)]

If a derivative contract will be settled only by the entity receiving or delivering a fixed number of own equity shares for a fixed amount of cash or another financial asset, then it is an equity instrument of the entity. [IAS 32.11, 16(b)(ii)]

If a derivative financial instrument gives one party a choice over how it is settled – e.g. the issuer or the holder can choose settlement net in cash or by exchanging shares for cash – then it is a financial asset or financial liability unless all of the settlement alternatives result in it being an equity instrument. [IAS 32.26]

Equity instruments include options and warrants on an entity's own equity if they meet certain conditions. [IAS 32.11, 16(b)(ii)]

A contract that will be settled by the entity receiving or delivering a fixed or variable number of puttable instruments, or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation, is a financial asset or a financial liability. [IAS 32.11]

Redemption options

An instrument may be redeemable at the option of the issuer but, through its terms and conditions, may establish an obligation indirectly for the issuer to transfer cash or other financial instruments to the holder. In such cases, the instrument is a liability. [IAS 32.20, IU 09-13]

Impact of share settlement

Unlike IFRS Accounting Standards, the classification of instruments that will or may require delivery of a variable number of shares depends on the predominant nature of the monetary value of the instrument, and other factors that are used to evaluate whether the entity has the ability to settle net in shares. [480-10-25-14]

Like IFRS Accounting Standards, if a contract will be settled by exchanging a fixed number of own equity shares for a fixed amount of cash or other financial assets then it is generally classified as equity. However, unlike IFRS Accounting Standards, under US GAAP there are additional criteria to be considered before concluding whether equity classification is appropriate. For example, the derivative contract should be considered indexed to the reporting entity's own stock (shares) and US GAAP provides detailed guidance on evaluating 'indexed to its own stock'. Therefore, instruments settled in own equity may be classified differently from IFRS Accounting Standards. [815-40-15-7, 15-7C – 15-7H]

Like IFRS Accounting Standards, contracts that give the counterparty a choice of settlement by physical delivery, net-shares or net-cash delivery are liabilities or assets. However, unlike IFRS Accounting Standards, contracts that can be settled net in shares are equity if they are indexed to the entity's own equity instruments and the entity has the ability to settle net in shares. [815-40-25-4]

Like IFRS Accounting Standards, equity instruments include options and warrants on an entity's own equity if they meet certain conditions. However, these conditions differ from IFRS Accounting Standards. For example, a contract should be considered 'indexed to the reporting entity's own stock' and 'classified in stockholder's equity' to be equity-classified. US GAAP provides detailed guidance on evaluating 'indexed to its own stock' and 'classified in stockholder's equity'. [815-40-15-7 – 15-8A, 815-40-25]

Unlike IFRS Accounting Standards, a contract that will be settled by the entity receiving or delivering a fixed or variable number of puttable instruments, or instruments that oblige the entity to deliver a pro rata share of the net assets of the entity only on liquidation, is evaluated using the above considerations and differences from IFRS Accounting Standards may arise in practice.

Redemption options

An instrument that is redeemable at the option of the issuer may establish an obligation indirectly for the issuer to transfer cash or other financial instruments to the holder. However, the requirements under US GAAP for making this evaluation (see above) differ from IFRS Accounting Standards, so differences may arise in practice.

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Classification of rights issues

Rights (and similar derivatives) to acquire a fixed number of an entity's own equity instruments for a fixed price stated in a currency other than the entity's functional currency are equity instruments, provided that the entity offers the rights pro rata to all of its existing owners of the same class of its non-derivative equity instruments. [IAS 32.16(b)(ii)]

Compound instruments

An instrument that contains both liability and equity elements – e.g. a convertible bond or convertible preference shares – is a compound instrument. Compound instruments are allocated between their liability and equity components (split accounting). [IAS 32.28–29, AG31]

The carrying amount of a compound instrument is allocated between its liability and equity components on initial recognition as follows.

- The amount allocated to the liability component is the fair value determined with reference to a similar stand-alone debt instrument including any embedded non-equity derivatives.
- The remaining issue proceeds are allocated to the equity component. [IAS 32.31–32]

Classification of rights issues

Unlike IFRS Accounting Standards, rights (and similar derivatives) to acquire a fixed number of an entity's own equity instruments for a fixed price stated in a currency other than the entity's functional currency are a financial liability because these rights are not considered indexed to the entity's own stock. [815-40-15-7I]

Compound instruments

Unlike IFRS Accounting Standards, instruments with characteristics of both liability and equity, such as convertible bonds, are not required to be split between their liability and equity components in all circumstances. An example of a circumstance in which split accounting of a compound instrument is required is a convertible debt instrument that is issued for a substantial premium, if the conversion option is not a separable embedded derivative (see chapter 7.2). [470-20-25-13]

Unlike IFRS Accounting Standards, debt issued with embedded, non-detachable warrants are treated entirely as liabilities if the warrants are not required to be separated from the liability host under other Codification subtopics. [815-15]

Unlike IFRS Accounting Standards, not all such compound instruments are separated between liability and equity. Unlike IFRS Accounting Standards, issue proceeds are recognised in full as a liability or as equity for many compound instruments. Unlike IFRS Accounting Standards, when split accounting is required for a convertible debt instrument issued at a substantial premium, the excess of issuance proceeds over the instrument's principal amount is recognised in equity unless the conversion feature is not substantive. [470-20-25-13]

- The amount allocated to the liability element is the present value of the future interest and principal cash flows, discounted at a rate applicable to a similar liability without an equity component. The value of any embedded derivatives, other than the equity feature (i.e. the embedded call represented by the conversion feature) is included in the amount allocated to the liability.
- The remaining issue proceeds are allocated to the equity element. [470-20-25-2, 30-3, 30-27 – 30-28]

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On early redemption of a convertible instrument, the redemption payment is allocated to the liability and equity components under the method initially used to allocate the instrument between its liability and equity components. [IAS 32.AG33]

Accounting for conversion at maturity

On conversion of a compound instrument, the entity derecognises the liability component, which is extinguished when the conversion feature is exercised, and recognises that amount as equity. The original equity component remains as equity. No gain or loss is recognised in profit or loss. In our view, this accounting applies even if the conversion feature is exercised before the liability's maturity date (i.e. in the case of an American-style feature). [IAS 32.AG32]

Induced conversion

An entity may amend the terms of a convertible instrument to induce early conversion – e.g. by offering a more favourable conversion ratio or paying other additional consideration in the event of conversion before a specified date. In these cases, the issuer recognises in profit or loss the difference, calculated at the date when the terms are amended, between:

- the fair value of the consideration that the holder receives on conversion of the instrument under the revised terms; and
- the fair value of the consideration that the holder would have received under the original terms. [IAS 32.AG35]

Unlike IFRS Accounting Standards, many compound instruments do not require split accounting. The redemption payment for a debt instrument that did not require split accounting is treated in its entirety as the retirement of liability with the gain or loss recognised in profit or loss. Also unlike IFRS Accounting Standards, when split accounting is required for a convertible debt instrument issued at a substantial premium, a portion of the redemption price is allocated to the premium as a reduction in paid-in capital based on the conversion feature's intrinsic value on the date of extinguishment. The remainder of the redemption price is allocated to the liability component to determine the gain or loss on extinguishment. [470-20-40-3, 40-20]

Accounting for conversion at maturity

Like IFRS Accounting Standards, on conversion of a compound instrument for which the conversion option was previously separated as equity from the liability host, the entity derecognises the liability component, which is extinguished when the conversion feature is exercised, and recognises the carrying amount of the liability as equity. Like IFRS Accounting Standards, any original equity component remains in equity. Like IFRS Accounting Standards, this accounting also applies in the case of an American-style feature that is exercised before the liability's redemption date.

Unlike IFRS Accounting Standards, if the conversion option was not separated from the liability host, then the carrying amount of the debt is reclassified from liability to equity on conversion of the convertible instrument, with no gain or loss recognised in profit or loss. [470-20-40-4]

Induced conversion

Unlike IFRS Accounting Standards, an entity applies 'inducement accounting' to a conversion if it involves the payment of additional consideration and meets the following criteria:

- it occurs based on changed conversion privileges that are exercisable only for a limited time; and
- it includes the issuance of all of the equity securities issuable based on the conversion privileges included in the terms of the debt at issuance.

Under inducement accounting, the entity recognises an expense on conversion equal to the fair value of the additional consideration offered. Although the precise language under US GAAP differs from IFRS Accounting Standards, we would not generally expect differences in practice. [470-20-40-13, 40-16]

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Recognition and measurement

The recognition and measurement of financial liabilities is discussed in chapters 7.6 and 7.7. The remainder of this chapter focuses on equity.

IFRS Accounting Standards do not have any specific measurement requirements related to equity, other than in respect of splitting compound instruments, the cost of equity transactions, treasury shares and equity instruments that are issued in share-based payment transactions (see chapter 4.5). [IFRS 9.2.1(d)]

An entity may be owed an amount in respect of a contribution for new equity shares that have already been issued. In our view, the equity and a corresponding receivable are recognised if the receivable meets the definition of a financial asset. This requires the entity to have a contractual right to receive the amount at the reporting date. A 'contractual right' is more than an informal agreement or a non-contractual commitment.

As a general principle, the definitions of income and expenses exclude transactions with holders of equity instruments acting in that capacity. Therefore, gains or losses on transactions in the entity's own equity are not recognised in profit or loss. The effects of transactions with owners are recognised in equity. However, derivatives on own equity that are classified as assets or liabilities (see above) result in gains and losses recognised in profit or loss.

There is no specific guidance under IFRS Accounting Standards on how to account for an issue of bonus shares to shareholders or distribution of shares in lieu of dividends (with or without a cash alternative). In our view:

- in the case of a simple split of shares or a bonus issue, there is no requirement to adjust total equity or an individual component of equity (however, the laws of the country of incorporation may require a reallocation of capital within equity);
- when shares with a value equal to the cash dividend amount are offered as an alternative to the cash dividend, it is acceptable to debit the liability and recognise a credit to equity as the proceeds of the issue; and
- when a share dividend is not an alternative to cash dividend, no accounting entries are required.

Recognition and measurement

The recognition and measurement of financial liabilities is discussed in chapters 7.6 and 7.7. The remainder of this chapter focuses on equity.

US GAAP contains more specific guidance on the measurement of equity than IFRS Accounting Standards; these general requirements apply to all equity transactions other than share-based payment transactions (see chapter 4.5). Under US GAAP, equity instruments are generally recognised at fair value on initial recognition or, in certain circumstances, using an allocation based on relative fair value or intrinsic value, at the date of issue. Because US GAAP contains more specific guidance than IFRS Accounting Standards, differences may arise in practice. [505-10]

Unlike IFRS Accounting Standards, a note receivable that is received in exchange for the issue of an equity instrument is generally treated as a deduction from equity rather than as an asset. [505-10-45]

Like IFRS Accounting Standards, the definitions of income and expenses exclude transactions with holders of equity instruments in their capacity as owners. Therefore, like IFRS Accounting Standards, gains or losses on transactions in the entity's own equity are not recognised in profit or loss; these amounts are recognised in equity. Like IFRS Accounting Standards, derivatives and other contracts on own equity that are classified as assets or liabilities (see above) result in gains and losses recognised in profit or loss. [480, 815, CON8]

Unlike IFRS Accounting Standards, there is specific guidance under US GAAP to distinguish share dividends from a share split.

- If a transaction meets the definition of a share split, then there is no requirement to adjust total equity or an individual component of equity, like IFRS Accounting Standards.
- If a transaction meets the definition of a share dividend, then an entity transfers from retained earnings to capital stock and to additional paid-in capital an amount equal to the fair value of the additional shares issued, unlike IFRS Accounting Standards. [505-20-25-3]

Because US GAAP has specific guidance, differences from IFRS Accounting Standards may arise in practice.

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Treasury shares

Any amounts paid by an entity to acquire its own shares are debited directly to equity. This applies whether the shares are cancelled immediately or held for resale – i.e. treasury shares. Amounts received from the sale of treasury shares are credited directly to equity. Generally, no gains or losses are recognised in profit or loss on any transactions in own shares and changes in the value of treasury shares are not recognised, even if these shares are held for trading purposes. [IAS 32.33, AG36]

Own shares held in connection with an equity compensation plan held by the entity are presented as treasury shares. [IAS 32.4(f), 33–34]

Generally, treasury shares, including those held for trading purposes, are not recognised as assets or measured at fair value with gains and losses recognised in profit or loss. [IAS 32.33, AG36]

An associate may have an investment in its investor. IFRS Accounting Standards do not provide specific guidance on whether the carrying amount of the associate under the equity method should include the investor's share of the associate's investment in the investor's own shares. However, in our view the investor is not required to make any adjustments. [IAS 1.79, 32.33, IFRS 10.A]

Cost of an equity transaction

Qualifying costs attributable to an equity transaction – e.g. issuing or buying back own equity instruments – are debited directly to equity. [IAS 32.35, 37]

A listing of existing shares, a secondary offering and share splits do not result in new equity instruments being issued; therefore, any costs associated with such transactions are expensed as they are incurred. [IAS 32.35, 38, IU 09-08]

Treasury shares

Like IFRS Accounting Standards, treasury shares are accounted for directly in equity, with treasury shares held for reissue presented as a deduction from equity; any difference between the purchase price and reissue proceeds does not impact income. On reissue, the classification within equity of gains or losses on share transactions differs based on the comparison of proceeds received to original cost. If the proceeds from the sale of the treasury shares are greater than the cost of the shares sold, then the entity recognises the excess proceeds as additional paid-in capital. If the proceeds from the sale of the treasury shares are less than the original cost of the shares sold, then, generally, the excess cost first reduces any additional paid-in capital arising from previous sales of treasury shares for that class of share, and any remaining excess is recognised as a reduction of retained earnings. [505-30-30-6, 30-10]

Like IFRS Accounting Standards, treasury share accounting also applies to own shares that will be used to satisfy obligations under share-based payment plans (see chapter 4.5) unless the plan constitutes an ESOP, in which case specific provisions apply such that allocated shares cannot be treated as treasury shares, so differences from IFRS Accounting Standards may arise in practice. [505-30-15-2, 718-40-25-10]

Like IFRS Accounting Standards, treasury shares, including those held for trading purposes, are not recognised as assets or measured at fair value with gains and losses recognised in profit or loss. [505-30]

Unlike IFRS Accounting Standards, the carrying amount of an equity-method investee (associate) that has an investment in the investor is adjusted in the investor's financial statements to show the amount related to the investee's investment in the investor as treasury shares.

Cost of an equity transaction

Like IFRS Accounting Standards, qualifying costs attributable to an equity transaction – e.g. issuing or buying back own equity instruments – are debited directly to equity. [505-10-25-2]

Like IFRS Accounting Standards, a listing of existing shares, a secondary offering and share splits do not result in additional proceeds or new equity instruments being issued; therefore, any costs associated with such transactions are expensed as they are incurred, like IFRS Accounting Standards.

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There is no specific guidance on how to account for certain modifications or exchanges of freestanding equity-classified written call options (e.g. warrants) that remain equity-classified after modification or exchange.

Equity presentation

There are no specific requirements in IFRS Accounting Standards on how to present the individual components of equity. See chapter 7.10 for a description of items that are presented in OCI.

Non-redeemable NCI are presented within equity separately from equity of the parent's shareholders. If the NCI are redeemable, then the terms of the instrument determine whether the NCI should be classified as equity or as a liability. [IAS 1.54, 106, IFRS 10.22]

Dividends

Dividends and other distributions to holders of equity instruments are recognised directly in equity. [IAS 32.35]

A liability for dividends is not recognised until the entity has an obligation to pay dividends, which is generally not until they are declared or approved, if approval is required (see chapter 2.9). [IAS 10.12]

Dividends on shares that are liabilities are recognised in profit or loss as a financing cost, even if the legal form of the payment is a dividend, unless the dividends are discretionary. Financing costs on shares that are liabilities are determined under the effective interest method (see chapter 7.7). [IAS 32.35]

Unlike IFRS Accounting Standards, US GAAP contains specific guidance on how to account for certain modifications or exchanges of freestanding equity-classified written call options (e.g. warrants) that remain equity-classified after modification or exchange. An entity determines the accounting based on whether the modification or exchange was done as part of or directly related to issuing equity, issuing or modifying debt or for other reasons. When the modification or exchange is done in conjunction with an equity raise, any increase in the written call option's fair value is recognised as an equity issuance cost. [815-40-35-15, 35-17]

Equity presentation

Like IFRS Accounting Standards, US GAAP does not include extensive requirements for the presentation of separate captions within equity, and differences from IFRS Accounting Standards may arise in practice. See chapter 7.10 for a description of items that are presented in OCI.

Like IFRS Accounting Standards, non-redeemable NCI are classified as equity but are presented separately from the parent's equity. [810-10-45-16]

Dividends

Like IFRS Accounting Standards, dividends and other distributions to holders of equity instruments are recognised directly in equity.

Like IFRS Accounting Standards, a liability for dividends is not recognised until the entity has an obligation to pay dividends, which is generally not until they are declared or approved, if approval is required (see chapter 2.9).

Like IFRS Accounting Standards, dividends on shares that are classified as liabilities are recognised in profit or loss as a financing cost, even if the legal form of payment is a dividend. Like IFRS Accounting Standards, financing costs on shares that meet the definition of a liability are determined under the effective interest method (see chapter 7.7).

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Distributions of non-cash assets to owners

There is specific guidance in respect of non-reciprocal distributions to shareholders in which all shareholders of the same class are treated equally; however, the guidance does not apply to common control transactions (see chapter 5.13) or to distributions of part of the ownership interests in a subsidiary when control is retained (see chapter 2.5). [IFRIC 17.3–7]

Distributions in the scope of the guidance, including spin-offs and demergers (see chapter 2.5), are accounted for on a fair value basis and any gain, representing the excess of the fair value of the assets distributed over their book value, is recognised in profit or loss on the date of settlement. [IFRIC 17.14]

Forthcoming requirements

There are no forthcoming requirements under IFRS Accounting Standards.

If an entity amends the terms of a convertible instrument to induce early conversion, then it recognises in profit or loss the difference (the inducement expense), calculated at the date when the terms are amended, between:

- the fair value of the consideration that the holder receives on conversion of the instrument under the revised terms; and
- the fair value of the consideration that the holder would have received under the original terms. [IAS 32.AG35]

Distributions of non-cash assets to owners

Like IFRS Accounting Standards, there is specific guidance in respect of non-reciprocal distributions to shareholders in which all shareholders of the same class are treated equally. Unlike IFRS Accounting Standards, the guidance also applies to common control transactions (see chapter 5.13). Like IFRS Accounting Standards, the guidance does not apply to distributions of part of the ownership interests in a subsidiary when control is retained (see chapter 2.5). [845-10-30-10 – 30-14]

Like IFRS Accounting Standards, distributions of non-cash assets to shareholders are generally accounted for on a fair value basis with the excess of the fair value of the assets distributed over their book value recognised in profit or loss. Unlike IFRS Accounting Standards, the gain resulting from remeasuring the asset is recognised on the date the distribution is declared. Unlike IFRS Accounting Standards, under US GAAP spin-offs are accounted for on the basis of book values (with no gain or loss recognised) when there is a pro rata distribution to owners. [810-10-40-5, 30-10 – 30-14]

Forthcoming requirements

Amendments to the debt Codification Topic are effective for annual periods beginning after 15 December 2025; early adoption is permitted. See appendix.

The amendments provide additional guidance on whether induced conversion or extinguishment accounting is applied to certain settlements of convertible debt instruments that do not occur in accordance with the instruments' pre-existing terms.

Unlike IFRS Accounting Standards, the circumstances under which 'inducement accounting' is applied differ under US GAAP. However, when inducement accounting is applied, the inducement expense recognised in profit or loss may be similar to what is recognised under IFRS Accounting Standards.

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7.4 Classification of financial assets

(IFRS 9)

Overview

- Financial assets are classified into one of three measurement categories:
  - amortised cost;
  - FVOCI; or
  - FVTPL.
- A financial asset is classified as subsequently measured at amortised cost if it is held within a held-to-collect business model and its contractual cash flows are solely payments of principal and interest on the principal amount outstanding (SPPI).
- A financial asset is classified as subsequently measured at FVOCI if it is held within a held-to-collect and for-sale business model and the contractual cash flows meet the SPPI criterion.
- On initial recognition, an entity may choose to irrevocably designate a financial asset that would otherwise qualify for amortised cost or FVOCI as subsequently measured at FVTPL if this designation eliminates or significantly reduces a measurement or recognition inconsistency.
- Investments in equity instruments fail the SPPI criterion and are therefore generally measured at FVTPL. On initial recognition, an entity may elect to present in OCI changes in the fair value of an investment in an equity instrument if it is not held for trading.

7.4 Classification of financial assets

(Subtopic 310-10, Subtopic 310-20, Subtopic 310-25, Subtopic 320-10, Subtopic 321-10, Subtopic 815-10, Subtopic 815-15, Subtopic 815-25, Subtopic 825-10, Subtopic 948-310)

Overview

- Unlike IFRS Accounting Standards, US GAAP does not have classification categories that are broadly applied to all financial assets. However, US GAAP does have classification categories for certain financial assets. Debt securities are classified as held-for-trading, available-for-sale or held-to-maturity, unlike IFRS Accounting Standards. Also unlike IFRS Accounting Standards, loans are either classified as held-for-sale or held-for-investment.
- Unlike IFRS Accounting Standards, debt securities classified as held-to-maturity, loans and trade receivables classified as held-for-investment are subsequently measured at amortised cost.
- Unlike IFRS Accounting Standards, there is no prescribed 'FVOCI' subsequent measurement classification for financial assets. Debt securities that are not classified as held-for-trading or held-to-maturity are classified as available-for-sale. Available-for-sale debt securities are subsequently measured at fair value, like IFRS Accounting Standards.
- On initial recognition, certain financial assets can be irrevocably designated as at FVTPL, like IFRS Accounting Standards. However, the eligibility criteria and financial assets to which the fair value option can be applied differ from IFRS Accounting Standards in certain respects.
- Unlike IFRS Accounting Standards, an entity may not elect to present in OCI changes in the fair value of any investments in equity securities.

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Overview (continued)

- **Reclassifications of financial assets are made only on a change in an entity's business model that is significant to its operations. These are expected to be very infrequent. No other reclassifications are permitted.**

Classification

On initial recognition, a financial asset is classified into one of three primary measurement categories:

- amortised cost;
- FVOCI; or
- FVTPL. [IFRS 9.4.1.1]

There are no special classification requirements for financial institutions or other entities that engage in mortgage lending or financing activities or transactions.

Overview (continued)

- **Unlike IFRS Accounting Standards, certain financial assets (i.e. debt securities, loans and trade receivables) may be reclassified if there are changes in management's intent and ability with respect to holding the financial assets. The requirements for reclassification of these financial assets differ from IFRS Accounting Standards and the frequency of reclassifications may also differ. Under US GAAP, the circumstances in which transfers of debt securities into and out of the held-for-trading category would be permitted are expected to be rare.**

Classification

Unlike IFRS Accounting Standards, the classification of financial assets is prescribed for investments in debt securities, loans (including purchased loans) and trade receivables.

Unlike IFRS Accounting Standards, debt securities are classified as trading, held-to-maturity or available-for-sale. If a debt security is bought and held principally for the purpose of selling in the near term or is a mortgage-backed security that is held for sale in conjunction with mortgage banking activities, then it is classified as a trading security. However, debt securities not acquired with the intent to be sold in the near term, or with the intent to generate short-term profits, may be designated as trading. A debt security is classified as held-to-maturity if the entity has the positive intent and ability to hold it to maturity. Investments in debt securities not classified as trading or held-to-maturity are classified as available-for-sale. [320-10-25-1, 948-310-40-1]

Unlike IFRS Accounting Standards, loans and trade receivables are classified as either held-for-sale or held-for-investment. Loans and trade receivables that an entity has the intent and ability to sell immediately or in the near term are classified as loans held-for-sale. [310-10-35-47]

Unlike IFRS Accounting Standards, there is specific guidance on accounting for loans and loans held for sale for the following:

- financial institutions (including banks, credit unions, finance companies, mortgage companies and savings institutions) that engage in transactions that involve lending to or financing the activities of others; and
- entities that engage in transactions that involve mortgage activities or transactions. [948-310-35-1 – 3A]

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Amortised cost

A financial asset is subsequently measured at amortised cost only if it meets both of the following conditions:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows (the held-to-collect business model); and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (the SPPI criterion). [IFRS 9.4.1.2]

Financial assets subsequently measured at FVOCI

A debt instrument is subsequently measured at FVOCI only if it meets both of the following conditions:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets (the held-to-collect and for-sale business model); and
- the contractual terms of the financial asset meet the SPPI criterion. [IFRS 9.4.1.2A]

Financial assets measured at FVTPL

All other financial assets – i.e. financial assets that do not meet the criteria for classification as subsequently measured at either amortised cost or FVOCI – are classified as subsequently measured at FVTPL (except for investments in equity instruments to which the FVOCI designation is applied – see below). [IFRS 9.4.1.4]

All financial assets held by an investment entity – including investments in subsidiaries, associates and joint ventures – are classified as subsequently measured at FVTPL, except for investments in subsidiaries that are not themselves investment entities and whose main purpose and activities are to provide services that relate to the investment entity's investment activities. [IFRS 10.31–32]

Amortised cost

Unlike IFRS Accounting Standards, different criteria apply to different types of assets for amortised cost classification. The following financial assets are required to be subsequently measured at amortised cost, unlike IFRS Accounting Standards:

- loans and trade receivables not classified as held-for-sale; and
- debt securities classified as held-to-maturity. [310-10-35-47 – 35-48, 948-310-35-1, 320-10-35-1]

Unlike IFRS Accounting Standards, the classification of debt securities as held-to-maturity or available-for-sale is an election based on the intent and ability of management with respect to holding the investment. [320-10-25-1]

Financial assets subsequently measured at FVOCI

Unlike IFRS Accounting Standards, there is no prescribed 'FVOCI' classification for financial assets. Debt securities classified as available-for-sale are subsequently measured at fair value, like IFRS Accounting Standards. See chapter 7.7 for details on recognition of gains and losses. [320-10-25-1]

Financial instruments at FVTPL

Like IFRS Accounting Standards, debt securities classified as trading and certain investments in equity securities are subsequently measured at FVTPL.

Like IFRS Accounting Standards, all financial assets held by investment companies are subsequently measured at FVTPL, except for investments in subsidiaries whose purpose is to provide services to the investment company. Unlike IFRS Accounting Standards, consolidation by an investment company of an investment company subsidiary is not precluded and practice under US GAAP varies. For a full discussion of the investment company consolidation exception and the differences from IFRS Accounting Standards, see chapter 5.6. [946-320-35-1, 946-810-45-3]

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In addition, an entity has the option on initial recognition to irrevocably designate a financial asset as at FVTPL if doing so eliminates or significantly reduces a measurement or recognition inconsistency – i.e. an accounting mismatch – that would otherwise arise from measuring assets or liabilities, or recognising the gains and losses on them, on different bases. [IFRS 9.4.1.5]

Entities also have an option to designate certain credit exposures as at FVTPL as a substitute for hedge accounting. Under this option, if an entity uses a credit derivative that is measured at FVTPL to manage the credit risk of all, or a part, of the exposure, and other criteria are met, then it can designate the exposure as at FVTPL (see chapter 7.9). [IFRS 9.6.7.1]

Investments in equity instruments

Investments in equity instruments fail the SPPI criterion and are therefore generally measured at FVTPL. However, on initial recognition an entity may make an irrevocable election to present in OCI the changes in the fair value of an investment in an equity instrument that is not held for trading. The election can be made on an instrument-by-instrument basis. [IFRS 9.5.7.5, B5.7.1]

Equity instruments are defined in the same way as in IAS 32. This means that a holder of an investment assesses whether the instrument meets the definition of equity from the perspective of the issuer. [IFRS 9.BC5.21]

Business model assessment

There are three business models that determine the classification of financial assets that meet the SPPI criterion – i.e. those in which the assets are:

- held-to-collect contractual cash flows: amortised cost;
- both held-to-collect and for-sale: FVOCI; and
- held in other business models: FVTPL. [IFRS 9.4.1.1, 4.1.4]

Unlike IFRS Accounting Standards, US GAAP lists specific financial assets that are eligible or ineligible to be irrevocably designated at FVTPL on initial recognition, or on the occurrence of a remeasurement event. Under US GAAP, the following are considered remeasurement events for financial assets:

- financial assets reported at FVTPL due to specialised accounting principles (e.g. investment company accounting) cease to qualify for that specialised accounting;
- an investment becomes subject to the equity method of accounting; or
- an event that requires a financial asset to be measured at fair value at the time of the event but does not require subsequent measurement at fair value (i.e. a business combination, consolidation or deconsolidation of a subsidiary or variable interest entity, or a significant modification of debt).

Also unlike IFRS Accounting Standards, this is a free election with no other criteria needing to be met for most instruments.

Unlike IFRS Accounting Standards, there is no specific guidance on designating credit exposures as at FVTPL. The general requirements for fair value option designation would apply under US GAAP (see above). [825-10-15-4, 25-2]

Investments in equity instruments

Like IFRS Accounting Standards, investments in equity securities are generally measured at FVTPL, unless the measurement alternative is elected (see chapter 7.7), unlike IFRS Accounting Standards. Also unlike IFRS Accounting Standards, an entity is not permitted to elect to present in OCI the changes in the fair value of any investments in equity instruments. [321-10-35-1 – 35-4]

Business model assessment

Unlike IFRS Accounting Standards, there is no business model assessment for determining the classification of financial assets. Under US GAAP, the classification of debt securities, loans and trade receivables is dependent on management's intent and ability with respect to holding the financial assets. See the 'classification' section above for classification criteria under US GAAP. [320-10-25-1, 948-310-35-1]

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Financial assets in a held-to-collect business model are managed to realise cash flows by collecting contractual cash flows. Sales are incidental to the objectives of the model. [IFRS 9.B4.1.2C]

Financial assets are both held-to-collect and for-sale in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. [IFRS 9.B4.1.4A]

Financial assets held in any other business model are classified as subsequently measured at FVTPL. This category includes financial assets that:

- meet the definition of held-for-trading (see chapter 7.5);
- are managed with the objective of maximising cash flows through sale; or
- are managed on a fair value basis. [IFRS 9.B4.1.5–B4.1.6]

The SPPI criterion

Contractual cash flows that meet the SPPI criterion are consistent with a basic lending arrangement. In such arrangements, consideration for the time value of money and credit risk are typically the most significant elements of interest. [IFRS 9.B4.1.7A]

'Principal' is the fair value of the financial asset on initial recognition. However, the principal may change over time – e.g. if there are repayments of principal. [IFRS 9.4.1.3(a), B4.1.7B]

'Interest' is consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks (e.g. liquidity risk) and costs (e.g. administrative costs), as well as a profit margin that is consistent with a basic lending arrangement. [IFRS 9.4.1.3(b), B4.1.7A, BC4.22]

An equity investment does not give rise to cash flows that are SPPI. In addition, the dates of cash flows are not usually specified.

If a contract contains a host that is an asset in the scope of the financial instruments standard, then any embedded feature(s) are not bifurcated but, rather, the SPPI analysis is applied to the entire contract. [IFRS 9.4.3.3]

The SPPI criterion

Unlike IFRS Accounting Standards, there is no concept of SPPI for the classification of financial assets under US GAAP.

Unlike IFRS Accounting Standards, embedded derivatives are always evaluated for bifurcation from the host contract under US GAAP. In addition, if an embedded derivative that is required to be bifurcated and accounted for separately cannot be reliably measured, then the entire contract has to be measured at fair value with gain or loss recognised in profit or loss. See chapter 7.2 for further discussion on embedded derivatives. [815-15-25-1, 25-53, 30-1(b), 35-2]

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Reclassifications of financial assets

The reclassification of financial assets is required if, and only if, the objective of the entity's business model for managing those financial assets changes. [IFRS 9.4.4.1, BCE.70]

Such changes are expected to be very infrequent and are determined by the entity's senior management as a result of external or internal changes. These changes have to be significant to the entity's operations and demonstrable to external parties. Accordingly, a change in the objective of an entity's business model will occur only when an entity either begins or ceases carrying out an activity that is significant to its operations – e.g. when the entity has acquired, disposed of or terminated a business line. [IFRS 9.B4.4.1, BC4.115–BC4.116]

Forthcoming requirements

Amendments to the financial instruments standard are effective for annual periods beginning on or after 1 January 2026; early adoption is permitted. [IFRS 9.7.1.12]

The amendments introduce an additional test to assess whether the SPPI criterion is met for certain financial assets with the following features:

- there are contractual terms that change the timing or amount of the contractual cash flows based on a contingent event;
- there are SPPI cash flows both before and after the contingent event; and
- the nature of the contingent event is not related directly to basic lending risks or costs (e.g. a borrower meeting specified ESG targets). [IFRS 9.B4.1.10A]

The contractual cash flows of such a financial asset meet the SPPI criterion if, and only if, in all contractually possible scenarios, the contractual cash flows are not significantly different from the contractual cash flows of an identical financial asset without such a contingent feature. The likelihood of the contingent event occurring is not considered in this analysis. [IFRS 9.B4.1.10–B4.1.10A]

Reclassifications of financial assets

Similar to IFRS Accounting Standards, certain financial assets (i.e. debt securities, loans and trade receivables) may be reclassified in limited circumstances. [310-10-35, 320-10-35-12, 948-310-25-1]

The requirements for reclassification of certain financial assets (i.e. debt securities, loans and trade receivables) differ from IFRS Accounting Standards. Therefore, the frequency of reclassifications may also differ from IFRS Accounting Standards. In general, a debt security, loan or trade receivable could be reclassified if there are changes in management's intent and ability with respect to holding the financial asset. Judgement is required in determining when circumstances have changed such that management can assert that it has changed its ability and intent for holding the financial asset. Under US GAAP, circumstances in which transfers of debt securities into and out of the held-for-trading category would be permitted are expected to be rare. [310-10-35, 320-10-35-12]

Forthcoming requirements

There are no forthcoming requirements under US GAAP.

Unlike IFRS Accounting Standards, there is no concept of SPPI for the classification of financial assets under US GAAP.

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7.5 Classification of financial liabilities

(IFRS 9)

Overview

- **Financial liabilities are generally classified into two measurement categories:**
  - **amortised cost; or**
  - **FVTPL.**
- **Financial liabilities classified as at FVTPL are further subcategorised as held-for-trading (which includes derivatives) or designated as at FVTPL on initial recognition.**
- **Reclassification of financial liabilities is not permitted.**

Classification

On initial recognition, financial liabilities are generally classified as subsequently measured at amortised cost unless they are measured at FVTPL. [IFRS 9.4.2.1]

Financial liabilities at FVTPL

Financial liabilities are measured at FVTPL if they meet one of the following conditions:

- financial liabilities held for trading (including derivatives); or
- financial liabilities that on initial recognition are designated as at FVTPL. [IFRS 9.A]

7.5 Classification of financial liabilities

(Subtopic 470-10, Subtopic 480-10, Subtopic 405-10, Subtopic 815-10, Subtopic 815-15, Subtopic 825-10)

Overview

- **Unlike IFRS Accounting Standards, classification categories for financial liabilities are not prescribed. However, like IFRS Accounting Standards, financial liabilities that are not measured at fair value are generally measured at amortised cost.**
- **Unlike IFRS Accounting Standards, there is no subcategorisation of financial liabilities as held-for-trading. Like IFRS Accounting Standards, financial liabilities may be designated as at FVTPL. However, the eligibility criteria for fair value option designation differ from IFRS Accounting Standards in certain respects.**
- **Like IFRS Accounting Standards, reclassification of financial liabilities is not permitted.**

Classification

Unlike IFRS Accounting Standards, the classification categories for financial liabilities are not generally prescribed. However, like IFRS Accounting Standards, financial liabilities can be designated as at FVTPL (see below). Financial liabilities that are not measured at fair value are generally measured at amortised cost. [405-10, 470-10, 825-10-15-4]

Financial liabilities at FVTPL

The following financial liabilities are measured at FVTPL:

- all derivatives other than derivatives that qualify as equity, or as cash flow or net investment hedging instruments, which differ in certain respects from IFRS Accounting Standards (see chapter 7.9);
- financial liabilities that are designated under the fair value option, which differs in certain respects from IFRS Accounting Standards (see below); and

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A financial liability is held for trading if it is:
- incurred principally for the purpose of repurchasing it in the near term;
- on initial recognition, part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or
- a derivative, except for a derivative that is a designated and effective hedging instrument (see chapter 7.9). [IFRS 9.A]

An entity may choose, on initial recognition, to irrevocably designate a financial liability as measured at FVTPL. An entity may use this designation only:
- if doing so results in more relevant information because either:
  - it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise result from measuring assets or liabilities, or recognising gains or losses on them, on different bases (an 'accounting mismatch'); or
  - a group of financial liabilities (or financial assets and financial liabilities) is managed and its performance is evaluated on a fair value basis in accordance with the entity's documented risk management or investment strategy, and information is provided to key management personnel on this basis; or
- in respect of an entire hybrid contract, if the contract contains one or more embedded derivatives, unless either:
  - the embedded derivatives do not significantly modify the cash flows that would otherwise be required by the contract; or
  - it is clear with little or no analysis that separation of the embedded derivative is prohibited. [IFRS 9.4.2.2, 4.3.5]

If an embedded derivative is required to be separated (see chapter 7.2) and its fair value cannot be measured reliably or cannot be determined as the difference between the fair value of the hybrid contract and the fair value of the host, then the entire hybrid contract is designated as at FVTPL. [IFRS 9.4.3.6, 9.4.3.7]

A designation may be made only on initial recognition and is not reversible. An entity can choose which, if any, of its financial liabilities are to be designated into this category. [IFRS 9.B4.1.28, B4.1.35]

- certain financial instruments that are required to be measured at fair value under the distinguishing liabilities from equity Codification Topic (see chapter 7.7). [815-10-35-1, 825-10-15-4]

Unlike IFRS Accounting Standards, financial liabilities are not categorised as held-for-trading.

Unlike IFRS Accounting Standards, US GAAP lists specific financial liabilities that are eligible or ineligible to be irrevocably designated at FVTPL on initial recognition or on the occurrence of a remeasurement event. Under US GAAP, the following are considered remeasurement events for financial liabilities:
- when financial liabilities reported at FVTPL due to specialised accounting principles (i.e. brokers and dealers) cease to qualify for that specialised accounting; and
- an event that requires a financial liability to be measured at fair value at the time of the event but does not require subsequent measurement at fair value (i.e. a business combination, consolidation or deconsolidation of a subsidiary or variable interest entity, or a significant modification of debt). [825-10-25-4, 940-320-30-2]

Unlike IFRS Accounting Standards, this is a free election with no other criteria needing to be met for most instruments.

Like IFRS Accounting Standards, if an embedded derivative that is required to be bifurcated and accounted for separately cannot be reliably measured, then the entire contract has to be measured at fair value with gain or loss recognised in earnings. [815-15-25-53, 30-1(b), 35-2]

Like IFRS Accounting Standards, the designation is not reversible. However, the designation can be made on initial recognition or on the occurrence of a remeasurement event, which may result in differences from IFRS Accounting Standards. [825-10]

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Reclassification

Classification of financial liabilities is determined on initial recognition. Subsequent reclassification is prohibited. [IFRS 9.4.2.1, 4.4.2]

Reclassification

Unlike IFRS Accounting Standards, classification categories for financial liabilities are not prescribed. However, like IFRS Accounting Standards, election of the fair value option is irrevocable and has to be made on initial recognition or on the occurrence of a remeasurement event. Therefore, like IFRS Accounting Standards, subsequent reclassification of financial liabilities between amortised cost and fair value is prohibited. [825-10]

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7.6 Recognition and derecognition

(IFRS 9, IFRIC 19)

Overview

- Financial assets and financial liabilities, including derivative instruments, are recognised in the statement of financial position when the entity becomes a party to the instrument. However, 'regular-way' purchases and sales of financial assets are recognised and derecognised using either trade date or settlement date accounting.
- A financial asset is derecognised only when the contractual rights to the cash flows from the financial asset expire or when the financial asset is transferred and the transfer meets certain conditions.
- A financial asset is 'transferred' if an entity transfers the contractual rights to receive the cash flows from the financial asset or enters into a qualifying 'pass-through' arrangement. If a financial asset is transferred, then an entity evaluates whether it has retained the risks and rewards of ownership of the transferred financial asset.
- An entity derecognises a transferred financial asset if it has: transferred substantially all of the risks and rewards of ownership; or neither retained nor transferred substantially all of the risks and rewards of ownership and has not retained control of the financial asset.
- An entity continues to recognise a financial asset to the extent of its continuing involvement if it has neither retained nor transferred substantially all of the risks and rewards of ownership and it has retained control of the financial asset.

7.6 Recognition and derecognition

(Subtopic 310-20, Subtopic 405-20, Subtopic 470-50, Subtopic 470-60, Subtopic 815-40, Topic 848, Topic 860, Subtopic 940-320, Subtopic 942-325, Subtopic 946-320)

Overview

- Like IFRS Accounting Standards, financial assets and financial liabilities, including derivative instruments, are recognised in the statement of financial position when an entity becomes a party to the instrument. Unlike IFRS Accounting Standards, certain industries are required to use trade date accounting for 'regular-way' transactions; otherwise US GAAP is silent and practice varies.
- Unlike IFRS Accounting Standards, the derecognition model for transfers of financial assets focuses on surrendering control over the transferred assets; the transferor has 'surrendered' control over transferred assets only if certain conditions are met.
- Unlike IFRS Accounting Standards, a financial asset is 'transferred' when it has been conveyed by and to someone other than its issuer.
- Unlike IFRS Accounting Standards, 'risks and rewards' is not an explicit consideration when testing a transfer for derecognition. Rather, an entity derecognises a transferred financial asset or a participating interest therein if it surrenders legal, actual and effective control of the financial asset or participating interest.
- After a transfer of a financial asset, or a participating interest therein, an entity continues to recognise the financial assets that it controls, which may be different from the treatment required by IFRS Accounting Standards.

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Overview (continued)

- **A financial liability is derecognised when it is extinguished or when its terms are substantially modified.**

Initial recognition

Financial instruments are recognised when an entity becomes party to the contractual terms of the instrument. [IFRS 9.3.1.1]

The purchase or sale of a non-derivative financial asset that is delivered in a 'regular-way' transaction may be recognised on either trade date or settlement date. The method adopted is applied consistently to all purchases and all sales of financial assets in the same category. [IFRS 9.B3.1.3, B3.1.5–B3.1.6]

Derecognition of financial assets

Derecognition criteria

An entity first consolidates all subsidiaries as required under IFRS Accounting Standards (see chapter 2.5) and then applies the derecognition principles to the resulting group. [IFRS 9.3.2.1]

The derecognition analysis can be applied to:

- a financial asset or a group of similar financial assets; or
- part of a financial asset or part of a group of similar financial assets. [IFRS 9.3.2.2]

The derecognition analysis is applied to a part of a financial asset or a group of similar financial assets only if that part comprises either:

- specifically identified cash flows;
- a fully proportionate share of the cash flows; or
- a fully proportionate share of specifically identified cash flows. [IFRS 9.3.2.2]

Overview (continued)

- **Like IFRS Accounting Standards, a financial liability is derecognised when it is extinguished or when its terms are substantially modified. However, unlike IFRS Accounting Standards, there is specific guidance on the modification of terms in respect of convertible debt and troubled debt restructuring. Also unlike IFRS Accounting Standards, there is specific guidance on modifications of freestanding equity-classified warrants that relate to issuances or modifications of financial liabilities.**

Initial recognition

Like IFRS Accounting Standards, initial recognition of a financial instrument occurs when an entity becomes party to the contractual terms of that instrument. [815-10-15-17]

Unlike IFRS Accounting Standards, certain industries are required to use trade date accounting for 'regular-way' transactions. Otherwise, US GAAP is silent and practice varies. Like IFRS Accounting Standards, the method selected is applied consistently to purchases and sales of financial assets in the same category. [940-320-25-1, 942-325-25-2, 946-320-25-1]

Derecognition of financial assets

Derecognition criteria

An entity first consolidates all subsidiaries as required (see chapter 2.5) and then applies the derecognition principles to the resulting group, like IFRS Accounting Standards. However, there are differences in the consolidation requirements between IFRS Accounting Standards and US GAAP (see chapter 2.5). [860-10-40-4]

The derecognition analysis can be applied to:

- a financial asset or a group of similar financial assets, like IFRS Accounting Standards; or
- participating interests, unlike IFRS Accounting Standards. [860-10-40-4D]

Unlike IFRS Accounting Standards, transferring a part of a financial asset that does not meet the definition of a participating interest does not qualify for derecognition. A 'participating interest' is generally a portion of a financial asset that:

- conveys proportionate ownership interest with equal priority (including in the event of bankruptcy) to each participating interest holder;

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In all other cases, the derecognition assessment applies to a financial asset in its entirety or to a group of similar financial assets in its entirety. [IFRS 9.3.2.2(b)]

An entity derecognises a financial asset when the contractual rights to the cash flows from that asset expire or when the entity transfers a financial asset and the transfer qualifies for derecognition. [IFRS 9.3.2.3]

An entity directly reduces the gross carrying amount of a financial asset when it has no reasonable expectations of recovering the asset in its entirety or a portion thereof. A write-off constitutes a derecognition event. [IFRS 9.5.4.4]

Evaluating whether there is a transfer

An entity is considered to have transferred a financial asset if the entity:

- transfers the contractual rights to receive the cash flows from the asset; or
- retains the contractual rights to receive the cash flows, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets certain criteria. [IFRS 9.3.2.4]

Modification of a financial asset

If the terms of a financial asset are modified, then in our view the holder of the financial asset should perform a quantitative and qualitative evaluation of whether the modification is substantial. If the modification is substantial, then we believe that the contractual rights to cash flows from the original financial asset should be deemed to have expired. In our view, in making this evaluation an entity needs to develop its own accounting policies and methods. In doing so, it may, but is not required to, analogise to the guidance on derecognition of financial liabilities.

- involves no recourse (other than standard representations and warranties) to the transferor or any participating interest holder;
- does not entitle any participating interest holder to receive cash before any other participating interest holder; and
- prohibits any party from pledging or exchanging the entire financial asset without the approval of all participating interest holders. [860-10-40-6A]

In all cases that do not constitute a participating interest, the derecognition assessment applies to a financial asset in its entirety or to the group of similar financial assets in its entirety, like IFRS Accounting Standards. [860-10-40-4E]

Unlike IFRS Accounting Standards, a ‘transfer’ of financial assets, or a participating interest, in which the transferor surrenders control over the assets (‘financial components approach’) is accounted for as a sale (i.e. derecognition). [860-10-40-5]

The amortised cost basis of a financial asset and its related allowance for credit losses are written off in the period in which the financial asset, in its entirety or a portion thereof, is deemed uncollectable. Due to differences in wording and specific requirements for regulated entities, the timing of write-offs under US GAAP may be different. Unlike IFRS Accounting Standards, the write-off of an asset is not in and of itself a derecognition event. [326-20-35-8, 326-30-35-13]

Evaluating whether there is a transfer

Unlike IFRS Accounting Standards, a ‘transfer’ is the conveyance of a non-cash financial asset by and to someone other than the issuer of that financial asset. Therefore, a transfer includes selling a receivable, putting a receivable into a securitisation trust or posting it as collateral. [860-10-20]

Modification of a financial asset

Like IFRS Accounting Standards, if the terms of a financial asset are modified, then the holder of the financial asset performs a quantitative and qualitative evaluation of whether the modification is substantial and should be accounted for as a new financial asset. The financial asset would be derecognised and accounted for as a new asset when both of the following (i.e. the quantitative test) are met:

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Pass-through arrangements

If an entity retains the contractual right to the cash flows of a financial asset, but also assumes a contractual obligation to pay the cash flows to the transferee (sometimes called a 'pass-through arrangement'), then the transaction is considered a transfer if and only if the entity:

- has no obligation to pay amounts to the transferee unless the entity collects equivalent amounts from the original financial asset;
- is prohibited from selling or pledging the original financial asset under the terms of the pass-through arrangement; and
- is obliged to remit all of the cash flows that it collects without material delay. [IFRS 9.3.2.5]

Risks and rewards evaluation

For all transactions that meet the transfer requirements, the entity next evaluates the extent to which it has transferred or retained the risks and rewards of ownership of the financial asset.

- If the entity retains substantially all of the risks and rewards of ownership, then it continues to recognise the financial asset.
- If the entity transfers substantially all of the risks and rewards of ownership, then it derecognises the financial asset.

- The terms of the new loan resulting from a loan modification are at least as favourable to the lender as the terms for comparable loans to other customers with similar credit risk who are not refinancing or restructuring a loan with the lender. This condition would be met if the new loan's effective yield is at least equal to the effective yield for such comparable loans.
- The modification of the instrument is more than minor – i.e. if the present value of the cash flows under the terms of the new debt instrument is at least 10 percent different from the present value of the cash flows under the terms of the original debt instrument. [310-20-35-9 – 35-11, 470-50-40-10]

Like IFRS Accounting Standards, the qualitative evaluation is only necessary if the modification of the financial asset does not meet the quantitative test (see above).

Depending on the chosen accounting policies and methods applied under IFRS Accounting Standards, differences may arise in practice.

Pass-through arrangements

Unlike IFRS Accounting Standards, there is no pass-through derecognition test. Transferred financial assets would not qualify for derecognition under US GAAP unless they met the criteria described below for derecognising a transferred financial asset.

Risks and rewards evaluation

Unlike IFRS Accounting Standards, 'risks and rewards' is not an explicit consideration when evaluating a transfer for derecognition. Unlike IFRS Accounting Standards, transferred financial assets or participating interests are derecognised when the transferor surrenders control over those assets. The transferor has 'surrendered' control over transferred assets only if all of the following conditions are met.

- *Legal control:* The transferred asset is isolated from the transferor – i.e. put legally beyond the reach of the transferor, including its consolidated affiliates and its creditors, even in the event of the transferor's bankruptcy or receivership.

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- If the entity neither transfers nor retains substantially all of the risks and rewards of ownership, then it determines whether it has retained control of the financial asset (see below). [IFRS 9.3.2.6]

Control evaluation

If an entity neither transfers nor retains substantially all of the risks and rewards of ownership of a financial asset, then it evaluates whether it has retained control of the financial asset. If the entity does not retain control, then it derecognises the financial asset. [IFRS 9.3.2.6(c)]

An entity is considered to have lost control if the transferee has the practical ability unilaterally to sell the transferred financial asset in its entirety to an unrelated party without needing to impose additional restrictions on the sale. [IFRS 9.3.2.9, B3.2.7]

Continuing involvement

If an entity retains control of a financial asset for which some but not substantially all of the risks and rewards have been transferred, then the entity continues to recognise the financial asset to the extent of its continuing involvement in the financial asset. [IFRS 9.3.2.6(c)(ii)]

- *Actual control:* (1) The transferee (or, if the transferee is an entity whose sole purpose is to engage in securitisation or asset-backed financing activities and that entity is constrained from pledging or exchanging the assets that it receives, each third party holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interests) that it received and (2) no condition both (i) constrains the transferee (or each third party holder of its beneficial interests) from taking advantage of its right to pledge or exchange and (ii) provides more than a trivial benefit to the transferor.
- *Effective control:* Neither the transferor nor its consolidated affiliates included in the financial statements being presented or its agents maintains effective control over the transferred financial assets or third party beneficial interests related to those transferred assets. Examples of effective control include, but are not limited to: (1) an agreement that both entitles and obligates the transferor to repurchase or redeem the transferred financial assets before their maturity; (2) an agreement that provides the transferor with both the unilateral ability to cause the holder to return specific financial assets and a more-than-trivial benefit attributable to that ability, other than through a clean-up call; or (3) an agreement that permits the transferee to require the transferor to repurchase the transferred financial assets at a price that is so favourable to the transferee that it is probable that the transferee will require the transferor to repurchase them. [860-10-40-4D – 40-5]

Control evaluation

Unlike IFRS Accounting Standards, control is always the focus of derecognition tests, rather than being considered only if an entity neither transfers nor retains substantially all of the risks and rewards of ownership. Derecognition is based on whether legal, actual and effective control as described above has been surrendered. [860-10-40-5]

Unlike IFRS Accounting Standards, derecognition is based on whether legal, actual and effective control as described above have been surrendered. [860-10-40-5]

Continuing involvement

As described above, unlike IFRS Accounting Standards, continuing involvement is not an explicit consideration when testing a transfer for derecognition, but rather derecognition is based on whether legal, actual and effective control have been surrendered. However, after a transfer of financial assets or participating interests, an entity continues to recognise the financial and servicing assets that it controls and derecognises the financial assets or participating interest for which it has surrendered control. [860-20-40-1A – 40-1B]

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Accounting for a sale

Transfers that qualify for derecognition

If only part of a financial asset is derecognised, then the carrying amount of the entire financial asset before the transfer is allocated between the sold and retained portions based on their relative fair values on the date of transfer. [IFRS 9.3.2.13]

Sometimes new financial assets, financial liabilities or servicing liabilities are created in the transfer – e.g. a credit guarantee. New financial assets or financial liabilities created as a result of the transfer are recognised separately and measured at fair value. Servicing assets and servicing liabilities are not considered financial instruments. [IFRS 9.3.2.10–3.2.11]

If an entity derecognises a transferred financial asset and retains the right to service the financial asset for a fee, then it recognises either:

- a servicing liability, at fair value, if the fee does not adequately compensate the entity for performing the servicing; or
- a servicing asset, calculated as an allocation of the carrying amount of the entire financial asset before the transfer between the sold and retained portions based on their relative fair values on the date of transfer, if the fee more than adequately compensates the entity for performing the servicing. [IFRS 9.3.2.10–3.2.13]

In derecognising a transferred financial asset, a gain or loss is recognised based on the difference between (1) the carrying amount of the financial asset or the carrying amount allocated to the part derecognised and (2) the consideration received for the asset or the part derecognised, including the fair value of any new asset obtained less any new liability assumed. For debt investments classified as at FVOCI, the cumulative amount previously recognised in OCI in respect of the derecognised financial asset or part thereof is reclassified and forms part of the gain or loss on derecognition. For equity investments classified as at FVOCI, the cumulative amount recognised in OCI is never reclassified to profit or loss. [IFRS 9.3.2.12–3.2.13, 9.5.7.10–5.7.11]

There is no specific guidance in the financial instruments standards on the subsequent measurement of servicing assets and servicing liabilities and they are subsequently measured in accordance with other applicable accounting standards.

Accounting for a sale

Transfers that qualify for derecognition

Like IFRS Accounting Standards, if a transfer of a participating interest qualifies as a sale, then the carrying amount of the transferred asset before the transfer is allocated between the sold and retained participating interests based on their relative fair values on the date of transfer. [860-20-40-1A(a)]

In general, if new financial assets, financial liabilities or servicing liabilities are created in the transfer, then they are recognised separately and measured at fair value, like IFRS Accounting Standards. Like IFRS Accounting Standards, servicing assets and servicing liabilities are not considered financial instruments. [860-20-40-1A(c)]

If an entity derecognises a transferred financial asset and retains the right to service the financial asset for a fee, then the entity recognises either:

- a servicing liability, at fair value, if the fee does not adequately compensate the entity for performing the servicing, like IFRS Accounting Standards; or
- a servicing asset, if the fee more than adequately compensates the entity for performing the servicing, like IFRS Accounting Standards; however, the servicing asset is recognised at fair value, unlike IFRS Accounting Standards. [860-50-25-1, 30-1 – 30-2]

Like IFRS Accounting Standards, in derecognising a transferred financial asset, a gain or loss is recognised based on the difference between (1) the carrying amount of the financial asset or the carrying amount allocated to the part derecognised and (2) the sum of the proceeds received for the asset or the participating interest derecognised, including the fair value of any new asset obtained less any new liability assumed. For debt investments classified as available-for-sale, the cumulative amount previously recognised in OCI in respect of the derecognised financial asset or part thereof is part of the gain or loss on derecognition, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, any gains or losses related to investments in equity securities are never recognised in OCI under US GAAP. [860-20-40-1B, 55-43 – 55-59, 321-10-35-1 – 35-2]

Unlike IFRS Accounting Standards, an entity chooses an accounting policy, to be applied consistently, to measure servicing assets and liabilities subsequently either at FVTPL or by amortising the servicing asset or liability in proportion to and over the period of estimated net servicing income or loss. [860-50-35-1]

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Transfers that do not qualify for derecognition

If a transfer does not qualify for derecognition, then the financial asset or the retained portion of the financial asset remains in the statement of financial position and a financial liability is recognised for any consideration received. [IFRS 9.3.2.15, B3.2.12]

If a transfer of a financial asset does not qualify for derecognition, then the transferee does not recognise the transferred asset as its asset in its statement of financial position. Instead, the transferee derecognises the cash or other consideration paid and recognises a receivable from the transferor. [IFRS 9.B3.2.15]

Securitisations

In a securitisation, the transferring entity securitises financial assets in return for cash proceeds. If financial instruments are securitised using a structured entity (see chapter 2.5) that is consolidated, then the transaction to evaluate for derecognition at the group level is any transfer of financial assets by the group, including the structured entity, to the investors in the securities issued by the structured entity. If the structured entity is not consolidated, then the transaction to evaluate for derecognition at the group level is any transfer of financial assets by the group, excluding the structured entity, to the structured entity. [IFRS 9.3.2.1]

Repurchase agreements and securities lending

If a sale of a financial asset is subject to a repurchase agreement at a fixed price, or at the initial selling price plus interest, or if the asset is lent to a third party who agrees to return it, then the transferor does not derecognise the asset, although it may need to reclassify it in the statement of financial position. [IFRS 9.B3.2.16(a), 3.2.23(a)]

Derecognition of financial liabilities

A financial liability is derecognised when it is extinguished – i.e. it is discharged or cancelled or expires. This may happen when:

- payment is made to the lender;
- the borrower is legally released from primary responsibility for the financial liability; or
- there is an exchange of debt instruments with substantially different terms between an existing borrower and lender or a substantial modification of the terms of an existing financial liability. [IFRS 9.3.3.1–3.3.2, B3.3.1, B3.3.3]

Transfers that do not qualify for derecognition

Like IFRS Accounting Standards, if a transfer does not qualify for derecognition, then the asset or the participating interest retained remains in the statement of financial position and a financial liability is recognised for any consideration received. [860-30-25]

Like IFRS Accounting Standards, if a transfer of a financial asset does not qualify for derecognition, then the transferee does not recognise the transferred asset as its asset in its statement of financial position. Instead, the transferee derecognises the cash or other consideration paid and recognises a receivable from the transferor. [860-30]

Securitisations

In a securitisation, the transferring entity transfers financial assets to a structure in return for cash proceeds. Like IFRS Accounting Standards, an entity first evaluates all securitisation structures for consolidation under the consolidation Codification Topic, which differs from IFRS Accounting Standards in certain respects (see chapter 2.5). Like IFRS Accounting Standards, if the structure is consolidated, then the transaction to evaluate for derecognition at the group level is any transfer of financial assets by the group, including the structure, to the structure's beneficial interest holders. Like IFRS Accounting Standards, if a structure is not consolidated, then the transaction to evaluate for derecognition at the group level is any transfer of the financial assets by the group, excluding the structure, to the structure. [860-10-40-4 – 40-5]

Repurchase agreements and securities lending

Like IFRS Accounting Standards, if a sale of a financial asset is subject to a repurchase agreement at a fixed price, or at the initial selling price plus interest, or if the asset is lent to a third party who agrees to return it, then the transferor does not generally derecognise the asset, although it might reclassify it in the statement of financial position. Unlike IFRS Accounting Standards, specific guidance is applied to repurchase-to-maturity transactions and repurchase financings. [860-10-40-12, 40-4C, 40-24 – 40-24A]

Derecognition of financial liabilities

Like IFRS Accounting Standards, a financial liability is derecognised when it is extinguished. This may happen when:

- the debtor pays the creditor and is relieved of its obligation for the liability;
- the debtor is legally released from being the primary obligor under the liability either judicially or by the creditor; or
- there is an exchange or modification that results in debt instruments with substantially different terms. [405-20-40-1, 470-50-40-6]

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Modification of a financial liability – Overview

If the terms of an existing financial liability have been substantially modified, then the transaction is accounted for as an extinguishment of the old debt. The difference between the carrying amount of the extinguished financial liability and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in profit or loss. The new debt is recognised at fair value. [IFRS 9.3.3.3]

Terms are considered to have been 'substantially modified' if the net present value of the cash flows under the new terms – including any fees paid, net of any fees received, discounted using the original effective interest rate of the original liability – differs by at least 10 percent from the present value of the remaining payments under the original terms. [IFRS 9.B3.3.6]

If the 10 percent limit is not breached – i.e. the difference in the present values of the cash flows is less than 10 percent – then in our view the entity should perform a qualitative assessment to determine whether the terms of the two instruments are substantially different.

There are no specific requirements for modifications of terms in respect of convertible debt and troubled debt restructurings, or modifications of freestanding equity-classified warrants that relate to issuances or modifications of financial liabilities.

Extinguishing a financial liability with equity

If renegotiation of the terms of a financial liability results in an entity issuing equity instruments to a creditor to extinguish all or part of the financial liability, then the debtor measures the equity instruments issued at their fair value, unless that fair value cannot be reliably measured. In this case, the equity instruments are measured with reference to the fair value of the financial liability extinguished. The difference between the carrying amount of the financial liability (or part of the financial liability) extinguished and the initial measurement amount of the equity instruments issued is recognised in profit or loss. [IFRIC 19.5–9]

Modification of a financial liability – Overview

Like IFRS Accounting Standards, if the terms of an existing financial liability have been substantially modified, then the transaction is accounted for as an extinguishment of the old debt. Like IFRS Accounting Standards, the difference between the carrying amount of the extinguished financial liability and the fair value of the new financial liability is recognised in profit or loss. Like IFRS Accounting Standards, the new debt is recognised at fair value. [470-50-40-2, 40-6, 40-13, 40-17 – 40-18]

Like IFRS Accounting Standards, terms are considered to have been 'substantially modified' if the net present value of the cash flows under the new terms – including any fees paid, net of any fees received, discounted using the original effective interest rate of the original liability – differs by at least 10 percent from the present value of the remaining payments under the original terms. [470-50-40-10]

Unlike IFRS Accounting Standards, if the 10 percent quantitative limit is not breached a qualitative assessment is not performed. However, when there is a change in the debt's currency, then in our view an entity can choose an accounting policy, to be applied consistently, to either apply the 10 percent test or automatically conclude that the terms of the debt have been substantially modified. [470-50-40-12]

Unlike IFRS Accounting Standards, there are specific requirements for the borrower's accounting for modifications of terms in respect of convertible debt and troubled debt restructurings. Also unlike IFRS Accounting Standards, there is specific guidance on modifications of freestanding equity-classified warrants that relate to issuances or modifications of financial liabilities. [470-50-40-10 – 40-11, 40-12A; 470-60-35-1 – 35-5, 35-8]

Extinguishing a financial liability with equity

Like IFRS Accounting Standards, if renegotiation of the terms of a financial liability results in an entity issuing equity instruments to a creditor to extinguish all or part of the financial liability, then generally the debtor measures the equity instruments at fair value. Unlike IFRS Accounting Standards, there is no 'reliably measurable' exception for measuring the equity interests at their fair value. The difference between the carrying amount of the financial liability (or part of the financial liability) extinguished and the initial measurement amount of the equity instruments issued is recognised in profit or loss, like IFRS Accounting Standards. [470-50-40]

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If the terms of a financial liability are amended such that the financial liability subsequent to the amendment of the terms meets the definition of an equity instrument, then in our view the transaction should be accounted for as an extinguishment of a financial liability with equity instrument, as set out above.

Derecognition of derivatives

Derivatives that might change from being an asset to a liability or vice versa are derecognised only when they meet both the derecognition criteria for financial assets and the derecognition criteria for financial liabilities. [IFRS 9.BC6.333]

Interest rate benchmark reform

When a modification of a financial asset or financial liability is required by interest rate benchmark reform, as a practical expedient an entity applies the guidance on floating-rate financial instruments to account for a change in the basis for determining the contractual cash flows of the financial instrument that is required by the reform. This practical expedient applies only where the new basis for determining the contractual cash flows is economically equivalent to the previous basis. Under the practical expedient, the entity updates the effective interest rate to reflect the change in the interest rate benchmark. If there are other changes to the financial instrument, then an entity first applies the practical expedient to the changes required by interest rate benchmark reform and then other applicable requirements of the financial instruments standard. [IFRS 9.5.4.5–5.4.9, B5.4.5]

Like IFRS Accounting Standards, if the terms of a financial liability are amended such that the financial liability subsequent to the amendment of the terms meets the definition of an equity instrument, then in our view the transaction should be accounted for as an extinguishment of a financial liability with equity instrument, as set out above.

Derecognition of derivatives

Like IFRS Accounting Standards, derivatives are derecognised when the derecognition criteria for financial assets and financial liabilities have been met. [815-10-40-1, 405-20-40-1, 860-10-40]

Interest rate benchmark reform

Like IFRS Accounting Standards, there is specific reference rate reform guidance. The guidance is currently effective for all entities. Unlike IFRS Accounting Standards, the amendments are optional and the relief provided by the amendments is generally no longer available after 31 December 2024.

An optional expedient is available if a modification of contractual terms of a financial asset or financial liability that changes (or has the potential to change) the amount or timing of cash flows is related to replacement of a reference rate that is expected to be discontinued as a result of reference rate reform. Under the optional expedient, an entity that has performed an eligible modification of a financial asset or a financial liability does not derecognise or remeasure their carrying amount, but instead updates the effective interest rate to reflect the change in terms arising from such a modification. The optional expedients do not apply if contemporaneous changes are made to terms that are unrelated to the replacement of a reference rate. [848-20-15-1 – 15-3, 848-20-55-1]

Unlike IFRS Accounting Standards, an entity can also apply an optional expedient to derivative contracts impacted by ‘discounting transition’, including derivatives that do not reference LIBOR or other reference rates expected to be discontinued. ‘Discounting transition’ refers to changing the interest rates used for margining, discounting or contract price alignment of certain derivative instruments to transition to alternative rates. [848-20-15-2 – 15-2A]

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Forthcoming requirements

Amendments to the financial instruments standard are effective for annual periods beginning on or after 1 January 2026; early adoption is permitted. [IFRS 9.7.1.12]

The amendments clarify the recognition and derecognition requirements of financial assets and financial liabilities, including clarifying that a financial liability is generally derecognised on the settlement date – i.e. the date on which the liability is extinguished because the obligation specified in the contract is discharged, cancelled, expired or otherwise qualifies for derecognition.

The amendments provide an exception to the requirement to derecognise a financial liability on the settlement date. Under the derecognition exception, an entity elects to derecognise a financial liability that is settled in cash using an electronic payment system before the settlement date if, and only if, the entity has initiated a payment instruction and:

- the entity has no practical ability to withdraw, stop or cancel the payment instruction;
- the entity has no practical ability to access the cash to be used for settlement as a result of the payment instruction; and
- the settlement risk associated with the electronic payment system is insignificant. [IFRS 9.B3.3.8]

If an entity elects to use this exception, then it needs to apply it to all settlements made through the same electronic payment system. [IFRS 9.B3.3.10]

Forthcoming requirements

There are no forthcoming requirements under US GAAP.

Unlike IFRS Accounting Standards, there is no specific guidance on when an entity may derecognise a financial liability when an electronic payment system is used. Therefore, differences in practice may arise.

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7.7 Measurement

(IFRS 9, IFRS 13, IAS 21, IAS 32)

Overview

- Generally, financial assets and financial liabilities are initially measured at fair value plus or minus directly attributable transaction costs, except for:
  - financial instruments classified as at FVTPL, which are initially measured at fair value; and
  - trade receivables that are initially measured at the transaction price as defined in the revenue standard.

- Financial assets are subsequently measured at fair value or amortised cost.

- If a financial asset is measured at fair value, then changes in its fair value are recognised as follows.
  - *Debt financial assets at FVOCI:* Gains and losses are recognised in OCI, except for interest, foreign exchange gains and losses and expected credit losses, which are recognised in profit or loss. On derecognition, any gains or losses accumulated in OCI are reclassified to profit or loss.
  - *Equity financial assets at FVOCI:* Gains and losses are recognised in OCI, except for dividends, which are generally recognised in profit or loss. The amounts in OCI are not reclassified to profit or loss.
  - *Financial assets at FVTPL:* All changes in fair value are recognised in profit or loss.

7.7 Measurement

(Subtopic 310-10, Subtopic 310-20, Subtopic 320-10, Subtopic 320-20, Subtopic 325-20, Subtopic 405-20, Topic 450-20, Subtopic 460-10, Subtopic 470-20, Subtopic 470-50, Subtopic 470-60, Subtopic 480-10, Subtopic 805-20, Subtopic 815-10, Subtopic 815-15, Subtopic 815-25, Subtopic 815-40, Subtopic 820-10, Subtopic 825-10, Subtopic 830-20, Subtopic 835-30, Subtopic 860-20, Subtopic 946-320, Subtopic 946-830, Subtopic 948-10)

Overview

- The initial measurement of financial assets and financial liabilities, including accounting for transaction costs, differs in certain respects from IFRS Accounting Standards. The measurement bases include:
  - fair value (like IFRS Accounting Standards); and
  - cost (unlike IFRS Accounting Standards).

- Like IFRS Accounting Standards, certain financial assets are subsequently measured at fair value or amortised cost. Unlike IFRS Accounting Standards, loans held for sale are measured at the lower of cost and fair value. Also unlike IFRS Accounting Standards, an alternative measurement basis is available for equity securities without readily determinable fair values.

- If a financial asset is measured at fair value, then changes in its fair value are recognised as follows.
  - *Available-for-sale debt securities:* Changes in fair value are recognised in OCI, except for interest and credit losses, which are recognised in profit or loss. The recognition and measurement of credit losses differs from IFRS Accounting Standards. Unlike IFRS Accounting Standards, the amount recognised in OCI includes foreign exchange gains and losses. Like IFRS Accounting Standards, on derecognition any gains or losses accumulated in OCI are reclassified to profit or loss.
  - *Equity Securities with readily determinable fair values:* Unlike IFRS Accounting Standards, there is no 'FVOCI' category for investments in equity securities. All changes in fair value are recognised in profit or loss.
  - *Financial assets for which the fair value option is elected and debt securities held for trading:* All changes in fair value are recognised in profit or loss, like IFRS Accounting Standards.

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Overview (continued)

- **Financial liabilities, other than those measured at FVTPL, are generally measured at amortised cost subsequent to initial recognition.**
- **If a financial liability is mandatorily measured at FVTPL, then all changes in fair value are recognised in profit or loss.**
- **If a financial liability is designated as at FVTPL, then the portion of the fair value changes that is attributable to changes in the financial liability's credit risk is generally recognised in OCI. The amount presented in OCI is never reclassified to profit or loss.**
- **All derivatives (including separated embedded derivatives) are measured at fair value, with changes in fair value generally recognised in profit or loss.**

Measurement on initial recognition

All financial instruments are initially measured at fair value plus (for financial assets) or minus (for financial liabilities) directly attributable transaction costs, except for:

- instruments classified as at FVTPL, which are initially measured at fair value; and
- trade receivables that are generally measured on initial recognition at the transaction price as defined in the revenue standard. [IFRS 9.5.1.1, 5.1.3, B5.1.1]

Overview (continued)

- **Like IFRS Accounting Standards, financial liabilities that are not measured at fair value are generally measured at amortised cost subsequent to initial recognition.**
- **Like IFRS Accounting Standards, if a financial liability is mandatorily measured at FVTPL, then all changes in fair value are recognised in profit or loss.**
- **Like IFRS Accounting Standards, if a financial liability is measured at fair value under the fair value option, then changes in fair value due to instrument-specific credit risk are recognised in OCI. Unlike IFRS Accounting Standards, the amount presented in OCI is reclassified to profit or loss on derecognition.**
- **Like IFRS Accounting Standards, all derivatives (including separated embedded derivatives) are measured at fair value, with changes in fair value generally recognised in profit or loss.**

Measurement on initial recognition

Unlike IFRS Accounting Standards, there is specific initial measurement guidance only for certain financial instruments. Accordingly, the following financial instruments are initially measured at either fair value or transaction price:

- instruments accounted for as derivatives – fair value;
- investments in debt securities classified as trading – transaction price or fair value;
- investments in available-for-sale debt securities (a category that does not exist under IFRS Accounting Standards) – transaction price or fair value;
- investments in equity securities with readily determinable fair values or without readily determinable fair values when the measurement alternative is not elected – transaction price or fair value;
- instruments for which the FVTPL option has been elected – fair value;
- certain issued mandatorily redeemable financial instruments – fair value;
- certain physically settled forward purchase contracts on the issuer's own shares – fair value of the shares at inception of the forward contract; and
- certain obligations to issue a variable number of shares – fair value. [815-10-30-1, 320-10-25-1, 35-1, 321-10-30-1, 825-10-25-1, 480-10-30-1, 480-10-30-3, 480-10-30-7]

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Generally, gains and losses are not recognised on the initial recognition of a financial instrument. The best evidence of the fair value of a financial instrument is normally the transaction price. If the entity determines that the fair value on initial recognition is different from the transaction price, then a gain or loss is recognised on initial recognition of the instrument only if the entity's estimate of fair value is supported by a quoted price in an active market for the same instrument or with a valuation technique that uses only data from observable markets. If this observability condition is not met, then the carrying amount of the financial instrument on initial recognition is adjusted to defer the difference between the fair value measurement and the transaction price. After initial recognition, any deferred difference is recognised as a gain or loss only to the extent that it arises from a change in a factor that market participants would take into account in pricing the asset or liability. [IFRS 9.5.1.1A, B5.1.2A, B5.2.2A]

In some cases, the consideration given or received on initial recognition is for something in addition to the financial instrument. In these cases, the transaction price for the acquisition of the financial instrument is its fair value determined in accordance with the fair value measurement standard without consideration of observability of any valuation inputs. Any additional element is accounted for separately. For example, in the case of a long-term loan that carries no interest, the fair value of the loan can be measured as the present value of all cash receipts discounted using the current market interest rate for a similar financial instrument. [IFRS 9.B5.1.1]

Transaction costs

'Transaction costs' are incremental costs that would not have been incurred if the instrument had not been acquired or issued. [IFRS 9.5.1.1, A, B5.4.8]

Unlike IFRS Accounting Standards, most other financial instruments (e.g. loans, receivables and financial liabilities not measured at fair value) are generally initially measured at cost, which includes transaction costs. [310-10-30, 310-20-30, 835-30-25]

Unlike IFRS Accounting Standards, equity securities without readily determinable fair values for which the measurement alternative is elected are initially measured at cost. (See 'Transaction costs' below for additional discussion about the accounting for transaction costs on initial recognition.)

Like IFRS Accounting Standards, in many cases the transaction price will equal the fair value on initial recognition. The best evidence of the fair value of a financial instrument is normally the transaction price. However, unlike IFRS Accounting Standards, for assets or liabilities that are initially measured at fair value, if an entity determines that the fair value on initial recognition is different from the transaction price, then recognition in profit or loss of any difference is not dependent on whether the inputs used in the valuation model include only data from observable markets. Unlike IFRS Accounting Standards, any day one gains or losses resulting from the difference between the fair value and the transaction price are recognised in profit or loss, unless the relevant Codification topic that requires or permits fair value measurement specifies otherwise. [820-10-30-6]

Unlike IFRS Accounting Standards, there is no general requirement for transactions in which part of the consideration given or received on initial recognition is for something in addition to the financial instrument. Like IFRS Accounting Standards, the initial measurement of a low-interest or interest-free loan is based on the present value of the expected future cash flows, discounted using a market interest rate. However, unlike IFRS Accounting Standards, the initial measurement guidance for a low-interest or interest-free loan does not apply to the customary lending activities of financial institutions. [310-10-30-2, 30-6, 835-30-15]

Transaction costs

Unlike IFRS Accounting Standards, there is no generally applicable definition of 'transaction costs'. Generally, 'transaction costs' represent costs that result from and are essential to a transaction and would not have been incurred if the transaction did not take place.

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IFRS Accounting Standards

Transaction costs on financial instruments subsequently measured at FVTPL are charged immediately to profit or loss. [IFRS 9.5.1.1, IG.E.1.1]

For other financial instruments, eligible transaction costs are included in the initial measurement of the instrument. Therefore, for debt instruments such transaction costs are included in the measurement of interest income or expense.

Transaction costs incurred on initial recognition of an equity investment for which the irrevocable election is made to present changes in fair value in OCI are effectively recognised in OCI. This is because the investment is initially measured at fair value plus those transaction costs, but subsequently at fair value. [IFRS 9.5.1.1, A, B5.2.2]

US GAAP

Like IFRS Accounting Standards, transaction costs on financial instruments subsequently measured at FVTPL are generally not included in the initial measurement and are charged immediately to profit or loss. However, unlike IFRS Accounting Standards, investment companies include directly related transaction costs for investments in debt and equity securities at FVTPL in the determination of cost on initial recognition. When these investments are subsequently remeasured at FVTPL, the transaction costs are included as a component of gain or loss on investments. [820-10-35-9 – 35-9C, 946-320-30-1, 35-1]

Like IFRS Accounting Standards, for financial assets measured at amortised cost transaction costs are generally included in the initial measurement of the instrument and are included in the measurement of interest income.

For available-for-sale debt securities, the accounting for transaction costs varies in practice between recognising them in profit or loss on initial recognition, unlike IFRS Accounting Standards, and including them in the initial measurement of the instrument, like IFRS Accounting Standards.

Debt issue costs are deducted from the carrying amount, like IFRS Accounting Standards. The amortisation of debt issuance costs is reported as interest expense, like IFRS Accounting Standards. [470-20-30-31, 835-30-45-1A, 45-3]

Unlike IFRS Accounting Standards, there is no prescribed 'FVOCI' classification for equity investments.

For equity instruments measured using the measurement alternative (a measurement method that does not exist under IFRS Accounting Standards), an entity may choose an accounting policy, to be applied consistently, to include transaction costs in the initial measurement of the instrument. If the instrument is subsequently remeasured at fair value, then any transaction costs previously capitalised are recognised in profit or loss. [820-10-35-9 – 35-9C]

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The inclusion in the initial measurement of a financial instrument of internal transaction costs is not specifically addressed by IFRS Accounting Standards. In our experience, few internal costs are likely to be eligible transaction costs. [IFRS 9.B5.4.8]

Any transaction costs that do not qualify for inclusion in the initial measurement of an instrument are expensed as they are incurred. [IFRS 9.5.1.1]

Subsequent measurement

The following measurement requirements apply to all financial assets and financial liabilities. However, financial assets and financial liabilities that are designated as hedged items may require further adjustment in accordance with the hedge accounting requirements (see chapter 7.9). [IFRS 9.5.2.1–5.3.2, 5.7.3]

Financial assets

Financial assets at FVTPL

Subsequent to initial recognition, financial assets at FVTPL are measured at fair value and all changes in fair value, both realised and unrealised, are recognised immediately in profit or loss. [IFRS 4.1.4–4.1.5, 5.2.1(c)]

Unlike IFRS Accounting Standards, certain internal costs directly attributable to the origination of a loan are capitalised as part of the cost of the loan. Such costs are directly related to specific activities performed by the lender for that loan, such as evaluating the prospective borrower's financial condition; evaluating and recording guarantees, collateral and other security arrangements; negotiating loan terms; preparing and processing loan documents; and closing the transaction. Amounts capitalised include only that portion of the staff compensation related to time spent performing these activities for that loan. Other costs – e.g. advertising, servicing of existing loans and supervision and administration – are not capitalised. [310-20-20, 310-20-25-1 – 25-7]

Like IFRS Accounting Standards, US GAAP does not specifically address the inclusion of internal debt issuance costs in the initial measurement of a financial liability. However, we believe that an entity should not defer and amortise internal costs related to the issuance of debt.

Like IFRS Accounting Standards, any transaction costs that do not qualify for inclusion in the initial measurement of an instrument are expensed as they are incurred. [820-10-35-9 – 35-9C, 310-20-20, 310-20-25-1 – 25-7]

Subsequent measurement

The following measurement requirements apply to all financial assets and financial liabilities. However, like IFRS Accounting Standards, financial assets and financial liabilities that are designated as hedged items may require further adjustment in accordance with the hedge accounting requirements (see chapter 7.9). As discussed in chapters 7.4 and 7.5 there are differences between IFRS Accounting Standards and US GAAP regarding the items that may be included in the categories that follow.

Financial assets

Financial assets at FVTPL

Like IFRS Accounting Standards, subsequent to initial recognition, financial assets at FVTPL are measured at fair value and all changes in fair value, both realised and unrealised, are recognised immediately in profit or loss. [320-10-35-1, 815-10-35-1, 825-10-35-4, 946-320-35-1]

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Measurement alternative for certain equity investments

Investments in equity instruments are subsequently measured at fair value. There is no measurement alternative under IFRS Accounting Standards.

Equity financial assets at FVOCI

Subsequent to initial recognition, equity financial assets at FVOCI are measured at fair value. Gains and losses are recognised in OCI, except for dividends, which are generally recognised in profit or loss. The amounts in OCI are not reclassified to profit or loss. [IFRS 9.4.1.4, 5.7.1(b), 5.7.1A, 5.7.5–5.7.6, B5.7.1]

Debt financial assets at FVOCI

Debt financial assets that meet certain criteria are classified as debt financial assets at FVOCI (see chapter 7.4).

Subsequent to initial recognition, debt financial assets at FVOCI are measured at fair value. Gains and losses are recognised in OCI, except for interest, foreign exchange gains and losses and expected credit losses, which are recognised in profit or loss. [IFRS 9.4.1.2A, 5.7.1(d), 5.7.10, B5.7.1A]

Interest is calculated under the effective interest method and is recognised in profit or loss (see below). [IFRS 9.5.7.10]

Amounts recognised in OCI are reclassified to profit or loss when the related asset is derecognised. For a partial disposal, a share of the fair value gains and losses recognised previously in OCI is reclassified to profit or loss. [IFRS 9.3.2.12–3.2.13, 5.6.7, 5.7.10, B5.7.1A]

Measurement alternative for certain equity investments

Unlike IFRS Accounting Standards, equity securities without readily determinable fair values for which the measurement alternative is elected are subsequently measured at cost minus impairment, if any, plus or minus changes in fair value when an entity identifies observable price changes in orderly transactions for the identical or a similar security of the same issuer. When an observable price is identified, the change in the carrying amount of the security is recognised in profit or loss. Similarly, if the security is impaired, then it is written down to fair value with the loss recognised in profit or loss. [321-10-35-2 – 35-4]

Equity financial assets

Unlike IFRS Accounting Standards, there is no 'FVOCI' category for equity financial assets. [321-10-35-1 – 35-2]

Available-for-sale debt securities

Unlike IFRS Accounting Standards, there is no 'FVOCI' classification for debt financial assets but there is a similar category of 'available-for-sale' for debt securities. Debt securities that are not classified as held-for-trading or held-to-maturity are classified as available-for-sale (see chapter 7.4).

Like IFRS Accounting Standards, subsequent to initial recognition available-for-sale debt securities are measured at fair value. Like IFRS Accounting Standards, interest income and credit losses are recognised in profit or loss. However, recognition and measurement of credit losses differs from IFRS Accounting Standards (see chapter 7.8). Unlike IFRS Accounting Standards, foreign exchange gains and losses are recorded in OCI, except for amounts recognised in credit losses. Like IFRS Accounting Standards, other fair value gains and losses are recognised in OCI. [320-10-35-1, 35-36]

Like IFRS Accounting Standards, for available-for-sale debt securities interest is calculated under the effective interest method and is recognised in profit or loss (see below). [320-10-35-38 – 35-43]

Like IFRS Accounting Standards, amounts recognised in accumulated OCI are reclassified to profit or loss when the related asset is derecognised. Also like IFRS Accounting Standards, for a partial disposal a share of the fair value gains and losses recognised previously in OCI is reclassified to profit or loss. [320-10-40-2]

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Financial assets at amortised cost
Amortised cost accounting is discussed below.

Financial assets at lower of cost and fair value
There is no such measurement category under IFRS Accounting Standards.

Financial liabilities

Financial liabilities at FVTPL
Subsequent to initial recognition, financial liabilities at FVTPL are measured at fair value. [IFRS 9.4.2.1]

If a financial liability is mandatorily measured at FVTPL, then all changes in fair value are recognised immediately in profit or loss. [IFRS 9.5.7.1]

If a financial liability is designated as at FVTPL, then a split presentation of changes in fair value is generally required. The portion of the fair value changes that is attributable to changes in the financial liability's credit risk is recognised in OCI. The remainder is recognised in profit or loss. The amount presented in OCI is never reclassified to profit or loss. [IFRS 9.5.7.1(c), 5.7.7]

There are two exceptions to this split presentation, in which cases all gains and losses are presented in profit or loss:
- if split presentation would create or enlarge an accounting mismatch in profit or loss; and
- if loan commitments and financial guarantee contracts issued are designated as at FVTPL (see chapter 7.1). [IFRS 9.5.7.8–5.7.9]

Other financial liabilities
Subsequent to initial recognition, other financial liabilities are generally measured at amortised cost under the effective interest method (see below). However, there are specific measurement requirements for the following financial liabilities:
- financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition;
- financial guarantee contracts;
- commitments to provide loans at a below-market rate; and
- obligations for an entity to purchase its own equity instruments for cash or another financial asset. [IFRS 9.4.2.1, IAS 32.23]

Financial assets at amortised cost
Amortised cost accounting is discussed below.

Financial assets at lower of cost and fair value
Unlike IFRS Accounting Standards, loans held for sale are measured at the lower of cost and fair value. [310-10-35-47 – 35-48, 948-310-35-1]

Financial liabilities

Financial liabilities at FVTPL
Subsequent to initial recognition, financial liabilities at FVTPL are measured at fair value, like IFRS Accounting Standards. [825-10-45-5]

Like IFRS Accounting Standards, if a financial liability is mandatorily measured at FVTPL, then all changes in fair value are recognised immediately in profit or loss. [940-320-30-2, 35-1 – 35-3]

If a financial liability is designated as at FVTPL, the portion of the total change in fair value that is attributable to changes in the instrument-specific credit risk is recognised in OCI and the remainder is recognised in profit or loss, like IFRS Accounting Standards. However, the amount presented in OCI is reclassified to profit or loss when the financial liability is derecognised, unlike IFRS Accounting Standards. [825-10-45-5 – 45-6]

Unlike IFRS Accounting Standards, there is no exception to this split presentation for financial liabilities designated as at FVTPL.

Other financial liabilities
Like IFRS Accounting Standards, subsequent to initial recognition financial liabilities that are not measured at FVTPL are generally measured at amortised cost under the effective interest method (see below). However, there are specific measurement requirements for the following financial liabilities:
- financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition, although the requirements differ from IFRS Accounting Standards;
- financial guarantee contracts, although the requirements differ from IFRS Accounting Standards;
- obligations to repurchase an issuer's own equity shares, although the requirements differ from IFRS Accounting Standards;

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Fair value

Fair value is measured in accordance with the fair value measurement standard (see chapter 2.4).

Amortised cost

The 'amortised cost' of a financial instrument is the amount at which it is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation under the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance. [IFRS 9.A]

Gross carrying amount

The 'gross carrying amount' of a financial asset is its amortised cost before adjusting for impairment. [IFRS 9.A, IG.B.26]

Effective interest rate calculation

The 'effective interest rate' is the rate that exactly discounts the estimated stream of future cash payments or receipts over the expected life of the financial instrument to the gross carrying amount of the financial asset or to the amortised cost of the financial liability. The effective interest rate is calculated on initial recognition. [IFRS 9.A]

- mandatorily redeemable instruments, unlike IFRS Accounting Standards; and
- certain obligations to issue a variable number of shares, unlike IFRS Accounting Standards. [480-10-35-3, 35-5, 460-10-25, 825-10-15-4]

Unlike IFRS Accounting Standards, there is no specific guidance for financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or commitments to provide loans at below-market rates.

Additionally, there are differences from IFRS Accounting Standards in the determination of cost for the purpose of applying amortised cost – e.g. in respect of transaction costs.

Fair value

Fair value is measured in accordance with the fair value measurement Codification Topic (see chapter 2.4).

Amortised cost

Like IFRS Accounting Standards, the 'amortised cost basis' of a financial instrument reflects the amount at which it is measured on initial recognition adjusted for applicable accrued interest, accretion or amortisation of premium, discount and net deferred fees or costs, principal repayments, write-offs and foreign exchange. Unlike IFRS Accounting Standards, the allowance for credit losses is not part of the amortised cost basis of a financial asset, except for purchased financial assets with credit deterioration. The initial amortised cost basis of purchased financial assets with credit deterioration is calculated as the purchase price plus the acquisition-date estimate of the allowance for credit losses (i.e. the grossed-up amount). [Master Glossary, 326-20-30-13 – 30-14]

Gross carrying amount

Unlike IFRS Accounting Standards, under US GAAP there is no concept of 'gross carrying amount' of a financial asset.

Effective interest rate calculation

Like IFRS Accounting Standards, the 'effective interest rate' for calculation of interest income and expense is the rate that exactly discounts the estimated stream of future cash payments or receipts, without consideration of future credit losses, through to maturity or to the next market-based repricing date, to the amortised cost of the financial asset or financial liability on initial recognition. Unlike IFRS Accounting Standards, the effective interest rate for calculating interest income for financial assets may differ from the effective interest rate used in a discounted cash flow method to develop an estimate of expected credit losses. [326-20-30-4, 835-30-35-2 – 35-3]

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The calculation of the effective interest rate takes into account the *estimated* cash flows, which consider all contractual terms of the financial instrument, including any embedded derivatives that are not separated – e.g. prepayment, extension, call and similar options – but without inclusion of expected credit losses. The calculation includes all fees and points paid or received that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. In those rare cases in which it is not possible to make a reliable estimate of the cash flows or the expected life of the financial instrument, or a group of financial instruments, the contractual cash flows over the full contractual term are used. [IFRS 9.A]

The effective interest rate for purchased or originated credit-impaired financial assets is calculated differently, using expected cash flows inclusive of initial lifetime expected credit losses. The resulting effective interest rate is defined as the 'credit-adjusted effective interest rate'. [IFRS 9.A, B5.4.7]

Revisions of cash flows (other than impairment)

If there is a change in the timing or amount of estimated future cash flows, then the gross carrying amount of the financial asset or amortised cost of the financial liability (or group of instruments) is adjusted in the period of change to reflect the actual and/or revised estimated cash flows, with a corresponding gain or loss recognised in profit or loss. The revised gross carrying amount of the financial asset or amortised cost of the financial liability is recalculated by discounting the revised estimated future cash flows at the instrument's original effective interest rate (or credit-impaired effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate. [IFRS 9.B5.4.6]

The periodic re-estimation of cash flows to reflect movements in market rates of interest will change the effective interest rate of a floating-rate financial asset or financial liability. [IFRS 9.B5.4.5]

Modifications of financial instruments that do not result in derecognition

If the modification of the contractual cash flows of a financial asset does not result in its derecognition, then the gross carrying amount of the financial asset is recalculated as the present value of the modified contractual cash flows discounted at the original effective interest rate and a modification gain or loss is recognised in profit or loss. Any costs or fees incurred adjust the carrying amount of the modified asset and are amortised over the remaining term of the asset. [IFRS 9.5.4.3]

Unlike IFRS Accounting Standards, the calculation of the effective interest rate is generally based on *contractual* cash flows. However, for certain financial instruments (e.g. a portfolio of loans receivable where prepayment is probable and reasonably estimated), if estimated cash flows differ from contractual cash flows (e.g. because of anticipated prepayments and such payments are probable and can be reasonably estimable), then the effective interest rate may be based on expected rather than contractual cash flows. Like IFRS Accounting Standards, the effective interest rate of an instrument includes the principal amount adjusted by eligible fees and costs and any purchase premium or discount. [310-20-35-17 – 35-33, 835-30-35-2 – 35-5]

Unlike IFRS Accounting Standards, the effective interest rate for purchased financial assets with credit deterioration is determined using the amortised cost basis as of the date of acquisition, which is the purchase price plus the acquisition-date estimate of the allowance for credit losses (i.e. the grossed-up amount). [310-10-35-53B, 326-20-30-13 – 30-14]

Revisions of cash flows (other than impairment)

If the criteria that allow an entity to calculate the effective interest rate using expected rather than contractual cash flows are met (see above), then changes in the timing or amount of estimated future cash flows (i.e. prepayments) are accounted for as follows:

- the effective yield is recalculated to reflect actual payments to date and anticipated future payments, unlike IFRS Accounting Standards; and
- the amortised cost of the financial asset is recalculated and adjusted through profit or loss, like IFRS Accounting Standards. The amortised cost is recalculated as the amount that would have existed had the new effective yield been applied since the acquisition of the loan, which differs from IFRS Accounting Standards. [310-20-35-17 – 35-33]

US GAAP has specific requirements for determining the effective interest rate for floating-rate financial instruments, which may differ from IFRS Accounting Standards. [310-20-35-18 – 35-20, 835-30-35-2 – 35-3]

Modifications of financial instruments that do not result in derecognition

Unlike IFRS Accounting Standards, if the modification of the financial asset does not result in its derecognition, then the effective interest rate of the financial asset is recalculated such that the present value of the modified contractual cash flows equals its amortised cost. Unlike IFRS Accounting Standards, there is no gain or loss recognised as a result of the modification. Any costs or fees associated with the restructuring or refinancing are included in the amortised cost of the modified asset and are amortised over the remaining term of the asset, like IFRS Accounting Standards. [310-20-35-10, 35-17 – 35-33]

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If an exchange or modification of a financial liability does not result in its derecognition, then the amortised cost of the financial liability is recalculated as the present value of the modified contractual cash flows discounted at the original effective interest rate and the adjustment is recognised in profit or loss. Any costs or fees incurred adjust the carrying amount of the modified liability and are amortised over the remaining term of the liability. [IFRS 9.B3.3.6, B5.4.6]

Modifications of financial instruments that result in derecognition

If a modification of the contractual cash flows of a financial asset results in its derecognition (see chapter 7.6), then (ignoring any modification fees and costs) a gain or loss is recognised, being the difference between (i) the carrying amount of the old asset and (ii) the consideration received (including the fair value of the modified asset). The modified asset is recognised as a new financial asset and initially measured at its fair value plus eligible transaction costs. The effective interest rate of the new financial asset is calculated based on the revised terms at the date of modification. [IFRS 9.3.2.12, 5.1.1, B5.5.25]

If a modification of the terms of a financial liability results in its derecognition and the recognition of a new financial liability (see chapter 7.6), the difference between the carrying amount of the extinguished financial liability and the consideration paid, including any non-cash assets transferred and liabilities assumed, is recognised in profit or loss. The modified financial liability is recognised as a new financial liability and initially measured at its fair value. Any costs or fees incurred are recognised as part of the gain or loss on extinguishment. In our view, no transaction costs should be included in the initial measurement of the new liability unless it can be incontrovertibly demonstrated that they relate solely to the new liability and in no way to the modification of the old liability, which would not usually be possible. The effective interest rate of the new financial liability is calculated based on the revised terms at the date of modification. [IFRS 9.3.3.2–3.3.3, B3.3.6]

Unlike IFRS Accounting Standards, if the exchange or modification of a financial liability does not result in its derecognition, then the effective interest rate of the financial liability is recalculated such that the present value of the modified contractual cash flows equals its amortised cost. Unlike IFRS Accounting Standards, there is no gain or loss recognised as a result of the modification. Any fees paid to the creditor as part of the modification (other than troubled debt restructurings) are amortised over the remaining term of the liability, like IFRS Accounting Standards. However, third party costs are recognised in profit or loss as they are incurred, unlike IFRS Accounting Standards. [470-50-40-13, 40-17 – 40-18]

Modifications of financial instruments that result in derecognition

Like IFRS Accounting Standards, if a modification of the contractual cash flows of a financial asset results in its derecognition (see chapter 7.6), then (ignoring any modification fees and costs) a gain or loss is recognised, being the difference between (i) the carrying amount of the old asset and (ii) the consideration received (including the carrying amount of the modified asset). Like IFRS Accounting Standards, the modified asset is recognised as a new financial asset but the measurement on initial recognition may be different from IFRS Accounting Standards. Also, the costs that are eligible for capitalisation may differ from IFRS Accounting Standards. Like IFRS Accounting Standards, the effective interest rate of the new financial asset is calculated based on the revised terms at the date of modification. [310-20-35-9, 35-11, 860-20-25-1 – 25-4, 40-1B]

If a modification of a financial liability results in its derecognition and the recognition of a new financial liability (see chapter 7.6), the difference between the carrying amount of the extinguished financial liability and the fair value of the new financial liability is recognised in profit or loss, like IFRS Accounting Standards. The new financial liability is initially measured at fair value and the effective interest rate of the new financial liability is calculated based on the revised terms at the date of the modification, like IFRS Accounting Standards. Any fees paid to the creditor as part of the modification are included in the gain or loss on extinguishment, like IFRS Accounting Standards. However, third party costs are capitalised as debt issue costs associated with the new financial liability, unlike IFRS Accounting Standards. [470-50-40-2, 40-13, 40-17 – 40-18]

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Modifications of freestanding equity-classified written call options

There are no specific requirements for modifications or exchanges of freestanding equity-classified written call options.

Instruments acquired in a business combination

All financial instruments that are acquired as part of a business combination are initially measured by the acquirer at their fair value at the date of acquisition. [IFRS 3.18]

At the date of acquisition, the fair value of the instrument and the total cash flows expected over the remaining term of the instrument are used by the acquirer to calculate a new original effective interest rate for the instrument. The new original effective interest rate is used to determine interest income or expense in the consolidated financial statements of the acquirer but has no impact on the acquiree's financial statements. [IFRS 3.18, 9.A]

Hedged item in a fair value hedge

When hedge accounting is discontinued, or at any earlier date, the carrying amount of an instrument otherwise measured at amortised cost and the total payments to be made over the remaining term of the instrument are used to calculate a revised effective interest rate for the instrument. [IFRS 9.6.5.10]

Modifications of freestanding equity-classified written call options

Unlike IFRS Accounting Standards, US GAAP contains specific guidance on how to account for certain modifications or exchanges of freestanding equity-classified written call options (e.g. warrants) that remain equity-classified after modification or exchange. An entity determines the accounting based on whether the modification or exchange was done as part of or directly related to issuing equity, issuing or modifying debt or for other reasons. When the nature of the modification relates to debt, how the modification's effect is measured and recognised depends on whether it relates to a debt issuance or modification and – for debt modifications – on whether the holder of the option is a creditor or a third party. [815-40-35-15, 35-17; 40-17A; 40-18A,]

Instruments acquired in a business combination

Like IFRS Accounting Standards, all financial instruments that are acquired as a part of a business combination are initially measured by the acquirer at their fair value at the date of acquisition, except for purchased financial assets with credit deterioration. [805-20-30-1]

Like IFRS Accounting Standards, a new original effective interest rate is calculated for financial instruments acquired in a business combination to reflect current market interest rates on the date of the acquisition and is used to recognise interest income or expense in the consolidated financial statements of the acquirer, except for purchased financial assets with credit deterioration. Unlike IFRS Accounting Standards, if 'push-down' accounting is elected in a business combination, and the acquirer's fair value adjustments are recognised in the financial statements of the acquiree, then the new effective interest rate will impact the acquiree's financial statements. If push-down accounting is not elected, then the new effective interest rate has no impact on the acquiree's financial statements, like IFRS Accounting Standards (see chapter 2.6). [805-20-25, 30-10]

Hedged item in a fair value hedge

Like IFRS Accounting Standards, when hedge accounting is discontinued, or at any earlier date, the carrying amount of an instrument otherwise measured at amortised cost and the total payments to be made over the remaining term of the instrument are used to calculate a revised effective interest rate for the instrument. [815-25-35-8 – 35-9]

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Discounts, premiums and pre-acquisition interest

Discounts and premiums are generally recognised over the expected life of the related instrument using the effective interest rate. The straight-line amortisation of discounts or premiums is not permitted. Interest that has accrued on an interest-bearing investment before it is acquired is not recognised as income. [IFRS 9.A, B5.4.4]

Interest income and expense

Interest income and expense are recognised under the effective interest method as follows.

- *Financial assets that are not credit-impaired:* Apply the effective interest rate to the gross carrying amount of the financial asset.
- *Financial assets that have become credit-impaired subsequent to initial recognition:* Apply the effective interest rate to the amortised cost of the financial asset. The calculation reverts to being based on the gross carrying amount if the asset is no longer credit-impaired.
- *Purchased or originated credit-impaired financial assets:* Apply the credit-adjusted effective interest rate to the amortised cost. The calculation can never be based on the gross carrying amount.
- *Financial liabilities:* Apply the effective interest rate to the amortised cost.

[IFRS 9.5.4.1–5.4.2, A, B5.4.4–B5.4.7]

For debt financial assets measured at FVOCI, interest is also recognised under the effective interest method. [IFRS 9.5.7.10]

Dividend income

'Dividends' are distributions of profits to holders of equity investments in proportion to their holdings of a particular class of capital. [IFRS 9.A]

Dividend income is recognised in profit or loss when the shareholder's right to receive payment is established, it is probable that the economic benefits associated with the dividend will flow to the entity and the amount of the dividend can be measured reliably. In our view, the shareholder's right to receive payment of dividends on *quoted* investments is normally established on the date when the security trades ex-dividend. In our view, for dividends on *unquoted* investments, the shareholder's right to receive payment is normally established when the shareholders have approved the dividends. If shareholder approval is not required for a dividend distribution, then a right to receive payment is established when the payment of dividends is binding. [IFRS 9.5.7.1A]

Discounts, premiums and pre-acquisition interest

Like IFRS Accounting Standards, discounts and premiums are recognised using the effective interest rate. However, unlike IFRS Accounting Standards, the term over which discounts and premiums are recognised is generally the contractual term of the instrument. Like IFRS Accounting Standards, the straight-line amortisation of discounts or premiums is not permitted. Interest that has accrued on an interest-bearing investment before it is acquired is not recognised as income, like IFRS Accounting Standards. [310-20-35-17 – 35-33, 835-30-35-2, 35-4]

Interest income and expense

Interest income and expense are generally recognised under the effective interest method, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, the effective interest rate is always applied to the amortised cost basis of the financial instrument (see discussion above on amortised cost and gross carrying amount). Unlike IFRS Accounting Standards, there is no concept of credit-impaired assets and, as such, the effective interest rate is not applied to a net amount (i.e. amortised cost less allowance for credit losses). Also unlike IFRS Accounting Standards, regulated entities are required to suspend the recognition of interest income from certain financial assets if certain conditions are met (i.e. non-accrual status).

[Master Glossary, 310-20-35-1 – 35-17, 326-20-30-1 – 30-15, 326-30-35-1 – 35-17, 835-30-35-2 – 35-3]

Like IFRS Accounting Standards, for debt securities classified as available-for-sale, interest is recognised under the effective interest method. [326-30-35-1 – 35-11]

Dividend income

'Dividends' are dividends paid or payable in cash, other assets or another class of stock and do not include stock dividends or stock splits. Differences from IFRS Accounting Standards may arise in practice. [Master Glossary]

Like IFRS Accounting Standards, dividend income is recognised in profit or loss when the shareholder's right to receive payment is established. Unlike IFRS Accounting Standards, there are no additional explicit conditions for recognising dividend income. The shareholder's right to receive dividends is generally established on the date the issuer has an obligation to pay dividends, which is not normally until they are declared or approved.

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Dividend income on equity financial assets at FVOCI is recognised in profit or loss unless it clearly represents a repayment of part of the cost of the investment. [IFRS 9.5.7.6, B5.7.1]

Share dividends

In some cases, shareholders may receive or choose to receive dividends in the form of additional shares rather than cash. If the investor has a cash alternative, then in our view dividend income should be recognised for the amount of the cash alternative because the substance of share dividends with a cash alternative is the payment of a cash dividend, with reinvestment of the cash in additional shares.

In other cases, an entity may receive bonus shares or other equity instruments on a pro rata basis with other ordinary shareholders, with no cash alternative. If all ordinary shareholders receive bonus shares or other equity instruments in proportion to their shareholdings, then the fair value of each shareholder's interest should be unaffected by the bonus issue. In our view, in such circumstances dividends should not be recognised as income because it is not probable that there is an economic benefit associated with the transaction that will flow to the investor. [IFRS 9.5.7.1A, IU 01-10]

Fee income

The accounting treatment of fee income related to interest-bearing instruments depends on whether the fees are an integral part of the effective interest rate of the instrument. [IFRS 9.B5.4.1–B5.4.3, B5.1.1–B5.1.2]

Fees that are an integral part of the effective interest rate of an instrument – e.g. origination fees, compensation from the borrower for transaction costs incurred by the lender or appraisal fees for evaluating collateral – are recognised as an adjustment to the effective interest rate of the instrument. However, if the financial instrument is measured at FVTPL, then the fees are recognised as revenue on initial recognition of the instrument. [IFRS 9.B5.4.1–B5.4.2]

Financial services fees that are not an integral part of the effective interest rate of an instrument are generally recognised in accordance with the revenue standard (see chapter 4.2). [IFRS 9.B5.4.3]

Unlike IFRS Accounting Standards, there is no 'FVOCI' category for equity financial assets. Dividend income from investments in equity securities is recognised in profit or loss. [321-10-35-6]

Share dividends

In some cases, shareholders may receive or choose to receive dividends in the form of additional shares rather than cash. Like IFRS Accounting Standards, if the substance of share dividends with a cash alternative is the receipt of a cash dividend, then it is accounted for as such.

Unlike IFRS Accounting Standards, US GAAP contains guidance on determining when bonus shares should be accounted for in a manner consistent with a stock (share) split and not as dividend income. We would not generally expect significant differences in practice. [505-20-30-7]

Fee income

Like IFRS Accounting Standards, the accounting treatment of fee income related to interest-bearing instruments depends on whether the fees are an integral part of the effective interest rate of the instrument. [310-10-25-19 – 25-20, 310-20-20, 25-1 – 25-2, 25-11 – 25-14, 25-19 – 25-20]

Like IFRS Accounting Standards, loan origination fees and commitment fees and costs are recognised as an adjustment to the effective interest rate of the instrument over the life of the loan; however, the items included in this determination differ in some respects from IFRS Accounting Standards. Like IFRS Accounting Standards, if the financial instrument is measured at FVTPL, then the fees are recognised as revenue on initial recognition of the instrument. [310-20-35-1 – 35-12]

Like IFRS Accounting Standards, financial services fees that are not an integral part of the effective yield of an instrument are generally recognised in accordance with the revenue Codification Topic (see chapter 4.2).

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Reclassifications of financial assets

If an entity reclassifies financial assets (see chapter 7.4), then it applies the reclassification prospectively from the reclassification date. [IFRS 9.5.6.1]

Interest rate benchmark reform

When a change in the basis for determining the contractual cash flows of a financial asset or financial liability is required by interest rate benchmark reform, as a practical expedient an entity applies the floating-rate approach to account for the change that is required by the reform. This practical expedient applies only where the new basis for determining the contractual cash flows is economically equivalent to the previous basis. Under the practical expedient, the entity updates the effective interest rate to reflect the change in the interest rate benchmark. If there are other changes to the basis for determining the contractual cash flows, then an entity first applies the practical expedient to the changes required by interest rate benchmark reform and then other applicable requirements of the financial instruments standard. [IFRS 9.5.4.5–5.4.9, B5.4.5]

Reclassifications of financial assets

Like IFRS Accounting Standards, if an entity reclassifies financial assets (see chapter 7.4), then it applies the reclassification prospectively from the reclassification date.

Interest rate benchmark reform

Like IFRS Accounting Standards, there is specific reference rate reform guidance. The guidance is currently effective for all entities. Unlike IFRS Accounting Standards, the amendments are optional and the relief provided by the amendments is generally no longer available after 31 December 2024.

An optional expedient is available if a modification of contractual terms of a financial asset or financial liability that changes (or has the potential to change) the amount or timing of cash flows is related to replacement of a reference rate that is expected to be discontinued as a result of reference rate reform. Under the optional expedient, an entity that has performed an eligible modification of a financial asset or a financial liability does not derecognise or remeasure the carrying amount, but instead updates the effective interest rate to reflect the change in terms arising from such a modification. The optional expedients do not apply if contemporaneous changes are made to terms that are unrelated to the replacement of a reference rate. [848-20-15-1 – 15-3, 848-20-55-1]

Unlike IFRS Accounting Standards, an entity can also apply an optional expedient to derivative contracts impacted by ‘discounting transition’, including derivatives that do not reference LIBOR or other reference rates expected to be discontinued. ‘Discounting transition’ refers to changing the interest rates used for margining, discounting or contract price alignment of certain derivative instruments to transition to alternative rates. [848-20-15-2 – 15-2A]

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7.8 Impairment

(IFRS 9)

Overview

- The impairment model in the financial instruments standard (ECL model) covers financial assets measured at amortised cost, investments in debt instruments measured at FVOCI, certain loan commitments and financial guarantee contracts issued, lease receivables and contract assets.
- Investments in equity instruments are outside the scope of the ECL requirements.
- Impairment is recognised using an expected loss model, which means that it is not necessary for a loss event to occur before an impairment loss is recognised.
- The general approach of the ECL model uses two measurement bases: 12-month ECLs and lifetime ECLs, depending on whether the credit risk on a financial instrument has increased significantly since initial recognition.
- ECLs on trade receivables and contract assets that do not have a significant financing component are always measured at lifetime ECLs. There is an accounting policy choice to measure ECLs on trade receivables that have a significant financing component and on lease receivables either under the general approach or at lifetime ECLs.

7.8 Impairment

(Subtopic 321-10, Subtopic 326-20, Subtopic 326-30)

Overview

- Like IFRS Accounting Standards, the expected credit loss model (Subtopic 326-20) covers financial assets measured at amortised cost, net investments in leases, contract assets and certain loan commitments and issued financial guarantee contracts not accounted for as insurance or derivatives. Unlike IFRS Accounting Standards, other off-balance sheet credit exposures may also be in scope. In addition, unlike IFRS Accounting Standards, a separate credit loss model covers debt securities classified as available-for-sale (AFS) (Subtopic 326-30).
- Like IFRS Accounting Standards, investments in equity instruments are outside the scope of the expected credit loss model. However, investments in equity instruments that do not have a readily determinable fair value for which an entity has elected the measurement alternative are subject to a qualitative impairment assessment, unlike IFRS Accounting Standards.
- Like IFRS Accounting Standards, for instruments in the scope of the expected credit loss model, impairment is recognised before a loss event occurs. However, for AFS debt securities and investments in equity instruments that do not have a readily determinable fair value for which an entity has elected the measurement alternative, an impairment loss is recognised in profit or loss only when incurred.
- Unlike IFRS Accounting Standards, the ECL model uses a single measurement approach based on lifetime ECLs. Lifetime ECLs are recorded upon initial recognition of an instrument. The measurement approach remains consistent throughout the life of the instrument.
- Unlike IFRS Accounting Standards, ECLs on all trade receivables, contract assets and lease receivables are based on the same single measurement approach of lifetime ECLs.

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Overview (continued)

- **For financial assets that are credit-impaired on initial recognition, ECLs are measured as the change in lifetime ECLs since initial recognition. Accordingly, the amount recognised as a loss allowance for these assets is not the total amount of lifetime ECLs, but instead the changes in lifetime ECLs since initial recognition of the asset.**

- **ECLs are measured in a way that reflects:**
  - **a probability-weighted amount determined by evaluating a range of possible outcomes;**
  - **the time value of money; and**
  - **reasonable and supportable information about past events, current conditions and forecasts of future economic conditions.**

Overview (continued)

- **Unlike IFRS Accounting Standards, there is no concept of credit-impaired financial assets on initial recognition. Instead, there is a concept of assets that are purchased credit deteriorated (PCD). Also unlike IFRS Accounting Standards, for PCD assets lifetime ECL is recognised on acquisition through a balance sheet gross-up that increases the amortised cost basis of the asset with no effect on profit or loss. Like IFRS Accounting Standards, subsequent changes in ECLs are recognised in profit or loss.**

- **Unlike IFRS Accounting Standards, a probability-weighted ECL measure determined by evaluating a range of possible outcomes is permitted, but not required. Also, unlike IFRS Accounting Standards, methods of estimating ECLs that include the impact of the time value of money are permitted, but not required. Like IFRS Accounting Standards, ECLs are measured in a way that reflects reasonable and supportable information about past events, current conditions and forecasts of future economic conditions.**

Scope

The impairment model in the financial instruments standard (the ECL model) covers financial assets measured at amortised cost, investments in debt instruments measured at FVOCI, certain loan commitments and financial guarantee contracts issued, lease receivables and contract assets. [IFRS 9.2, 5.5.1]

Loans and receivables between entities under common control are in the scope of the ECL model.

Reinsurance contracts held are outside the scope of the financial instruments standard.

Scope

Like IFRS Accounting Standards, the ECL model covers financial assets measured at amortised cost, including financing receivables (loans), held-to-maturity debt securities, trade receivables, contract assets, net investments in leases recognised by a lessor, receivables that relate to repurchase agreements and securities lending agreements, certain loan commitments and issued financial guarantee contracts not accounted for as insurance contracts or derivatives. Unlike IFRS Accounting Standards, other off-balance sheet credit exposures may also be in the scope of the ECL model. [326-20-15-2]

Unlike IFRS Accounting Standards, AFS debt securities are outside the scope of the ECL model; instead a separate credit loss model applies to AFS debt securities. [326-30-15-2]

Unlike IFRS Accounting Standards, loans and receivables between entities under common control are not in the scope of the ECL model. [326-20-15-3]

Unlike IFRS Accounting Standards, reinsurance recoverables are in the scope of the ECL model. [326-20-15-2]

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Investments in equity instruments are outside the scope of the impairment requirements.

The ECL concept

The impairment model is an expected loss model, which means that it is not necessary for a loss event to occur before an impairment loss is recognised. As a result, all financial assets generally carry a loss allowance. [IFRS 9.5.5.1, 5.5.13]

ECLs are a probability-weighted estimate of credit losses – i.e. the present value of cash shortfalls. For a financial asset that is credit-impaired (see below), the ECLs are the difference between the asset's gross carrying amount and the present value of estimated future cash flows. [IFRS 9.A, B5.5.28, B5.5.33]

General approach

Impairment is measured as either 12-month ECLs or lifetime ECLs, depending on whether there has been a significant increase in credit risk since initial recognition. If a significant increase in credit risk has occurred since initial recognition, then impairment is measured as lifetime ECLs. If the credit risk on a financial instrument for which lifetime ECLs have been recognised subsequently improves so that the requirement for recognising lifetime ECLs is no longer met, then the loss allowance is measured at an amount equal to 12-month ECLs. [IFRS 9.5.5.3, 5.5.5, 55.57]

'Lifetime ECLs' are defined as the ECLs that result from all possible default events over the expected life of the financial instrument. '12-month ECLs' are defined as the portion of lifetime ECLs that represents the ECLs resulting from default events on the financial instrument that are possible within 12 months after the reporting date. [IFRS 9.A]

Like IFRS Accounting Standards, investments in equity instruments are outside the scope of the ECL requirements. However, investments in equity instruments that do not have a readily determinable fair value for which an entity has elected the measurement alternative (see chapter 7.7) are subject to a qualitative impairment assessment, unlike IFRS Accounting Standards. [321-10-35-3 – 35-4]

The ECL concept

Like IFRS Accounting Standards, the impairment model is an expected credit loss model, which means that it is not necessary for a loss event to occur before an expected credit loss is recognised. As a result, all financial instruments in its scope generally carry a loss allowance, even if the risk of loss is remote. [326-20-30-10]

Unlike IFRS Accounting Standards, a probability-weighted ECL measure determined by evaluating a range of possible outcomes is permitted, but not required. [ASU 2016-13.BC67–BC68]

Unlike IFRS Accounting Standards, a specific method to be used to estimate ECLs is not prescribed. A discounted cash flow method is permitted, but not required. If an entity uses a discounted cash flow method, generally the ECLs reflect the difference between (a) the amortised cost basis and (b) the present value of principal and interest cash flows expected to be collected. If an undiscounted method is used, the allowance reflects an entity's expected credit losses of the amortised cost basis of the assets. [326-20-30-3, 30-5, 55-6 – 55-7]

General approach

Unlike IFRS Accounting Standards, the ECL model is based on a single measurement approach of full lifetime ECLs throughout the life of an instrument. As a result, the ECL model does not require an assessment of whether there has been a significant deterioration in credit quality.

Unlike IFRS Accounting Standards, there is no definition of lifetime ECLs. Like IFRS Accounting Standards, lifetime ECLs reflect losses an entity expects to incur over the expected lifetime of the financial asset or group of financial assets. There is no concept of 12-month ECLs under US GAAP.

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Definition of default

The term 'default' is not defined in the financial instruments standard. An entity is required to define default in a way that is consistent with that used for internal credit risk management purposes for the relevant financial instrument, and considers qualitative indicators when appropriate. An entity can use a regulatory definition of default if it is consistent with the above requirements. [IFRS 9.B5.5.37, BC5.248]

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 corroborate a more lagging default criterion. [IFRS 9.B5.5.37]

Significant increase in credit risk

The term 'significant increase in credit risk' is not defined. An entity decides how to define it in the context of its specific types of financial instruments. The assessment is made by comparing the risk of default estimated as at the reporting date with the risk of default estimated as at the date of initial recognition. There is a rebuttable presumption that credit risk on a financial instrument has increased significantly when payments are more than 30 days past due. [IFRS 9.5.5.9, 5.5.11, B5.5.7]

Measurement of ECLs

ECLs are a probability-weighted estimate of credit losses over the expected life of the financial instrument. Credit losses are the present value of expected cash shortfalls. The measurement of ECLs reflects:

- an unbiased and probability-weighted amount;
- the time value of money; and
- reasonable and supportable information that is available without undue cost or effort. [IFRS 9.5.5.17, A, B5.5.28]

Definition of default

Like IFRS Accounting Standards, the term 'default' is not defined. An entity generally applies regulatory guidance and/or internal credit risk management policies for a default-based statistical approach to measuring ECLs. [326-20-55-6]

Unlike IFRS Accounting Standards, there is no rebuttable presumption that default occurs after a certain number of days past due. An entity generally applies regulatory guidance and/or internal credit risk management policies for a default-based statistical approach. [326-20-55-6]

Significant increase in credit risk

Unlike IFRS Accounting Standards, 'significant increase in credit risk' is not a threshold that is used to measure ECLs.

Measurement of ECLs

Unlike IFRS Accounting Standards, entities may, but are not required to, consider multiple probability-weighted scenarios when measuring ECLs. However, the scenario(s) used should be carefully selected to adequately represent the best estimate of ECLs. [ASU 2016-13.BC67–BC68]

Unlike IFRS Accounting Standards, the Codification Subtopic permits, but does not require, methods of estimating credit losses that include the impact of the time value of money. [326-20-30-3]

Like IFRS Accounting Standards, measurement of ECLs reflects reasonable and supportable information that is available without undue cost or effort. [326-20-30-7]

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The financial instruments standard does not prescribe a single method to measure ECLs, so different approaches are possible providing the chosen method complies with the requirements of the ECL model. The methods used to measure ECLs may vary based on the type of financial instrument and the information available. [IFRS 9.B5.5.12]

Entities may use practical expedients when estimating ECLs, provided that they are consistent with the principles above. An example is a provision matrix to measure ECLs for trade receivables. [IFRS 9.B5.5.35]

The impairment loss (or reversal) recognised in profit or loss is the amount required to adjust the loss allowance to the appropriate amount at the reporting date. However, for financial guarantee contracts issued and commitments to provide a loan at a below market interest rate the amount of impairment loss (or reversal) recognised in profit or loss is the amount required to measure those financial instruments at the higher of:

- the amount of loss allowance; and
- the amount initially recognised less the cumulative amount of income recognised in accordance with the principles of the revenue standard (see chapter 7.1). [IFRS 9.4.2.1(c)–4.2.1(d), 9.5.5.8]

Cash shortfalls

Generally, a cash shortfall is the difference between (a) the cash flows due to the entity in accordance with the contract and (b) the cash flows that the entity expects to receive. Cash shortfalls are identified as follows.

- *12-month ECLs:* Cash shortfalls resulting from default events that are possible in the next 12 months (or a shorter period if the expected life is less than 12 months) – i.e. not just the cash shortfalls that are expected over the next 12 months.
- *Lifetime ECLs:* Cash shortfalls resulting from default events that are possible over the expected life of the financial instrument. [IFRS 9.A, B5.5.28, B5.5.43]

Like IFRS Accounting Standards, the Codification Subtopic does not prescribe a single method to measure ECLs. Rather, given the subjective nature of the estimate, the ECL model provides for the ability to use judgement to develop an approach that faithfully reflects ECLs and can be applied consistently over time. Examples of methods that may be used to estimate ECLs include:

- discounted cash flow methods;
- probability of default and loss given default methods;
- loss-rate and roll-rate methods; and
- methods that use an ageing schedule. [326-20-30-3, 55-6 – 55-7]

Although not referred to as a practical expedient, like IFRS Accounting Standards, entities may use simplified measurement methods when estimating ECLs, provided that they are consistent with the principles above. Like IFRS Accounting Standards, an example is a provision matrix to measure ECLs for trade receivables. [326-20-30-3, 55-6 – 55-7, 55-37 – 55-40]

Like IFRS Accounting Standards, the changes in the estimate of ECL are recognised through earnings as a credit loss expense or a reversal of credit loss expense at the reporting date. [326-20-30-1, 35-1]

Cash shortfalls

Unlike IFRS Accounting Standards, there is no definition of cash shortfall. When an entity uses a discounted cash flow method, ECL is estimated as:

- For PCD financial assets, the present value of ECLs, which is similar to the definition of cash shortfall under IFRS Accounting Standards; and
- For other financial assets, the difference between (a) the amortised cost basis, and (b) the present value of principal and interest cash flows expected to be collected. [326-20-30-4, 30-14]

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The period over which to estimate ECLs

The maximum period over which ECLs are measured is the contractual period – including any extension options – over which there is exposure to credit risk on the financial instrument. This is the case even if a longer period is consistent with business practice. [IFRS 9.5.5.19, B5.5.38]

For loan commitments and financial guarantee contracts, this period is the maximum contractual period over which an entity has a present contractual obligation to extend credit.

Certain financial instruments include both a loan and an undrawn commitment component, and 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. For such instruments (and only for such instruments), an entity measures ECLs over the period for which it is exposed to credit risk – and for which ECLs would not be mitigated by credit risk management actions – even if that period extends beyond the maximum contractual period. [IFRS 9.5.5.20, BC5.260–BC5.261]

Expected modifications of financial assets

It appears that if the lender expects that a financial asset will be modified because of the debtor's financial difficulty then the following applies.

- If the expected modification will not result in the derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.
- If the expected modification will result in the derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. [IFRS 9.5.4.3, A, B5.5.25]

The period over which to estimate ECLs

Like IFRS Accounting Standards, the maximum period over which ECLs are measured is the contractual period. This is the case even if the entity has established a past practice of renewing similar financial assets, like IFRS Accounting Standards. If the borrower has an unconditional right to extend the maturity date, or if the borrower has a right to extend the maturity date that is conditional upon the occurrence of events outside the lender's control, the extension period is considered in the contractual term, like IFRS Accounting Standards. [326-20-30-6]

Like IFRS Accounting Standards, for off-balance sheet credit exposures, ECLs are estimated over the contractual period over 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. [326-20-30-11]

Unlike IFRS Accounting Standards, for financial instruments that include both a funded and an unfunded commitment component (e.g. credit cards), ECLs on the unfunded commitment component are recognised only if it is not unconditionally cancellable by the issuer. This is the case even if it has a history of incurring losses on additional amounts funded before the commitment component was cancelled. [326-20-30-11, TRG 06-17.5, TRG 06-17.6]

Expected modifications of financial assets

Unlike IFRS Accounting Standards, US GAAP does not address how modifications impact the estimate of ECL, except as it relates to the determination of the contractual term. US GAAP prohibits extending a financial asset's contractual term in anticipation of expected modifications. In contrast, in determining the contractual term we believe an entity is permitted to consider expected modifications before the maturity date as expected prepayments. [326-20-30-6]

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Probability-weighted outcome

The estimate of ECLs reflects an unbiased and probability-weighted amount, determined by evaluating a range of possible outcomes rather than based on a best- or worst-case scenario. An entity is not required to identify every possible scenario, but the estimate always reflects at least two scenarios:

- the probability that a credit loss occurs, even if this probability is very low; and
- the probability that no credit loss occurs. [IFRS 9.5.5.17(a), 5.5.18, B5.5.41]

Time value of money

The estimate of ECLs reflects the time value of money, using the following discount rates.

- *Financial assets other than purchased or originated credit-impaired financial assets and lease receivables:* the effective interest rate determined on initial recognition or an approximation thereof; if a financial asset has a variable interest rate, then ECLs are discounted using the current effective interest rate.
- *Purchased or originated credit-impaired financial assets:* the credit-adjusted effective interest rate determined on initial recognition.
- *Lease receivables:* the discount rate used in measuring the lease receivable in accordance with the leases standard.
- *Undrawn loan commitments:* the effective interest rate (or an approximation thereof) that will be applied to the financial asset resulting from the loan commitment.
- *Undrawn loan commitments for which the effective interest rate cannot be determined, and financial guarantee contracts:* the discount rate that reflects the current market assessment of the time value of money and the risks that are specific to the cash flows. [IFRS 9.5.5.17(b), B5.5.44–B5.5.48]
- *Modified financial instruments:* the effective interest rate determined on initial recognition based on the original contractual terms (adjusted for modification costs or fees), unless the current effective interest rate applies. [IFRS 9.5.5.17(b), B5.5.44–B5.5.48]

Probability-weighted outcome

Unlike IFRS Accounting Standards, the Codification Subtopic does not require the use of multiple probability-weighted scenarios when developing a reasonable and supportable forecast of future economic conditions. Therefore, an entity may use either a single most likely economic scenario, or multiple probability-weighted economic scenarios. In addition, if multiple scenarios are used, we believe the estimate of ECLs should include at least one scenario that is more favourable and at least one that is less favourable than the most likely. Like IFRS Accounting Standards, the Codification Subtopic requires the consideration of the risk of loss even if that risk is remote. Unlike IFRS Accounting Standards, this objective is met primarily through the pooling of loans with similar risk characteristics and the application of a reasonable and supportable forecast that contemplates a risk of loss. [ASU 2016-13.BC67–BC68, 326-20-50-10 – 50-11]

Time value of money

Like IFRS Accounting Standards, if an entity estimates ECLs using methods that reflect the time value of money and projects future principal and interest cash flows (that is, a discounted cash flow method), the entity uses the following discount rates.

- *Financial assets other than PCD financial assets and lease receivables:* The effective interest rate determined on initial recognition, like IFRS Accounting Standards. However, the calculation of the effective interest rate may differ from IFRS Accounting Standards. If the financial asset's contractual interest rate varies based on subsequent changes in an independent factor, e.g. LIBOR or US Treasury, that financial asset's effective interest rate is calculated based on the factor as it changes over the life of the financial asset.
- *PCD financial assets:* the effective interest rate that equates the present value of expected cash flows on initial recognition to the purchase price, like IFRS Accounting Standards.
- *Lease receivables:* the discount rate used in measuring the lease receivable under the leases Codification Topic, like IFRS Accounting Standards.
- *Off-balance sheet credit exposures, including undrawn loan commitments:* the discount rate determined in accordance with section 310-20-35, which may be different from IFRS Accounting Standards. [326-20-30, 30-11, 55-8]
- *Modified receivables:* the effective interest rate based on the receivable's modified terms, unlike IFRS Accounting Standards. [326-20-30-4, 30-4A, 30-11, 55-8]

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Information to be used in measurement

The estimates of ECLs are required to reflect reasonable and supportable information that is available without undue cost or effort – including information about past events and current conditions, and forecasts of future economic conditions. An entity is not required to undertake an exhaustive search for information but is required to consider all reasonable and supportable information that is available without undue cost or effort that is relevant for the estimation. The information used includes:

- factors that are specific to the borrower; and
- general economic conditions, including assessment of both the current conditions and the forecast direction of the change of conditions. [IFRS 9.5.5.17, B5.5.49, B5.5.51]

Historical information is an important base from which to measure ECLs. It is adjusted on the basis of current observable data to reflect current conditions and an entity's forecast of future conditions and to remove the effects of historical conditions that are no longer relevant. The information about historical loss rates is applied to groups that are defined in a manner that is consistent with the groups for which the historical loss rates were observed. [IFRS 9.B5.5.52–B5.5.53]

For periods that are far in the future, an entity may extrapolate its projections from available detailed information. The entity will need to determine that the projections are reasonable in the circumstances and cannot simply apply methods that are arbitrary or otherwise unsupported. For example, in some circumstances it may not be appropriate to assume that parameters will immediately revert to long-term historical averages at the end of the detailed forecast period, or that they will continue at the same levels as included in the detailed forecast for the entire remaining period over which ECLs are measured. [IFRS 9.B5.5.50]

An entity reviews the methodology and assumptions used for estimating ECLs regularly, to reduce any differences between estimates and actual credit losses. [IFRS 9.B5.5.52]

Information to be used in measurement

Like IFRS Accounting Standards, the estimate of ECLs is based on relevant information about past events, current economic conditions, and reasonable and supportable forecasts of future economic conditions that affect the collectability of cash flows. An entity should not default to using only the most observable external data if its internal data is sufficient. Like IFRS Accounting Standards, although an entity should not ignore relevant data when considering historical loss information, it is not required to search for information that is not reasonably available without undue cost and effort. Like IFRS Accounting Standards, the information used includes qualitative and quantitative factors that relate:

- specifically to the borrower(s); and
- to the environment in which the entity operates. [326-20-30-7, ASU 2016-13.BC51]

Like IFRS Accounting Standards, historical loss experience is generally the starting point for estimating ECLs. Like IFRS Accounting Standards, adjustments are then made to historical loss experience to reflect:

- differences in asset-specific risk characteristics: e.g. underwriting standards, portfolio mix or asset terms.
- differences in economic conditions: both current conditions and reasonable and supportable forecasts of future conditions. [326-20-30-9, ASU 2016-13.BC52–BC53]

Unlike IFRS Accounting Standards, for periods beyond the reasonable and supportable forecast period, an entity reverts to historical loss information under a reversion method. [326-20-30-9]

Like IFRS Accounting Standards, an entity reviews the methodology and assumptions used for estimating ECLs regularly, to reduce any differences between estimates and actual credit losses.

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Zero loss

An estimate of ECLs should always reflect the possibility that a credit loss occurs and the possibility that no credit loss occurs even if the possibility of credit loss occurring is very low. [IFRS 9.5.5.18, B5.5.41]

Collateral and other credit enhancements

The estimate of ECLs reflects the cash flows expected from collateral and other credit enhancements that are part of the contractual terms of the financial instrument and are not recognised separately from the financial instrument being assessed for impairment. [IFRS 9.A, B5.5.55]

Irrespective of whether foreclosure is probable, the estimate of expected cash shortfalls on a collateralised financial asset reflects:

- the amount and timing of cash flows that are expected from foreclosure; less
- costs for obtaining and selling the collateral. [IFRS 9.B5.5.55]

Zero loss

Like IFRS Accounting Standards, the ECLs should include a measure of the expected risk of credit loss even if that risk is remote, regardless of the method applied to estimate credit losses. However, the Codification Subtopic does not require ECLs on a financial asset (or group of financial assets) in which historical credit loss experience adjusted for current conditions and reasonable and supportable forecasts results in an expectation that non-payment of the amortised cost basis is zero (e.g. US treasury securities), unlike IFRS Accounting Standards. Except in these specific circumstances, for a non-collateral-dependent financial asset (see below for the type of assets that may be considered collateral-dependent) an entity does not expect non-payment of the amortised cost basis to be zero solely on the basis of the current value of collateral securing the financial asset(s). Instead, the entity also considers the nature of the collateral, potential future changes in collateral values, and historical loss experience for financial assets secured with similar collateral. [326-20-30-10]

Collateral and other credit enhancements

Like IFRS Accounting Standards, the estimate of ECLs reflects the cash flows expected from collateral and credit enhancements that are not freestanding. However, unlike IFRS Accounting Standards, the principles for estimating ECLs of collateral-dependent assets differ from the general measurement principles under the ECL model.

Unlike IFRS Accounting Standards, US GAAP has specific guidance for collateral-dependent assets. A financial asset is collateral-dependent when the borrower is experiencing financial difficulty and repayment is expected to be provided substantially through the sale or operation of the collateral. [326-20-35-4]

Unlike IFRS Accounting Standards, the collateral-dependent practical expedient is applied when:

- *foreclosure is probable*: an entity uses the collateral's fair value at the reporting date (less costs to sell) to estimate ECLs; and
- *the financial asset is collateral-dependent but foreclosure is not probable*: an entity can elect to apply the practical expedient to use the collateral's fair value at the reporting date (less costs to sell) to estimate ECLs. [326-20-35-4 – 35-5]

Like IFRS Accounting Standards, other forms of credit enhancements that are not freestanding are considered in estimating ECLs. Credit enhancements that are freestanding are not considered in estimating ECLs, like IFRS Accounting Standards. However, differences in practice may arise compared to IFRS Accounting Standards based on the concepts of 'freestanding' under US GAAP and 'recognised separately' under IFRS Accounting Standards. [326-20 Glossary, 326-20-30-12]

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Individual vs collective basis of measurement

There is no specific guidance on when ECLs should be measured on an individual or collective basis. However, if an entity does not have reasonable and supportable information that is available without undue cost or effort to measure lifetime ECLs on an individual basis, then it recognises lifetime ECLs on a collective basis, by considering comprehensive credit risk information. In addition to using past-due information, this measurement incorporates all relevant credit information – including forward-looking macro-economic information. [IFRS 9.B5.5.4–B5.5.5]

Assets that are credit-impaired on initial recognition (POCI)

An asset is credit-impaired if one or more events have occurred that have a detrimental impact on the estimated future cash flows of the asset. The following are examples of such events:

- significant financial difficulty of the issuer or the borrower;
- a breach of contract: e.g. a default or past-due event;
- a lender having granted a concession to the borrower (for economic or contractual reasons relating to the borrower's financial difficulty) that the lender would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- the purchase of a financial asset at a deep discount that reflects the incurred credit losses. [IFRS 9.A]

On initial recognition, a POCI asset does not carry an impairment allowance. [IFRS 9.5.5.13, A, B5.4.7]

The ECLs for a POCI asset is always measured at an amount equal to lifetime ECLs. However, the amount recognised as a loss allowance is the change in lifetime ECLs since initial recognition of the asset. Favourable changes in lifetime ECLs are recognised as an impairment gain, even if the favourable changes are more than the amount, if any, previously recognised in profit or loss as impairment losses. [IFRS 9.5.5.13–5.5.14]

Individual vs collective basis of measurement

Unlike IFRS Accounting Standards, the Codification Subtopic requires the use of a collective assessment to estimate ECLs for financial assets and off-balance sheet credit exposures with similar risk characteristics. If an instrument does not share similar risk characteristics with other instruments held by the reporting entity, the ECL is determined on an individual basis. [326-20-30-2, 55-5]

PCD financial assets

The definition and the accounting for PCD assets are different under US GAAP compared to IFRS Accounting Standards.

An asset (or a group of financial assets with similar risk characteristics) is a PCD asset if, on the date of acquisition, it has experienced a more-than-insignificant deterioration in credit quality since origination as determined by the acquirer. The term 'more-than-insignificant deterioration in credit quality' is not defined and judgement is required to determine which assets meet the condition. [326-20 Glossary]

Unlike IFRS Accounting Standards, an entity records a PCD asset at the purchase price plus the allowance for credit losses expected at the time of acquisition, which becomes the asset's amortised cost basis. Like IFRS Accounting Standards, there are no ECLs affecting profit or loss on acquisition. [326-20-30-15]

Like IFRS Accounting Standards, the ECLs for a PCD asset is always measured at an amount equal to lifetime ECLs. However, unlike IFRS Accounting Standards, the loss allowance always reflects the total lifetime ECLs rather than only the change since initial acquisition. Like IFRS Accounting Standards, changes in estimates of ECLs after acquisition are recognised as credit loss expense (or reversal of credit loss expense) in subsequent periods as they arise. [326-20-30-15]

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The ECL for a purchased or originated credit-impaired asset is calculated by discounting expected credit losses using the credit-adjusted effective interest rate. [IFRS 9.B5.5.45]

Trade and lease receivables and contract assets

A loss allowance on trade receivables and contract assets that do not have a significant financing component (see chapter 4.2) is measured as lifetime ECLs. For trade receivables and contract assets that have a significant financing component, and lease receivables, there are accounting policy choices to measure the loss allowance either in accordance with the general approach (see above) or at lifetime ECLs. An entity may apply the policy choices for trade receivables, contract assets, finance lease receivables and operating lease receivables independently of each other. [IFRS 9.5.5.15–5.5.16]

Write-offs and recoveries

The gross carrying amount of a financial asset is reduced when there is no reasonable expectation of recovery. [IFRS 9.5.4.4]

Write-offs can relate to a financial asset in its entirety, or to a portion of it. [IFRS 9.B5.4.9]

A write-off constitutes a derecognition event. [IFRS 9.5.4.4]

It would not be consistent with either the guidance on measurement of ECLs or the guidance on write-offs to write off an amount in respect of which significant recoveries are expected because there is a reasonable expectation of making those recoveries. Therefore, it appears that a write-off is appropriate only to the extent that no significant recoveries are expected in respect of the amount to be written off. [IFRS 9.5.4.4]

If an entity estimates ECLs under a discounted cash flow method, it discounts expected credit losses at the effective interest rate (calculated as discussed in 'Time value of money' above), like IFRS Accounting Standards.

If an entity uses a method other than a discounted cash flow method, it estimates ECLs on the basis of the unpaid principal balance of the asset(s), unlike IFRS Accounting Standards. [326-20-30-14]

Trade and lease receivables and contract assets

Unlike IFRS Accounting Standards, there is no separate guidance for trade and lease receivables, and contract assets. Lifetime ECLs are estimated for such assets. See forthcoming requirements.

Write-offs and recoveries

The amortised cost basis of a financial asset and its related allowance for credit losses are written off in the period in which the financial asset is deemed uncollectable. Due to differences in wording and specific requirements for regulated entities, the timing of write-offs under US GAAP may be different. [326-20-35-8, 326-30-35-13]

Like IFRS Accounting Standards, write-offs can relate to a financial asset in its entirety, or a portion of it. [326-20-35-8]

Unlike IFRS Accounting Standards, the write-off of an asset is not in and of itself a derecognition event.

Unlike IFRS Accounting Standards, the allowance for credit losses is required to include expected recoveries of amounts previously written off and expected to be written off. Including recoveries of previously written off financial assets in the estimate of expected credit losses may, in some circumstances, result in the allowance for credit losses being negative (i.e. a debit balance). [326-20-30-1]

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Investments in debt instruments measured at FVOCI

The loss allowance for debt instruments at FVOCI is measured on the same basis as for amortised cost assets. Impairment loss or gain is recognised in profit or loss but no loss allowance is recognised in the statement of financial position, because the carrying amount of these assets is their fair value. However, an entity is required to provide disclosures about the loss allowance amount (see chapter 7.10). [IFRS 9.5.5.2, 7.16A]

AFS debt securities credit loss model

Overview

Unlike IFRS Accounting Standards, there is a separate credit loss model for AFS debt securities, which prescribes the following steps.

1. Assess whether the investment is impaired. An AFS debt security is impaired when its fair value declines below its amortised cost basis.
2. If the asset is impaired, consider whether management: (i) has the intent to sell, or (ii) will more-likely-than-not be required to sell the impaired security before recovery of its amortised cost basis. If either of these requirements is met, the entity should write off any previously recognised allowance for credit losses and write down the amortised cost basis to the debt security's fair value through earnings.
3. If neither of the conditions in (2) apply, determine if the decline in fair value below the amortised cost basis is a result of a credit loss. If so, record the portion of impairment relating to the credit loss through an allowance for credit losses.

[326-30-35-1 – 35-2, 35-4 – 35-5, 35-10]

Estimating the allowance for credit losses

An entity is required to use a discounted cash flow method to estimate a credit loss. Therefore, an entity compares:

- the present value of cash flows expected to be collected from the security; and
- the amortised cost basis of the security. [326-30-35-6]

The allowance is limited to the amount that fair value is less than the amortised cost basis (the fair value floor). [326-30-35-2]

Recognition of a credit loss

Once a credit loss is identified for an impaired AFS debt security, it is recognised in profit or loss, like IFRS Accounting Standards. Like IFRS Accounting Standards, no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. Like IFRS Accounting Standards, an entity is required to provide disclosures about the loss allowance amount. However, unlike IFRS Accounting Standards, an entity is also required to parenthetically disclose the amortised cost basis and the allowance for credit losses in the statement of financial position. [326-30-45-1]

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Forthcoming requirements

There are no forthcoming requirements under IFRS Accounting Standards.

Entities may use practical expedients when estimating ECLs, provided that they are consistent with the principles above. An example is a provision matrix to measure ECLs for trade receivables. [IFRS 9.B5.5.35]

Accounting subsequent to credit loss recognition

AFS debt securities are evaluated for credit losses each reporting period with changes recognised in profit or loss. [326-30-35-12]

Reductions in the allowance for credit losses can be due to either (1) improvements in credit or (2) increases in the security's fair value that are independent of improvements in credit (i.e. changes to the fair value floor). At no point should the allowance for credit losses be reduced below zero. [326-30-35-12]

Forthcoming requirements

Amendments to the financial instruments Codification Topic are effective for annual periods beginning after 15 December 2025; early adoption is permitted. See appendix.

The amendments provide an additional practical expedient and accounting policy election for estimating credit losses for current accounts receivable and current contract assets arising from transactions accounted for under the revenue Codification Topic. 'Current' in this context refers to a one-year period, or an entity's operating cycle if it exceeds 12 months.

- *Practical expedient:* The practical expedient permits an entity to assume that current conditions as of the balance sheet date do not change for the remaining life of the current accounts receivable and current contract assets. This practical expedient is available to all entities.
- *Accounting policy election:* This election allows an entity to consider cash collection activity after the balance sheet date when estimating expected credit losses on current accounts receivable and current contract assets. The election is available to entities other than public business entities, and it may only be made if the above practical expedient is also elected.

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7.9 Hedge accounting: IFRS 9

(IFRS 9, IAS 39, IFRIC 16)

Overview

- Hedge accounting is voluntary and, if it is elected, allows an entity to measure assets, liabilities and firm commitments selectively on a basis different from that otherwise stipulated in IFRS Accounting Standards, or to defer the recognition in profit or loss of gains or losses on derivatives. Entities may apply the hedge accounting requirements in the financial instruments standard, IFRS 9, or in the old accounting standard, IAS 39.
- There are three hedge accounting models: fair value hedges of fair value exposures; cash flow hedges of cash flow exposures; and net investment hedges of foreign currency exposures on net investments in foreign operations.
- Hedge accounting is permitted only when specific requirements related to documentation and effectiveness are met.
- Hedge accounting is required to be closely aligned with an entity's actual risk management objectives.
- Qualifying hedged items can be recognised assets or liabilities, unrecognised firm commitments, a highly probable forecast transactions, net investments in foreign operations or aggregated exposures (a combination of a non-derivative exposure and a derivative exposure).
- The hedged risk should be one that could affect profit or loss or OCI only if the hedged item is an investment in equity instruments for which changes in fair value are presented in OCI.

7.9 Hedge accounting: IFRS 9

(Topic 815, Topic 848)

Overview

- Like IFRS Accounting Standards, hedge accounting is voluntary and, if it is elected, allows an entity to measure assets, liabilities and firm commitments selectively on a basis different from that otherwise stipulated in US GAAP, or to defer the recognition in profit or loss of gains or losses on derivatives.
- Like IFRS Accounting Standards, there are three hedge accounting models: fair value hedges of fair value exposures; cash flow hedges of cash flow exposures; and net investment hedges of foreign currency exposures on net investments in foreign operations. However, the requirements differ from IFRS Accounting Standards in certain respects.
- Like IFRS Accounting Standards, hedge accounting is permitted only when specific requirements related to documentation and effectiveness are met.
- Although US GAAP does not specifically require an entity's hedge accounting to be 'closely aligned' with its actual risk management objectives, the intent of the hedging guidance is to enable an entity to closely align hedge accounting with risk management strategies and to accurately reflect hedging results in the financial statements.
- Like IFRS Accounting Standards, qualifying hedged items can be recognised assets or liabilities, unrecognised firm commitments, probable forecast transactions or net investments in foreign operations. Unlike IFRS Accounting Standards, aggregated exposures do not qualify as a hedged item.
- Like IFRS Accounting Standards, the hedged risk should be one that could affect profit or loss; an equity investment is not permitted to be designated as a hedged item, unlike IFRS Accounting Standards.

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Overview (continued)

- An entity can designate an item in its entirety or a component of an item as the hedged item. However, only certain components may be designated as the hedged item.
- The following contracts with a party external to the reporting entity qualify as hedging instruments: derivative instruments (with some exceptions), non-derivative financial instruments measured at FVTPL (with some exceptions) and for hedges of foreign exchange risk only, the foreign currency risk component of a non-derivative financial instrument.
- An entity may exclude the time value of a purchased option, forward element of a forward contract and foreign currency basis spread from the designation of a hedging instrument.
- For a hedge to meet the hedge effectiveness requirement, there has to be an economic relationship between the hedged item and the hedging instrument. Also, the value changes should not be dominated by the effect of credit risk and specific requirements relating to the hedge ratio should be met. Having an 'economic relationship' means that the hedging instrument and the hedged item have values that generally move in the opposite direction because of the same (hedged) risk. The assessment relates to expectations about hedge effectiveness; therefore, the test is only forward-looking or prospective.
- Rebalancing of the hedge ratio in a hedging relationship is a mandatory requirement if certain conditions are met.

Overview (continued)

- Like IFRS Accounting Standards, an entity can designate an item in its entirety or only a component (portion) of an item as the hedged item. Like IFRS Accounting Standards, only certain components of financial and non-financial items may be designated, although the requirements are more specific and restrictive under US GAAP.
- Unlike IFRS Accounting Standards, in general only derivative instruments with a party external to the reporting entity qualify as hedging instruments. Non-derivative financial instruments may qualify as hedging instruments only for hedges of foreign exchange risk exposure in (1) hedges of a net investment in a foreign operation, or (2) hedges of unrecognised firm commitments, unlike IFRS Accounting Standards.
- Certain components of a hedging instrument's fair value or cash flows may be excluded from the assessment of hedge effectiveness, which differs from IFRS Accounting Standards.
- Although the requirements differ, there are certain hedge effectiveness requirements that need to be met for a hedging relationship to be eligible for hedge accounting, like IFRS Accounting Standards. Also like IFRS Accounting Standards, to qualify for hedge accounting at inception a hedge should be 'expected to be' (prospectively) highly effective (effective as an economic hedge for net investment hedges). However, unlike IFRS Accounting Standards, to qualify for hedge accounting subsequently a hedge should be 'expected to be' (prospectively) and 'actually have been' (retrospectively) highly effective (effective as an economic hedge for net investment hedges). Also unlike IFRS Accounting Standards, certain derivatives may be considered to be perfectly effective hedging instruments without quantitatively assessing hedge effectiveness (e.g. critical terms match and shortcut methods). However, this is allowed only in very limited circumstances.
- Unlike IFRS Accounting Standards, rebalancing of the hedge ratio is not mandatory.

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Overview (continued)

- **For a cash flow hedge and a net investment hedge, the ineffective portion of the gain or loss on the hedging instrument is recognised in profit or loss, even if the hedge has been highly effective.**
- **Hedge accounting is discontinued prospectively if the hedging relationship ceases to meet the qualifying criteria after considering rebalancing. Voluntary discontinuation when the qualifying criteria are met is prohibited.**
- **If an entity uses a credit derivative that is measured at FVTPL to manage the credit risk of all, or a part, of a credit exposure, and other criteria are met, then it can designate the exposure as at FVTPL as an alternative to hedge accounting.**
- **The IASB has a separate active project to address dynamic risk management. In the meantime, an entity may apply the hedge accounting requirements of the old accounting standard, IAS 39, for a portfolio fair value hedge of interest rate risk. This policy choice is also available if an entity applies the hedge accounting requirements in the financial instruments standard, IFRS 9.**

Hedge accounting models

There are three hedge accounting models, and the type of model applied depends on whether the hedged exposure is a fair value exposure, a cash flow exposure or a foreign currency exposure of a net investment in a foreign operation. [IFRS 9.6.5.2]

Overview (continued)

- **Unlike IFRS Accounting Standards, when a cash flow hedging relationship is deemed highly effective the entire change in the fair value of the designated hedging instrument that is included in the assessment of hedge effectiveness is recognised in OCI and becomes a component of accumulated OCI. For a net investment hedge, the entire gain or loss on the hedging instrument that is included in the assessment of hedge effectiveness is recognised in OCI as an offset to the foreign currency translation of that foreign operation.**
- **Like IFRS Accounting Standards, hedge accounting is discontinued prospectively if the hedging relationship ceases to meet the qualifying criteria. Unlike IFRS Accounting Standards, voluntary discontinuation when the qualifying criteria are met is permitted.**
- **Unlike IFRS Accounting Standards, there is no specific guidance on designating credit exposures as at FVTPL. The general requirements for fair value option designation would apply under US GAAP.**
- **The FASB has a research project to consider broad changes to the hedge accounting model.**

Hedge accounting models

Like IFRS Accounting Standards, there are three hedge accounting models, and the type of hedge accounting model applied depends on whether the hedged exposure is a fair value exposure, a cash flow exposure or a foreign currency exposure on a net investment in a foreign operation. However, the requirements differ in certain respects from IFRS Accounting Standards. [815-20-05-1 – 05-2]

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Fair value hedges

A 'fair value hedge' is a hedge of the exposure to changes in the fair value of a recognised asset or liability, an unrecognised firm commitment or a component of such an item that is attributable to a particular risk and could affect:

- profit or loss; or
- OCI, if the hedged item is an investment in equity instruments for which the entity has elected to present changes in fair value in OCI. [IFRS 9.6.5.2(a), 6.5.3]

A hedge of the foreign currency risk of a firm commitment may be accounted for as either a fair value hedge or a cash flow hedge. [IFRS 9.6.5.4]

If the hedging instrument is a derivative, then it is measured at fair value with changes in fair value recognised in profit or loss or in OCI if the hedged item is an equity investment for which the entity has elected to present changes in fair value in OCI. [IFRS 9.6.5.8(a)]

The hedged item is remeasured to fair value in respect of the hedged risk, even if it is normally measured at amortised cost. Any resulting fair value adjustment to the hedged item related to the hedged risk is recognised in profit or loss, even if such a change would normally be recognised in OCI. However, if the hedged item is an equity investment for which the entity has elected to present changes in fair value in OCI, then those amounts remain in OCI. [IFRS 9.6.5.3, 6.5.8(a)–6.5.8(b)]

For a hedge of a firm commitment, fair value hedge accounting results in the change in fair value of the firm commitment attributable to the hedged risk during the period of the hedging relationship being recognised as an asset or a liability in the statement of financial position. When a hedged item in a fair value hedge is a firm commitment to acquire an asset or liability, the initial carrying amount of the asset or the liability that results from the entity meeting the firm commitment is adjusted to include the cumulative change in the fair value of the hedged item that was recognised in the statement of financial position (basis adjustment). [IFRS 9.6.5.8(b), 6.5.9]

Fair value hedges

Like IFRS Accounting Standards, a 'fair value hedge' is a hedge of changes in the fair value of a recognised asset or liability, an unrecognised firm commitment or an identified portion of such an asset, liability or firm commitment that are attributable to a particular risk and could affect profit or loss. Unlike IFRS Accounting Standards, US GAAP prohibits designating investments in equity securities as hedged items in a fair value (or cash flow) hedging relationship. [815-20-20, 25-43(b)(1)]

Like IFRS Accounting Standards, a hedge of the foreign currency risk of a firm commitment may be accounted for as either a fair value hedge or a cash flow hedge. However, the definition of a firm commitment differs from IFRS Accounting Standards in certain respects (see 'Qualifying hedged items' below). [815-20-25-12(f)(3), 25-15(i)(1)]

Like IFRS Accounting Standards, the derivative hedging instrument is measured at fair value with changes in fair value recognised in profit or loss. However, unlike IFRS Accounting Standards, an equity investment is not permitted to be designated as a hedged item. [815-20-25-43, 35-1(b)]

Like IFRS Accounting Standards, the hedged item is remeasured to fair value in respect of the hedged risk, even if it is normally measured at amortised cost. Like IFRS Accounting Standards, any resulting fair value adjustment to the hedged item related to the hedged risk is recognised in profit or loss, even if such a change would normally be recognised in OCI (e.g. available-for-sale debt securities). Unlike IFRS Accounting Standards, an equity investment is not permitted to be designated as a hedged item. [815-20-35-1(b)]

Like IFRS Accounting Standards, for a hedge of a firm commitment, fair value hedge accounting results in the change in fair value of the firm commitment attributable to the hedged risk during the period of the hedging relationship being recognised as an asset or a liability in the statement of financial position. Like IFRS Accounting Standards, when a hedged item in a fair value hedge is a firm commitment to acquire an asset or liability, the initial carrying amount of the asset or liability that results from the entity meeting the firm commitment is adjusted to include the cumulative change in the fair value of the hedged item that was previously recognised in the statement of financial position (basis adjustment). [815-25-35-1, 35-13]

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Cash flow hedges

A 'cash flow hedge' is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all of, or a component of, a recognised asset or liability, or a highly probable forecast transaction, and that could affect profit or loss. [IFRS 9.6.5.2(b)]

If the hedging instrument is a derivative or non-derivative financial instrument measured at FVTPL, then it is measured at fair value with the effective portion of changes in its fair value recognised in OCI and presented as a separate component of equity. Ineffectiveness due to the hedging instrument's cumulative change in fair value being greater than the cumulative change in the hedged item's value is recognised immediately in profit or loss. [IFRS 9.6.2.2, 6.5.11(b)–6.5.11(c)]

If the hedging instrument is a foreign currency risk component of a non-derivative financial instrument designated in a hedge of foreign currency risk, then the effective portion of the foreign currency gains and losses on the hedging instrument determined under the foreign exchange rates standard is recognised in OCI. Ineffectiveness due to the hedging instrument's cumulative change in fair value being greater than the cumulative change in the hedged item's value is recognised immediately in profit or loss. [IFRS 9.6.2.2, 6.5.11, B6.2.3]

The effective portion of changes in the fair value of the hedging instrument that is recognised in OCI – i.e. the amount accumulated in the cash flow hedge reserve – is accounted for as follows.

- If a hedged forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, or a hedged forecast transaction for a non-financial asset or a non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, then the entity removes that accumulated amount from the cash flow hedge reserve and includes it directly in the initial cost or other carrying amount of the asset or the liability (basis adjustment). This is not a reclassification adjustment and therefore it does not affect OCI.
- For other cash flow hedges, the accumulated amount is reclassified from the cash flow hedge reserve to profit or loss as a reclassification adjustment in the period(s) during which the hedged expected future cash flows affect profit or loss.

Cash flow hedges

Like IFRS Accounting Standards, a 'cash flow hedge' is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all of, or a component of, a recognised asset or liability, or a probable forecast transaction that is attributable to a particular risk that could affect profit or loss. However, the details differ in certain respects from IFRS Accounting Standards. [815-20-20]

Like IFRS Accounting Standards, a derivative hedging instrument is measured at fair value. However, unlike IFRS Accounting Standards, non-derivative instruments are not eligible to be designated as hedging instruments for cash flow hedges. Also unlike IFRS Accounting Standards, when the cash flow hedging relationship is deemed highly effective the entire change in the fair value of the designated hedging instrument that is included in the assessment of hedge effectiveness is recognised in OCI and becomes a component of accumulated OCI. [815-20-25-83A, 35-1(c), 815-30-35-3]

Unlike IFRS Accounting Standards, a non-derivative financial instrument cannot be designated as a hedging instrument in a cash flow hedge. [815-20-25-71]

The change in the fair value of the hedging instrument that is recognised in accumulated OCI is reclassified to profit or loss when the hedged item affects profit or loss. The timing and methods for reclassification of such amounts differ from IFRS Accounting Standards in some respects, as follows.

- If a hedged forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, or a hedged forecast transaction of a non-financial asset or a non-financial liability becomes a firm commitment for which fair value hedge accounting is subsequently applied, then the entity leaves the amount in accumulated OCI and reclassifies it to profit or loss as the related asset or liability affects profit or loss, unlike IFRS Accounting Standards.
- For other cash flow hedges, the amount in accumulated OCI is reclassified to profit or loss in the period(s) during which the hedged item affects profit or loss, like IFRS Accounting Standards.

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- However, if the accumulated amount is a loss and the entity expects that all or a portion of that loss will not be recovered in one or more future periods, then it immediately reclassifies the amount that is not expected to be recovered into profit or loss as a reclassification adjustment. [IFRS 9.6.5.11(d)]

Net investment hedges

A 'net investment hedge' is a hedge of the foreign currency exposure arising from a net investment in a foreign operation when the net assets of that foreign operation are included in the financial statements of the reporting entity. [IFRS 9.6.5.2(c), IFRIC 16.2]

The hedged risk is the foreign currency exposure arising from a net investment in that foreign operation when the net assets of the foreign operation are included in the financial statements. The hedged risk cannot be designated as the fair value of the underlying shares, or the currency exposure on the fair value of the shares. [IFRS 9.B6.3.2]

The hedged item may be an amount of net assets that is equal to or less than the carrying amount of the net assets of the foreign operation. Consequently, the expected profits from the foreign operation cannot be designated as the hedged item unless an entity redesignates the hedged item. [IFRIC 16.2, 11]

A derivative, a non-derivative instrument or a combination of both may be used as the hedging instrument. The hedging instrument can be held by any entity or entities within the group. [IFRIC 16.14]

The effective portion of the gain or loss on the hedging instrument is recognised in OCI as an offset to the foreign currency translation reserve in respect of that foreign operation. Any ineffectiveness is recognised in profit or loss immediately. [IFRS 9.6.5.13, IFRIC 16.3]

- Like IFRS Accounting Standards, if an entity expects that all or a portion of a loss recognised in OCI will not be recovered in one or more future periods, then it immediately reclassifies the amount that is not expected to be recovered to profit or loss. [815-20-35-1(c), 815-30-35-3, 35-38 – 35-41]

Net investment hedges

Like IFRS Accounting Standards, a 'net investment hedge' is a hedge of the foreign currency exposure arising from a net investment in a foreign operation when the net assets of that foreign operation are included in the financial statements of the reporting entity. However, the requirements differ in certain respects from IFRS Accounting Standards. [815-20-25-66 – 25-71]

Like IFRS Accounting Standards, the hedged risk is the foreign currency exposure on the designated carrying amount of the net assets of the foreign operation in the financial statements. Also like IFRS Accounting Standards, the hedged risk cannot be designated as the fair value of the underlying shares, or the currency exposure on the fair value of the shares. [815-20-25-23 – 25-33]

Like IFRS Accounting Standards, the hedged item may be an amount of net assets that is equal to or less than the carrying amount of the net assets of the foreign operation. Also like IFRS Accounting Standards, the expected profits from the foreign operation cannot be designated as the hedged item. The net investment balance can change from period to period and there may be a need for an entity to monitor the hedging relationship on an ongoing basis and redesignate if necessary. [815-35-35-27, 55-1]

Like IFRS Accounting Standards, a derivative or a non-derivative instrument may be used as the hedging instrument. Unlike IFRS Accounting Standards, a combination of a derivative and a non-derivative instrument cannot be used as the hedging instrument in one relationship. Also unlike IFRS Accounting Standards, the party to the derivative hedging instrument should be either the operating unit with the foreign currency exposure or another member of the consolidated group that has the same functional currency and for which there is no intervening subsidiary with a different functional currency. [815-20-25-30, 25-66]

Unlike IFRS Accounting Standards, if the hedging relationship is effective as an economic hedge, then the entire gain or loss on the hedging instrument that is included in the assessment of hedge effectiveness is recognised in OCI as an offset to the foreign currency translation of that foreign operation. [815-20-35-1(d), 35-5A – 35-5B]

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Hedge accounting criteria

The following conditions apply to all three types of hedges. Hedge accounting is permitted only if all of the following conditions are met.

- The hedging relationship consists only of eligible hedging instruments and eligible hedged items.
- At the inception of the hedging relationship, there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. This documentation identifies:
  - the hedging instrument, the hedged item and the nature of the risk being hedged; and
  - how the entity will assess whether the hedging relationship meets the hedge effectiveness requirements (including its analysis of the sources of hedge ineffectiveness and how it determines the hedge ratio).
- The hedging relationship meets all of the hedge effectiveness requirements (see 'Effectiveness assessment' below). [IFRS 9.6.4.1]

The financial instruments standard requires an entity's hedge accounting to be closely aligned with its actual risk management objectives. Judgement is involved in assessing how closely a hedge accounting designation needs to align with an entity's risk management objectives to be able to qualify for hedge accounting – e.g. the accounting standard clarifies that some 'proxy hedging' strategies are permitted even if they do not exactly represent the actual risk management approach. [IFRS 9.B6.5.24, BC6.98]

Hedge accounting criteria

The general conditions for hedge accounting for all three types of hedges are as follows.

- The hedging relationship consists only of eligible hedging instruments and eligible hedged items, like IFRS Accounting Standards.
- The hedging relationship involves a hedge of an eligible hedged risk, like IFRS Accounting Standards; however, the criteria for risks to be eligible differ from IFRS Accounting Standards. Risks eligible to be hedged need to affect profit or loss and are specifically prescribed, unlike IFRS Accounting Standards (see additional discussion in 'Qualifying hedged items' below).
- Like IFRS Accounting Standards, at inception of the hedging relationship there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge, including identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk will be assessed (both prospectively, like IFRS Accounting Standards, and retrospectively, unlike IFRS Accounting Standards). Unlike IFRS Accounting Standards, US GAAP extends the length of time for which a private company has to document its hedging relationship.
- The hedging relationship needs to meet certain hedge effectiveness requirements, like IFRS Accounting Standards. However, the hedge effectiveness requirements differ in certain respects from IFRS Accounting Standards (see 'Effectiveness assessment' below). [815-20-25-3, 25-5, 25-75, 25-136]

There are additional criteria that need to be met for fair value, cash flow and net investment hedges, which differ from IFRS Accounting Standards. [815-20-25-4 – 25-72, 25-87 – 25-132]

Although US GAAP does not specifically require an entity's hedge accounting to be 'closely aligned' with its actual risk management objectives, the intent of the hedging guidance is to enable an entity to closely align hedge accounting with risk management strategies. [ASU 2017-12.BC4]

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Qualifying hedged items

The hedged item is an item (in its entirety or a component of an item) that is exposed to the specific risk(s) that an entity has chosen to hedge based on its risk management activities. To qualify for hedge accounting, the hedged item needs to be reliably measurable. A hedged item can be:

- a single recognised asset or liability, unrecognised firm commitment, highly probable forecast transaction or net investment in a foreign operation;
- a group of recognised assets or liabilities, unrecognised firm commitments, highly probable forecast transactions or net investments in foreign operations, if they meet certain conditions; or
- aggregated exposures: i.e. a combination of a non-derivative exposure and a derivative exposure. [IFRS 9.6.1.3, 6.3.1–6.3.4]

A firm commitment to acquire a business in a business combination can be a hedged item only for foreign exchange risk because other risks cannot be specifically identified and measured. In our view, an entity may also hedge the foreign exchange risk of a highly probable forecast business combination. In our view, in the consolidated financial statements a cash flow hedge of the foreign exchange risk of a firm commitment to acquire a business or a forecast business combination relates to the foreign currency equivalent of the consideration paid. [IFRS 9.B6.3.1]

To qualify for hedge accounting, the hedged risk should ultimately be capable of affecting either profit or loss or, if the hedged item is an equity investment for which the entity has elected to present changes in fair value in OCI, OCI. [IFRS 9.6.5.2–6.5.3]

Hedging risks and components

An entity can designate an item in its entirety or a component of an item as the hedged item. However, only the following types of components, or any combination thereof, may be designated:

- risk components that are separately identifiable and reliably measurable;
- one or more selected contractual cash flows; and
- components of nominal amounts. [IFRS 9.6.3.7]

Qualifying hedged items

Like IFRS Accounting Standards, the hedged item is an item (in its entirety or a component of an item) that is exposed to the specific risk(s) that an entity has chosen to hedge based on its risk management activities. In general, the qualifying hedged items are similar to those under IFRS Accounting Standards. However, because US GAAP has more guidance, including on the concept of a firm commitment, differences may arise in practice. A combination of non-derivative and derivative exposures (i.e. aggregate exposures) is not permitted to be designated as hedged items, unlike IFRS Accounting Standards. [815-20-25-4 – 25-44]

Unlike IFRS Accounting Standards, a firm commitment to acquire a business or an anticipated business combination is not a qualifying hedged item. [815-20-25-15(g)]

Like IFRS Accounting Standards, the hedged risk should be one that could affect profit or loss; however, an equity investment is not permitted to be designated as a hedged item under US GAAP, unlike IFRS Accounting Standards. [815-20-25-12(c), 25-15(c)(2)]

Hedging risks and components

Like IFRS Accounting Standards, an entity can designate an item in its entirety or only a component (portion) of an item as the hedged item. Like IFRS Accounting Standards, only certain components may be designated, although the requirements are more specific and restrictive under US GAAP. Only the following components may be designated:

- *fair value hedge:* a specific portion (or percentage) of a recognised asset or liability or unrecognised firm commitment, including:
  - selected consecutive interest payments with the assumption that the principal payment occurs at the end of the hedge term (partial-term hedge of interest rate risk);
  - embedded put or call options;
  - residual value in a lessor's net investment in a lease; or
  - one or more layers of a closed portfolio of financial assets if certain conditions are met (see below);

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Risk components include the changes in the cash flows or fair value of an item attributable to a specific risk or risks. To be eligible for designation as a hedged item, a risk component needs to meet the following criteria:

- it is a separately identifiable component of the financial or non-financial item; and
- the changes in the cash flows or fair value of the item attributable to changes in that risk component are reliably measurable. [IFRS 9.B6.3.8]

A contractually specified inflation risk component of the cash flows of a recognised inflation-linked bond is separately identifiable and reliably measurable, as long as other cash flows of the instrument are not affected by the inflation risk component. [IFRS 9.B6.3.15]

An entity may designate a financial instrument as the hedged item for only a portion of its period to maturity. In our view, an entity may designate the changes in the cash flows of a financial asset or financial liability that relate to only a component of its term – i.e. a partial-term cash flow hedge. [IFRS 9.6.3.7]

- *cash flow hedge:* (1) specified cash flows, which must include (but are not limited to only including) the first cash flows received or paid in a particular period or (2) contractually specified components of a non-financial asset or liability, or a contractually specified interest rate of a financial instrument; and
- *net investment hedge:* a portion of the net investment in a foreign operation.

[815-20-25-11, 25-12 – 25-12A, 55-21, 55-33A, 815-25-35-13, 35-13B]

Unlike IFRS Accounting Standards, for a financial asset or financial liability an entity is limited to hedging interest rate risk, foreign currency risk, credit risk, overall changes in cash flows or fair value (i.e. price risk), or a combination of one or more of these risks. [815-20-25-6 – 25-44]

Unlike IFRS Accounting Standards, US GAAP is more restrictive over which components of risk may be hedged. Either of the following risks can be hedged in a cash flow hedge of interest rate risk:

- changes in a contractually specified interest rate for variable-rate financial instruments or forecast issuances or purchases of variable-rate financial instruments; or
- changes in the benchmark interest rate for forecast issuances or purchases of fixed-rate financial instruments. [815-20-25-6 – 25-44]

Unlike IFRS Accounting Standards, a component of a non-financial item other than servicing rights may be hedged only if it is contractually specified. [815-20-25-12]

Unlike IFRS Accounting Standards, there is no specific guidance for designating an inflation risk component of cash flows of a recognised inflation-linked bond.

Like IFRS Accounting Standards, in a fair value hedging relationship an entity may designate certain consecutive interest payments of a financial instrument for a portion of its period to maturity as the hedged item (i.e. partial-term hedge). An entity may assume that the principal payment occurs at the end of the hedge term and differences from IFRS Accounting Standards may arise in practice. Also, like IFRS Accounting Standards, in a cash flow hedging relationship an entity may designate the changes in the cash flows of a financial asset or financial liability that relate to only a component of its term. [815-20-25-12(b)(2)(ii), 55-21, 55-33A]

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An entity may designate a specified part of the amount of an item as the hedged item. It designates the component for accounting purposes consistently with its risk management objective. Two types of components of nominal amounts can be designated as the hedged item in a hedging relationship:

- a component that is a proportion of an entire item; or
- a layer component. [IFRS 9.6.3.7(c), B6.3.16]

The term 'portion' is distinct from the term 'proportion', the latter being used to indicate a certain percentage of an item. It is possible to designate a proportion of the cash flows, fair value or net investment as a hedged item. Once a partial designation is made, hedge effectiveness is measured on the basis of the hedged exposure. [IFRS 9.B6.3.17]

A layer component may be specified from a defined, but open, population or from a defined nominal amount. An entity may designate a layer component of an eligible group of items – e.g. the bottom layer – if certain requirements are met (see 'Hedges of groups of items' below). [IFRS 9.6.6.2–6.6.3, B6.3.18]

If a component of the cash flows of a financial or a non-financial item is designated as the hedged item, then that component needs to be less than or equal to the total cash flows of the entire item. However, all of the cash flows of the entire item may be designated as the hedged item and hedged for only one particular risk. [IFRS 9.B6.3.21]

Forecast transactions

Forecast transactions should be 'highly probable' and should present an exposure to variations in cash flows that could ultimately affect profit or loss. IFRS Accounting Standards do not define what is meant by 'highly probable'. In our view, for a forecast transaction to be considered 'highly probable', there should be at least a 90 percent probability of the transaction occurring. [IFRS 9.6.3.3, 6.5.2(b)]

Like IFRS Accounting Standards, an entity may designate a proportion of an entire item or, if certain criteria are met, a layer component as the hedged item in a hedging relationship. However, the layer component that may be designated may be different from what may be designated under IFRS Accounting Standards. [815-20-25-11 – 25-12]

Like IFRS Accounting Standards, the term 'portion' is different from the term 'proportion', the latter being used to indicate a certain percentage of the hedged item. Like IFRS Accounting Standards, it is possible to designate a proportion of the cash flows, fair value or net investment as a hedged item. Like IFRS Accounting Standards, once a partial designation is made, hedge effectiveness is measured on the basis of the hedged exposure. [815-20-25-11 – 25-12]

Like IFRS Accounting Standards, a layer component may be specified as the hedged item. However, unlike IFRS Accounting Standards, an entity may only do so using the portfolio-layer method fair value hedge model (see additional discussion in 'Portfolio fair value hedges of interest rate risk' below). [815-20-25-11 – 25-12]

Unlike IFRS Accounting Standards, if a portion of the cash flows or fair value of a financial asset or financial liability is designated as the hedged item, then that designated portion may exceed the total cash flows of the asset or liability. Also, like IFRS Accounting Standards, an entity may designate all of the cash flows of the entire financial asset or financial liability as the hedged item and hedge them for only one particular risk, as long as the hedged risk is one of the eligible specified risks. As discussed above, the eligible risks may differ from IFRS Accounting Standards. [815-20-25-6 – 25-44, ASU 2017-12.BC92–BC93]

Forecast transactions

Unlike IFRS Accounting Standards, for a cash flow hedge of a forecast transaction, the transaction needs to be 'probable' and create an exposure to variability in cash flows that ultimately could affect profit or loss. Like IFRS Accounting Standards, there is no specific guidance in the hedging Codification Topic on what percentage probability constitutes probable of occurring. US GAAP defines 'probable' as 'the future event or events are likely to occur' and the term 'probable' requires significantly greater likelihood of occurrence than the phrase 'more likely than not'. [815-20-25-3, 25-5, 25-75, 25-132]

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Hedges of groups of items

A group of items, which can be a gross or net position, has to meet the following conditions to be an eligible hedged item for fair value and cash flow hedges:

- the position consists of items (including components of items) that individually would be eligible hedged items; and
- the items in the group are managed together on a group basis for risk management purposes. [IFRS 9.6.6.1(a)–(b)]

In addition to these two conditions, there are further requirements for a cash flow hedge of a group of items for which an offsetting position arises because the variability in cash flows of items in the group is not expected to be approximately proportional to the group's overall variability in cash flows. These are that:

- it is a hedge of foreign currency risk; and
- the designation specifies the reporting period in which the forecast transactions are expected to affect profit or loss, as well as their nature and volume. [IFRS 9.6.6.1(c), B6.6.7–B6.6.8]

A layer component of an overall group of items (e.g. a bottom layer) is eligible for hedge accounting only if:

- it is separately identifiable and reliably measurable;
- the risk management objective is to hedge a layer component;
- the items in the overall group from which the layer is identified are exposed to the same hedged risk (so that the measurement of the hedged layer is not significantly affected by which particular items from the overall group form part of the hedged layer);
- for a hedge of existing items (e.g. an unrecognised firm commitment or a recognised asset), an entity can identify and track the overall group of items from which the hedged layer is defined (so that the entity is able to comply with the requirements for the accounting for qualifying hedging relationships); and
- any items in the group that contain prepayment options meet the requirements for components of a nominal amount. [IFRS 9.6.6.3]

Hedges of groups of items

Like IFRS Accounting Standards, a group of items may be aggregated and designated as the hedged item for fair value and cash flow hedges if certain conditions are met. However, groups of items in a net position are always ineligible to be designated as a hedged item (see 'Net positions' below), unlike IFRS Accounting Standards. Also, the conditions for grouping differ from those under IFRS Accounting Standards. To be aggregated, each item individually needs to:

- share the risk exposure that is designated as being hedged; and
- in a fair value hedging relationship, respond proportionately to the total change in fair value of the hedged portfolio attributable to the hedged risk. [815-20-25-1, 25-12(b)]

Unlike IFRS Accounting Standards, there is no specific guidance for a cash flow hedging strategy of a group of items in which an offsetting position arises because the variability in cash flows of items in the group is not expected to be approximately proportional to the group's overall variability in cash flows. An entity should apply the general hedge accounting criteria for hedging groups of items.

Like IFRS Accounting Standards, a layer component of an overall group of items may be designated as the hedged item. However, this is only permitted under the portfolio-layer method, unlike IFRS Accounting Standards (see 'Portfolio fair value hedges of interest rate risk' below). For an entity to apply the portfolio-layer method, the financial assets in the closed portfolio should share the same risk exposure for the risk being hedged (i.e. the same benchmark interest rate risk). In other words, they need to pass the 'similarity' test. An entity is permitted to assess similarity qualitatively and is permitted to perform this assessment only at hedge inception only when it:

- applies the partial-term hedge guidance; and
- elects to hedge only the benchmark rate component of the contractual coupon cash flows. [815-20-25-12A, 55-14 – 55-14A, ASU 2017-12.BC112]

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Net positions

A net position is eligible for hedge accounting only if an entity hedges on a net basis for risk management purposes. Whether an entity hedges in this way is a matter of fact (not merely of assertion or documentation). An entity cannot apply hedge accounting on a net basis solely to achieve a particular accounting outcome if that would not reflect its risk management approach. [IFRS 9.B6.6.1]

Aggregated exposures

An aggregated exposure consists of a non-derivative exposure that can qualify as a hedged item and a derivative. Such a combination may create a different exposure that is managed as a single exposure for a particular risk or risks. An entity may designate such an aggregated exposure as the hedged item. The components that make up the aggregated exposure do not need to be designated in a separate hedging relationship. [IFRS 9.6.3.4, B6.3.3]

Portfolio fair value hedges of interest rate risk

The financial instruments standard, IFRS 9, permits entities to designate portfolio fair value hedges of interest rate risk using the guidance in the old accounting standard, IAS 39 (see chapter 7.9B). [IFRS 9.6.1.3]

Net positions

Unlike IFRS Accounting Standards, a net position cannot be a hedged item, although a portion of the assets or liabilities making up the net position may be designated as the hedged item. [815-20-25-12]

Aggregated exposures

Unlike IFRS Accounting Standards, derivative instruments are not permitted to be designated as hedged items in combination with other non-derivative exposures.

Portfolio fair value hedges of interest rate risk

Although an entity may hedge a portfolio of financial assets under the portfolio hedging model, the requirements differ from IFRS Accounting Standards. To hedge the interest rate risk of a portfolio of financial assets, an entity may use the portfolio-layer fair value hedge model.

To qualify for the portfolio-layer method, the following criteria need to be met, unlike IFRS Accounting Standards:

- the portfolio has to be a closed portfolio of 'similar' financial assets (both prepayable and non-prepayable);
- the partial-term hedging designation should be elected; and
- the entity expects that the designated amount will remain outstanding at the end of the hedge term after considering expected prepayments, defaults and other factors affecting the timing and amount of cash flows. [815-20-25-12A]

For entities that use the portfolio-layer method hedging relationships for a single closed portfolio, the following applies.

- Multiple layers may be hedged in a single closed portfolio.
- Fair value hedge basis adjustments can exist at the closed portfolio level (i.e. not allocated to individual assets).
- Fair value hedge basis adjustments related to a portfolio-layer method hedge cannot be considered when estimating credit losses.
- Fair value basis adjustments are considered when discontinuing a portfolio-layer method hedge.

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Qualifying hedging instruments

The following contracts with a party external to the reporting entity may qualify as hedging instruments.

- All derivatives measured at FVTPL, with the following limitations.
  - Written options not designated as offsets to purchased options.
  - Derivatives embedded in hybrid contracts that are not accounted for separately.
- Certain non-derivative financial assets or non-derivative financial liabilities.

[IFRS 9.6.2.1–6.2.3, B6.2.1, B6.2.4]

A hedging instrument may not be designated for a part of its change in fair value that results from only a portion of the time period during which the hedging instrument remains outstanding. A qualifying hedging instrument needs to be designated in its entirety or as a proportion thereof except as noted below. [IFRS 9.6.2.4(c)]

An entity may exclude the time value of a purchased option, forward element of a forward contract and foreign currency basis spread from the designation of a hedging instrument (see additional discussion in 'Excluded components' below). [IFRS 9.6.2.4(a)–(b)]

An instrument or combination of instruments that in effect is a net written option qualifies as a hedging instrument only if it is designated as an offset to a purchased option, including one that is embedded in another financial instrument – e.g. a written call option used to hedge a callable liability. [IFRS 9.6.2.6, B6.2.4]

Qualifying hedging instruments

The following contracts with a party external to the reporting entity may qualify as hedging instruments.

- Like IFRS Accounting Standards, all derivatives measured at FVTPL, including separable embedded derivatives, with the following limitations.
  - Unlike IFRS Accounting Standards, the use of written options as hedging instruments is not restricted to hedges of purchased options; however, additional hedge criteria apply (see below).
  - Like IFRS Accounting Standards, derivatives embedded in hybrid contracts that are not accounted for separately.
- Unlike IFRS Accounting Standards, non-derivatives may be used as hedging instruments only for hedges of foreign currency exposure of a net investment in a foreign operation and foreign currency fair value hedges of unrecognised firm commitments. [815-20-25-37(d), 25-45 – 25-71]

Like IFRS Accounting Standards, a hedging instrument may not be designated for only a part of its change in fair value that results from only a portion of time during which the hedging instrument remains outstanding. Also like IFRS Accounting Standards, all or a proportion of a derivative may be designated as a hedging instrument. If a proportion of a derivative is designated, then it needs to be a percentage of the entire derivative instrument. Designation of only certain components (e.g. a portion) of derivatives is not permitted, except as noted below. [815-20-25-71]

Certain components of a hedging instrument's fair value or cash flows may be excluded from the assessment of hedge effectiveness, which differs from IFRS Accounting Standards (see additional discussion in 'Excluded components' below). [815-20-25-82]

Unlike IFRS Accounting Standards, a written option may be designated as a hedge of a recognised asset or liability or unrecognised firm commitment, or related variability in cash flows, but only if the combination of the hedged item and the written option provides at least as much potential for gains as a result of a favourable change in the fair value of the combined instruments as exposure to losses from an unfavourable change in their combined fair value (or, for cash flow hedges, at least as much potential for favourable cash flows as exposure to unfavourable cash flows). That test is met if all possible favourable percentage changes in the underlying (from 0 to 100 percent) would provide at least as much gain (or favourable cash flows) as the loss (or unfavourable cash flows) that would be incurred from an unfavourable change in the underlying of the same percentage. [815-20-25-94 – 25-97]

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Non-derivative financial assets or non-derivative financial liabilities measured at FVTPL may be designated as hedging instruments in hedging relationships, except for financial liabilities designated as at FVTPL for which the amount of changes in fair value attributable to changes in credit risk is presented in OCI. These eligible instruments may be designated as a hedge of any risk – not only foreign currency risk. For hedges of foreign currency risk, an entity may designate the foreign currency risk component of a non-derivative financial asset or a non-derivative financial liability as the hedging instrument. In our view, this may be permitted even if the hedging instrument is a non-derivative financial instrument outside the scope of the financial instruments standard (e.g. a lease liability in the scope of the leases standard). [IFRS 9.6.2.2]

Unlike IFRS Accounting Standards, non-derivatives may be used as hedging instruments only for hedges of foreign currency exposure of a net investment in a foreign operation and foreign currency fair value hedges of unrecognised firm commitments. [815-20-25-66, 25-37(d)]

An entity may view in combination, and jointly designate as the hedging instrument, any combination of the following. This includes those circumstances in which the risk or risks arising from some hedging instruments offset those arising from others:

- derivatives or a proportion of them; and
- non-derivatives or a proportion of them. [IFRS 9.6.2.5]

Like IFRS Accounting Standards, an entity may combine and designate two or more derivative instruments as the hedging instrument. Unlike IFRS Accounting Standards, using a combination of derivatives and non-derivatives, or proportions thereof, as the hedging instrument is prohibited. [815-20-25-66]

Dynamic hedging strategies

The IASB has a separate active project to address dynamic risk management. In the meantime, for a fair value hedge of the interest rate exposure of a portfolio of financial instruments, an entity may apply the hedge accounting requirements of the old accounting standard, IAS 39, rather than the financial instruments standard, IFRS 9.

Dynamic hedging strategies

The FASB has a research project to consider broad changes to the hedge accounting model.

IFRS Accounting Standards allow an entity to apply dynamic hedging strategies such as 'delta-neutral' hedging strategies and other dynamic strategies under which the quantity of the hedging instrument is constantly adjusted to maintain a desired hedge ratio. The entity needs to comply with all normal criteria for hedge accounting and in addition document how it will monitor and update the hedge and measure hedge effectiveness and be able to track properly all terminations and redesignations of the hedging instrument. Also, it needs to be able to demonstrate an expectation that the hedge will be highly effective for a specified short period of time during which the hedge is not expected to be adjusted.

Like IFRS Accounting Standards, an entity may apply dynamic hedging strategies such as 'delta-neutral' hedging strategies and other dynamic strategies under which the quantity of the hedging instrument is constantly adjusted to maintain a desired hedge ratio. However, the details of the application of hedge accounting to these strategies differ from IFRS Accounting Standards in certain respects. [815-20-25-101]

Hedge effectiveness and ineffectiveness

Effectiveness assessment

'Hedge effectiveness' is the extent to which changes in the fair value or cash flows of the hedging instrument offset changes in the fair value or cash flows of the hedged item for the hedged risk. [IFRS 9.B6.4.1]

Hedge effectiveness and ineffectiveness

Effectiveness assessment

Like IFRS Accounting Standards, 'hedge effectiveness' is the extent to which changes in the fair value or cash flows of the hedging instrument offset changes in the fair value or cash flows of the hedged item or hedged transaction for the hedged risk. [815-20-25-77]

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A hedging relationship meets the hedge effectiveness requirements if:

- there is an economic relationship between the hedged item and the hedging instrument;
- the effect of credit risk does not dominate the value changes that result from that economic relationship; and
- the hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item. However, that designation should not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting. [IFRS 9.6.4.1(c)]

The assessment relates to expectations about hedge effectiveness; therefore, the assessment is only forward-looking or prospective. [IFRS 9.B6.4.12]

An entity assesses hedge effectiveness:

- at inception of the hedging relationship; and
- on an ongoing basis: at a minimum, at each reporting date or on a significant change in the circumstances affecting the hedge effectiveness requirements, whichever comes first. [IFRS 9.B6.4.12]

IFRS Accounting Standards do not prescribe the methods that should be used in measuring effectiveness (i.e. qualitative or quantitative methods). An entity's hedge documentation specifies how it will assess whether the hedging relationship meets the hedge effectiveness requirements, including the method or methods used. [IFRS 9.6.4.1(b), B6.4.19]

Although the requirements differ, there are certain hedge effectiveness requirements that need to be met for a hedging relationship to be eligible for hedge accounting, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, to qualify for hedge accounting, a hedge should be 'expected to be' (prospectively) and 'actually have been' (retrospectively) highly effective at inception and subsequently, which requires the following conditions to be met (for net investment hedges, the hedge should be effective as an economic hedge instead of 'highly effective'):

- the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated (prospective effectiveness); and
- the hedge has actually been highly effective (retrospective effectiveness). An 80–125 percent range is not explicitly specified, although it is widely used and accepted in practice for both prospective and retrospective effectiveness. The FASB has acknowledged that practice has interpreted this range to result in a highly effective hedging relationship. The SEC staff has also indicated that this is an acceptable range. [815-20-25-72 – 25-132, ASU 2017-12.BC165]

Notwithstanding the above, certain derivatives may be considered to be perfectly effective hedging instruments without quantitatively assessing hedge effectiveness, unlike IFRS Accounting Standards (e.g. critical terms match and shortcut methods). However, this is allowed only in very limited circumstances. [815-20-25-84 – 25-85, 25-102 – 25-118, 25-126 – 25-129]

Unlike IFRS Accounting Standards, the assessment of hedge effectiveness needs to be performed on both a retrospective and a prospective basis. [815-20-25-79]

An entity assesses hedge effectiveness:

- at inception of the hedging relationship, like IFRS Accounting Standards;
- whenever financial statements are reported, like IFRS Accounting Standards; and
- at least every three months, regardless of whether the entity is subject to interim reporting, unlike IFRS Accounting Standards. [815-20-25-79]

Like IFRS Accounting Standards, no particular method to be used in assessing effectiveness is prescribed (i.e. qualitative or quantitative methods). Like IFRS Accounting Standards, the method that will be used in assessing hedge effectiveness is specified in the hedge documentation at the inception of the hedging relationship. If qualitative assessment is elected, then how the entity intends to carry out that qualitative assessment also needs to be documented at hedge inception, like IFRS Accounting Standards. [815-20-25-3(b)(2)(iv)]

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The approach that will be used to assess effectiveness is determined on a hedge-by-hedge basis. There is no requirement to adopt a consistent method for all hedging relationships. However, in our view an entity should adopt a method for assessing hedge effectiveness that is applied consistently for similar types of hedges unless different methods are explicitly justified. [IFRS 9.6.4.1(b)]

An entity needs to use a method that captures the relevant characteristics of the hedging relationship, including the sources of hedge ineffectiveness. Depending on those factors, the method can be a qualitative or a quantitative assessment. [IFRS 9.B6.4.13]

Regression analysis is an example of a quantitative method that can be used to analyse the possible behaviour of the hedging relationship during its term to ascertain whether it can be expected to meet the risk management objective. However, the mere existence of a statistical correlation between two variables does not, by itself, support a valid conclusion that an economic relationship exists between the hedged item and the hedging instrument. [IFRS 9.6.4.1(b), B6.4.6]

If the critical terms of the hedging instrument and the hedged item – e.g. the nominal amount, maturity and underlying – match or are closely aligned, then it may be possible to use a qualitative methodology to determine whether an economic relationship exists between the hedged item and the hedging instrument. However, 'comparing all critical terms' does not mean applying the 'shortcut method' that is permitted under US GAAP. [IFRS 9.B6.4.14, BC6.289–BC6.290]

Hedge ineffectiveness

Hedge ineffectiveness is measured based on the actual performance of the hedging instrument and the hedged item, by comparing the changes in their values. The gain or loss on the hedged item is measured independently from that on the hedging instrument – i.e. it cannot be assumed that the change in fair value or cash flows of the hedged item in respect of the hedged risk equals the fair value change of the hedging instrument. This is because any ineffectiveness of the hedging instrument needs to be recognised in profit or loss. [IFRS 9.6.5.8, 6.5.11, BC6.278–BC6.279]

In a fair value hedge, ineffectiveness is recognised automatically in profit or loss as a result of separately remeasuring the hedging instrument and the hedged item. No separate calculation is required of the amount of ineffectiveness to be recognised in profit or loss. [IFRS 9.6.5.8]

Like IFRS Accounting Standards, the approach that will be used to assess effectiveness is determined on a hedge-by-hedge basis, although an entity needs to justify using different methods for similar hedges. [815-20-25-81]

Unlike IFRS Accounting Standards, which have only prospective effectiveness requirements, different methods may be used to assess prospective effectiveness and retrospective effectiveness for a single hedging relationship. [815-20-25-3]

Unlike IFRS Accounting Standards, prospective effectiveness may be demonstrated using statistical or offset methods or by applying a method that allows an entity to assume that the hedging relationship is perfectly effective by comparing the critical terms (i.e. shortcut method, critical terms match method or terminal value approach). [815-20-25-3, 25-84, 25-102, 25-126 – 25-129, 25-133 – 25-137]

Unlike IFRS Accounting Standards, retrospective effectiveness may be demonstrated using statistical or offset methods and it may be assessed on a cumulative or period-by-period basis. Also unlike IFRS Accounting Standards, subsequent prospective and retrospective effectiveness may be assessed qualitatively if certain criteria are met. [815-20-35-2A]

Hedge ineffectiveness

Unlike IFRS Accounting Standards, if a hedging relationship is determined to be highly effective (effective as an economic hedge for net investment hedges) but not perfectly aligned, then the resulting 'ineffectiveness' is not separately measured or reported. [815-20-35-1]

Like IFRS Accounting Standards, in a fair value hedge the mismatch between the gains and losses on the hedging instrument and the hedged item is recognised automatically in profit or loss as a result of separately remeasuring the hedging instrument and the hedged item. [815-20-35-1(b)]

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In a cash flow hedge or a net investment hedge, the hedge ineffectiveness recognised in profit or loss is calculated under the offset method on a cumulative basis to ensure that all ineffectiveness is recognised in profit or loss immediately. In a cash flow hedge, if the cumulative gain or loss on the hedging instrument is more than the cumulative change in the fair/present value of the expected future cash flows on the hedged item attributable to the hedged risk, then the difference is recognised in profit or loss as ineffectiveness. However, if the reverse is true, then the full cumulative gain or loss on the hedging instrument is recognised in OCI. Consequently, the ineffectiveness is recognised in profit or loss only when the cumulative change in fair value of the hedging instrument is greater than the cumulative change in the fair/present value of the expected future cash flows on the hedged item attributable to the hedged risk. A similar 'lower of' test is also used for net investment hedges. [IFRS 9.6.5.11, 6.5.13, IU 03-16]

When measuring hedge ineffectiveness, an entity is required to consider the time value of money and so it determines the value of the hedged item on a present value basis. [IFRS 9.B6.5.4]

Excluded components

An entity may exclude the time value of a purchased option, forward element of a forward contract and foreign currency basis spread from the designation of a hedging instrument. If the time value of a purchased option is separated, then the excluded portion is separately accounted for as a cost of hedging. If the forward element of a forward contract or foreign currency basis spread is separated and excluded from the designated hedging instrument, then the change in fair value of the excluded portion may be accounted for as a cost of hedging. [IFRS 9.6.2.4, 6.5.15–6.5.16]

Unlike IFRS Accounting Standards, if a cash flow or net investment hedging relationship is determined to be highly effective (effective as an economic hedge for net investment hedges) but not perfectly aligned, then the resulting mismatch between the gains and losses on the hedging instrument and the hedged item is not separately measured and recorded in profit or loss, or disclosed; instead, the entire change in fair value of the hedging instrument is recognised in OCI (or the cumulative translation adjustment within OCI for net investment hedges). [815-20-35-1, 25-77]

Unlike IFRS Accounting Standards, an entity is not required to separately measure hedge ineffectiveness. [815-20-35-1, 25-77]

Excluded components

Certain components of a hedging instrument's fair value or cash flows may be excluded from the assessment of hedge effectiveness, which differs from IFRS Accounting Standards. For cash flow, fair value and net investment hedges, the following components may be excluded from the assessment of hedge effectiveness.

- *Options:* If effectiveness is assessed using the changes in intrinsic value, then all changes in time value or changes in time value attributable to either passage of time, volatility or interest rates may be excluded. If effectiveness is assessed using changes in minimum value (i.e. intrinsic value after the effect of discounting), then volatility may be excluded.
- *Forward or futures contracts:* The difference between the spot price and the forward or futures price (i.e. forward points) may be excluded (the 'spot method').
- *For currency swaps designated as hedging instruments in cash flow and fair value hedges*, the cross-currency basis spread may be excluded.
- *For currency swaps designated as hedging instruments in net investment hedges*, the change in fair value of the derivative attributable to changes in the difference between the forward rate and the spot rate (spot-forward difference) may be excluded. [815-20-25-82]

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If the time value of an option, the forward element of a forward contract or the foreign currency basis spread of a financial instrument are excluded from the designation of a hedging instrument, then the excluded portion is not considered for measuring hedge ineffectiveness. However, an entity is not permitted to exclude the credit risk (or any other risk) associated with a derivative from the measurement of hedge ineffectiveness. [IFRS 9.6.2.4]

The accounting for the excluded portion of a designated hedging instrument as a cost of hedging depends on whether the hedged item is a transaction-related or a time period-related hedged item. An entity assesses the type of hedged item based on the nature of the hedged item, including how and when it affects profit or loss. This is required regardless of whether the hedging relationship is a cash flow hedge or a fair value hedge.

- *Transaction-related:* The hedged item may subsequently result in the recognition of a non-financial asset or non-financial liability, or a firm commitment for which fair value hedge accounting is applied. In these cases, the entity removes the amount from the separate component of equity and includes it directly in the initial cost or other carrying amount of the item. This is not a reclassification adjustment and therefore does not affect OCI. In other cases, the entity reclassifies the amount from the separate component of equity to profit or loss as a reclassification adjustment in the period or periods during which the hedged expected future cash flows affect profit or loss. If all or part of the excluded portion of a designated hedging instrument recognised in OCI is not expected to be recovered in future periods, then the amount not expected to be recovered is immediately reclassified into profit or loss as a reclassification adjustment.
- *Time period-related:* The excluded portion of the designated hedging instrument at the date of designation, to the extent that it relates to the hedged item, is amortised on a systematic and rational basis over the period during which the hedge adjustment for the designated hedging instrument could affect profit or loss or, only if the hedged item is an equity instrument for which the entity has elected to present changes in fair value in OCI, OCI. This period is also likely to be the hedged period. In each reporting period, the amortisation amount is reclassified from the separate component of equity to profit or loss as a reclassification adjustment. [IFRS 9.6.5.15–6.5.16, B6.5.29–B6.5.30, B6.5.34, B6.5.39]

Unlike IFRS Accounting Standards, an entity is not required to separately measure hedge ineffectiveness. [815-20-35-1, 25-77]

Unlike IFRS Accounting Standards, if an entity has excluded components from its assessment of hedge effectiveness, then it can elect to recognise the initial value of the excluded components in earnings using either of the following approaches.

- *Amortisation approach:* a systematic and rational method over the life of the hedging instrument. Any difference between the change in fair value of the excluded component and the amounts recognised in earnings is included in accumulated OCI (or the cumulative translation adjustment in accumulated OCI for a net investment hedge).
- *Mark-to-market approach:* a method that recognises all fair value changes of the excluded components currently in earnings. [815-20-25-83A – 25-83B, 35-1, 35-5A – 35-5B, 815-30-35-3]

Unlike IFRS Accounting Standards, there is no concept of a transaction-related or a time period-related hedged item.

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Effect of credit risk

Entities consider the effect of both changes in counterparty credit risk and own credit risk on the assessment of hedge effectiveness and the measurement of hedge ineffectiveness. Even if there is an economic relationship between the hedging instrument and the hedged item, the level of offset might be erratic because of the effect of credit risk. This can result when the credit risk dominates the value changes that result from the economic relationship. Credit risk dominating the economic relationship would cause the hedge to be discontinued. In a cash flow hedge, the credit risk on the hedged item may also affect the assessment of whether the forecast transaction is highly probable. [IFRS 9.B6.4.7]

Rebalancing

A hedging relationship may subsequently fail to meet the hedge effectiveness requirement regarding the hedge ratio but the entity's risk management objective for that designated hedging relationship may remain the same. In this case, the entity adjusts the hedge ratio so that it meets the qualifying criteria again (this is referred as 'rebalancing'). If the risk management objective for the designated hedging relationship has changed, then rebalancing does not apply. Instead, hedge accounting is discontinued. [IFRS 9.6.5.5, B6.5.15]

Not every change in the extent of offset constitutes a change in the relationship between the hedging instrument and hedged item. An entity determines whether the changes in offset are:

- fluctuations around a hedge ratio that remains valid; or
- an indication that the hedge ratio no longer appropriately reflects the relationship between the hedging instrument and the hedged item. [IFRS 9.B6.5.11]

Effect of credit risk

Like IFRS Accounting Standards, entities consider the effects of both counterparty credit risk and own non-performance risk when assessing the effectiveness of hedging relationships. For fair value hedges, excluding those applying the shortcut method, these changes would generally have no offsetting effect on the measurement of the changes in the value of the hedged item attributable to the hedged risk and may lead to a conclusion that the hedging relationship has not been and/or is not expected to be highly effective, like IFRS Accounting Standards. However, the specific hedge effectiveness requirements differ from IFRS Accounting Standards (see 'Effectiveness assessment' above). Also, unlike IFRS Accounting Standards, for cash flow hedges, hedges of net investment in foreign operations and fair value hedges applying the shortcut method, the effectiveness assessment ignores the potential effect of these changes unless it is no longer probable that the counterparty or the entity itself will not default. If it is no longer probable, then the entity will generally be unable to conclude that the hedging relationship is expected to be highly effective (effective as an economic hedge for net investment hedges) and will be required to discontinue the hedging relationship. [815-20-25-77, 25-102 – 25-106, 25-122, 35-14 – 35-16, 35-18]

Rebalancing

Unlike IFRS Accounting Standards, there is no concept of mandatory 'rebalancing' if a hedging relationship subsequently fails to meet the hedge effectiveness requirements for hedge accounting. In general, if an entity modifies the critical terms of a hedging relationship as documented at inception, then the entity needs to dedesignate the original hedging relationship and may designate a new hedging relationship that incorporates the revised terms. In certain circumstances, an entity may partially dedesignate a hedging relationship if it:

- concurrently modifies the original hedge documentation;
- demonstrates that the original hedging relationship was retrospectively highly effective;
- demonstrates that the modified hedging relationship is expected to be prospectively highly effective; and
- maintains the same hedge ratio that was included in the original hedging relationship. [815-20-55-56, 55-95]

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If an entity rebalances a hedging relationship, then it updates its hedge documentation. This includes analysing the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its remaining term. [IFRS 9.B6.5.21]

Discontinuing hedge accounting

A hedging relationship is discontinued in its entirety when as a whole it ceases to meet the qualifying criteria after considering any rebalancing of the hedging relationship (if applicable). Voluntary discontinuation when the qualifying criteria are met is prohibited. The following are examples of when discontinuation is required:

- the hedging instrument expires or is sold, terminated or exercised;
- there is no longer an economic relationship between the hedged item and hedging instrument; and
- the effect of credit risk starts dominating the value changes that result from the economic relationship. [IFRS 9.6.5.6, B6.5.26]

The hedging instrument is subsequently accounted for according to the normal requirements of IFRS Accounting Standards. The hedged item is also subsequently accounted for according to the normal requirements of IFRS Accounting Standards, except as noted below.

If an entity discontinues hedge accounting for a fair value hedge, then it ceases adjusting the carrying amount of the hedged item for the change in fair value arising from the hedged risk from the date of discontinuation. If the hedged item is a financial instrument (or a component thereof) measured at amortised cost, then any hedging adjustment is amortised to profit or loss. Amortisation may begin as soon as an adjustment exists, and begins no later than when the hedged item ceases to be adjusted for hedging gains and losses. Amortisation is based on a recalculated effective interest rate at the date on which amortisation begins. If the hedged item is a financial asset, other than an equity investment that is measured at FVOCI, then the amount amortised is the cumulative gain or loss previously recognised in profit or loss. [IFRS 9.6.5.6, 6.5.10]

Discontinuing hedge accounting

Like IFRS Accounting Standards, a hedging relationship is required to be discontinued in its entirety when, as a whole, any eligibility criteria cease to be met. However, unlike IFRS Accounting Standards, there is no concept of mandatory 'rebalancing' as mentioned above. The following are examples of when discontinuation is required:

- the hedged transaction is no longer probable;
- the hedging instrument expires or is sold, terminated or exercised;
- the hedged item is sold, settled or otherwise disposed of;
- the hedge is no longer highly effective; or
- the entity revokes the designation (dedesignates). [815-25-40-1 – 40-6, 815-30-40-1 – 40-7]

Unlike IFRS Accounting Standards, voluntary discontinuation when the qualifying criteria are met is permitted.

The hedging instrument is subsequently accounted for according to the normal requirements of US GAAP, which may differ from the requirements of IFRS Accounting Standards. Like IFRS Accounting Standards, the hedged item is also subsequently accounted for according to the normal requirements of US GAAP except as noted below.

Like IFRS Accounting Standards, if an entity discontinues hedge accounting for a fair value hedge, then it ceases adjusting the hedged item for the change in fair value arising from the hedged risk from the date of discontinuation. Like IFRS Accounting Standards, any basis adjustment made previously to the hedged financial instrument for which the effective interest method is used is treated like a premium or a discount and is amortised to profit or loss under the effective interest method from the date on which the amortisation begins. Like IFRS Accounting Standards, an entity can make an accounting policy choice, to be applied consistently, to begin amortisation as soon as an adjustment exists – i.e. while the hedging relationship still exists – and cannot begin later than the date when the hedged item ceases to be adjusted for changes in its fair value attributable to the hedged risk. [815-25-35-9 – 35-9A, 40-7]

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The treatment of the cumulative gain or loss previously recognised in the cash flow hedge reserve in respect of a terminated cash flow hedge depends on whether the hedged transaction is still expected to occur.

- If the hedged future cash flows are *still expected to occur*, then that amount remains in the cash flow hedge reserve until the future cash flows occur. However, if the amount is a loss and the entity expects that all or a portion of that loss will not be recovered in one or more future periods, then it immediately reclassifies the amount that is not expected to be recovered to profit or loss as a reclassification adjustment.
- If the hedged future cash flows are *no longer expected to occur*, then that amount is immediately reclassified from the cash flow hedge reserve to profit or loss as a reclassification adjustment. [IFRS 9.6.5.12]

If an entity discontinues hedge accounting for a net investment hedge, then any cumulative gain or loss on the hedging instrument relating to the effective portion of the hedge that has been accumulated in the foreign currency translation reserve remains there and is reclassified from equity to profit or loss as a reclassification adjustment on the disposal (or partial disposal) of the foreign operation. [IFRS 9.6.5.14]

The subsequent accounting for any excluded portion of the hedging instrument that was accounted for as a cost of hedging is immediately reclassified into profit or loss as a reclassification adjustment if the hedged item is a time period-related item (for the transaction-related item, see 'Excluded components' above). [IFRS 9.6.5.15–6.5.16]

Clearing derivatives with central counterparties

IFRS Accounting Standards provide relief from discontinuing hedge accounting if a novation that was not contemplated in the original hedge documentation meets the following criteria:

- as a consequence of laws or regulations or the introduction of laws and regulations, a clearing counterparty becomes a new counterparty to each of the original parties; and
- any changes to a derivative's terms are limited to those necessary to replace the counterparty – e.g. changes to collateral terms. [IFRS 9.6.5.6]

The treatment of the cumulative gain or loss previously recognised in OCI in respect of a discontinued cash flow hedge depends on whether the hedged transaction is probable of not occurring by the end of the originally forecast time period or within two months thereafter. There is a potential difference between 'expected to occur' for IFRS Accounting Standards and 'probable of not occurring by the end of the originally forecast time period or within two months thereafter' for US GAAP, which may give rise to differences in practice.

- If it is probable that the forecast transaction will not occur by the end of the originally specified time period or within a two-month period thereafter, then the amounts in accumulated OCI are reclassified to profit or loss. However, like IFRS Accounting Standards, if the amount is a loss and the entity expects that all or a portion of that loss will not be recovered in one or more future periods, then it immediately reclassifies the amount that is not expected to be recovered to profit or loss.
- If it is not probable that the forecast transaction will fail to occur in this period, then the amount deferred in accumulated OCI remains there until the forecast transaction impacts profit or loss. [815-30-35-38 – 35-41, 40-4]

Like IFRS Accounting Standards, if an entity discontinues hedge accounting for a net investment hedge, then the cumulative amount recognised in the cumulative translation adjustment within accumulated OCI remains in accumulated OCI until the investment is fully or partially disposed of. [830-40]

If the hedged item is not derecognised, then any amounts in accumulated OCI associated with a previously excluded component of the hedging instrument remains in accumulated OCI, unlike IFRS Accounting Standards. When the hedged item is derecognised, any amount remaining in accumulated OCI associated with the previously excluded component of the hedging instrument is recorded in earnings. [815-25-40-7]

Clearing derivatives with central counterparties

For the purpose of applying hedge accounting, a change in the counterparty to a derivative instrument (e.g. a novation) that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument, provided that all other hedge accounting criteria continue to be met. [815-25-40-1A, 815-30-40-1A, 815-20-55-56A]

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Changes to the contractual terms of the clearing arrangements used for the execution of derivative contracts may impact the hedging relationship if an affected derivative is designated as a hedging instrument. This may be the case if the legal characterisation of variation margin payments is changed from collateral to partial settlement – i.e. change from collateralised-to-market to settled-to-market – without any other changes to the contractual terms. In our view, such a change on its own would not represent a termination of the derivative contract or a change in its critical terms and would not require clearing members or end users to discontinue the existing hedge accounting relationship for those reasons.

Hedging on a group basis

Internal derivatives

An entity may use internal derivatives to transfer risk from individual operations within the group to a centralised treasury. Derivatives between entities within the same reporting group can also be used to control and monitor risks through the central treasury function to benefit from pricing advantages and to offset equal and opposite exposures arising from different parts of the group. However, all such internal derivatives eliminate on consolidation and therefore are not eligible for hedge accounting in the consolidated financial statements, even if at a group level the overall net position is hedged externally. Therefore, only derivatives involving external third parties can be designated as hedging instruments in consolidated financial statements. However, it is possible for the centralised treasury to enter into one or more derivatives with external counterparties to offset the internal derivatives. Such external derivatives may qualify as hedging instruments in the consolidated financial statements provided that they are legally separate contracts and serve a valid business purpose – e.g. laying off risk exposures on a gross basis. In our view, a relationship should exist between the internal transactions and one or multiple related external transactions, and this relationship should be documented at inception of the hedging relationship. [IFRS 9.6.2.3]

Unlike IFRS Accounting Standards, the reason for a change in counterparty is not limited to the requirements of laws and regulations, but may also include other circumstances – e.g. financial institution mergers, inter-company transactions, an entity exiting a particular derivatives business or relationship, or an entity managing against internal credit limits. [ASU 2016-05.BC2]

There may be cases in which the legal characterisation of variation margin is changed from collateralised-to-market to settled-to-market without any other changes to the contractual terms. Like IFRS Accounting Standards, such a change on its own would not require clearing members or end users to discontinue the existing hedging relationship.

Hedging on a group basis

Internal derivatives

Unlike IFRS Accounting Standards, a foreign currency derivative instrument that has been entered into with another member of a consolidated group can be a hedging instrument in the consolidated financial statements if that other member has entered into an offsetting contract with an unrelated third party and certain other criteria are met. [815-20-25-52 – 25-56]

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Intra-group balances or transactions as the hedged item

The foreign currency risk on recognised intra-group monetary items qualifies for hedge accounting in the consolidated financial statements if it results in an exposure that is not fully eliminated on consolidation. [IFRS 9.6.3.6]

The foreign currency risk of a highly probable forecast intra-group transaction may qualify as the hedged item in the consolidated financial statements provided that the transaction is denominated in a currency other than the currency of the entity entering into the transaction and the foreign currency risk will affect consolidated profit or loss. [IFRS 9.B6.3.5]

Interest rate benchmark reform

The accounting implications of interest rate benchmark reform comprise two phases.

- The Phase 1 amendments are effective for annual periods beginning on or after 1 January 2020. Application of the Phase 1 amendments is mandatory (see 'Phase 1 amendments' below).
- The Phase 2 amendments are effective for annual periods beginning on or after 1 January 2021. Application of the Phase 2 amendments is also mandatory (see 'Phase 2 amendments' below). [IFRS 9.7.1.8, 7.1.10]

Phase 1 amendments

A hedging relationship is directly affected by interest rate benchmark reform (IBOR reform) if it is subject to the following uncertainty arising from the reform:

- an interest rate benchmark subject to the reform is designated as the hedged risk, regardless of whether the rate is contractually specified; and/or
- the timing or amounts of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument are uncertain. [IFRS 9.6.8.1]

If a hedging relationship is directly affected by IBOR reform, then specific exceptions apply to the following hedge requirements:

- highly probable requirement for cash flow hedges;
- reclassifying any amount accumulated in the cash flow hedge reserve;
- assessing the economic relationship between the hedged item and the hedging instrument; and
- designating a non-contractually specified benchmark component of an item as a hedged item. [IFRS 9.6.8.4–6.8.8]

Intra-group balances or transactions as the hedged item

Unlike IFRS Accounting Standards, a hedge of the currency risk on a forecast intra-group transaction qualifies for hedge accounting provided that:

- either (1) the operating unit that has the foreign currency exposure is a party to the hedging instrument or (2) another member of the consolidated group that has the same functional currency as that operating unit is a party to the hedging instrument and there is no intervening subsidiary with a different functional currency;
- the hedge transaction is denominated in a currency other than the hedging unit's functional currency; and
- the other cash flow hedge criteria are met, including that the transaction will affect consolidated profit or loss. [815-20-25-30]

Interest rate benchmark reform

Unlike IFRS Accounting Standards, the optional expedients in the reference rate reform guidance do not have a 'phased' approach and the related amendments are currently effective for all entities. Unlike IFRS Accounting Standards, the amendments are optional.

A number of expedients allow hedging relationships to continue, without dedesignation, when one or more critical terms of a hedging instrument, hedged item or hedged forecast transaction designated in a fair value, cash flow or net investment hedge relate to the replacement of the reference rate; these expedients differ from IFRS Accounting Standards in a number of ways. The expedients that an entity may elect without dedesignating the hedging relationship when certain conditions are met include the following.

- Update its formal documentation.
- Change the contractual terms of a hedging instrument, hedged item or forecast transaction.
- Change the method used to assess effectiveness, including using methods that disregard certain mismatches between the hedging instrument and hedged item or forecast transaction.
- Rebalance fair value and cash flow hedging relationships in certain ways.
- Change the systematic and rational method used to recognise in earnings the components excluded from the assessment of effectiveness.
- Change the designated benchmark interest rate in a fair value hedging relationship or hedged risk in a cash flow hedging relationship.

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The exceptions provided by the Phase 1 amendments generally cease to apply at the earlier of:

- when the uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows is no longer present; or
- when the hedging relationship is discontinued. [IFRS 9.6.8.9–6.8.12]

The 'uncertainty' applies to the hedged item and/or the hedging instrument individually as opposed to the hedging relationship in its entirety. [IFRS 9.6.8.9–6.8.12]

An entity discloses the uncertainty arising from IBOR reform when it applies the exceptions to a hedging relationship that is directly affected by IBOR reform (see chapter 7.10). [IFRS 7.24H]

The Phase 1 amendments do not affect other guidance related to financial instruments.

- Disregard potential discontinuation of a referenced interest rate when assessing probability of forecast interest payments in a cash flow hedging relationship.
- Disregard the requirement that individual hedged transactions in a group of forecast transactions share the same risk exposure for a cash flow hedging relationship. [848-30, 848-40, 848-50]

Unlike IFRS Accounting Standards, these expedients are optional. Also unlike IFRS Accounting Standards, an entity may elect the expedients on an individual hedging relationship basis (i.e. a hedge-by-hedge basis), and may generally elect the expedients independently of one another. [848-30-25-2, 848-40-25-1, 848-50-25-1]

Unlike IFRS Accounting Standards, an entity can also apply certain optional expedients to derivative contracts impacted by 'discounting transition', including derivatives that do not reference LIBOR or other reference rates expected to be discontinued. 'Discounting transition' refers to changing the interest rates used for margining, discounting or contract price alignment of certain derivative instruments to transition to alternative rates. [848-20-15-2 – 15-2A]

Unlike IFRS Accounting Standards, the relief provided by the amendments is generally not available after 31 December 2024.

Unlike IFRS Accounting Standards, other than disclosing the nature of and the reason for electing the optional expedients, specific additional disclosures are not required when an entity applies the optional expedients related to hedging relationships. [848-30-25-2]

Unlike IFRS Accounting Standards, the amendments affect the guidance on modifications of financial instruments (see chapters 7.6 and 7.7), disclosure (see chapter 7.10) and leases (see chapter 5.1).

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Phase 2 amendments

Under the amendments, when an entity ceases to apply the IBOR Phase 1 amendments to the hedged item or hedging instrument, it applies the following exceptions from applying the general hedge accounting requirements to the hedging relationship:

- the entity amends the formal designation of the hedging relationship to reflect the changes that are required by IBOR reform by the end of the reporting period during which the changes are made;
- when a hedged item in a cash flow hedge is amended to reflect the changes that are required by the reform, the amount accumulated in the cash flow hedge reserve is deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined. A similar exception is provided for a discontinued cash flow hedging relationship;
- when a group of items is designated as a hedged item and an item in the group is amended to reflect the changes that are required by IBOR reform, an entity allocates the hedged items to subgroups based on the benchmark rate being hedged, and designates the benchmark rate for each subgroup as the hedged risk; and
- if an entity reasonably expects that an alternative benchmark rate will be a separately identifiable risk component within 24 months, then it can designate the rate as a non-contractually specified risk component even if it is not separately identifiable at the designation date. This is applied on a rate-by-rate basis and also applies to a new hedging relationship. [IFRS 9.6.9.1–6.9.13]

An entity discloses the progress of transition to alternative benchmark rates at the reporting date and quantitative information on financial instruments that have yet to transition to an alternative benchmark rate at the reporting date (see chapter 7.10). [IFRS 7.24I–J]

The Phase 2 amendments affect the guidance on modifications of financial instruments (see chapters 7.6 and 7.7), disclosure (see chapter 7.10) and leases, and the guidance for insurers that are not applying the new financial instruments standard under the temporary exemption.

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Forthcoming requirements

Contracts referencing nature-dependent electricity (NDE)

Amendments to the financial instruments standard are effective for annual periods beginning on or after 1 January 2026; early adoption is permitted. [IFRS 9.7.1.15, IFRS 7.44OO]

For hedging relationships in which NDE contracts are designated in hedges of forecast electricity transactions, the amendments permit an entity to:

- designate as the hedged item a variable nominal amount of forecast electricity transactions that is aligned with the variable amount of NDE expected to be delivered by a specified generation facility; and
- presume the forecast transaction to be highly probable if the cash flows of the NDE contracts designated as hedging instruments are conditional on the occurrence of the hedged forecast transaction. [IFRS 9.6.10.1–6.10.2, IFRS 7.30B]

Forthcoming requirements

Contracts referencing nature-dependent electricity (NDE)

There are no forthcoming requirements under US GAAP.

Unlike IFRS Accounting Standards, there are no specific requirements under US GAAP for hedging relationships designated using NDE contracts and the general hedge accounting requirements described above apply.

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7.9B Hedge accounting: IAS 39

(IAS 39, IFRIC 16)

Overview

- Hedge accounting is voluntary and, if it is elected, allows an entity to measure assets, liabilities and firm commitments selectively on a basis different from that otherwise stipulated in IFRS Accounting Standards, or to defer the recognition in profit or loss of gains or losses on derivatives.
- There are three hedge accounting models: fair value hedges of fair value exposures; cash flow hedges of cash flow exposures; and net investment hedges of foreign currency exposures on net investments in foreign operations.
- Hedge accounting is permitted only when strict requirements related to documentation and effectiveness are met.
- Qualifying hedged items can be recognised assets or liabilities, unrecognised firm commitments, highly probable forecast transactions or net investments in foreign operations.
- In general, only derivative instruments entered into with an external party qualify as hedging instruments. However, for hedges of foreign exchange risk only, non-derivative financial instruments may qualify as hedging instruments.
- The hedged risk should be one that could affect profit or loss.

7.9B Hedge accounting: IAS 39

(Topic 815, Topic 848)

Overview

- Like IFRS Accounting Standards, hedge accounting is voluntary and, if it is elected, allows an entity to measure assets, liabilities and firm commitments selectively on a basis different from that otherwise stipulated, or to defer the recognition in profit or loss of gains or losses on derivatives.
- Like IFRS Accounting Standards, there are three hedge accounting models: fair value hedges of fair value exposures; cash flow hedges of cash flow exposures; and net investment hedges of foreign currency exposures on net investments in foreign operations. However, the requirements differ from IFRS Accounting Standards in certain respects.
- Like IFRS Accounting Standards, hedge accounting is permitted only when strict requirements related to documentation and effectiveness are met.
- Like IFRS Accounting Standards, qualifying hedged items can be recognised assets or liabilities, unrecognised firm commitments, probable forecast transactions or net investments in foreign operations.
- Like IFRS Accounting Standards, in general only derivative instruments qualify as hedging instruments. Non-derivative financial instruments may qualify as hedging instruments only for hedges of foreign exchange risk exposure in (1) hedges of a net investment in a foreign operation, or (2) hedges of unrecognised firm commitments, unlike IFRS Accounting Standards.
- Like IFRS Accounting Standards, the hedged risk should be one that could affect profit or loss.

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Overview (continued)

- **Effectiveness testing is conducted on both a prospective and a retrospective basis. A hedge is 'highly effective' if changes in the fair value or cash flows of the hedged item attributable to the hedged risk are offset by changes in the fair value or cash flows of the hedging instrument within a range of 80–125 percent.**

- **For a cash flow hedge and a net investment hedge, the ineffective portion of the gain or loss on the hedging instrument is recognised in profit or loss, even if the hedge has been highly effective.**

- **Hedge accounting is discontinued prospectively if: the hedged transaction is no longer highly probable; the hedging instrument expires or is sold, terminated or exercised; the hedged item is sold, settled or otherwise disposed of; the hedge is no longer highly effective; or the entity revokes the designation.**

Overview (continued)

- **Although the requirements differ, there are certain hedge effectiveness requirements that need to be met for a hedging relationship to be eligible for hedge accounting like IFRS Accounting Standards, including that a hedge needs to be 'highly effective' (effective as an economic hedge for net investment hedges). Like IFRS Accounting Standards, effectiveness testing is conducted on both a prospective and a retrospective basis. Unlike IFRS Accounting Standards, the 80–125 percent range to be 'highly effective' is not specified. However, this range is very commonly used in practice and the SEC Staff has indicated that this is an acceptable range. Unlike IFRS Accounting Standards, in limited cases, hedging instruments meeting very restrictive criteria are accounted for as if they are perfectly effective without quantitatively testing effectiveness.**

- **Unlike IFRS Accounting Standards, when a cash flow hedging relationship is deemed highly effective the entire change in the fair value of the designated hedging instrument that is included in the assessment of hedge effectiveness is recognised in OCI and becomes a component of accumulated OCI. For a net investment hedge, the entire gain or loss on the hedging instrument that is included in the assessment of hedge effectiveness is recognised in OCI as an offset to the foreign currency translation of that foreign operation.**

- **Like IFRS Accounting Standards, hedge accounting is discontinued prospectively if: the hedged transaction is no longer probable; the hedging instrument expires or is sold, terminated or exercised; the hedged item is sold, settled or otherwise disposed of; the hedge is no longer highly effective (effective as an economic hedge for net investment hedges); or the entity revokes the designation. However, the requirements differ in certain respects from IFRS Accounting Standards.**

Hedge accounting models

There are three hedge accounting models, and the type of model applied depends on whether the hedged exposure is a fair value exposure, a cash flow exposure or a foreign currency exposure on a net investment in a foreign operation. [IAS 39.86]

Hedge accounting models

Like IFRS Accounting Standards, there are three hedge accounting models, and the type of hedge accounting model applied depends on whether the hedged exposure is a fair value exposure, a cash flow exposure or a foreign currency exposure on a net investment in a foreign operation. However, the requirements differ in certain respects from IFRS Accounting Standards. [815-20-05-1 – 05-2]

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Fair value hedges

A 'fair value hedge' is a hedge of changes in the fair value of a recognised asset or liability, an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. [IAS 39.86(a)]

A hedge of the foreign currency risk of a firm commitment may be accounted for as either a fair value hedge or a cash flow hedge. [IAS 39.87]

If the hedging instrument is a derivative, then it is measured at fair value with changes in fair value recognised in profit or loss. The hedged item is remeasured to fair value in respect of the hedged risk, even if it is normally measured at amortised cost. Any resulting fair value adjustment to the hedged item related to the hedged risk is recognised in profit or loss, even if such a change would normally be recognised in OCI. [IAS 39.89]

For a hedge of a firm commitment, fair value hedge accounting results in the change in fair value of the firm commitment attributable to the hedged risk during the period of the hedging relationship being recognised as an asset or a liability in the statement of financial position. When the hedged transaction is recognised, the amount previously recognised in the statement of financial position adjusts the initial measurement of the underlying transaction (basis adjustment). [IAS 39.93–94]

Cash flow hedges

A 'cash flow hedge' is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecast transaction that could affect profit or loss. [IAS 39.86(b)]

If the hedging instrument is a derivative, then it is measured at fair value with the effective portion of changes in its fair value recognised in OCI and presented as a separate component of equity. Ineffectiveness due to the derivative's cumulative change in fair value being greater than the cumulative change in the hedged item's value is recognised immediately in profit or loss. [IAS 39.95–96]

Fair value hedges

Like IFRS Accounting Standards, a 'fair value hedge' is a hedge of changes in the fair value of a recognised asset or liability, an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. [815-20-20, 25-43(b)(1)]

Like IFRS Accounting Standards, a hedge of the foreign currency risk of a firm commitment may be accounted for as either a fair value hedge or a cash flow hedge. However, the definition of a firm commitment differs from IFRS Accounting Standards in certain respects. [815-20-25-12(f)(3), 25-15(i)(1)]

Like IFRS Accounting Standards, the derivative hedging instrument is measured at fair value with changes in fair value recognised in profit or loss. Like IFRS Accounting Standards, the hedged item is measured to fair value in respect of the hedged risk, even if it is normally measured at amortised cost. Like IFRS Accounting Standards, any resulting adjustment to the amortised cost of the hedged item related to the hedged risk is recognised in profit or loss, even if such a change would normally be recognised in OCI (e.g. available-for-sale debt securities). [815-20-25-83A, 35-1(b)]

Like IFRS Accounting Standards, for a hedge of a firm commitment, fair value hedge accounting results in the change in fair value of the firm commitment attributable to the hedged risk during the period of the hedging relationship being recognised as an asset or a liability in the statement of financial position. Like IFRS Accounting Standards, when the hedged transaction is recognised the amount previously recognised in the statement of financial position adjusts the initial measurement of the underlying transaction (basis adjustment). [815-25-35-1, 35-13]

Cash flow hedges

Like IFRS Accounting Standards, a 'cash flow hedge' is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability, or a probable forecast transaction that is attributable to a particular risk that could affect profit or loss. However, the details differ in certain respects from IFRS Accounting Standards. [815-20-20]

Like IFRS Accounting Standards, a derivative hedging instrument is measured at fair value. However, unlike IFRS Accounting Standards, when the cash flow hedging relationship is deemed highly effective the entire change in the fair value of the designated hedging instrument that is included in the assessment of hedge effectiveness is recognised in OCI and becomes a component of accumulated OCI. [815-20-35-1(c), 25-83A, 815-30-35-3]

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If the hedging instrument is a non-derivative financial asset or non-derivative financial liability, which is permitted only for hedges of foreign currency risk, then the effective portion of the foreign currency gains and losses on the hedging instrument is recognised in OCI. Ineffectiveness due to the hedging instrument's cumulative change in fair value being greater than the cumulative change in the hedged item's value is recognised immediately in profit or loss. [IAS 39.72, 95–96]

The change in the fair value of the hedging instrument that is recognised in OCI is accounted for as follows.

- If the future transaction results in the recognition of a non-financial asset or a non-financial liability, then an entity may either:
  - include the cumulative amount in equity in the initial carrying amount of that asset or liability (basis adjustment); or
  - retain the amount in equity and reclassify it to profit or loss in the period during which the related asset or liability affects profit or loss.
- The same choice applies to a forecast transaction of a non-financial asset or a non-financial liability that becomes a firm commitment for which fair value hedge accounting is subsequently applied. An entity chooses an accounting policy to be applied consistently to all cash flow hedges of transactions that lead to the recognition of non-financial assets or non-financial liabilities.
- If the future transaction results in the acquisition of a financial instrument, then the amount deferred in OCI remains there and is reclassified to profit or loss in the period(s) during which the financial instrument's hedged forecast cash flows affect profit or loss.
- If an entity expects that all or a portion of a loss recognised in OCI will not be recovered in one or more future periods, then it reclassifies from equity to profit or loss, as a reclassification adjustment, the amount that is not expected to be recovered. [IAS 39.97–100]

Net investment hedges

A 'net investment hedge' is a hedge of the foreign currency exposure arising from a net investment in a foreign operation when the net assets of that foreign operation are included in the financial statements of the reporting entity. [IAS 39.86(c)]

The hedged risk is the foreign currency exposure arising from a net investment in that foreign operation when the net assets of the foreign operation are included in the financial statements. The hedged risk cannot be designated as the fair value of the underlying shares, or the currency exposure on the fair value of the shares. [IAS 39.AG99]

Unlike IFRS Accounting Standards, a non-derivative financial asset or non-derivative financial liability cannot be designated as a hedging instrument in a cash flow hedge. [815-20-25-71]

Like IFRS Accounting Standards, the change in the fair value of the hedging instrument that is recognised in accumulated OCI is accounted for as follows.

- If the future transaction results in the recognition of a non-financial asset or a non-financial liability, then the entity leaves the amount in accumulated OCI and reclassifies it to profit or loss as the related asset or liability affects profit or loss. The same applies to a forecast transaction of a non-financial asset or a non-financial liability that becomes a firm commitment for which fair value hedge accounting is subsequently applied, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, a basis adjustment approach is not permitted.
- If the future transaction results in the acquisition of a financial instrument, then the amount deferred in accumulated OCI remains there and is reclassified to profit or loss in the period(s) during which the financial instrument affects profit or loss, like IFRS Accounting Standards.
- If an entity expects that all or a portion of a loss recognised in OCI will not be recovered in one or more future periods, then it reclassifies from OCI to profit or loss the amount that is not expected to be recovered, like IFRS Accounting Standards. [815-20-35-1(c), 815-30-35-3, 35-38 – 35-41]

Net investment hedges

Like IFRS Accounting Standards, a 'net investment hedge' is a hedge of the foreign currency exposure arising from a net investment in a foreign operation using a derivative, or a non-derivative monetary item, as the hedging instrument. However, the requirements differ in certain respects from IFRS Accounting Standards. [815-20-25-66 – 25-71]

Like IFRS Accounting Standards, the hedged risk is the foreign currency exposure on the designated carrying amount of the net assets of the foreign operation in the financial statements. Also like IFRS Accounting Standards, the hedged risk cannot be designated as the fair value of the underlying shares, or the currency exposure on the fair value of the shares. [815-20-25-23 – 25-33]

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The hedged item may be an amount of net assets that is equal to or less than the carrying amount of the net assets of the foreign operation. Consequently, the expected profits from the foreign operation cannot be designated as the hedged item unless an entity redesignates the hedged item. [IFRIC 16.2, 11]

A derivative, a non-derivative instrument or a combination of both may be used as the hedging instrument. The hedging instrument can be held by any entity or entities within the group. [IFRIC 16.14]

The effective portion of the gain or loss on the hedging instrument is recognised in OCI as an offset to the foreign currency translation reserve in respect of that foreign operation. Any ineffectiveness is recognised in profit or loss immediately. [IAS 39.102, IFRIC 16.3]

Hedge accounting criteria

The following conditions apply to all three types of hedges. Hedge accounting is permitted only if all of the following conditions are met.

- There is formal designation and written documentation at inception of the hedge that identifies:
  - the hedging instrument, the hedged item and the risk being hedged;
  - the risk management objective and strategy for undertaking the hedge; and
  - how effectiveness will be assessed, both prospectively and retrospectively.
- The hedge is expected to be highly effective in achieving fair value or cash flow offsets in accordance with the original documented risk management strategy.
- The effectiveness of the hedge can be measured reliably. This requires the fair value of the hedging instrument, and the fair value (or cash flows) of the hedged item with respect to the risk being hedged, to be reliably measurable.

Like IFRS Accounting Standards, the hedged item may be an amount of net assets that is equal to or less than the carrying amount of the net assets of the foreign operation at the beginning of any given period in respect of a foreign currency exposure. Also like IFRS Accounting Standards, the expected profits from the foreign operation cannot be designated as the hedged item. The net investment balance can change from period to period and there may be a need for an entity to monitor the hedging relationship on an ongoing basis and redesignate if necessary. [815-35-35-27, 55-1]

Like IFRS Accounting Standards, a derivative or a non-derivative instrument may be used as the hedging instrument. Unlike IFRS Accounting Standards, a combination of a derivative and non-derivative instrument cannot be used as the hedging instrument in one relationship. Also unlike IFRS Accounting Standards, the party to the derivative hedging instrument should be either the operating unit with the foreign currency exposure or another member of the consolidated group that has the same functional currency and for which there is no intervening subsidiary with a different functional currency. [815-20-25-30, 25-66]

Unlike IFRS Accounting Standards, if the hedging relationship is deemed effective as an economic hedge, then the entire gain or loss on the hedging instrument that is included in the assessment of hedge effectiveness is recognised in OCI as an offset to the foreign currency translation of that foreign operation. [815-20-35-1(d), 35-5A – 35-5B]

Hedge accounting criteria

The general conditions for hedge accounting for all three types of hedges are as follows.

- Like IFRS Accounting Standards, at inception of the hedge there is formal designation and written documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge, including identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk will be assessed (both prospectively and retrospectively). Unlike IFRS Accounting Standards, US GAAP extends the length of time for which a private company has to document its hedging relationship.

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- The hedge is assessed and determined to be highly effective on an ongoing basis throughout the hedging relationship. A hedge is 'highly effective' if changes in the fair value of the hedging instrument, and changes in the fair value or expected cash flows of the hedged item attributable to the hedged risk, offset within the range of 80–125 percent.
- For a cash flow hedge of a forecast transaction, the transaction is highly probable and creates an exposure to variability in cash flows that ultimately could affect profit or loss. IFRS Accounting Standards do not define what is meant by a forecast transaction that is 'highly probable' to occur. In our view, for a forecast transaction to be considered 'highly probable', there should be at least a 90 percent probability of the transaction occurring. [IAS 39.88]

Risk exposure is assessed on a transaction basis, and entity-wide risk is not a condition for hedge accounting. [IAS 39.IG.F.2.6]

Qualifying hedged items

The hedged item is an item that is exposed to the specific risk(s) that an entity has chosen to hedge. The hedged item can be:

- a single recognised asset or liability, unrecognised firm commitment, highly probable forecast transaction or net investment in a foreign operation;
- a group of recognised assets or liabilities, unrecognised firm commitments, highly probable forecast transactions or net investments in foreign operations, if they share the same hedged risk; or
- in a portfolio hedge of interest rate risk, a portion (i.e. an amount of currency) of a portfolio of financial assets or financial liabilities that share the risk being hedged. [IAS 39.78]

- Both at inception of the hedge and on an ongoing basis, the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated, like IFRS Accounting Standards. For net investment hedges, the hedge needs to be effective as an economic hedge of the net investment. However, the effectiveness testing requirements differ in certain respects from IFRS Accounting Standards (see below).
- There is no explicit requirement that the effectiveness of the hedge can be measured reliably, unlike IFRS Accounting Standards. However, we do not expect differences to arise in practice.
- Like IFRS Accounting Standards, for a cash flow hedge of a forecast transaction, the transaction is probable and creates an exposure to variability in cash flows that ultimately could affect profit or loss. A forecast transaction needs to be 'probable of occurring', whereas under IFRS Accounting Standards it needs to be 'highly probable'. Like IFRS Accounting Standards, there is no specific guidance on what percentage probability constitutes 'probable of occurring'. Under US GAAP, 'probable' is defined as 'the future event or events are likely to occur' and the term 'probable' requires significantly greater likelihood of occurrence than the phrase 'more likely than not'. [815-20-25-3, 25-5, 25-75, 25-136]

There are additional criteria that need to be met for fair value, cash flow and net investment hedges, which differ from IFRS Accounting Standards. [815-20-25-4 – 25-72, 25-87 – 25-132]

Like IFRS Accounting Standards, risk exposure is assessed on a transaction basis, and entity-wide risk is not a condition for hedge accounting. [815-20-25-4 – 25-44]

Qualifying hedged items

Like IFRS Accounting Standards, the hedged item is an item that exposes an entity to risk of changes in fair value or future cash flows that an entity has chosen to designate as a hedged item. The qualifying hedged items under US GAAP are similar to those in IFRS Accounting Standards. Although there are different requirements, a portfolio hedge is allowed, like IFRS Accounting Standards, as follows:

- an entity may designate a group of similar assets or liabilities as the hedged item if certain criteria are met, like IFRS Accounting Standards (see below); and
- an entity may designate one or more layers of a closed portfolio of similar financial assets if the entity expects that the designated amount will remain outstanding at the end of the hedge term, unlike IFRS Accounting Standards. [815-20-25-4 – 25-44]

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A firm commitment to acquire a business in a business combination can be a hedged item only for foreign exchange risk because other risks cannot be specifically identified and measured. In our view, an entity may also hedge the foreign exchange risk of a highly probable forecast business combination. In our view, in the consolidated financial statements a cash flow hedge of the foreign exchange risk of a firm commitment to acquire a business or a forecast business combination relates to the foreign currency equivalent of the consideration paid. [IAS 39.AG98]

Unlike IFRS Accounting Standards, a business combination is not a qualifying hedged item. [815-20-25-15(g)]

There are no restrictions on the timing of designation or redesignation of a hedged item and an item may be hedged after its initial recognition. [IAS 39.IG.F.2.17]

Like IFRS Accounting Standards, there are no restrictions on the timing of designation or redesignation of a hedged item and an item may be hedged after its initial recognition. [815-20-25-4 – 25-44]

Hedging a portion

It is possible to designate only a portion of the cash flows, fair value or net investment as a hedged item. If a portion of the cash flows of a financial asset or financial liability is designated as the hedged item, then the designated portion needs to be less than the total cash flows of the asset or liability. The designated risks and portions need to be separately identifiable components of the financial instrument, and changes in cash flows or the fair value of the entire financial instrument arising from the changes in the designated risks and portions need to be reliably measurable. [IAS 39.81, AG99E–AG99F]

Hedging a portion

Like IFRS Accounting Standards, it is possible to designate only a portion of hedged items for hedge accounting. For a cash flow hedge, an entity may designate (1) specified cash flows that must include (but are not limited to) the first cash flows received or paid in a particular period or (2) contractually specified components of a non-financial asset or liability, or a contractually specified interest rate of a financial instrument. For a fair value hedge, an entity may designate a specific portion (or percentage) of a recognised asset or liability or unrecognised firm commitment, including:

- hedging only the benchmark interest rate component of total contractual coupon cash flows;
- selected consecutive interest payments with the assumption that the principal payment occurs at the end of the hedge term (partial-term hedge of interest rate risk);
- embedded put or call options;
- residual value in a lessor's net investment in a lease; or
- one or more layers of a closed portfolio of prepayable and non-prepayable financial assets as the hedged item if certain conditions are met (see 'Portfolio fair value hedges of interest rate risk' below). [815-20-25-11, 25-12 – 25-12A, 55-g21, 55-33A, 815-25-35-13, 35-13B]

For example, for a fixed-rate financial instrument hedged for changes in fair value attributable to changes in a risk-free or benchmark interest rate, the risk-free or benchmark rate is normally regarded as both a separately identifiable component of the financial instrument and reliably measurable. [IAS 39.AG99F(a)]

Like IFRS Accounting Standards, a portion of the coupon on a fixed-rate instrument can be designated as a hedged component. [815-20-25-11 – 25-12]

An item may be hedged for only a portion of its period to maturity (partial-term hedging). [IAS 39.IG.F.2.17]

Like IFRS Accounting Standards, an item may be hedged for only a portion of its period to maturity (partial-term hedge). [815-20-25-12(b)(2)(ii)]

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Hedging a proportion

The term 'portion' is distinct from the term 'proportion', the latter being used to indicate a certain percentage only. It is possible to designate a proportion of the cash flows, fair value or net investment as a hedged item. Once a partial designation is made, hedge effectiveness is measured on the basis of the hedged exposure. [IAS 39.81, AG107A]

If a proportion of the cash flows or fair value of a financial asset or financial liability is designated as the hedged item, then that designated proportion needs to be less than the total cash flows of the asset or liability. However, an entity may designate all of the cash flows of the entire financial asset or financial liability as the hedged item and hedge them for only one particular risk as long as it is one of the eligible specified risks. [IAS 39.AG99C]

Forecast transactions

Forecast transactions should be 'highly probable' and should present an exposure to variations in cash flows that could ultimately affect profit or loss. IFRS Accounting Standards do not define what is meant by 'highly probable'. In our view, for a forecast transaction to be considered 'highly probable', there should be at least a 90 percent probability of the transaction occurring. [IAS 39.88(c), IG.F.2.4, IG.F.3.7, IU 03-19]

Hedging groups of similar items

The hedged item can be a portfolio of similar assets, liabilities, unrecognised firm commitments, highly probable forecast transactions or net investments in foreign operations. Only similar items can be grouped together in a portfolio. Items are considered to be 'similar' if:

- they share the hedged risk; and
- the change in fair value attributable to the hedged risk for each individual item is expected to be approximately proportional to the overall change in the fair value of the portfolio attributable to the hedged risk. [IAS 39.83, BC176]

Hedging a proportion

Like IFRS Accounting Standards, the term 'portion' is different from the term 'proportion', the latter being used to indicate a certain percentage of the hedged item. Like IFRS Accounting Standards, it is possible to designate a proportion of the cash flows, fair value or net investment as a hedged item. Like IFRS Accounting Standards, once a partial designation is made hedge effectiveness is measured on the basis of the hedged exposure. [815-20-25-11 – 25-12]

Unlike IFRS Accounting Standards, if a proportion of the cash flows or fair value of a financial asset or financial liability is designated as the hedged item, then that designated proportion may exceed the total cash flows of the asset or liability. Also like IFRS Accounting Standards, an entity may designate all of the cash flows of the entire financial asset or financial liability as the hedged item and hedge them for only one particular risk, as long as the hedged risk is one of the eligible specified risks. As discussed in 'Qualifying hedged risks' below, the eligible risks may differ from IFRS Accounting Standards. [815-20-25-6 – 25-44, ASU 2017-12.BC92–BC93]

Forecast transactions

Unlike IFRS Accounting Standards, for a cash flow hedge of a forecast transaction, the transaction needs to be 'probable' and create an exposure to variability in cash flows that ultimately could affect profit or loss. Like IFRS Accounting Standards, there is no specific guidance in the hedging Codification Topic on what percentage probability constitutes probable of occurring. US GAAP defines 'probable' as 'the future event or events that are likely to occur' and the term 'probable' requires significantly greater likelihood of occurrence than the phrase 'more likely than not'. [815-20-25-3, 25-5, 25-75, 25-132]

Hedging groups of similar items

Like IFRS Accounting Standards, similar assets, liabilities, unrecognised firm commitments, probable forecast transactions or net investments in foreign operations may be aggregated and hedged as a group only if the individual items in the group share the risk exposure that is designated as being hedged. Also like IFRS Accounting Standards, the change in fair value attributable to the hedged risk for each individual item in the group needs to be expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group of items. [815-20-25-12(b)]

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Net positions

A net position cannot be a hedged item, although a specific item or portion of assets or liabilities within the net position may be designated as the hedged item. [IAS 39.AG101]

Portfolio fair value hedges of interest rate risk

An entity is permitted to designate the interest rate exposure of a portfolio of financial assets or financial liabilities as the hedged item based on expected rather than contractual cash flows under the portfolio fair value hedge model. Although the hedged item may include both assets and liabilities, the amount designated is an amount of assets or an amount of liabilities; designation of a net amount comprising both assets and liabilities is not permitted. The entity may also hedge a portion of the interest rate risk associated with the designated amount. The portfolio fair value hedge model can be applied only for hedges of interest rate risk. [IAS 39.78, 81A, AG114(b)–AG114(c), AG116, AG118]

For an entity to apply the portfolio-layer method, the financial assets in the closed portfolio need to share the same risk exposure for the risk being hedged (i.e. the same benchmark interest rate risk). In other words, they need to pass the 'similarity' test. An entity is permitted to assess similarity qualitatively, and is permitted to perform this assessment only at hedge inception when it:

- applies the partial-term hedge guidance; and
- elects to hedge only the benchmark rate component of the contractual coupon cash flows. [815-20-25-12A, 55-14 – 55-14A, ASU 2017-12.BC112]

Net positions

Like IFRS Accounting Standards, a net position cannot be a hedged item, although a specific item or portion of assets and liabilities within the net position may be designated as the hedged item. [815-20-25-12]

Portfolio fair value hedges of interest rate risk

Although an entity may hedge a portfolio of financial assets under the portfolio fair value hedge model, the requirements differ from IFRS Accounting Standards. To hedge the interest rate risk of a portfolio of financial assets, an entity may use the portfolio-layer fair value hedge model. To qualify for the portfolio-layer method, the following criteria need to be met, unlike IFRS Accounting Standards:

- the portfolio has to be a closed portfolio of 'similar' financial assets (both prepayable and non-prepayable);
- the partial-term hedging designation should be elected; and
- the entity expects that the designated amount will remain outstanding at the end of the hedge term after considering expected prepayments, defaults and other factors affecting the timing and amount of cash flows. [815-20-25-12A]

For entities that use the portfolio-layer method hedging relationships for a single closed portfolio, the following applies.

- Multiple layers may be hedged in a single closed portfolio.
- Fair value hedge basis adjustments can exist at the closed portfolio level (i.e. not allocated to individual assets).
- Fair value hedge basis adjustments related to a portfolio-layer method hedge cannot be considered when estimating credit losses; and
- Fair value basis adjustments are considered when discontinuing a portfolio-layer method hedge.

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Qualifying hedging instruments

All derivatives, including separable embedded derivatives, can qualify as hedging instruments, with the following limitations.

- Written options may be designated as hedging instruments only for hedges of purchased options.
- A derivative cannot be designated as a hedging instrument for only a portion of its remaining period to maturity.
- Derivatives in their entirety or a proportion thereof need to be designated as hedging instruments. Designation of only certain components of derivatives is not permitted, except as noted below. [IAS 39.72, 74–75, AG94]

There are two exceptions from the requirement not to split the components of derivative hedging instruments: separating the intrinsic value and time value of an option; and separating the interest element and the spot price element in a forward (see additional discussion in 'Excluded components' below). [IAS 39.74]

A written option cannot be designated as a hedging instrument unless the hedged item is a purchased option, including one that is embedded in, but not separated from, another contract. [IAS 39.AG94]

Non-derivatives may be used as hedging instruments only for hedges of foreign currency risk. [IAS 39.72]

A combination of derivatives or proportions thereof may be used as the hedging instrument. In addition, in the case of a hedge of foreign currency risk, two or more non-derivatives or proportions of them, or a combination of derivatives and non-derivatives or proportions of them, may be used as the hedging instrument. [IAS 39.77]

Qualifying hedging instruments

All derivatives, including separable embedded derivatives, can qualify as hedging instruments, with the following limitations.

- Unlike IFRS Accounting Standards, the use of written options as hedging instruments is not restricted to hedges of purchased options; however, additional hedge criteria apply (see below).
- Like IFRS Accounting Standards, a derivative cannot be designated as a hedging instrument for only a portion of its remaining period to maturity.
- Like IFRS Accounting Standards, all or a proportion of a derivative may be designated as a hedging instrument. Designation of only certain components (e.g. a portion) of derivatives is not permitted. [815-20-25-45 – 25-71]

Unlike IFRS Accounting Standards, the intrinsic value component or the spot price element of a hedging instrument cannot be designated as a hedging instrument. However, the entire hedging instrument may be designated and hedge effectiveness may be based on only the intrinsic value of an option or on the spot price element of a forward contract. [815-20-25-82]

Unlike IFRS Accounting Standards, a written option may be designated as a hedge of a recognised asset or liability or unrecognised firm commitment, or related variability in cash flows, but only if the combination of the hedged item and the written option provides at least as much potential for gains as a result of a favourable change in the fair value of the combined instruments as exposure to losses from an unfavourable change in their combined fair value (or, for cash flow hedges, at least as much potential for favourable cash flows as exposure to unfavourable cash flows). That test is met if all possible favourable percentage changes in the underlying (from 0 percent to 100 percent) would provide at least as much gain (or favourable cash flow) as the loss (or unfavourable cash flow) that would be incurred from an unfavourable change in the underlying of the same percentage. [815-20-25-94 – 25-97]

Unlike IFRS Accounting Standards, non-derivatives may be used as hedging instruments only for hedges of foreign currency exposure of a net investment in a foreign operation and foreign currency fair value hedges of unrecognised firm commitments. [815-20-25-66, 25-37(d)]

Like IFRS Accounting Standards, an entity may combine and designate two or more derivative instruments as the hedging instrument. Unlike IFRS Accounting Standards, using a combination of derivatives and non-derivatives, or proportions thereof, as the hedging instrument is prohibited. [815-20-25-66]

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Dynamic hedging strategies

IFRS Accounting Standards allow an entity to apply dynamic hedging strategies such as 'delta-neutral' hedging strategies and other dynamic strategies under which the quantity of the hedging instrument is constantly adjusted to maintain a desired hedge ratio. The entity needs to comply with all normal criteria for hedge accounting and in addition document how it will monitor and update the hedge and measure hedge effectiveness and be able to track properly all terminations and redesignations of the hedging instrument. Also, it needs to be able to demonstrate an expectation that the hedge will be highly effective for a specified short period of time during which the hedge is not expected to be adjusted. [IAS 39.74–75, 91(a), 101(a), IG.F.1.9]

Qualifying hedged risks

The hedged risk should be one that could affect profit or loss. [IAS 39.86, AG110]

A financial asset or financial liability can be hedged against exposure to any one or more of its individual risk types that are identifiable and reliably measurable, including market prices, interest rates or a component of interest rates, foreign currency rates or credit risk. [IAS 39.81, IG.F.3.5]

A non-financial item may be hedged with respect to either all of its risks or foreign currency risk only. [IAS 39.82, AG100]

The risks associated with treasury share transactions (see chapter 7.3), forecast transactions in own equity and distributions to shareholders do not qualify for hedge accounting. [IAS 39.86, AG110, IG.F.2.7]

To qualify for hedge accounting, the hedged risk needs to be specific and identifiable. A hedge against general business risks does not qualify for hedge accounting. [IAS 39.AG98, AG110, IG.F.2.8]

Dynamic hedging strategies

Like IFRS Accounting Standards, an entity may apply dynamic hedging strategies such as 'delta-neutral' hedging strategies and other dynamic strategies under which the quantity of the hedging instrument is constantly adjusted to maintain a desired hedge ratio. However, the details of the application of hedge accounting to these strategies differ from IFRS Accounting Standards in certain respects. [815-20-25-101]

Qualifying hedged risks

Like IFRS Accounting Standards, the hedged risk should be one that could affect profit or loss. [815-20-25-12(c), 25-15(c)(2)]

Unlike IFRS Accounting Standards, for a financial asset or financial liability, an entity is limited to hedging interest rate risk, foreign currency risk, credit risk, overall changes in cash flows or fair value (i.e. price risk) or a combination of one or more of these risks. Either of the following risks can be hedged in a cash flow hedge of interest rate risk:

- changes in a contractually specified interest rate for variable-rate financial instruments or forecast issuances or purchases of variable-rate financial instruments; or
- changes in the benchmark interest rate for forecast issuances or purchases of fixed-rate financial instruments. [815-20-25-6 – 25-44]

Unlike IFRS Accounting Standards, a non-financial item other than servicing rights may be hedged in respect of:

- the risk of changes in the total fair value or cash flows of the non-financial item (i.e. price risk);
- changes in a contractually specified component (i.e. a component of price risk in a cash flow hedge); or
- foreign currency risk. [815-20-25-12]

Like IFRS Accounting Standards, the risks associated with treasury share transactions (see chapter 7.3), forecast transactions in own equity and distributions to shareholders do not qualify for hedge accounting. [815-20-25-43(b)(3)]

Like IFRS Accounting Standards, the hedged risk needs to be specifically identifiable and general business risk does not qualify for hedge accounting. [815-20-25-6 – 25-44]

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Effectiveness testing

To qualify for hedge accounting, a hedge should be 'expected to be' (prospectively) and 'actually have been' (retrospectively) highly effective at inception and subsequently, which requires the following conditions to be met:

- the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated or for the period until the amount of the hedging instrument is next adjusted (prospective effectiveness); and
- the actual results of the hedge are within the range of 80–125 percent (retrospective effectiveness). [IAS 39.88(b), 88(e), AG105]

IFRS Accounting Standards do not specify how often effectiveness needs to be measured, beyond noting that it needs to be done at a minimum at each reporting date, including interim reporting dates. [IAS 39.AG106]

IFRS Accounting Standards do not prescribe the methods that should be used in measuring effectiveness. The method that will be used in measuring hedge effectiveness is specified in the hedge documentation. Different methods may be used to measure prospective effectiveness and retrospective effectiveness for a single hedging relationship, as well as for different hedging relationships. [IAS 39.88(a), AG107]

Effectiveness testing

Although the requirements differ, there are certain hedge effectiveness requirements that need to be met for a hedging relationship to be eligible for hedge accounting, like IFRS Accounting Standards. Like IFRS Accounting Standards, to qualify for hedge accounting, a hedge should be 'expected to be' (prospectively) and 'actually have been' (retrospectively) highly effective at inception and subsequently, which requires the following conditions to be met (for net investment hedges, the hedge needs to be effective as an economic hedge instead of 'highly effective'):

- the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated (prospective effectiveness), like IFRS Accounting Standards; and
- the hedge has actually been highly effective (retrospective effectiveness); unlike IFRS Accounting Standards, the 80–125 percent range is not explicitly specified, although it is widely used and accepted in practice for both prospective and retrospective effectiveness. The FASB has acknowledged that practice has interpreted this range to result in a highly effective hedging relationship. The SEC Staff has also indicated that this is an acceptable range. [815-20-25-72 – 25-132, ASU 2017-12.BC165]

Notwithstanding the above, certain derivatives may be considered to be perfectly effective hedging instruments without quantitatively assessing hedge effectiveness, unlike IFRS Accounting Standards (e.g. critical terms match and shortcut methods). However, this is allowed only in very limited circumstances. [815-20-25-84 – 25-85, 25-102 – 25-118, 25-126 – 25-129]

Like IFRS Accounting Standards, hedge effectiveness needs to be assessed whenever financial statements or profit or loss are reported. However, unlike IFRS Accounting Standards, there is an explicit requirement to assess effectiveness at least every three months, regardless of whether the entity is subject to interim reporting. Also, unlike IFRS Accounting Standards, there are different requirements for certain private companies. [815-20-25-79 – 25-79A]

Like IFRS Accounting Standards, no particular method to be used in assessing effectiveness is prescribed. Unlike IFRS Accounting Standards, subsequent prospective and retrospective assessments may be performed on a qualitative or quantitative basis (see below). Like IFRS Accounting Standards, the method that will be used in assessing hedge effectiveness is specified in the hedge documentation at inception of the hedging relationship. If the qualitative assessment is elected, then how the entity intends to carry out that qualitative assessment is also documented at hedge inception, like IFRS Accounting Standards. [815-20-25-3(b)(2)(iv)]

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The approach that will be used to measure effectiveness is determined on a hedge-by-hedge basis. There is no requirement to adopt a consistent method for all hedging relationships. However, in our view an entity should adopt a method for assessing hedge effectiveness that is applied consistently for similar types of hedges unless different methods are explicitly justified. [IAS 39.88(a)]

Effectiveness calculations may be done on a pre-tax or post-tax basis. Whichever method is used, the basis of calculating the change in fair value or cash flows of the hedged item and the change in fair value of the hedging instrument should be consistent and documented. [IAS 39.IG.F.4.1]

Prospective and retrospective effectiveness

Prospective effectiveness may be demonstrated in several ways – e.g. by using statistical or offset methods or by comparing all critical terms. 'Comparing all critical terms' does not mean applying the 'shortcut method' that is allowed under US GAAP. Rather, it is a qualitative approach that requires reviewing and comparing all critical terms at inception and in subsequent periods. [IAS 39.AG105, IG.F.4.4]

Retrospective effectiveness may be demonstrated using statistical or offset methods and be measured on a cumulative or period-by-period basis. IFRS Accounting Standards do not permit the 'critical terms match' approach to test retrospective effectiveness. [IAS 39.AG105, IG.F.5.5]

Hedge ineffectiveness

If a hedging relationship is not perfectly aligned, then the gain or loss on the hedging instrument will differ from the gain or loss on the hedged item. The difference may give rise to hedge ineffectiveness.

Any actual ineffectiveness is recognised in profit or loss immediately, even if the hedge has been 'highly effective'. [IAS 39.95(b), 102(b)]

Also like IFRS Accounting Standards, different methods may be used to assess prospective effectiveness and retrospective effectiveness for a single hedging relationship. [815-20-25-3]

Like IFRS Accounting Standards, the approach that will be used to measure effectiveness is determined on a hedge-by-hedge basis, although an entity needs to justify using different methods for similar hedges. [815-20-25-81]

Like IFRS Accounting Standards, effectiveness calculations may be done on a pre- or post-tax basis. Whichever method is used, the basis of calculating the change in fair value or cash flows of the hedged item and the change in fair value of the hedging instrument should be consistent and documented, like IFRS Accounting Standards. [815-20-25-3(b)(vi)]

Prospective and retrospective effectiveness

Unlike IFRS Accounting Standards, prospective effectiveness may be demonstrated using statistical or offset methods or by applying a method that allows an entity to assume that the hedging relationship is perfectly effective by comparing the critical terms (i.e. shortcut method, critical terms match method or terminal value approach). [815-20-25-3, 25-84, 25-102, 25-126 – 25-129, 25-133 – 25-137]

Like IFRS Accounting Standards, retrospective effectiveness may be demonstrated using statistical or offset methods and it may be assessed on a cumulative or period-by-period basis. Unlike IFRS Accounting Standards, subsequent retrospective effectiveness may be assessed qualitatively if certain criteria are met. [815-20-35-2A]

Hedge ineffectiveness

Like IFRS Accounting Standards, if a hedging relationship is not perfectly aligned, then there will be a mismatch between the gain or loss on the hedging instrument and the gain or loss on the hedged item. [815-20-25-77]

Unlike IFRS Accounting Standards, if a hedging relationship is determined to be highly effective (effective as an economic hedge for net investment hedges) but not perfectly aligned, then the resulting 'ineffectiveness' is not separately measured and reported. [815-20-35-1]

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In a fair value hedge, ineffectiveness is recognised automatically in profit or loss as a result of separately remeasuring the hedging instrument and the hedged item. No separate calculation is required of the amount of ineffectiveness to be recognised in profit or loss. [IAS 39.89]

In a cash flow hedge, regardless of the methods that are used to assess prospective and retrospective effectiveness, the actual ineffectiveness recognised in profit or loss is calculated under the offset method on a cumulative basis to ensure that all ineffectiveness is recognised in profit or loss immediately. If the cumulative gain or loss on the hedging instrument is more than the cumulative change in fair value of the expected future cash flows on the hedged item, then the excess is recognised in profit or loss as ineffectiveness. However, if the reverse applies, then no ineffectiveness is recognised in profit or loss. [IAS 39.96, IG.F.5.5]

In a net investment hedge, similar to the mechanics of a cash flow hedge, when the cumulative gain or loss on the hedging instrument is more than the cumulative change in value of the net investment, the excess is recognised in profit or loss as ineffectiveness. However, if the reverse applies, then no ineffectiveness is recognised in profit or loss. [IAS 39.102]

Excluded components

If it is appropriately documented at inception of the hedging relationship, then the time value of an option may be excluded from the effectiveness tests and effectiveness may be tested based solely on the intrinsic value of the option. Similarly, the interest element of a forward contract may be excluded and effectiveness may be measured based solely on the spot component of the forward contract. [IAS 39.74, AG105, IG.F.4.2, IG.F.4.4, IG.F.5.5]

Like IFRS Accounting Standards, in a fair value hedge the mismatch between the gains and losses on the hedging instrument and the hedged item is recognised automatically in profit or loss as a result of separately remeasuring the hedging instrument and the hedged item. [815-20-35-1(b)]

Unlike IFRS Accounting Standards, if a cash flow hedging relationship is determined to be highly effective but not perfectly aligned, then the resulting mismatch between the gains and losses on the hedging instrument and the hedged item is not separately measured and recorded in profit or loss, or disclosed; instead, the entire change in fair value of the hedging instrument is recognised in OCI. [815-20-35-1, 25-77]

Unlike IFRS Accounting Standards, if a net investment hedge is determined to be effective as an economic hedge but not perfectly aligned, then the resulting mismatch between the gains and losses on the hedging instrument and the hedged item (i.e. ineffectiveness) is not separately measured and recorded in profit or loss; instead, the entire change in fair value of the hedging instrument is recognised in the cumulative translation adjustment within OCI.

Excluded components

Like IFRS Accounting Standards, certain components of a hedging instrument's fair value or cash flows may be excluded from the assessment of hedge effectiveness. For cash flow, fair value and net investment hedges, the following components may be excluded from the assessment of hedge effectiveness.

- *Options:* If effectiveness is assessed using the changes in intrinsic value, then all changes in time value or changes in time value attributable to either passage of time, volatility or interest rates may be excluded. If effectiveness is assessed using changes in minimum value (i.e. intrinsic value after the effect of discounting), then volatility may be excluded.
- *Forward or futures contracts:* The difference between the spot price and the forward or futures price (i.e. forward points) may be excluded. This method is referred to as the 'spot method'.
- *For currency swaps designated as hedging instruments in cash flow and fair value hedges,* the cross-currency basis spread may be excluded.
- *For currency swaps designated as hedging instruments in net investment hedges,* the change in fair value of the derivative attributable to changes in the difference between the forward rate and the spot rate (spot-forward difference) may be excluded. [815-20-25-82]

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Changes in the fair value of components of the hedging instrument that are excluded from the effectiveness measurement – i.e. the time value or interest component – are recognised immediately in profit or loss. [IAS 39.96(c)]

Effect of credit risk on effectiveness testing

Entities consider the effect of both changes in counterparty credit risk and own credit risk on the assessment of hedge effectiveness and the measurement of hedge ineffectiveness. Changes in both counterparty credit risk and own credit risk would probably have no offsetting effect on the measurement of the changes in the value of the hedged item attributable to the hedged risk and may lead to a conclusion that the hedging relationship has not been and/or is not expected to be highly effective. For cash flow hedges, if it becomes probable that a counterparty will default by failing to make any contractual payments to the entity, then the entity will be unable to conclude that the hedging relationship will be highly effective. [IAS 39.AG107, AG109, IG.F.4.3, IG.F.5.2]

Unlike IFRS Accounting Standards, if certain conditions are met for a hedge of a one-sided risk in a cash flow hedge using a purchased option, then the assessment of effectiveness may be performed by comparing the changes in the purchased option's total fair value with a hypothetical derivative that would be considered perfectly effective according to the terminal value approach noted above. [815-20-25-82 – 25-83, 25-126 – 25-129]

Unlike IFRS Accounting Standards, if an entity has excluded components from its assessment of hedge effectiveness, then it can elect to recognise the initial value of the excluded components in earnings using either of the following approaches:

- *amortisation approach:* a systematic and rational method over the life of the hedging instrument. Any difference between the change in fair value of the excluded component and the amounts recognised in earnings is included in accumulated OCI (or the cumulative translation adjustment in accumulated OCI for a net investment hedge); or
- *mark-to-market approach:* a method that recognises all fair value changes of the excluded components currently in earnings. [815-20-25-83A – 25-83B, 35-1, 35-5A – 35-5B, 815-30-35-3]

Effect of credit risk on effectiveness testing

Like IFRS Accounting Standards, entities consider the effects of both counterparty credit risk and own non-performance risk when assessing the effectiveness of hedging relationships. For fair value hedges, excluding those applying the shortcut method, these changes would generally have no offsetting effect on the measurement of the changes in the value of the hedged item attributable to the hedged risk and may lead to a conclusion that the hedging relationship has not been and/or is not expected to be highly effective, like IFRS Accounting Standards. However, for cash flow hedges, hedges of net investment in foreign operations and fair value hedges applying the shortcut method, the effectiveness assessment ignores the potential effect of these changes unless it is no longer probable that the counterparty or the entity itself will not default. If this is no longer probable, then the entity will generally be unable to conclude that the hedging relationship is expected to be highly effective (effective as an economic hedge for net investment hedges) and will be required to discontinue the hedging relationship. [815-20-25-77, 25-102 – 25-106, 25-122, 35-14 – 35-16, 35-18]

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Discontinuing hedge accounting

Hedge accounting is discontinued prospectively if:

- the hedged transaction is no longer highly probable;
- the hedging instrument expires or is sold, terminated or exercised;
- the hedged item is sold, settled or otherwise disposed of;
- the hedge is no longer highly effective; or
- the entity revokes the designation. [IAS 39.91, 101, AG113, IG.F.6.2(i)]

If the hedge effectiveness criteria are not met, then hedge accounting is discontinued from the last date on which compliance with the criteria was demonstrated. However, if an entity can identify the event or change in circumstances that caused the hedging relationship to fail the effectiveness criteria, and demonstrates that the hedge was effective before the event or change in circumstances occurred, then the entity discontinues hedge accounting from the date of the event or change in circumstances. All ineffectiveness up to that date is recognised in profit or loss. [IAS 39.AG113]

The hedging instrument is subsequently accounted for according to the normal requirements of IFRS Accounting Standards. The hedged item is also subsequently accounted for according to the normal requirements of IFRS Accounting Standards, except as noted below.

When fair value hedge accounting is discontinued, any hedging adjustment made previously to a hedged financial instrument for which the effective interest method is used is amortised to profit or loss by adjusting the effective interest rate of the hedged item from the date on which amortisation begins. Amortisation may begin as soon as an adjustment exists – i.e. while the hedging relationship still exists – and cannot begin later than the date on which the hedged item ceases to be adjusted for changes in fair value attributable to the hedged risk. [IAS 39.92]

Discontinuing hedge accounting

Like IFRS Accounting Standards, hedge accounting is discontinued prospectively if:

- the hedged transaction is no longer probable;
- the hedging instrument expires or is sold, terminated or exercised;
- the hedged item is sold, settled or otherwise disposed of;
- the hedge is no longer highly effective (effective as an economic hedge for net investment hedges); or
- the entity revokes the designation (dedesignates the hedging relationship). [815-25-40-1 – 40-6, 815-30-40-1 – 40-7]

Like IFRS Accounting Standards, hedge accounting is discontinued when the hedging relationship is no longer highly effective (effective as an economic hedge for net investment hedges). Like IFRS Accounting Standards, the date on which hedge accounting has to be discontinued depends on whether the hedging relationship failed the prospective or retrospective effectiveness test.

- *Prospective effectiveness assessment:* Discontinue hedge accounting prospectively.
- *Retrospective effectiveness assessment:* Discontinue hedge accounting on the last date on which effectiveness testing indicated that the relationship was highly effective, or the date of a specific event or change in circumstances. [815-25-40-3 – 40-4, 815-30-40-1 – 40-2]

The hedging instrument is subsequently accounted for according to the normal requirements of US GAAP. The hedged item is also subsequently accounted for according to the normal requirements of US GAAP (except as noted below), which may differ from the requirements of IFRS Accounting Standards.

Like IFRS Accounting Standards, when fair value hedge accounting is discontinued, any basis adjustment made previously to the hedged financial instrument for which the effective interest method is used is treated like a premium or a discount and is amortised to profit or loss under the effective interest method from the date on which the amortisation begins. Like IFRS Accounting Standards, an entity can make an accounting policy choice to begin amortisation as soon as an adjustment exists – i.e. while the hedging relationship still exists – and cannot begin later than the date when the hedged item ceases to be adjusted for changes in its fair value attributable to the hedged risk. [815-25-35-9 – 35-9A]

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The treatment of the cumulative gain or loss previously recognised in OCI in respect of a terminated cash flow hedge depends on whether the hedged transaction is still expected to occur.

- If the hedged transaction is *still expected to occur,* then the amount deferred in OCI remains there until the forecast transaction impacts profit or loss.
- If the transaction is *no longer expected to occur,* then the amount previously recognised in OCI is reclassified to profit or loss immediately. [IAS 39.101]

For a hedge of a net investment in a foreign operation, the cumulative amount previously recognised in OCI remains in OCI until the investment is disposed of or partially disposed of. [IAS 39.102]

Clearing derivatives with central counterparties

IFRS Accounting Standards provide relief from discontinuing hedge accounting if a novation that was not contemplated in the original hedging documentation meets the following criteria:

- as a consequence of laws or regulations or the introduction of laws and regulations, a clearing counterparty becomes a new counterparty to each of the original parties; and
- any changes to a derivative's terms are limited to those necessary to replace the counterparty – e.g. changes to collateral terms. [IAS 39.91(a)]

The treatment of the cumulative gain or loss previously recognised in OCI in respect of a discontinued cash flow hedge depends on whether the hedged transaction is probable of not occurring by the end of the originally forecast time period or within two months thereafter. There is a potential difference between 'expected to occur' for IFRS Accounting Standards and 'probable of not occurring by the end of the originally forecast time period or within two months thereafter' for US GAAP, which may give rise to differences in practice.

- If it is probable that the forecast transaction will not occur by the end of the originally forecast time period or within a two-month period thereafter, then the amounts in accumulated OCI are reclassified to profit or loss.
- If it is not probable that the forecast transaction will fail to occur in this period, then the amount deferred in accumulated OCI remains there until the forecast transaction impacts profit or loss. [815-30-35-38 – 35-41, 40-4]

Like IFRS Accounting Standards, for a hedge of a net investment in a foreign operation the cumulative amount recognised in the cumulative translation adjustment within accumulated OCI remains in accumulated OCI until the investment is fully or partially disposed of. [830-30-40-1 – 40-3]

Clearing derivatives with central counterparties

For the purpose of applying hedge accounting a change in the counterparty to a derivative instrument (e.g. a novation) that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument, provided that all other hedge accounting criteria continue to be met. [815-25-40-1A, 815-30-40-1A, 815-20-55-56A]

Unlike IFRS Accounting Standards, the reason for a change in counterparty is not limited to the requirements of laws and regulations, but may also include other circumstances – e.g. financial institution mergers, inter-company transactions, an entity exiting a particular derivatives business or relationship, or an entity managing against internal credit limits. [ASU 2016-05.BC2]

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Changes to the contractual terms of the clearing arrangements used for the execution of derivative contracts may impact the hedging relationship if an affected derivative is designated as a hedging instrument. This may be the case if the legal characterisation of variation margin payments is changed from collateral to partial settlement – i.e. change from collateralised-to-market to settled-to-market – without any other changes to the contractual terms. In our view, such a change on its own would not represent a termination of the derivative contract or a change in its critical terms and would not require clearing members or end users to discontinue the existing hedge accounting relationship for those reasons.

Hedging on a group basis

Internal derivatives

An entity may use internal derivatives to transfer risk from individual operations within the group to a centralised treasury. Derivatives between entities within the same reporting group can also be used to control and monitor risks through the central treasury function to benefit from pricing advantages and to offset equal and opposite exposures arising from different parts of the group. However, all such internal derivatives eliminate on consolidation and therefore are not eligible for hedge accounting in the consolidated financial statements, even if at a group level the overall net position is hedged externally. Therefore, only derivatives involving external third parties can be designated as hedging instruments in consolidated financial statements. However, it is possible for the centralised treasury to enter into one or more derivatives with external counterparties to offset the internal derivatives. Such external derivatives may qualify as hedging instruments in the consolidated financial statements provided that they are legally separate contracts and serve a valid business purpose – e.g. laying off risk exposures on a gross basis. In our view, a relationship should exist between the internal transactions and one or multiple related external transactions, and this relationship should be documented at inception of the hedging relationship. [IAS 39.73, IG.F.1.4]

Intra-group balances or transactions as the hedged item

The foreign currency risk on recognised intra-group monetary items qualifies for hedge accounting in the consolidated financial statements if it results in an exposure that is not fully eliminated on consolidation. [IAS 39.80]

The foreign currency risk of a highly probable forecast intra-group transaction may qualify as the hedged item in the consolidated financial statements provided that the transaction is denominated in a currency other than the currency of the entity entering into the transaction and the foreign currency risk will affect consolidated profit or loss. [IAS 39.80, AG99A]

There may be cases in which the legal characterisation of variation margin is changed from collateralised-to-market to settled-to-market without any other changes to the contractual terms. Like IFRS Accounting Standards, such a change on its own would not require clearing members or end users to discontinue the existing hedging relationship.

Hedging on a group basis

Internal derivatives

Unlike IFRS Accounting Standards, a foreign currency derivative instrument that has been entered into with another member of a consolidated group can be a hedging instrument in the consolidated financial statements if that other member has entered into an offsetting contract with an unrelated third party and certain other criteria are met. [815-20-25-52 – 25-56]

Intra-group balances or transactions as the hedged item

Unlike IFRS Accounting Standards, a hedge of the currency risk on a forecast intra-group transaction qualifies for hedge accounting provided that:

- either (1) the operating unit that has the foreign currency exposure is a party to the hedging instrument; or (2) another member of the consolidated group that has the same functional currency as that operating unit is a party to the hedging instrument and there is no intervening subsidiary with a different functional currency;
- the hedge transaction is denominated in a currency other than the hedging unit's functional currency; and
- the other cash flow hedge criteria are met, including that the transaction will affect consolidated profit or loss. [815-20-25-30]

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Interest rate benchmark reform

The accounting implications of interest rate benchmark reform comprise two phases.

- The Phase 1 amendments are effective for annual periods beginning on or after 1 January 2020. Application of the Phase 1 amendments is mandatory (see 'Phase 1 amendments' below).
- The Phase 2 amendments are effective for annual periods beginning on or after 1 January 2021. Application of the Phase 2 amendments is also mandatory, except for resetting the cumulative fair value changes to zero for retrospective assessment (see 'Phase 2 amendments' below). [IAS 39.108G–108H]

Phase 1 amendments

A hedging relationship is directly affected by interest rate benchmark reform (IBOR reform) if it is subject to the following uncertainty arising from the reform:

- an interest rate benchmark subject to the reform is designated as the hedged risk, regardless of whether the rate is contractually specified; and/or
- the timing or amounts of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument are uncertain. [IAS 39.102A]

If a hedging relationship is directly affected by IBOR reform, then specific exceptions apply to the following hedge requirements:

- highly probable requirement for cash flow hedges;
- reclassifying any cumulative gain or loss recognised in OCI;
- the prospective and retrospective effectiveness assessment; and
- designating a non-contractually specified benchmark portion of interest rate risk as a hedged item. [IAS 39.102D–102I]

Interest rate benchmark reform

Unlike IFRS Accounting Standards, the optional expedients in the reference rate reform guidance do not have a 'phased' approach and the related amendments are currently effective for all entities. Unlike IFRS Accounting Standards, the amendments are optional.

A number of expedients allow hedging relationships to continue, without dedesignation, when one or more critical terms of a hedging instrument, hedged item or hedged forecast transaction designated in a fair value, cash flow or net investment hedge relate to the replacement of the reference rate; these expedients differ from IFRS Accounting Standards in a number of ways. The expedients that an entity may elect without dedesignating the hedging relationship when certain conditions are met include the following.

- Update its formal documentation.
- Change the contractual terms of a hedging instrument, hedged item or forecast transaction.
- Change the method used to assess effectiveness, including using methods that disregard certain mismatches between the hedging instrument and hedged item or forecast transaction.
- Rebalance fair value and cash flow hedging relationships in certain ways.
- Change the systematic and rational method used to recognise in earnings the components excluded from the assessment of effectiveness.
- Change the designated benchmark interest rate in a fair value hedging relationship or hedged risk in a cash flow hedging relationship.
- Disregard potential discontinuation of a referenced interest rate when assessing probability of forecast interest payments in a cash flow hedging relationship.
- Disregard the requirement that individual hedged transactions in a group of forecast transactions share the same risk exposure for a cash flow hedging relationship. [848-30, 848-40, 848-50]

Unlike IFRS Accounting Standards, these expedients are optional. Also unlike IFRS Accounting Standards, an entity may elect the expedients on an individual hedging relationship basis (i.e. a hedge-by-hedge basis), and may generally elect the expedients independently of one another. [848-30-25-2, 848-40-25-1, 848-50-25-1]

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The 'uncertainty' applies to the hedged item and/or the hedging instrument individually as opposed to the hedging relationship in its entirety. [IAS 39.102J–102N]

An entity discloses the uncertainty arising from IBOR reform when it applies the exceptions to a hedging relationship that is directly affected by IBOR reform (see chapter 7.10). [IFRS 7.24H]

The Phase 1 amendments do not affect other guidance related to financial instruments.

The exceptions provided by the Phase 1 amendments generally cease to apply at the earlier of:

- when the uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows is no longer present; or
- when the hedging relationship is discontinued. [IAS 39.102J–102M]

Phase 2 amendments

Under the amendments, when an entity ceases to apply the IBOR Phase 1 amendments to the hedged item or hedging instrument, it applies the following exceptions from applying the general hedge accounting requirements to the hedging relationship:

- the entity amends the formal designation of the hedging relationship to reflect the changes that are required by IBOR reform by the end of the reporting period during which the changes are made;
- when a hedged item in a cash flow hedge is amended to reflect the changes that are required by the reform, the amount accumulated in the cash flow hedge reserve is deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined. A similar exception is provided for a discontinued cash flow hedging relationship;
- when a group of items is designated as a hedged item and an item in the group is amended to reflect the changes that are required by IBOR reform, an entity allocates the hedged items to subgroups based on the benchmark rate being hedged, and designates the benchmark rate for each subgroup as the hedged risk;

Unlike IFRS Accounting Standards, an entity can also apply certain optional expedients to derivative contracts impacted by 'discounting transition', including derivatives that do not reference LIBOR or other reference rates expected to be discontinued. 'Discounting transition' refers to changing the interest rates used for margining, discounting or contract price alignment of certain derivative instruments to transition to alternative rates. [848-20-15-2 – 15-2A]

Unlike IFRS Accounting Standards, other than disclosing the nature of and the reason for electing the optional expedients, specific additional disclosures are not required when an entity applies the optional expedients related to hedging relationships. [848-30-25-2]

Unlike IFRS Accounting Standards, the amendments affect the guidance on modifications of financial instruments (see chapters 7.6 and 7.7), disclosure (see chapter 7.10) and leases (see chapter 5.1).

Unlike IFRS Accounting Standards, the relief provided by the amendments is generally not available after 31 December 2024.

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- if an entity reasonably expects that an alternative benchmark rate will be a separately identifiable risk component within 24 months, then it can designate the rate as a non-contractually specified risk component even if it is not separately identifiable at the designation date. This is applied on a rate-by-rate basis and also applies to a new hedging relationship; and
- when performing a retrospective hedge effectiveness assessment, an entity may reset the cumulative fair value changes of the hedged item and hedging instrument to zero immediately after ceasing to apply the Phase 1 amendments.

[IAS 39.102P–102Z3]

An entity discloses the progress of transition to alternative benchmark rates at the reporting date and quantitative information on financial instruments that have yet to transition to an alternative benchmark rate at the reporting date (see chapter 7.10).

[IFRS 7.24I–J]

The Phase 2 amendments affect the guidance on modifications of financial instruments (see chapters 7.6 and 7.7), disclosure (see chapter 7.10) and leases, and the guidance for insurers that are not applying the new financial instruments standard under the temporary exemption.

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7.10 Presentation and disclosure

(IFRS 7, IFRS 9, IFRS 13, IAS 1, IAS 32)

Overview

- **IFRS Accounting Standards mandate separate presentation of certain amounts in the statement of financial position and in the statement of profit or loss and OCI. Additional line items may also be presented.**
- **A financial asset and a financial liability are offset only if there is both a current legally enforceable right to set off and an intention to settle the asset and the liability either on a net basis or simultaneously.**
- **Disclosure is required in respect of the significance of financial instruments.**
- **The overriding principle is to disclose sufficient information to enable users of financial statements to evaluate the significance of financial instruments for an entity's financial position and performance.**

7.10 Presentation and disclosure

(Subtopic 210-10, Subtopic 210-20, Subtopic 235-10, Subtopic 320-10, Subtopic 321-10, Subtopic 326-20, Subtopic 326-30, Subtopic 405-50, Subtopic 470-10, Subtopic 815-10, Subtopic 815-20, Subtopic 815-35, Subtopic 825-10, Subtopic 835-30, Subtopic 842-50, Subtopic 860-10, Reg S-K, Reg S-X)

Overview

- **Like IFRS Accounting Standards, separate presentation of certain amounts in the statement of financial position and in the statement of profit or loss and other comprehensive income is required. Additional line items may also be presented.**
- **A financial asset and a financial liability may be offset only if there is both a legally enforceable right to set off and an intention to settle the asset and the liability either on a net basis or simultaneously, like IFRS Accounting Standards. However, unlike IFRS Accounting Standards, derivatives with the same counterparty, and related collateral, may be offset, provided that they are subject to a master netting arrangement and certain other criteria are met. Also, unlike IFRS Accounting Standards, repurchase agreements and reverse repurchase agreements that clear through a qualified clearing house may be offset, provided that they are subject to a master netting arrangement and certain other criteria are met. Once the applicable criteria are met, offsetting is a policy choice, unlike IFRS Accounting Standards.**
- **Like IFRS Accounting Standards, disclosures are required to enable users to evaluate the significance of financial instruments.**
- **Like IFRS Accounting Standards, the overriding principle is to disclose sufficient information to enable users of financial statements to evaluate the significance of financial instruments for an entity's financial position and performance. However, the specific requirements differ from IFRS Accounting Standards.**

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Overview (continued)

- **Disclosure is also required about the nature and extent of risks arising from financial instruments and how the entity manages those risks. This includes both qualitative and quantitative information.**
- **Qualitative disclosures describe management's objectives, policies and processes for managing risks arising from financial instruments.**
- **Quantitative data about the exposure to risks arising from financial instruments is based on information provided internally to key management personnel. However, certain disclosures about the entity's exposures to credit risk (including amounts arising from expected credit losses), liquidity risk, market risk and concentration risk arising from financial instruments are required, irrespective of whether this information is provided to management.**

The discussion of presentation and disclosure requirements in this chapter is not exhaustive, and is intended to provide an overview only.

Overview (continued)

- **Like IFRS Accounting Standards, disclosures are also required about the extent of risk arising from financial instruments. However, risk disclosure requirements differ for public and non-public entities under US GAAP. Public entities are required to disclose qualitative and quantitative information; however, the specific disclosure requirements differ from IFRS Accounting Standards. The disclosure requirements for non-public entities are primarily qualitative and much less detailed than for public entities under US GAAP or under IFRS Accounting Standards.**
- **Unlike IFRS Accounting Standards, US GAAP does not require specific qualitative disclosures in respect of financial instruments other than related to credit risk. Instead, qualitative disclosures about market risk including interest rate risk, foreign currency risk, commodity price risk and other relevant price risk are required to be disclosed by SEC registrants outside the financial statements in MD&A.**
- **Unlike IFRS Accounting Standards, non-SEC registrants are not required to make specific quantitative risk-related disclosures in respect of financial instruments, other than related to credit risk. Non-SEC registrants are encouraged, but not required, to disclose quantitative information about market risks of financial instruments. The SEC does require certain quantitative disclosures; however, unlike IFRS Accounting Standards, these disclosures are limited to market risk disclosures and are provided outside the financial statements in MD&A.**

The discussion of presentation and disclosures requirements in this chapter is not exhaustive, and is intended to provide an overview only. In addition, even though a general area of presentation or disclosure under US GAAP may be like IFRS Accounting Standards, differences may arise in the detailed requirements that are not discussed in this publication.

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Presentation

Statement of financial position

Financial assets are presented in the statement of financial position, with separate presentation of cash and cash equivalents, trade and other receivables, and investments accounted for under the equity method. [IAS 1.54]

Financial liabilities are presented in the statement of financial position, with separate presentation of trade and other payables. [IAS 1.54]

Additional line items are presented when such presentation is relevant to an understanding of the entity's financial position (see chapter 3.1). [IAS 1.55]

Statement of profit or loss and OCI

Line items presenting the following amounts are required to be included in profit or loss:

- revenue, presenting separately interest revenue calculated under the effective interest method and insurance revenue;
- gains or losses arising from the derecognition of financial assets measured at amortised cost;
- finance costs;
- impairment losses, including reversals of impairment losses or impairment gains, determined under the financial instruments standard;
- gains or losses arising on the reclassification of a financial asset from the amortised cost measurement category to FVTPL measurement; and
- gains or losses arising on the reclassification of a financial asset from the FVOCI measurement category to FVTPL measurement. [IAS 1.82]

Negative interest arising from a financial asset is presented in an appropriate expense classification. In our view, interest resulting from a negative effective interest rate on a financial liability is presented as interest income. If this interest income relates to a financial liability that is measured at amortised cost, then we believe that the interest should be presented as interest revenue calculated under the effective interest method if it arises in the course of the entity's ordinary activities. [IU 01-15, IAS 1.82(a)]

Presentation

Statement of financial position

Unlike IFRS Accounting Standards, US GAAP does not require separate presentation of specific financial assets; however, practice is similar to IFRS Accounting Standards. Additionally, separate presentation on the face of the statement of financial position is required by SEC registrants for cash and cash equivalents and accounts and notes receivable, like IFRS Accounting Standards; and for marketable securities, unlike IFRS Accounting Standards. [210-10-S99]

Like IFRS Accounting Standards, financial liabilities are presented in the statement of financial position, with SEC registrants required to present separately trade payables, notes payable and other payables. [210-10-S99]

Unlike IFRS Accounting Standards, additional line items for certain financial assets and financial liabilities are also required for SEC registrants. Other additional line items may also be presented (see chapter 3.1).

Statement of profit or loss and OCI

Unlike IFRS Accounting Standards, US GAAP generally does not provide specific guidance for separate presentation of gains or losses on financial instruments in profit or loss. However, SEC Regulation S-X provides some guidance for separate presentation in profit or loss specific to investment companies, insurance companies and bank holding companies. [326-20-45, S-X Rules 6.07, 7-04, 9-04]

Under US GAAP, expected credit loss expense, including reversals of expected credit loss expense, is required to be separately presented in profit or loss, like IFRS Accounting Standards. [326-20-30-1]

Unlike IFRS Accounting Standards, US GAAP does not require specific presentation related to negative interest arising from a financial asset or financial liability.

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Each component of OCI classified by nature is presented as a separate line item and is grouped into line items that may be subsequently reclassified to profit or loss (when specific conditions are met) and those that will not. Separate line items include:

- the amount of change in the fair value of investments in equity instruments measured at FVOCI;
- the amount of change in the fair value of financial assets mandatorily measured at FVOCI;
- the amount of change in the fair value of financial liabilities designated at FVTPL that is attributable to changes in credit risk;
- the effective portion of the net gain or loss on hedges of net investments in foreign operations;
- the amount of change in the fair value of the hedging instrument in a fair value hedge if it hedges an investment in an equity instrument that an entity has elected to measure at FVOCI;
- the amount of change in the time value of options when separating the intrinsic value and time value of an option and designating as the hedging instrument only changes in the intrinsic value;
- the amount of change in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as a hedging instrument only the changes in the spot element;
- the amount of changes in the value of the foreign currency basis spread of a financial instrument when excluding it on designation of the instrument as a hedging instrument; and
- the effective portion of changes in fair value in respect of hedging instruments in cash flow hedges. [IAS 1.7, 82A(a)]

In our view, gains or losses on cash flow hedges and costs of hedging relating to the future recognition of a non-financial asset or liability should be presented in OCI as items that may be subsequently reclassified to profit or loss when specific conditions are met.

Reclassification adjustments are included with the related component of OCI. [IAS 1.93]

Like IFRS Accounting Standards, specific guidance is provided on the presentation and classification of components of OCI; however, these requirements may differ from IFRS Accounting Standards. Components of OCI are classified based on their nature within the statement of profit or loss and other comprehensive income as follows:

- gains and losses on foreign currency transactions that are designated as, and are effective as, economic hedges of a net investment in a foreign entity, commencing as of the designation date;
- gains and losses on derivative instruments that are designated as, and qualify as, cash flow hedges;
- for derivatives that are designated in qualifying hedging relationships, the difference between changes in fair value of the excluded components and the initial value of the excluded components recognised in earnings under a systematic and rational method;
- unrealised holding gains and losses on available-for-sale debt securities;
- unrealised holding gains and losses that result from a debt security being transferred into the available-for-sale category from the held-to-maturity category; and
- changes in fair value attributable to instrument-specific credit risk of liabilities for which the fair value option is elected. [220-10-45-1C, 45-10A]

Like IFRS Accounting Standards, reclassification adjustments are included with the related component of OCI. [220-10-45-15 – 45-17B]

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There are no specific requirements in IFRS Accounting Standards addressing the presentation of gains and losses on derivatives except for hedging gains and losses included in OCI (as described above) and the following requirements for hedging derivative gains and losses for hedges of groups of items.

- For cash flow hedges or fair value hedges of a group of items that do not have offsetting risk positions, the hedging instrument gains or losses (reclassified to profit or loss for cash flow hedges) are apportioned to the line items in profit or loss that are affected by the hedged items on a systematic and rational basis.
- For cash flow hedges or fair value hedges of a group of items that have offsetting risk positions affecting different line items in profit or loss any hedging instrument gains or losses in profit or loss (reclassified to profit or loss for cash flow hedges) are presented in a separate line item from those affected by the hedged items.
- For a fair value hedge of a net position with an interest rate swap, the net interest accrual is presented in a separate line item in profit or loss. [IFRS 9.6.6.4, B6.6.14–B6.6.16]

Offsetting

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only if both of the following conditions are met:

- the entity currently has a legally enforceable right to set off the recognised amounts; and
- the entity has the intention to settle on a net basis or to realise the asset and settle the liability simultaneously. [IAS 32.42, 45]

An entity currently has a legally enforceable right to set off if the right is:

- not contingent on a future event; and
- enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all of the counterparties. [IAS 32.AG38B]

Once these criteria are met, offsetting is required. [IAS 32.42]

Like IFRS Accounting Standards, US GAAP provides guidance on the presentation of gains or losses on qualifying hedging instruments, including the presentation of hedging gains and losses in OCI (as described above). However, the specific presentation requirements differ from IFRS Accounting Standards.

- *Cash flow hedge:* The gain or loss reclassified from accumulated OCI (AOCI) into profit or loss when the hedged transaction affects profit or loss is offset in the same line item where the gain or loss of the hedged item is recognised.
- *Fair value hedge:* The gain or loss on the hedging instrument and the change in value of the hedged item that is attributable to the hedged risk are recognised in the same line item where the gain or loss on the hedged item is recognised in profit or loss.
- *Net investment hedge:* When the hedged net investment is sold, exchanged or liquidated, both the gains and losses on the hedging instrument and the translation adjustments on the hedged net investment accumulated in the cumulative translation adjustment are recorded in the same line item in profit or loss. [815-20-45-1A, 45-1C]

For derivatives that are not designated as hedging instruments, split presentation of the unrealised and realised portions is prohibited for SEC registrants and they have to be presented in the same line item. Otherwise, like IFRS Accounting Standards, there is no other specific guidance on the presentation of gains or losses on financial instruments in the statement of profit or loss and other comprehensive income, and practice varies. [220-10-45-10A, 815-20-25-83A, 45-3, 815-35-35-5A]

Offsetting

Under US GAAP, a financial asset and a financial liability may be offset only if a right of set-off exists. US GAAP contains detail on the criteria for offsetting and therefore differences from IFRS Accounting Standards are likely. A 'right of set-off' is a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor. A right of set-off exists if all of the following conditions are met:

- each of two parties owes the other determinable amounts;
- the reporting entity has the right to set off the amount owed with the amount owed by the other party;
- the reporting entity intends to set off; and
- the right to set off is enforceable at law and there is reasonable assurance that the right would be upheld in bankruptcy. [210-20-20, 210-20-45]

Once these criteria are met, offsetting is an accounting policy choice, unlike IFRS Accounting Standards. [210-20-45]

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Individual instruments that, when viewed together, form a synthetic instrument are not usually offset unless the offsetting conditions above are met. [IAS 32.49(a)]

Like IFRS Accounting Standards, individual instruments that, when viewed together, form a synthetic instrument do not usually qualify for offsetting unless the offsetting conditions above are met. [815-10-25-4]

If a transfer of financial assets does not qualify for derecognition (see chapter 7.6), then the associated liability and the corresponding assets are not offset. [IAS 32.42]

Like IFRS Accounting Standards, if a transfer of financial assets does not qualify for derecognition (see chapter 7.6), then the associated liability and the corresponding assets are not offset. [860-30-25]

Derivative assets and liabilities are presented on a gross basis as separate line items in the statement of financial position (see above) when they do not meet the offsetting criteria even if they have the same primary risk exposure. This is because they are usually entered into with different counterparties and therefore there is no right to set off the recognised amounts. If they are entered into with (or novated to) the same counterparty – e.g. a central counterparty clearing house – then the entity may not have a current legally enforceable right to set off or the intent to settle on a net basis or to realise the asset and the liability simultaneously because it may be difficult to identify matching cash flows that could be offset at a specific date and a legal right to offset may be conditional on a specified future event. [IAS 32.42, 49(b), BC82]

Unlike IFRS Accounting Standards, US GAAP allows derivatives and fair value amounts recognised for the right to receive or return cash collateral arising from derivative transactions subject to a master netting arrangement with the same counterparty to be offset even though there may be no intention to settle on a net basis, provided that certain criteria are met. Once these criteria are met, offsetting is an accounting policy choice. [815-10-45-5 – 45-6]

Repurchase agreements and reverse repurchase agreements are generally presented on a gross basis in the statement of financial position because they do not usually meet the offsetting criteria – i.e. there is no current legally enforceable right to set off or they are not intended to be settled on a net basis or simultaneously. A master netting arrangement does not provide a basis for offsetting unless both of the offsetting criteria are met. [IAS 32.42, 50]

Unlike IFRS Accounting Standards, US GAAP allows repurchase agreements and reverse repurchase agreements subject to a master netting arrangement to be offset even though there may be no intention to settle on a net basis, provided that certain criteria are met. Once the criteria are met, offsetting is an accounting policy choice. [210-20-45-11 – 45-17]

A lessor is prohibited from presenting its lease receivable along with its related financing on a net basis. [IAS 32.42]

Unlike IFRS Accounting Standards, if the criteria are met for a lease to be classified as a leveraged lease, then a lessor presents only a net investment in the lease (see chapter 5.1). Otherwise, under US GAAP, a lessor is prohibited from presenting its lease receivable along with its related financing on a net basis. [842-50-25-1]

Minimum quantitative and qualitative disclosures are required for financial assets and financial liabilities that are:

1. offset in the statement of financial position; or
2. subject to an enforceable master netting agreement or similar arrangement that covers similar financial instruments and transactions, irrespective of whether they are offset in the statement of financial position. [IFRS 7.13A–13C, B40]

Like IFRS Accounting Standards, the disclosures include minimum quantitative and qualitative information about financial assets and financial liabilities that are:

1. offset in the statement of financial position; or
2. subject to enforceable master netting agreements or similar arrangements, irrespective of whether they are offset in the statement of financial position. [210-20-50]

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'Similar financial instruments and transactions' include derivatives, sales and repurchase agreements, and securities borrowing and lending agreements. Financial instruments that are outside the scope of the disclosure requirements (in (2) above) include loans and customer deposits at the same institution, and instruments subject only to a collateral agreement. [IFRS 7.B41]

The significance of financial instruments

Financial assets or financial liabilities designated as at FVTPL

Disclosures required for financial assets and financial liabilities that an entity has elected to measure at FVTPL include:

- the nature of instruments;
- how the entity has satisfied the conditions for such election; and
- the methods used to measure the effects of changes in credit risk and, for financial liabilities, the methods used to determine whether presenting those effects in OCI would create an accounting mismatch. [IFRS 7.11, B5]

For financial assets designated as at FVTPL, in addition, an entity discloses:

- the maximum exposure to credit risk and the amount by which this risk is mitigated by credit derivatives or similar instruments;
- the amount of change in the fair value of the financial asset attributable to credit risk; and
- the amount of change in the fair value of any related credit derivative or similar instrument. [IFRS 7.9]

For financial liabilities designated as at FVTPL, in addition, an entity discloses:

- the change in the fair value of the financial liability that is attributable to changes in credit risk;
- the difference between the carrying amount of the financial liability and the amount that the entity is contractually required to pay at maturity;
- any transfers of the cumulative gain or loss within equity during the period, including the reasons for such transfers; and
- the amount presented in OCI that was realised at derecognition if the liability is derecognised during the period. [IFRS 7.10, 10A]

Unlike IFRS Accounting Standards, US GAAP specifically identifies financial instruments that are subject to the offsetting disclosures as follows: derivatives, sales and repurchase agreements and securities borrowing and lending agreements. [210-20-50-1]

The significance of financial instruments

Financial assets or financial liabilities designated as at FVTPL

Disclosures required for financial assets and financial liabilities that an entity has elected to measure at FVTPL include the reasons for making such an election, and the reasons why such an election was made for only some eligible items within a group but not others, which is more specific than IFRS Accounting Standards. US GAAP has disclosure requirements on credit risk exposure for financial liabilities, loans and other receivables, which are similar to (but not exactly the same as) IFRS Accounting Standards. [825-10-50-28(a), 50-28(b), 50-30]

For financial assets (loans and other receivables) designated as at FVTPL, in addition, US GAAP requires an entity to disclose the amount of change in fair value of the financial asset attributable to credit risk, like IFRS Accounting Standards. Unlike IFRS Accounting Standards, there is no specific requirement to disclose separately the amount of change in the fair value of any credit derivative (or similar instrument) related to financial assets designated as at FVTPL. For additional credit risk disclosure requirements, see 'Nature and extent of risks arising from financial instruments' below. [825-10-50-30(c)]

For financial liabilities designated as at FVTPL, US GAAP requires an entity to disclose:

- the change in the fair value of the financial liability attributable to changes in credit risk, like IFRS Accounting Standards;
- for financial liabilities settled during the period, the amount, if any, previously recognised in OCI that was recognised in net income at settlement, unlike IFRS Accounting Standards; and
- the difference between the carrying amount and the amount that the entity is contractually required to pay at maturity only in respect of long-term debt, unlike IFRS Accounting Standards. [825-10-50-28(d), 50-30(d)]

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Investments in equity instruments designated as at FVOCI

If an entity has elected to measure an investment in equity instruments at FVOCI, then it makes disclosures including the reasons for the designation, the fair value of each investment at the reporting date, dividends recognised during the period and any transfers of the cumulative gain or loss within equity during the period and the reason for those transfers. [IFRS 7.11A]

Hedge accounting[1]

An entity discloses the following information about risk exposures for which it applies hedge accounting:

- its risk management strategy and how it applies that strategy to manage risk;
- how its hedging activities may affect the amount, timing and uncertainty of its future cash flows; and
- the effect that hedge accounting has had on its financial position and performance. [IFRS 7.21A]

Separate qualitative and quantitative information is disclosed, generally by risk category, for fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation, including:

- a description of the financial instruments designated as hedging instruments for the hedge and their carrying amounts, nominal amounts and the change in fair value for the period; and
- the nature and extent of the risks being hedged. [IFRS 7.22A–24F]

Additional disclosures are required in respect of financial instruments designated as at FVTPL because the entity uses a credit derivative to manage credit risk. [IFRS 7.24G]

Interest rate benchmark reform

Entities are required to disclose the effect of interest rate benchmark reform on financial instruments and risk management strategy as introduced by the Phase 2 amendments to the financial instruments standards. Additional disclosures are required when an entity applies the temporary exceptions from applying specific hedge accounting requirements to hedge accounting relationships directly affected by interest rate benchmark reform introduced by the Phase 1 amendments (see chapter 7.9). [IFRS 7.24H-24J]

[1] These requirements are applicable when applying hedge accounting under IFRS 9 and IAS 39.

Investments in equity instruments designated as at FVOCI

Unlike IFRS Accounting Standards, under US GAAP there is no 'FVOCI' category for investments in equity instruments.

Hedge accounting

Under US GAAP, the disclosure requirements for derivatives designated as hedging instruments include the objectives for holding or issuing the derivative instruments, the context needed to understand those objectives, and the risk management strategies for achieving those objectives. [815-10-50-1A]

Like IFRS Accounting Standards, separate quantitative and qualitative information is disclosed, by type of contract, for fair value hedging instruments, cash flow hedging instruments and hedging instruments for a net investment in a foreign operation, including:

- a description of the financial instruments being designated as hedging instruments and their notional amounts, fair values, the change in fair value for the period and the location of such amounts in the financial statements; and
- the nature and extent of the risks being hedged. [815-10-50-1A, 50-2, 50-4A, 50-5]

Unlike IFRS Accounting Standards, there is no specific guidance on designating credit exposures as at FVTPL. The general disclosure requirements for items designated under the fair value option would apply under US GAAP.

Interest rate benchmark reform

Unlike IFRS Accounting Standards, other than disclosing the nature of and the reason for electing the optional expedients, specific additional disclosures are not required when an entity applies the optional expedients related to hedging relationships (see chapter 7.9). [848-30-25-2]

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Fair values

For each class of financial asset and financial liability, an entity discloses the fair value in a manner that allows for it to be compared with its carrying amount. This disclosure is not required:

- if the carrying amount is a reasonable approximation of the fair value; or
- for lease liabilities. [IFRS 7.25, 29]

The fair value measurement standard provides guidance on fair value measurement and the related disclosure requirements (see chapter 2.4).

Nature and extent of risks arising from financial instruments

Qualitative risk disclosures

Qualitative disclosures are required in respect of each type of risk arising from financial instruments:

- exposure to the risk and how it arises;
- the entity's objectives, policies and process for managing the risk; and
- the methods used to measure the risk. [IFRS 7.33(a)–(b)]

Quantitative risk disclosures

Quantitative disclosures are required for each type of risk arising from financial instruments, as follows:

- summary quantitative data based on the information provided internally to key management personnel;
- additional information specifically required by the accounting standard; and
- information on concentrations of risk, if this is not apparent from the above disclosures. [IFRS 7.34]

Fair values

Like IFRS Accounting Standards, US GAAP requires fair value disclosures to be presented for each class of financial asset and financial liability in a manner that allows for them to be compared with their carrying amounts. US GAAP also provides additional detailed guidance on defining major classes of debt securities, and therefore differences from IFRS Accounting Standards may arise in practice. Unlike IFRS Accounting Standards, if a financial asset or financial liability measured at amortised cost is held by an entity that is not a public business entity, then fair value disclosures are not required. [320-10-50-1B, 820-10-50-1D, 50-2B, 825-10-45-1A, 50-2A, 50-10 – 50-11]

The fair value measurement Codification Topic provides guidance on fair value measurement and the related disclosure requirements (see chapter 2.4).

Nature and extent of risks arising from financial instruments

Qualitative risk disclosures

Unlike IFRS Accounting Standards, US GAAP does not require specific qualitative disclosures in respect of financial instruments other than related to credit risk. However, qualitative disclosures about market risk (interest rate risk, foreign currency risk, commodity price risk and other relevant price risk – e.g. equity price risk) are required to be disclosed by SEC registrants outside the financial statements (e.g. in MD&A). [235-10-S99, 326-20-50, 825-10-50-20 – 50-22, Reg S-K 229.305(b)]

Quantitative risk disclosures

Unlike IFRS Accounting Standards, non-SEC registrants are not required to make specific quantitative risk-related disclosures in respect of financial instruments, other than related to credit risk (see below). Non-SEC registrants are encouraged, but not required, to disclose quantitative information about market risks of financial instruments. However, like IFRS Accounting Standards, SEC registrants are required to make certain quantitative disclosures; however, unlike IFRS Accounting Standards, those disclosures are limited to market risk disclosures and are provided outside the financial statements (e.g. in MD&A). [235-10-S99, 326-20-50, 825-10-50-20 – 50-23, Reg S-K 229.305(a)]

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Disclosures about concentrations of risk are required. Concentrations of risk arise from financial instruments that have similar characteristics and are affected in a similar manner when there are changes in economic or other conditions. Identifying concentrations of risk is a matter of judgement and therefore an entity discloses:

- a description of how management determines concentrations;
- a description of the shared characteristics that identify each concentration – e.g. counterparty, geographic area, currency or market; and
- the amount of the risk exposure associated with financial instruments sharing that characteristic. [IFRS 7.34(c), B8]

Credit risk

For financial instruments to which the impairment requirements in the financial instruments standard are applied, an entity discloses:

- the credit risk management practices and how they relate to the recognition and measurement of expected credit losses;
- quantitative and qualitative information about amounts arising from expected credit losses; and
- information about an entity's credit risk exposure, including significant risk concentrations. [IFRS 7.35B]

The specific quantitative disclosures include:

- the gross carrying amounts of financial assets and the exposure to credit risk on loan commitments and financial guarantee contracts, by credit rating grade;
- information about the collateral held as security and other credit enhancements;
- reconciliation from the opening balance to the closing balance of the impairment loss allowance; and
- certain information about financial assets that have been modified but the modification has not resulted in derecognition. [IFRS 7.35H–35K, 35M, B8E, B8I]

Unlike IFRS Accounting Standards, concentration disclosures in US GAAP are required only in the context of credit risk. In addition, US GAAP and IFRS Accounting Standards differ in the level of detail of the disclosure requirements for concentration of credit risk. Under US GAAP, for each significant credit concentration an entity's disclosures include:

- the nature and characteristic of the credit concentration;
- the maximum credit exposure;
- collateral information, including the entity's policy on requiring collateral; and
- information about the entity's master netting arrangements, including the entity's policy on entering into master netting arrangements. [825-10-50-20 – 50-22]

Credit risk

The disclosure requirements for credit risk are similar to IFRS Accounting Standards, although the language under US GAAP differs from IFRS Accounting Standards. Like IFRS Accounting Standards, US GAAP requires disclosure of how management monitors the credit quality of its financial assets as well as information that would allow a financial statement user to understand the types of credit risk inherent in its financial assets, management's estimate of credit losses, and changes in the estimate of credit losses that have taken place in the period. [326-20-50-4, 326-30-50-2]

In addition, US GAAP has credit risk disclosures that are specific to the type of financial asset. For example, US GAAP has disclosure requirements specific to the credit risk of available-for-sale debt securities. These disclosure requirements include information that enables financial statement users to understand the types of credit risk inherent in available-for-sale securities, management's estimate of credit losses, and changes in the estimate of credit losses that have taken place during the period. [326-30-50-4, 825-10-50-21]

Like IFRS Accounting Standards, specific quantitative disclosures are required, although the required disclosures may vary. Disclosures include:

- the amortised cost basis amounts of financial assets and the exposure to credit risk on off-balance sheet credit exposures (i.e. loan commitments, standby letters of credit, financial guarantees (not accounted for as insurance) and other similar instruments not accounted for as a derivative), by portfolio segment and credit quality indicator;
- for financing receivables and net investments in leases held by public entities, the amortised cost basis within each credit quality indicator by year of origination (i.e. vintage year); and
- a reconciliation from opening balance to the closing balance of the allowance for credit losses. [326-20-50-6 – 50-6A, 50-13]

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Certain credit risk disclosures are also required for financial instruments to which the impairment requirements in the financial instruments standard are not applied. [IFRS 7.36]

Liquidity risk

In respect of liquidity risk, an entity discloses quantitative data, including:

- a maturity analysis for non-derivative financial liabilities, including issued financial guarantee contracts, showing their remaining contractual maturities;
- a maturity analysis for derivative financial liabilities, including the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows; and
- information about how liquidity risk is managed.

An entity discloses a maturity analysis of financial assets held to manage liquidity risk if such information is necessary to evaluate the extent and nature of liquidity risk. [IFRS 7.39, B11–B11F]

Market risk

IFRS Accounting Standards do not mandate the form of the disclosures about market risk. However, an entity presents a sensitivity analysis for each type of market risk: currency risk, interest rate risk and other price risk that it is exposed to as at the reporting date. [IFRS 7.40–41, B18–B20]

Transfers of financial assets

An entity discloses information on:

- transferred financial assets that are not derecognised in their entirety; and
- transferred financial assets that are derecognised in their entirety and in which the entity retains continuing involvement. [IFRS 7.42A–42B]

Examples of disclosures that are required for each class of transferred financial assets that are not derecognised in their entirety include:

- the nature of the transferred assets;
- the nature of the risks and rewards associated with those assets to which the entity is exposed; and
- the nature of the relationship between the transferred assets and the associated liabilities and the restrictions on the entity's use of those assets. [IFRS 7.42D]

Like IFRS Accounting Standards, certain credit risk disclosures are required for other financial instruments not in the scope of the credit losses Codification Topic. [825-10-50]

Liquidity risk

Unlike IFRS Accounting Standards, maturity disclosures in the financial statements are not required for financial liabilities, other than the current and non-current distinction (see chapter 3.1) and the requirement to disclose amounts to be paid in each of the next five years and in the aggregate thereafter. If the tabular format is used by SEC registrants in their MD&A market risk disclosures (see below), then a maturity analysis is required to be included. Like IFRS Accounting Standards, an entity discloses a maturity analysis of financial assets if such information is necessary to evaluate the extent and nature of liquidity risk. However, US GAAP contains specific guidance requiring maturity disclosures of debt securities based on appropriate groupings of each of held-to-maturity and available-for-sale securities. Furthermore, SEC-registrant banks are required to provide a maturity analysis of their loan portfolio in MD&A. [320-10-50-3, 50-5, 470-10-50-1, 825-10-50-23(c)]

Market risk

Like IFRS Accounting Standards, US GAAP does not mandate the form of disclosures. However, market risk disclosures provided in MD&A by SEC registrants are required to be in one of three forms: tabular, sensitivity analysis or value-at-risk. An entity is not required to use the same format for each risk. In all cases, the inherent limitations of the disclosure are explained. Like IFRS Accounting Standards, separate quantitative information is presented for each market risk exposure category – i.e. interest rate risk, foreign currency risk, commodity price risk and other relevant market risks, such as equity price risk.

Transfers of financial assets

The principal objectives of the disclosure requirements in US GAAP are to provide an understanding of:

- a transferor's continuing involvement, if any, with transferred financial assets;
- the nature of any restrictions on assets reported by an entity in its statement of financial position that relate to a transferred financial asset, including carrying amounts of those assets;
- how servicing assets and liabilities are reported; and
- how the transfer affects the transferor's financial position, financial performance and cash flows when transfers are accounted for either as secured borrowings or as sales when the transferor has some form of continuing involvement. [860-10-50-3]

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Examples of disclosures that are required for each type of continuing involvement in transferred financial assets that are derecognised in their entirety include:

- the carrying amounts and fair values of the assets and liabilities representing the entity's continuing involvement;
- the entity's maximum exposure to loss from its continuing involvement;
- a maturity analysis of the undiscounted cash flows that may be payable to the transferee in respect of those assets; and
- the gain or loss on transfer and income and expense arising from the entity's continuing involvement. [IFRS 7.42E, 42G]

Borrower financial difficulty modifications

IFRS Accounting Standards do not have specific disclosure requirements for modifications made due to financial difficulty of the borrower. Specific quantitative disclosures are required about financial assets that have been modified but where the modification has not resulted in derecognition. [IFRS 7.35J]

Reverse factoring arrangements

An entity is required to provide information about its reverse factoring arrangements that enables the users of financial statements to:

- assess how the arrangements affect the entity's liabilities and cash flows (see chapter 2.3); and
- understand the effect of the arrangements on the entity's exposure to liquidity risk and how the entity might be affected if the arrangements were no longer available to it. [IAS 7.44F-44H, IFRS 7.B11F(j)]

Forthcoming requirements

Amendments to the financial instruments standard are effective for annual periods beginning on or after 1 January 2026; early adoption is permitted. [IFRS 9.7.1.12, IFRS 9.7.1.15, IFRS 7.44OO]

Statement of profit or loss and OCI

The amendments require additional disclosures for financial assets and financial liabilities that are not measured at FVTPL and have contractual features that could change the amount of contractual cash flows based on the occurrence (or non-occurrence) of a contingent event that is not related directly to a basic lending risk or cost. [IFRS 7.20B–20C]

Borrower financial difficulty modifications

Unlike IFRS Accounting Standards, disclosures are required by creditors for modifications of receivables from debtors experiencing financial difficulty in the form of principal forgiveness, an interest rate reduction, an other-than-insignificant payment delay or a term extension.

Reverse factoring arrangements

Under US GAAP, a buyer of goods or services is required to provide additional disclosures about its reverse factoring (i.e. supplier finance) arrangements that enable users of financial statements to analyse the effect of such arrangements on the buyer's working capital, liquidity and cash flows over time (see chapter 2.3). [405-50]

Forthcoming requirements

There are no forthcoming requirements under US GAAP.

Statement of profit or loss and OCI

Unlike IFRS Accounting Standards, there are no additional disclosures for financial assets and financial liabilities that are not measured at FVTPL and have contractual features that could change the amount of contractual cash flows based on the occurrence (or non-occurrence) of a contingent event that is not related directly to a basic lending risk or cost.

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Under the amendments, an entity needs to disclose, separately for each class of financial assets and financial liabilities:

- a qualitative description of the nature of the contingent event;
- quantitative information about the possible changes to contractual cash flows that could result from those contractual terms – e.g. the range of possible changes; and
- the gross carrying amount of financial assets and the amortised cost of financial liabilities subject to those contractual terms. [IFRS 7.20B–20D]

Investments in equity instruments designated as at FVOCI

The amendments modify existing disclosures and add new disclosures for investments in equity instruments at FVOCI. The new disclosures are required on:

- the fair value gain or loss presented in OCI during the reporting period, separately showing the amount related to investments derecognised during the reporting period and the amount related to investments held at the reporting date; and
- for investments derecognised during the reporting period, any transfers of the cumulative gain or loss within equity during the reporting period. [IFRS 7.11A(f), 11B(d)]

Contracts referencing nature-dependent electricity (NDE)

The amendments add new disclosures for contracts referencing NDE. The new disclosures are required on:

- contractual features that expose the entity to variability in electricity volume and risk of having to buy electricity that the entity cannot use at the time of delivery;
- estimated future cash flows from unrecognised contractual commitments to buy electricity;
- qualitative information about how the entity assessed whether such contracts might become onerous; and
- qualitative and quantitative information about the costs and proceeds associated with purchases and sales of electricity, based on the information used for the 'net-purchaser' assessment. [IFRS 7.30A]

Investments in equity instruments designated as at FVOCI

Unlike IFRS Accounting Standards, there is no FVOCI category for investments in equity securities.

Contracts referencing nature-dependent electricity (NDE)

Unlike IFRS Accounting Standards, there are no specific required disclosures for contracts referencing NDE.

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8 Insurance contracts

8.1 Insurance contracts

(IFRS 17)

Overview

- **The insurance contracts standard applies generally to all insurance contracts (including reinsurance contracts) that an entity issues and reinsurance contracts that it holds, regardless of the type of entity that issued the contract.**
- **The aggregation of contracts into groups is required on initial recognition for all contracts in the scope of the insurance contracts standard. Individual contracts are grouped in a way that limits the offsetting of profitable contracts against onerous ones, and also considering how an entity manages and evaluates the performance of its business.**
- **An entity recognises a group of insurance contracts that it issues from the earliest of:**
  - **the start of the coverage period of the group of contracts;**
  - **the due date of the initial payment from a policyholder; and**
  - **the date when a group of contracts becomes onerous.**
- **The insurance contracts standard introduces the general measurement model (GMM). This is the default measurement model for insurance contracts.**
- **For contracts that meet certain criteria, an entity is permitted to use a simplified measurement approach – the premium allocation approach (PAA). For issued contracts with direct participation features, an entity is required to use a modified measurement model – the variable fee approach (VFA).**

8.1 Insurance contracts

(Topic 944)

Overview

- **Unlike IFRS Accounting Standards, the financial services – insurance Codification Topic applies to all insurance or reinsurance companies in its scope; there are no specific requirements in this Codification Topic for other entities that accept significant insurance risk.**
- **Unlike IFRS Accounting Standards, US GAAP does not have level of aggregation requirements, except for traditional and limited-payment long-duration contracts.**
- **Unlike IFRS Accounting Standards, under US GAAP the recognition of an insurance contract that is issued by an insurance entity varies and depends on the type of contract.**
- **Unlike IFRS Accounting Standards, under US GAAP there is no default measurement model for insurance contracts. The specific measurement model to apply depends on the type of contract.**
- **Like IFRS Accounting Standards, under US GAAP the measurement of an insurance contract that is issued by an insurance entity varies and depends on the type of contract.**

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Overview (continued)

- Under the GMM, on initial recognition and subsequently a group of insurance contracts is measured as:
  - the sum of the estimates of expected cash flows, adjusted to reflect the time value of money and financial risk, plus a risk adjustment for non-financial risks; and
  - the contractual service margin (CSM) for profitable groups of contracts, representing the unearned profit.
- The requirements of the insurance contracts standard apply equally to reinsurance contracts issued. The GMM and PAA requirements are modified for reinsurance contracts held by an entity.
- An insurance contract is derecognised when it is extinguished or when the terms of the contract are modified in a way that would have significantly changed the accounting for the contract had the new terms always existed.
- Insurance contracts acquired in a business combination or portfolio transfer are classified and measured as if they were newly written. Contracts acquired in a business combination are measured at the date of acquisition under the insurance contracts standard.
- The insurance contracts standard requires separate presentation of amounts relating to insurance contracts issued and reinsurance contracts held in the primary statements.
- The insurance contracts standard contains extensive disclosure requirements to enable users of the financial statements to assess the impacts that insurance contracts have on an entity's financial position, financial performance and cash flows.

Overview (continued)

- Unlike IFRS Accounting Standards, under US GAAP there is no default measurement model for insurance contracts. The initial recognition and subsequent measurement of insurance contracts depend on the type of contract.
- Unlike IFRS Accounting Standards, under US GAAP all contracts, including contracts that may not be structured or described as reinsurance, and contract amendments are accounted for as reinsurance if they qualify for reinsurance accounting. To qualify for reinsurance accounting, a contract must indemnify the ceding entity against loss or liability relating to insurance risk.
- Like IFRS Accounting Standards, an insurance contract is derecognised when it is extinguished or in some cases when its terms are modified.
- Unlike IFRS Accounting Standards, under US GAAP the acquiree's classification of insurance contracts acquired in a business combination is carried forward by the acquirer. Like IFRS Accounting Standards, under US GAAP a liability for the acquired insurance contracts is measured in accordance with the acquirer's existing accounting policies.
- Like IFRS Accounting Standards, US GAAP requires the ceding entity to present amounts relating to insurance contracts issued separately from reinsurance contracts on the balance sheet.
- Like IFRS Accounting Standards, there are extensive disclosure requirements under US GAAP, enabling users of the financial statements to understand the amount, timing and uncertainty of risks arising from insurance cash flows and the significant inputs, judgements, assumptions and methods used in measurement.

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Scope

The insurance contracts standard applies generally to all insurance contracts (including reinsurance contracts) that an entity issues and reinsurance contracts that it holds, regardless of the type of entity that issued the contract. The insurance contracts standard also applies to investment contracts with discretionary participation features (DPFs) if the issuer also issues insurance contracts. [IFRS 17.3]

Definition

An 'insurance contract' is a contract that transfers significant insurance risk under which the issuer agrees to compensate the policyholder if a specified uncertain future event adversely affects the policyholder. 'Insurance risk' refers to a risk other than financial risk to which the policyholder was already exposed. Insurance risk is 'significant' if an insured event could cause an insurer to pay significant additional benefits in any scenario that has commercial substance. In addition, a contract transfers significant insurance risk only if there is a scenario in which the issuer has a possibility of loss on a present value basis. [IFRS 17.A, B7–B21]

Scope

Unlike IFRS Accounting Standards, US GAAP establishes industry-specific accounting and reporting guidance for insurance entities, as opposed to insurance contracts. An 'insurance entity' is an entity that has registered under the relevant local regulations. For entities other than insurance entities, any contract issued that would meet the definition of an insurance contract under IFRS Accounting Standards is accounted for under other applicable US GAAP literature, most notably the Codification Topics on financial instruments (see section 7), revenue (see chapter 4.2) and provisions (see chapter 3.12). [944-10-15]

This chapter discusses only those sections of US GAAP that apply to insurance entities and that are directly comparable to the requirements of the IFRS accounting standard on insurance contracts. It does not provide an overview of other requirements of US GAAP for insurance entities. Therefore, it does not address insurance industry-specific guidance for assets or liabilities other than those resulting from insurance contracts. This chapter does not provide information about the accounting when an entity that is not an insurance entity issues a contract that would meet the definition of an insurance contract under IFRS Accounting Standards.

Definition

Unlike IFRS Accounting Standards, an insurance contract is a contract that provides economic protection from identified risks occurring or discovered within a specified period of time. The accounting for an insurance contract issued by an insurance entity depends on whether it is classified as short-duration or long-duration and whether the contract transfers insurance risk. If an insurance or reinsurance contract does not transfer insurance risk, then an entity applies the deposit method of accounting. Insurance risk arises from uncertainties about both underwriting risk (the ultimate amount of net cash flows under a contract) and timing risk (the timing of receipt and payments of the net cash flows under a contract). Conclusions about whether a contract meets the definition of an insurance contract may differ under IFRS Accounting Standards and US GAAP. [944-20-05-2A, 05-5, 944-20 Glossary]

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Exclusions

The insurance contracts standard deals with all insurance contracts, except for:

- warranties issued directly by a manufacturer, dealer or retailer in connection with a sale of its goods or services to a customer (see chapters 3.12 and 4.2);
- employers' assets and liabilities under employee benefit plans (see chapter 4.4);
- retirement benefit obligations reported by defined benefit retirement plans;
- contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item;
- residual value guarantees provided by a manufacturer, dealer or retailer, and a lessee's residual value guarantee embedded in a lease (see chapter 5.1);
- financial guarantee contracts, unless the issuer meets certain requirements and makes an irrevocable election to apply the insurance contracts standard to the financial guarantee contract (see chapter 7.1);
- contingent consideration payable or receivable in a business combination (see chapter 2.6);
- insurance contracts in which the entity is the policyholder, unless these contracts are reinsurance contracts held by the entity; and
- credit card and similar contracts that provide insurance coverage but whose pricing does not reflect an assessment of insurance risk for the individual customer, unless the insurance component is a contractual term that is separated. [IFRS 17.7]

Optional exemptions

For some fixed-fee service contracts, an entity can choose to apply the insurance contracts standard or the revenue standard (see chapter 4.2). Similarly, for contracts that limit compensation to the policyholder's obligation created by the contract, an entity may be able to apply the insurance contracts standard or the financial instruments standard (see section 7). [IFRS 17.8, 8A]

'Long-duration contracts' include contracts such as whole-life, universal life-type, guaranteed renewable term life, endowment, annuity and participating life that are expected to remain in force for an extended period. Long-duration contracts with terms that are not fixed and guaranteed are referred to as 'universal life-type' contracts. 'Investment contracts' are long-duration contracts that do not subject the insurance entity to risks arising from policyholder mortality or morbidity. Most other insurance contracts are considered short-duration contracts and include most property and liability insurance contracts. There is specific guidance for financial guarantee contracts. [944-20-05-3A, 05-12 – 05-13, 05-20, 05-37, 15-05 – 15-19]

Exclusions

See 'Scope' above.

Optional exemptions

Unlike IFRS Accounting Standards, there are no optional scope exemptions under US GAAP for contracts issued by insurance entities. [944]

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Combination

In some instances, it may be necessary to account for a set or series of insurance contracts with the same or related counterparty as a whole to reflect the substance of the arrangement. [IFRS 17.9]

Separation

Some insurance contracts may contain one or more components that would be in the scope of another IFRS accounting standard if they were separate contracts. These components could be investment components, promises to provide goods and services other than insurance contract services, or embedded derivatives. [IFRS 17.10]

Investment components and goods and services components are separated from an insurance contract only if they are distinct. [IFRS 17.11–13]

Embedded derivatives that do not meet the definition of insurance contracts are separated if it is required by the financial instruments standard (see chapter 7.2). [IFRS 9.2.1(e), 17.11(a)]

An entity attributes cash flows to a distinct investment component or to a separated embedded derivative on a stand-alone basis. After excluding the cash flows related to separated investment components and embedded derivatives, an entity applies the revenue standard to separate promises to transfer distinct goods or non-insurance services from the insurance component(s) (see chapter 4.2). It then applies the insurance contracts standard to all remaining components of the host insurance contract. [IFRS 17.12–13, BC111–BC113]

Combination

Like IFRS Accounting Standards, under US GAAP in some instances, it may be necessary to account for contracts (insurance or reinsurance) with the same or related counterparty as a whole to reflect the substance of the arrangement. [944]

Separation

Like IFRS Accounting Standards, insurance contracts may contain one or more components that would be in the scope of other applicable US GAAP literature. An insurance entity determines whether elements of the contract should be accounted for under the revenue Codification Topic (see chapter 4.2) or financial instruments Codification Topic (see chapter 7.2). [ASU 2016-20, BC14-BC15, 815-10-15-52 – 15-58, 825-10-15-4]

Unlike IFRS Accounting Standards, US GAAP does not have a broad separation concept for investment components of an insurance contract issued by an insurance entity; however, contract holder contributions for certain types of contracts, such as universal life-type contracts and investment contracts, are accounted for as deposits similar to financial instruments. Deposit accounting is used for contracts that do not transfer significant insurance risk. [944-20]

Like IFRS Accounting Standards, derivatives that are embedded in insurance contracts issued by an insurance entity and meet certain criteria are separated from the host insurance contract and accounted for as if they were stand-alone derivatives (see chapter 7.2). [815-15]

Like IFRS Accounting Standards, when a long-duration contract includes benefits in addition to the account balance, an assessment of the appropriate accounting treatment for each individual contract or contract feature is made at contract issuance. However, unlike IFRS Accounting Standards, an entity follows the applicable US GAAP literature for each contract or contract feature. It determines the accounting for the contract or contract feature in the following order:

- market risk benefit(s);
- derivative or embedded derivative(s); and
- annuitisation, death or other insurance benefit(s). [944-40-25-25B]

Unlike IFRS Accounting Standards, if a contract or contract feature of a universal life-type contract or investment contract provides potential benefits in addition to the contract holder's account balance and meets the definition of a market risk benefit, then that contract or contract feature is accounted for separately at fair value. [944-40]

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Recognition

Under the insurance contracts standard, an entity recognises a group of insurance contracts that it issues from the earliest of:

- the start of the coverage period of the group of contracts;
- the due date of the initial payment from a policyholder; and
- the date when a group of contracts becomes onerous. [IFRS 17.25]

If there is no premium due date specified in the contract, then it is considered to be the date when the first payment is received from the policyholder. [IFRS 17.26]

Insurance acquisition cash flows

Insurance acquisition cash flows arise from the costs of selling, underwriting and starting a group of insurance contracts, both issued and expected to be issued. They include costs that are directly attributable to a portfolio of contracts and allocated to groups using a rational and systematic method. [IFRS 17.28A, A]

An entity recognises an asset for any insurance acquisition cash flows for a group of existing or future insurance contracts that it pays or incurs before the group is recognised. The asset is derecognised when the group is recognised and the insurance acquisition cash flows are included in measuring the group of insurance contracts to which the cash flows are allocated. [IFRS 17.28B–28C]

If the facts and circumstances indicate that the asset may be impaired, then the entity is required to assess the recoverability of the asset and recognise any identified impairment loss. A second impairment test is required if the asset is related to a group that is expected to arise from renewals of insurance contracts. [IFRS 17.28E, B35D]

If subsequently the impairment conditions no longer exist or have improved, then an entity reverses some or all of the impairment loss previously recognised in profit or loss. [IFRS 17.28F]

Recognition

Unlike IFRS Accounting Standards, under US GAAP the accounting for an insurance contract that is issued by an insurance entity varies and depends on whether it is classified as short-duration, long-duration or financial guarantee and, if it is a long-duration contract, whether it is whole-life, universal life, guaranteed renewable term life, endowment, annuity or participating life. As a consequence, the recognition criteria depend on the type of insurance arrangement as well as other factors. [944]

Insurance acquisition cash flows

Unlike IFRS Accounting Standards, only costs that are directly related to the successful acquisition of new or renewal insurance contracts can be capitalised as deferred acquisition costs under US GAAP. This may result in differences from IFRS Accounting Standards in practice. [944-30]

Unlike IFRS Accounting Standards, under US GAAP an entity does not derecognise the capitalised deferred acquisition costs when the related contracts are initially recognised. Instead, US GAAP requires an entity to amortise capitalised deferred acquisition costs. The amortisation method depends on whether the contract is classified as a short-duration, long-duration, financial guarantee or investment contract. [944-30]

Like IFRS Accounting Standards, US GAAP has a similar concept to the recoverability assessment for short-duration contracts. However, it does not use the term 'impairment' and instead requires insurance entities to perform a premium deficiency test. If a premium deficiency exists, then deferred acquisition costs are written off to the extent of the deficiency (see also 'Onerous contracts' below). [944-60]

Unlike IFRS Accounting Standards, under US GAAP long-duration contracts subject to the simplified deferred acquisition costs amortisation model are not assessed for the existence of a premium deficiency. However, deferred acquisition costs are written down for unexpected contract terminations (see also 'Onerous contracts' below). [944-30]

Unlike IFRS Accounting Standards, amounts previously written off are not reversed if impairment conditions no longer exist or have improved. [944-60]

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Measurement

Models and eligibility

The GMM applies to all groups of insurance contracts in the scope of the insurance contracts standard, except for groups measured under the PAA. Modifications apply to groups of:

- reinsurance contracts held;
- direct participating contracts measured using the VFA; and
- investment contracts with DPFs. [IFRS 17.29]

The PAA is a simplified model for measuring eligible groups of insurance contracts issued or reinsurance contracts held. An entity is permitted to apply the PAA if, at inception of the group:

- the coverage period of each contract in the group is one year or less; or
- the entity reasonably expects that the PAA would produce a measurement of the liability for remaining coverage (LRC) that would not differ materially from applying the GMM. [IFRS 17.53]

The VFA is a modification of the GMM for insurance contracts issued that have direct participation features (or direct participating contracts). This modified measurement model cannot be applied to groups of reinsurance contracts held. [IFRS 17.B109]

Direct participating contracts are substantially investment-related service contracts under which the entity assumes an obligation to pay the policyholder an amount equal to the fair value of the underlying items, less a variable fee for future service. [IFRS 17.B101, B104]

An insurance contract is a direct participating contract if:

- the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items;
- the entity expects to pay the policyholder an amount equal to a substantial share of the fair value returns on the underlying items; and
- the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in the fair value of the underlying items. [IFRS 17.B101]

An entity assesses whether the above conditions are met for each contract based on its expectations at inception of the contract, and this is not reassessed subsequently unless the contract is modified. [IFRS 17.B102]

Measurement

Models and eligibility

Unlike IFRS Accounting Standards, under US GAAP the accounting model to apply depends on whether a contract is classified as short-duration, long-duration or a financial guarantee and, if it is a long-duration contract, whether it is whole-life, universal life, guaranteed renewable term life, endowment, annuity or participating life. [944]

Like IFRS Accounting Standards, the short-duration measurement model under US GAAP is similar to the PAA model. For further discussion, see 'Premium allocation approach' below.

Like IFRS Accounting Standards, US GAAP addresses the accounting for participating insurance contracts. Specifically, US GAAP addresses the accounting for dividends to policyholders, defined as amounts that are distributable to policyholders of participating insurance contracts when the amounts distributed are determined by the insurer. Under US GAAP, these participating insurance contracts are accounted for as insurance contracts. However, unlike IFRS Accounting Standards, an entity accounts for participating contracts with terms that are, in substance, universal life-type contracts applying the requirements for long-duration insurance contracts. [944-50, 944-50-15-2]

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Measurement on initial recognition

Applying the GMM and VFA, on initial recognition a profitable group of insurance contracts is measured as the sum of:

- the fulfilment cash flows, which include:
  - estimates of future cash flows that will arise as the insurer fulfils the contracts;
  - an adjustment to reflect the time value of money (i.e. discounting) and the financial risks related to the future cash flows (to the extent that they are not already included in the estimates of future cash flows); and
  - an explicit risk adjustment for non-financial risk; and
- the CSM – i.e. the amount that represents the unearned profit that the entity will recognise in profit or loss as it provides services. [IFRS 17.32]

If the fulfilment cash flows are a net outflow on initial recognition, then the group of insurance contracts is onerous and the entity recognises a loss immediately in profit or loss for the entire net cash outflow. [IFRS 17.47]

A loss component is created for this net cash outflow, which determines the amounts that are subsequently presented in profit or loss as reversals of losses on onerous groups. These amounts are not included in determining insurance revenue. [IFRS 17.49]

There is no concept of shadow accounting under the insurance contracts standard.

Level of aggregation

To determine the level of aggregation, an entity identifies portfolios of insurance contracts. A portfolio comprises contracts subject to similar risks and managed together. Each portfolio is divided into a minimum of a group of:

- contracts that are onerous on initial recognition;
- contracts that on initial recognition have no significant possibility of becoming onerous subsequently; and
- any remaining contracts in the portfolio. [IFRS 17.14, 16]

Measurement on initial recognition

Unlike IFRS Accounting Standards, under US GAAP the accounting for an insurance contract that is issued by an insurance entity varies and depends on whether it is classified as short-duration, long-duration or a financial guarantee and, if it is a long-duration contract, whether it is whole-life, universal life, guaranteed renewable term life, endowment, annuity or participating life. Consequently, the measurement criteria depend on the type of the insurance contract or contract features as well as other factors. [944]

Unlike IFRS Accounting Standards, the use of shadow accounting is required under US GAAP by insurance entities for certain long-duration contracts. Shadow accounting is applied when the measurement of an insurance liability considers investment margins. Under shadow accounting, the effect of unrealised losses and gains on the available-for-sale securities used to measure the insurance liability is recognised in OCI, consistent with the recognition of those unrealised gains and losses on the related financial assets classified as available-for-sale (see chapter 7.4). [320-10-S99-2, 944-60-15-5]

Level of aggregation

Unlike IFRS Accounting Standards, US GAAP does not have level of aggregation requirements, except for certain long-duration contracts. Therefore, an entity calculates the insurance liability on an individual contract (seriatim) basis or by contract group. [944, 944-40]

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Contracts issued more than one year apart cannot be included in the same group. Therefore, each portfolio is disaggregated into annual cohorts, or cohorts consisting of periods of less than one year. A group could have only one contract. [IFRS 17.22–23]

All contracts in the scope of the insurance contracts standard are required to be aggregated into groups. Groups are established on initial recognition and newly recognised contracts are added. The composition of groups is not reassessed subsequently. [IFRS 17.24]

Estimating future cash flows

To measure a group of insurance contracts, an entity needs to develop current, explicit, unbiased and probability-weighted estimates of expected cash flows within the boundary of each contract in the group.

Under the insurance contracts standard, estimates of future cash flows should:

- incorporate all reasonable and supportable information that is available without undue cost or effort about the amount, timing and uncertainty of those future cash flows in an unbiased way;
- include all of the future cash flows within the boundary of each contract in the group;
- reflect the perspective of the entity, provided that, when relevant, the estimates are consistent with observable market prices for those variables; and
- be current and explicit. [IFRS 17.33]

All of the future expected cash flows within the boundary of each contract in the group are included in the measurement of a group of insurance contracts. The contract boundary distinguishes the future cash flows that relate to existing recognised contracts from those that relate to future contracts. When determining the contract boundary, an entity considers its substantive rights and obligations – whether they arise from contract, law or regulation – and disregards terms that have no commercial substance. [IFRS 17.2, 33–34, B61, B64, BC164]

Cash flows within the boundary of an insurance contract are those that relate directly to the fulfilment of the contract and include those over which the entity has discretion. [IFRS 17.B65, BC168]

Like IFRS Accounting Standards, traditional and limited-payment long-duration contracts from different issue years cannot be grouped to measure the liability for future policy benefits. Unlike IFRS Accounting Standards, US GAAP does not provide additional guidance on how to group contracts to calculate the liability for future policy benefits for traditional and limited-payment long-duration contracts or on contract grouping once established. [944, 944-40]

Like IFRS Accounting Standards, an entity makes new contract grouping determinations as new traditional and limited-payment long-duration contracts are written and contract groupings are not reassessed subsequently. [944, 944-40]

Estimating future cash flows

Like IFRS Accounting Standards, to measure the liability for insurance contracts, an entity develops estimates of the expected cash flows within the boundary of the contract or group of contracts. Like IFRS Accounting Standards, these estimates include information about the amount, timing and uncertainty of the cash flows. However, unlike IFRS Accounting Standards, under US GAAP the cash flows used in the measurement of the liability depend on the underlying classification of the insurance contract (e.g. short-duration, long-duration, financial guarantee contract). [944]

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An entity is required to remeasure the fulfilment cash flows, and reassess the contract boundary, at each reporting date to reflect estimates based on current assumptions, applying the same requirements that apply to initial measurement. Changes in estimates of the fulfilment cash flows are reflected in either profit or loss, or OCI, or they adjust the CSM depending on their nature. [IFRS 17.40–41, 43–45, B54, B64]

Discounting

The estimates of future cash flows are adjusted to reflect the time value of money and financial risks associated with those cash flows.

The discount rates used are required to:

- reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts;
- be consistent with observable current market prices; and
- exclude the effects of factors that affect observable market prices, but do not affect the expected cash flows of the insurance contract. [IFRS 17.36]

Discount rates are determined on a basis consistent with other estimates that are used to measure the insurance contracts. For example:

- cash flows that do not vary based on the returns on underlying items are discounted at a rate that does not reflect any such variability – i.e. based on a risk-free rate;
- cash flows that do vary based on the returns on any financial underlying items are discounted using rates that reflect that variability (or adjusted for the effect of that variability and discounted using a rate that reflects the adjustment made);
- nominal cash flows are discounted at a rate that includes the effect of inflation; and
- real cash flows are discounted at a rate that excludes the effect of inflation. [IFRS 17.B74]

The insurance contracts standard does not prescribe an estimation technique to derive discount rates. However, it does specify that a 'top-down' or 'bottom-up' approach may be used. [IFRS 17.B80–B81, B84]

Risk adjustment for non-financial risk

In measuring a group of insurance contracts, the present value of expected cash flows is also adjusted for non-financial risk.

Like IFRS Accounting Standards, for traditional and limited-payment long-duration contracts, entities are required to remeasure the expected future cash flows used to measure the liabilities. [944-40-35-5 – 35-7B]

Discounting

Unlike IFRS Accounting Standards, US GAAP permits an entity to discount its liabilities for short-duration contracts only if the payment pattern is fixed or reliably determinable. [944-20-S99-1]

Like IFRS Accounting Standards, the liabilities for traditional and limited-payment long-duration contracts and the additional liabilities for death, annuitisation and other benefits are discounted under US GAAP. [944-40]

Unlike IFRS Accounting Standards, the discount rate used to measure the:

- liabilities for traditional and limited-payment long-duration contracts is defined as the upper-medium grade (low-credit-risk) fixed-income instrument yield updated each reporting period; and
- additional liabilities for death, annuitisation and other benefits is defined as either the contract rate in effect at inception of the book of contracts or the latest revised rate applied to the remaining benefit period, with the approach consistently applied. [944-40-30-9, 944-40-30-29]

Like IFRS Accounting Standards, US GAAP does not prescribe an estimation technique to derive discount rates. Unlike IFRS Accounting Standards, US GAAP does not specify an approach to be used. [944]

Risk adjustment for non-financial risk

Unlike IFRS Accounting Standards, US GAAP does not have a concept similar to the risk adjustment for non-financial risk.

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The risk adjustment for non-financial risk is explicit and considers risks arising from insurance contracts other than financial risk. This includes insurance risk and other non-financial risks – e.g. lapse and expense risk. [IFRS 17.B86, B89–B90, B98]

The insurance contracts standard does not prescribe an estimation technique to determine the risk adjustment for non-financial risk and judgement is required to determine an appropriate technique. [IFRS 17.B91–92]

Contractual service margin

In measuring a profitable group of insurance contracts, an entity needs to determine the unearned profit, represented by the CSM. For groups of onerous contracts, the entity needs to determine the loss component. [IFRS 17.38, 47]

On initial recognition of a profitable group of insurance contracts, the CSM is the equal and opposite amount of the net cash inflow that arises from the sum of:

- fulfilment cash flows;
- any previously recognised insurance acquisition cash flow assets and any other assets or liabilities previously recognised for cash flows related to the group of contracts; and
- any cash flows arising from the contracts in the group at that date. [IFRS 17.32, 38]

Subsequent measurement

Subsequent to initial recognition, the total liability of a group of insurance contracts is the sum of the LRC and the liability for incurred claims (LIC). The LRC is measured as the fulfilment cash flows that relate to service that will be provided under the contract in future periods, plus the remaining CSM. The LIC is measured as the fulfilment cash flows for claims and expenses already incurred but not yet paid. [IFRS 17.40]

At each reporting date, the fulfilment cash flows are remeasured to reflect estimates based on current assumptions, applying the same requirements as on initial measurement. Changes in estimates of the fulfilment cash flows are reflected in either profit or loss or OCI – or, in some cases, they adjust the CSM. [IFRS 17.43–44]

Under US GAAP, the assumptions used to measure the liability for future policy benefits for traditional and limited-payment long-duration contracts are best estimate assumptions without a provision for the risk of adverse deviation. [944-40]

Contractual service margin

There is no similar concept under US GAAP.

Subsequent measurement

Unlike IFRS Accounting Standards, the initial and subsequent measurement under US GAAP depends on the underlying classification of the insurance contracts. [944]

Like IFRS Accounting Standards, under US GAAP the liability for traditional and limited-payment long-duration insurance products, and non-traditional long-duration contract benefits, such as the additional liability for death or other insurance benefits for universal life policies, are subject to periodic remeasurement using current assumptions. [944-40-30-25, 944-40-35-5 – 35-7B]

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The CSM is also updated to reflect the unwinding of discounting for the time value of money. The CSM balance is allocated to profit or loss each period to reflect the provision of insurance contract services in the period. [IFRS 17.43–44]

The CSM at the reporting date equals:

- the CSM at the previous reporting date; plus
- the effect of any new contracts added to the group; plus
- interest accreted on the CSM during the period; plus/minus
- changes in fulfilment cash flows relating to future service; plus/minus
- the effect of any currency exchange differences on the CSM; minus
- the amount of the CSM recognised in profit or loss as insurance revenue because of the transfer of insurance contract services in the period. [IFRS 17.44]

The requirements for measuring the CSM under the VFA are the same as under the GMM on initial recognition. On subsequent measurement, the requirements for adjusting the CSM under the VFA are modified to reflect the specific nature of direct participating contracts. The modification conveys that the entity substantially provides investment-related services and is compensated for these services by a fee that is determined with reference to the underlying items. Therefore, under the VFA the CSM at the reporting date equals:

- the CSM at the previous reporting date; plus
- the effect of any new contracts added to the group; plus/minus
- the change in the amount of the entity's share of the fair value of the underlying items; plus/minus
- changes in the fulfilment cash flows relating to future service; plus/minus
- the effect of any currency exchange differences on the CSM; minus
- the amount of the CSM recognised in profit or loss as insurance revenue because of the transfer of insurance contract services in the period. [IFRS 17.45, B101]

Onerous contracts

Some groups of contracts may already be onerous on initial recognition and can become more or less onerous over time. A group of contracts that has a CSM at inception can become onerous in subsequent periods. This occurs if unfavourable changes relating to future service in the fulfilment cash flows, arising from changes in estimates of future cash flows and the risk adjustment for non-financial risk, exceed the carrying amount of the CSM. For direct participating contracts, any decrease (or increase) in the amount of the entity's share of the fair value of underlying items is also included in that assessment because this represents a fee for services.

There is no similar concept to the CSM under US GAAP.

Onerous contracts

Unlike IFRS Accounting Standards, US GAAP does not use the term 'onerous contracts'. For subsequent measurement of short-duration contracts, under US GAAP an entity is required to perform premium deficiency testing at each reporting date to determine whether its reported liabilities (less deferred acquisition costs and related intangible assets arising from insurance contracts acquired in a business combination) are adequate, using current estimates of future cash flows under the insurance contracts. Any shortfall is recognised in profit or loss. [944-60]

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The excess is considered the loss component of the LRC and a corresponding amount is recognised immediately in profit or loss when it is first measured. The loss component may be increased or decreased as a result of subsequent changes in estimates of future cash flows related to future service in subsequent periods. [IFRS 17.48–50]

Once a group of contracts has a loss component (either on initial recognition or subsequently), subsequent changes in the fulfilment cash flows of the LRC relating to service and finance income and expense in the current period are allocated on a systematic basis between the:

- loss component of the LRC; and
- LRC, excluding the loss component. [IFRS 17.50(a)]

The systematic allocation results in the total amounts allocated to the loss component being zero by the end of the coverage period of the group of contracts. [IFRS 17.51–52]

Subsequent decreases in fulfilment cash flows arising from changes in estimates of expected cash flows relating to future service and, for direct participating contracts, any subsequent increases in the amount of the entity's share of fair value of the underlying items are allocated solely to the loss component until it is reduced to zero. Once it has been reduced to zero, a CSM is created for the excess of the decrease over the amount allocated to the loss component. [IFRS 17.50(b)]

For subsequent measurement of certain long-duration contracts, under US GAAP an entity is required to perform premium deficiency testing at each reporting date to determine whether its reported liabilities (less intangible assets arising from insurance contracts acquired in a business combination) are adequate, using current estimates of future cash flows under the insurance contracts. Any shortfall is recognised in profit or loss. Premium deficiency testing applies to universal life-type long-duration contracts and participating life insurance contracts of mutual life insurance entities that meet certain criteria. It also applies to intangible assets arising from insurance contracts acquired in a business combination. [944-60]

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Premium allocation approach

An entity is permitted to apply the PAA to measure a group of insurance contracts if a specified condition is met (see 'Models and eligibility' above).

On initial recognition, the LRC is equal to:

- the premiums received; minus
- any insurance acquisition cash flows at that date; plus/minus
- any amount arising from the derecognition on that date of:
  - any asset recognised for insurance acquisition cash flows; or
  - any other asset or liability previously recognised. [IFRS 17.55(a)]

At each reporting date, the LRC equals:

- the previous carrying amount; plus
- the premiums received in the period; minus
- insurance acquisition cash flows paid in the period; plus
- any amortisation of insurance acquisition cash flows as an expense; plus
- any adjustment to a financing component; minus
- insurance revenue recognised for services provided in the period; minus
- any investment component paid or transferred to the LIC. [IFRS 17.55(b)]

Groups of contracts measured under the PAA are assumed not to be onerous. However, when facts and circumstances indicate that a group of contracts is onerous, the entity calculates the fulfilment cash flows for remaining coverage using the GMM requirements (subject to a possible exemption from discounting future cash flows). An adjustment and loss are recognised for any excess between measuring the LRC (applying the GMM requirements above) and the LRC (applying the PAA requirements). [IFRS 17.57]

If each contract in the group has a coverage period of one year or less, then an entity may recognise any insurance acquisition cash flows as expenses when they are incurred rather than applying the requirements above to them.

Under the PAA, the LIC is measured following the requirements of the GMM. However, if the future cash flows are expected to be paid or received within one year or less from when they are incurred, then an entity may choose not to adjust the future cash flows for the time value of money. [IFRS 17.59(b)]

Premium allocation approach

The short-duration measurement model under US GAAP is similar to the PAA model under IFRS Accounting Standards. Under US GAAP, a liability for unpaid claims and claim adjustment expenses is recognised when an insurable event occurs. Additionally, an unearned premium liability is recorded for the portion of premium revenue that the policyholder is required to pay that has not yet been earned – i.e. the portion of premium the policyholder is required to pay to cover future periods. On initial recognition, the unearned premium liability is equal to the premium that the policyholder is required to pay. At each reporting date, the subsequent measurement of the unearned premium liability is equal to:

- the previous carrying amount; plus
- any additional premium the policyholder is required to pay; minus
- premium earned during the period – i.e. the amount of premium recognised as revenue for coverage provided under the insurance contract during the period.

As such, differences from IFRS Accounting Standards may result in practice. [944-40]

For a detailed discussion of the premium deficiency evaluation for short-duration contracts under US GAAP, see 'Onerous contracts' above.

For a detailed discussion of insurance acquisition cash flows, see 'Insurance acquisition cash flows' above.

For a detailed discussion of the discounting of short-duration contract liabilities under US GAAP, see 'Discounting' above.

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Reinsurance contracts

A 'reinsurance contract' is a type of insurance contract that is issued by one entity (the reinsurer) to compensate another entity (the cedant) for claims arising from insurance contracts issued by the cedant. [IFRS 17.A, BC296]

The insurance contracts standard applies to both reinsurance contracts issued by the entity and reinsurance contracts that the entity holds. The same requirements generally apply to both insurance contracts issued and reinsurance contracts issued. However, there are certain modifications for reinsurance contracts held.

The cedant accounts for a group of reinsurance contracts held separately from the underlying contracts that it relates to because the cedant does not normally have a right to reduce the amounts that it owes to the underlying policyholder. The cedant's contractual obligations to the underlying policyholder(s) are not extinguished because the underlying contract is reinsured. [IFRS 17.BC298]

An entity needs to identify cash flows within the contract boundary when measuring a group of reinsurance contracts held. [IFRS 17.34]

Consistent assumptions are used to measure the estimates of the present value of the future cash flows for the group of reinsurance contracts held and the estimates of the present value of the future cash flows for the group(s) of underlying insurance contracts. The fulfilment cash flows are adjusted to reflect the non-performance risk of the reinsurer. [IFRS 17.63, BC300]

For a discussion of how to determine the discount rate (the same principles apply as to insurance contracts issued), see 'Discounting'.

The risk adjustment for non-financial risk for a group of reinsurance contracts held represents the amount of risk being transferred by the cedant to the reinsurer. [IFRS 17.64]

Reinsurance contracts

Like IFRS Accounting Standards, in a 'reinsurance contract' a reinsurer (assuming entity) assumes all or part of a risk undertaken originally by another insurer (ceding entity) for a consideration (premium). [944-20-Glossary]

Unlike IFRS Accounting Standards, under US GAAP all reinsurance contracts issued by the entity and reinsurance contracts that the entity holds, including contracts that may not be structured or described as reinsurance, and contract amendments are accounted for as reinsurance if they qualify for reinsurance accounting. To qualify for reinsurance accounting, a contract must indemnify the ceding entity against loss or liability relating to insurance risk. The evaluation requires a complete understanding of that contract and other contracts or agreements between the ceding entity and related reinsurer(s). Contracts that do not qualify for reinsurance accounting are accounted for as deposits (i.e. financing arrangements). [944-20-15-37, 944-20-15-40]

Like IFRS Accounting Standards, the cedant accounts for a group of reinsurance contracts held separately from the underlying contracts. Like IFRS Accounting Standards, the cedant's contractual obligations to the underlying policyholder(s) are not extinguished because the underlying contract is reinsured, unless the reinsurance contract is a legal replacement of one insurer by another. [944-40, 944-40-25-33]

Like IFRS Accounting Standards, an entity identifies cash flows within the contract boundary when measuring a reinsurance contract. [944-40]

Like IFRS Accounting Standards, under US GAAP a ceding entity recognises the reinsurance recoverable using methods and assumptions consistent with those used to measure the underlying insurance contracts, subject to the terms of the reinsurance contract. [944-40-25-34]

For a discussion of how to determine the discount rate (the same principles apply as to insurance contracts issued), see 'Discounting'.

Unlike IFRS Accounting Standards, US GAAP does not have a concept similar to the 'risk adjustment for non-financial risk'.

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For a group of reinsurance contracts held measured under the GMM, the CSM on initial recognition is the net cost or net gain from purchasing reinsurance. A group of reinsurance contracts held is not treated as onerous if it is a net cost. If the coverage of the group of reinsurance contracts held relates to events that occurred before the purchase of the group (e.g. coverage against an adverse development of claims incurred), then any net cost of purchasing reinsurance coverage is recognised immediately in profit or loss as an expense. In all other cases, the CSM at the date of initial recognition of the group equals the sum of:

- the inverse amount of the sum of the fulfilment cash flows;
- amounts derecognised for assets or liabilities previously recognised for related cash flows;
- any cash flows arising from the contracts in the group at that date; and
- any income recognised in profit or loss to cover losses on underlying insurance contracts that are onerous on initial recognition or on the addition of onerous underlying contracts to that group. [IFRS 17.65, 65A, 66A]

When an entity recognises a loss on initial recognition of underlying contracts at the same time as or after entering into a reinsurance contract held, it adjusts the CSM of the reinsurance contracts held to compensate for all or some of that loss. The entity simultaneously recognises the corresponding amount in profit or loss and establishes a loss-recovery component of the asset for remaining coverage under the reinsurance contracts. The CSM adjustment is determined by multiplying:

- the loss recognised on the underlying insurance contracts; and
- the percentage of claims on the underlying insurance contracts that the entity expects to recover from the reinsurance contract held. [IFRS 17.66A–66B, B119D]

At each reporting date, the CSM equals the net total of:

- the CSM at the previous reporting date;
- the effect of new contracts added to the group;
- interest accreted on the CSM during the period;
- any changes in fulfilment cash flows relating to future service that are not reflected in profit or loss;
- any effects of currency exchange differences on the CSM;
- any income recognised in profit or loss in the period for the recovery of losses recognised on initial recognition of underlying contracts;
- any reversals of loss-recovery components to the extent that the reversals are not changes in fulfilment cash flows of the reinsurance contracts held; and
- the amount of CSM recognised in profit or loss because of the services received during the period. [IFRS 17.66]

Unlike IFRS Accounting Standards, reinsurance contracts do not result in immediate recognition of gains, unless the reinsurance contract is a legal replacement of one insurer by another and extinguishes the ceding entity's liability to the policyholder. Those gains are deferred and recognised in earnings based on the nature of the underlying reinsured contracts (e.g. short-duration, long-duration). [944-40, 944-40-25-33]

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Investment contracts with DPFs

For investment contracts with DPFs, the following modifications are applied to the recognition and measurement requirements.

- The date of initial recognition is when the entity becomes party to the contract.
- Cash flows are within the contract boundary if they result from a substantive obligation of the entity to deliver cash at a present or future date. The entity has no substantive obligation to deliver cash if it has the practical ability to set a price for the promise to deliver cash that fully reflects the amount of cash promised and related risks.
- The CSM is recognised over the duration of the group of contracts in a systematic way that reflects the transfer of investment services under the contract – i.e. the pattern of provision of investment services. [IFRS 17.3(c), 71]

Investment contracts with DPFs

Unlike IFRS Accounting Standards, US GAAP does not address investment contracts with DPFs. As a result, differences from IFRS Accounting Standards may arise in practice. [944-50-25-2]

Derecognition and modifications

An entity derecognises an insurance contract when it is extinguished (i.e. when the obligation specified in the contract expires or is discharged or cancelled), or in some cases when its terms are modified. [IFRS 17.74]

An entity derecognises an insurance contract from within a group of insurance contracts by adjusting:

- the fulfilment cash flows to eliminate those that relate to the rights and obligations that have been derecognised from the group;
- the CSM for the change in those fulfilment cash flows to the extent applicable; and
- the number of coverage units for the expected remaining insurance contract services to reflect the coverage units derecognised from the group. [IFRS 17.76]

Contract modification could be a result of either an agreement between the parties or a change in regulation. The exercise of a right included in the contract is not a modification. If the terms of a contract are modified in a way that would have significantly changed the accounting for the contract had the new terms always existed, then the modification triggers derecognition of the original contract and recognition of a new contract. This applies if any of the following conditions are met.

- If the modified terms had been included at contract inception:
  - the contract would have been excluded from the scope of the insurance contracts standard;
  - the entity would have separated different components from the host insurance contract, resulting in a different insurance contract to which the insurance contracts standard applies;
  - the modified contract would have had a substantially different contract boundary; or
  - the modified contract would have been included in a different group of contracts.

Derecognition and modifications

Like IFRS Accounting Standards, an entity derecognises an insurance contract when it is extinguished. Unlike IFRS Accounting Standards, under US GAAP an insurance contract with annuity benefits is derecognised on the date of annuitisation and a liability for the pay-out annuity is established. As such, differences from IFRS Accounting Standards may arise in practice. [944-40, 944-40-35-16]

Like IFRS Accounting Standards, an entity derecognises a contract in some cases when its terms are modified. Unlike IFRS Accounting Standards, the evaluation for contract modification and derecognition depends on whether the contract modification substantially changed the replaced contract. As a result, differences from IFRS Accounting Standards may arise in practice. [944-30]

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- The original contract is a direct participating contract, but the modified contract no longer is (or vice versa).
- The entity applied the PAA to the original contract, but the modified contract no longer meets the eligibility criteria for it. [IFRS 17.72]

Contract modifications that do not meet any of the conditions above are accounted for as changes in estimates of fulfilment cash flows. [IFRS 17.72–73, BC317]

Insurance contracts acquired

Insurance contracts issued and reinsurance contracts held that are acquired in a business combination in the scope of the business combinations standard or in a transfer of insurance contracts that do not form a business combination (portfolio transfer) are classified and measured in the same way as insurance contracts issued by the entity at the date of the transaction. The entity identifies the groups of contracts acquired based on the level of aggregation requirements as if it had entered into the contracts at the date of the transaction. [IFRS 17.39, B93–B95]

For the purpose of measuring the LRC for contracts acquired, the consideration received or paid for the contracts is treated as a proxy for the premiums received. For contracts acquired in a business combination that are in the scope of the business combinations standard, this consideration is deemed to be the contracts' fair value at the transaction date. [IFRS 17.B94, BC166, 13.47]

If the contracts acquired are onerous, then the difference between the consideration received or paid and the fulfilment cash flows is treated differently for contracts:

- acquired in a business combination in the scope of the business combinations standard: the excess of the fulfilment cash flows over the consideration paid or received is recognised as part of goodwill or the gain on a bargain purchase; and
- acquired in a portfolio transfer of insurance contracts: the excess of the fulfilment cash flows over the consideration paid or received is recognised as a loss in profit or loss. [IFRS 17.B95A]

Once the newly acquired contracts have been initially recognised, an entity applies all of the other requirements of the insurance contracts standard in the same way as for any other insurance contract.

Insurance contracts acquired

Like IFRS Accounting Standards, a liability for the acquired insurance contracts is measured in accordance with the insurer's existing accounting policies. The entity measures at fair value the assets and liabilities arising from insurance contracts acquired in a business combination at the date of the transaction. Unlike IFRS Accounting Standards, an entity is required to split and recognise the fair value of the acquired insurance contracts in two components:

- a liability measured in accordance with the insurer's existing accounting policies; and
- an intangible asset, representing the difference between the fair value of the acquired insurance contracts and the reported amount under the first component. [944-805-30-1]

Like IFRS Accounting Standards, once the newly acquired contracts have been initially recognised, an entity applies all the other requirements of the financial services – insurance Codification Topic in the same way as for any other insurance contract. [944]

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Presentation

The insurance contracts standard requires presentation of amounts relating to insurance contracts issued separately from reinsurance contracts held in the primary statements.

Insurance contracts and reinsurance contracts held need to be aggregated by portfolio and presented separately in the statement of financial position as follows:

- insurance contracts issued that are assets;
- insurance contracts issued that are liabilities;
- reinsurance contracts held that are assets; and
- reinsurance contracts held that are liabilities. [IFRS 17.98]

An entity is required to disaggregate the amounts recognised in the statement of profit or loss and OCI into:

- an insurance service result comprising insurance revenue and insurance service expenses; and
- insurance finance income or expense. [IFRS 17.80, IAS 1.82]

An entity may present income or expense from reinsurance contracts held other than insurance finance income or expenses as a single amount or it may present separately the amounts recovered from the reinsurer and an allocation of the premiums paid. [IFRS 17.86]

For contracts not measured applying the PAA, insurance revenue is derived from the changes in the LRC for each reporting period that relate to services for which the entity expects to receive consideration. For contracts measured applying the PAA, the insurance revenue is the amount of expected premium receipts for providing services in the period. Investment components do not represent consideration for providing services and are not included in insurance revenue.

An entity can disaggregate insurance finance income or expense between profit or loss and OCI. This disaggregation choice is made at a portfolio of insurance contracts level.

Where this disaggregation choice is made, an entity applies a systematic allocation of total insurance finance income or expense between profit or loss and OCI.

Presentation

Like IFRS Accounting Standards, US GAAP requires the ceding entity to present amounts relating to insurance contracts issued separately from reinsurance contracts on the balance sheet – e.g. to present reinsurance recoverables and prepaid reinsurance premiums separately from the related underlying liabilities. [944-310-25-2]

Unlike IFRS Accounting Standards, US GAAP does not require further disaggregation in the balance sheet.

Unlike IFRS Accounting Standards, under US GAAP the accounting and presentation of insurance revenue varies and depends on whether a contract is classified as short-duration, long-duration or financial guarantee and, if it is a long-duration contract, whether it is whole-life, universal life, guaranteed renewable term life, endowment, annuity or participating life.

Like IFRS Accounting Standards, US GAAP permits the amounts of earned premiums ceded and recoveries recognised under reinsurance contracts to be presented net in the income statement. However, unlike IFRS Accounting Standards, under US GAAP an entity does not present insurance finance income or expense. [944-605-50-1]

Unlike IFRS Accounting Standards, under US GAAP an entity does not present insurance finance income or expense. [944-605-50-1]

Under US GAAP, changes in the discount rate used to measure traditional and limited-payment long-duration contracts, and changes in instrument-specific credit risk of market risk benefits, are recognised in OCI.

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Disclosures

The insurance contracts standard contains extensive disclosure requirements that are designed to enable users of the financial statements to assess the effects that insurance contracts have on an entity's financial position, financial performance and cash flows. To meet this objective the disclosure requirements focus on qualitative and quantitative information about:

- amounts recognised in the financial statements;
- significant judgements and changes in those judgements; and
- the nature and extent of risks that arise from insurance contracts. [IFRS 17.93]

If the specified disclosures are insufficient to meet the objective, then an entity discloses additional information that is necessary to meet the objective. [IFRS 17.94]

Disclosures

Like IFRS Accounting Standards, US GAAP contains extensive disclosure requirements to provide users of the financial statements with decision-useful financial information, helping them understand the amount, timing and uncertainty of risks arising from insurance cash flows. [944]

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Appendix – Effective dates: US GAAP

The following table shows the effective dates of Accounting Standards Updates (ASUs) issued by 31 October 2025 that are not yet effective for all entities. The titles have been condensed and are not necessarily the exact titles of the ASUs. For completeness, this table also includes the interim periods in which ASUs are effective. Not-for-profit entities and employee benefit plans are not in the scope of this publication and are therefore excluded. Amendments that comprise minor Codification improvements and conforming SEC content updates are also excluded.

For many ASUs, the effective date distinguishes between entities that are public business entities and other entities; the comparisons in this publication typically refer to public and non-public entities for simplicity. In some cases, the FASB may make a further distinction between SEC filers and non-SEC filers.

Since 2019, the FASB has sometimes made a further distinction in effective dates between SEC filers that are eligible to be 'smaller reporting companies' (under the SEC's definition) and other SEC filers. A smaller reporting company is a registrant that generally has a public float of less than $250 million, or annual revenues of less than $100 million (as of the most recent annual period for which audited financial statements are available) and a public float ranging from $0 to less than $700 million.

A public business entity is a business entity (which excludes not-for-profit entities and employee benefit plans) that meets any of the following criteria.

- It is required by the SEC to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
- It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
- It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for the purposes of issuing securities that are not subject to contractual restrictions on transfer.
- It has issued, or is a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market.
- It has one or more securities that are not subject to contractual restrictions on transfer, and is required by law, contract or regulation to prepare US GAAP financial statements (including notes) and make them publicly available on a periodic basis (e.g. interim or annual periods). An entity is required to meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In this case, the entity is a public business entity only for the purposes of financial statements that are filed or furnished with the SEC.

Unless otherwise noted, the effective dates in the following table should be read as periods in fiscal years beginning **after** the stated date.

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In this table:
A = annual periods
I = interim periods
SRC = smaller reporting company

	Chapter		Public business entities			All other entities	Early adoption allowed?
			SEC filers		Not an SEC filer		
			Not eligible to be an SRC	Eligible to be an SRC			
ASU 2025-07: Derivatives scope refinements and scope clarification for share-based non-cash consideration from a customer in a revenue contract	7.2	A	15 Dec 2026	15 Dec 2026	15 Dec 2026	15 Dec 2026	Yes
		I	15 Dec 2026	15 Dec 2026	15 Dec 2026	15 Dec 2026	
ASU 2025-06: Targeted improvements to the accounting for internal-use software	3.3	A	15 Dec 2027	15 Dec 2027	15 Dec 2027	15 Dec 2027	Yes
		I	15 Dec 2027	15 Dec 2027	15 Dec 2027	15 Dec 2027	
ASU 2025-05: Measurement of credit losses for accounts receivable and contract assets	7.8	A	15 Dec 2025	15 Dec 2025	15 Dec 2025	15 Dec 2025	Yes
		I	15 Dec 2025	15 Dec 2025	15 Dec 2025	15 Dec 2025	
ASU 2025-04: Clarifications to share-based consideration payable to a customer	4.2, 4.5	A	15 Dec 2026	15 Dec 2026	15 Dec 2026	15 Dec 2026	Yes
		I	15 Dec 2026	15 Dec 2026	15 Dec 2026	15 Dec 2026	
ASU 2025-03: Determining the accounting acquirer in the acquisition of a variable interest entity	2.6	A	15 Dec 2026	15 Dec 2026	15 Dec 2026	15 Dec 2026	Yes
		I	15 Dec 2026	15 Dec 2026	15 Dec 2026	15 Dec 2026	
ASU 2024-04: Induced conversions of convertible debt instruments	7.3	A	15 Dec 2025	15 Dec 2025	15 Dec 2025	15 Dec 2025	Yes
		I	15 Dec 2025	15 Dec 2025	15 Dec 2025	15 Dec 2025	
ASU 2024-03: Disaggregation of income statement expenses; ASU 2025-01: Clarifying the effective date	4.1, 4.1A	A	15 Dec 2026	15 Dec 2026	15 Dec 2026	N/A	Yes
		I	15 Dec 2027	15 Dec 2027	15 Dec 2027	N/A	
ASU 2024-01: Stock compensation – Scope application of profits interest and similar awards	–[1]	A	Effective	Effective	Effective	15 Dec 2025	Yes
		I	Effective	Effective	Effective	15 Dec 2025	
ASU 2023-09: Improvements to income tax disclosures	–[2]	A	Effective	Effective	Effective	15 Dec 2025	Yes
		I	N/A	N/A	N/A	N/A	
ASU 2022-05: Financial services – Insurance – Transition for sold contracts	8.1	A	Effective	Effective	Effective	Effective	Yes
		I	Effective	15 Dec 2025	15 Dec 2025	15 Dec 2025	

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In this table:
A = annual periods
I = interim periods
SRC = smaller reporting company

	Chapter		Public business entities			All other entities	Early adoption allowed?
			SEC filers		Not an SEC filer		
			Not eligible to be an SRC	Eligible to be an SRC			
ASU 2020-11: Financial services – Insurance – Effective date and early application	8.1	A	Effective	Effective	Effective	Effective	Yes
		I	Effective	15 Dec 2025	15 Dec 2025	15 Dec 2025	
ASU 2018-12: Financial services – Insurance – Targeted improvements to the accounting for long-duration contracts; ASU 2020-11: Financial services – Insurance – Deferral of effective date	8.1	A	Effective	Effective	Effective	Effective	Yes
		I	Effective	15 Dec 2025	15 Dec 2025	15 Dec 2025	

Notes:

1. The amendments in this ASU are not (fully) included in this publication because they are too detailed relative to the differences highlighted.
2. The amendments in this ASU are not included because they impact disclosures that are not the focus of this publication.

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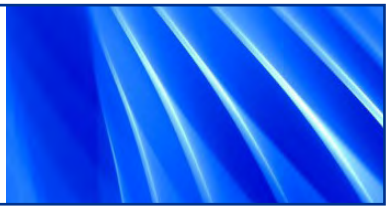

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