Other IFRS publications
PricewaterhouseCoopers has published the following publications on International Financial Reporting Standards. They are available from your nearest PricewaterhouseCoopers office or as indicated.

Manual of Accounting – IFRS for the UK 2005
Accounting Briefing newsletter
Applying IFRS – Finding the right solution (available on PwC inform)
IAS 39 Hedging – Aligning theory with practice
IFRS / UK illustrative financial statements 2005
IFRS / UK main differences indicator – June 2005
IFRS Illustrative Consolidated Corporate Financial Statements 2004
IFRS Illustrative Consolidated Financial Statements 2004 – Banks
IFRS Illustrative Consolidated Financial Statements 2004 – Insurance
IFRS Illustrative Consolidated Financial Statements 2004 – Investment Property
IFRS Illustrative Financial Statements 2004 – Investment Funds
IFRS in the UK: Convergence at a glance
IFRS in the UK: Latest developments – June 2005
IFRS in the UK: PwC inform IFRS site map
IFRS in the UK: Your guide to conversion
IFRS Disclosure Checklist 2004
IFRS Measurement Checklist 2004
IFRS News – Shedding light on the IASB’s activities
IFRS Pocket Guide 2004
IFRS: Ready for take-off? – a survey of over 300 companies’ readiness for IFRS
Illustrative Interim Financial Statements for First-time Adopters
Share-based Payment – A practical guide to applying IFRS 2
SIC-12 and FIN 46R – the substance of control
World Watch – Governance and Corporate Reporting

1 You can register for a 60-day free trial of PwC inform (www.pwcinform.com) by calling +44 (0) 20 7213 4030 or e-mailing pwcinform.sysadmin@uk.pwc.com

2 You can purchase these books by completing the online registration form accessible from www.pwc.com/uk (select Publications)

3 Only available on the PwC inform website

Contact your nearest PricewaterhouseCoopers office for a hard copy of all the other listed publications or e-mail our Publications department on Publications@emea-uk.intl.pwc.com.

Contacting PricewaterhouseCoopers
To discuss any of the issues raised with one of PricewaterhouseCoopers’ experts, please refer to the list of names at the back of this publication or speak to your usual PricewaterhouseCoopers contact.
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Preface

International Financial Reporting Standards (IFRS) will be adopted for the first time in 2005 by all UK listed groups and some unlisted groups and companies. The International Accounting Standards Board (IASB) has been busy putting in place a stable platform of IFRS for first-time adopters. Since 2002, the IASB and the US Financial Accounting Standards Board (FASB) have been committed to working towards converging the two frameworks. Despite convergence initiatives, there are many differences between the two frameworks, which this publication seeks to highlight.

Further, the UK’s Accounting Standards Board (ASB) has been working to gradually converge UK GAAP with IFRS. This has resulted in the issue of seven new UK accounting standards based on their international equivalents in 2004 and plans for the issue of more over the coming months and years.

This publication provides a means by which companies can quickly identify key similarities and differences between IFRS, US GAAP and UK GAAP.

Developments under all three frameworks are ongoing, and this publication has been updated to fully reflect the final standards required for 2005.

I hope this latest version of the publication helps you keep pace with the changes and assists in identifying the similarities and differences that exist between IFRS, US GAAP and UK GAAP.

Peter Holgate
Senior Partner UK Accounting Technical
PricewaterhouseCoopers
Introduction

This PricewaterhouseCoopers publication is for those who wish to gain a broad understanding of the key similarities and differences between three accounting frameworks: International Financial Reporting Standards (IFRS), US Generally Accepted Accounting Principles (US GAAP) and UK Generally Accepted Accounting Principles (UK GAAP). The first section provides details of the plans to converge UK and US GAAP with IFRS. The second section provides a summary of the similarities and differences between IFRS, US GAAP and UK GAAP and refers to subsequent sections where key divergences are highlighted and the likely impact of recent proposals are explained.

No summary publication can do justice to the many differences of detail that exist between IFRS, US GAAP and UK GAAP. Even if the guidance is similar, there can be differences in the detailed application, which could have a material impact on the financial statements. In this publication, we have focused on the measurement similarities and differences most commonly found in practice. When applying the individual accounting frameworks, readers must consult all the relevant accounting standards and, where applicable, their national law. Listed companies must also follow relevant securities regulations – for example, the Listing Rules of the United Kingdom Listings Authority or other applicable stock exchange listing rules.

This publication takes account of authoritative pronouncements issued under IFRS, US GAAP and UK GAAP up to 31 December 2004 (for US GAAP, the relevant date is 30 June 2004) and is based on the most recent version of those pronouncements, should an earlier version of a pronouncement still be operative at the date of this publication.

PLEASE NOTE: This publication does not take account of the following developments in IFRS, which had not been made into authoritative pronouncements as of 31 December 2004:

- Amendment to IAS 39 Financial Instruments: Recognition and Measurement – Cash flow hedge accounting of forecast intragroup transactions
- Amendment to IAS 39, Financial Instruments: Recognition and Measurement – Transition and initial recognition of financial assets and financial liabilities
- Amendment to IAS 39, Financial Instruments: Recognition and Measurement – The fair value option
- ED7, Financial instrument disclosures
- IFRIC D5, Applying IAS 29, Financial reporting in hyperinflationary economies for the first time
- IFRIC D6, Multi-employer plans
- IFRIC D7, Scope of SIC-12 consolidations – Special purpose entities
- IFRIC D9, Employee benefit plan with a promised return on contributions or notional contributions
- IFRIC D10, Waste electrical and electronic equipment
- IFRIC D11, Changes in contributions to employee share purchase plans (IFRS 2)
- IFRIC D12, Service concession arrangements – Determining the accounting model
- IFRIC D13, Service concession arrangements – The financial asset model
- IFRIC D14, Service concession arrangements – The intangible asset model
- IFRIC D15, Reassessment of embedded derivatives
- IFRIC D16, Scope of IFRS 2
- IFRIC D17, IFRS 2 – Group and treasury share transactions
- Discussion paper – Preliminary views on accounting for small and medium-sized entities
Convergence

Both the Accounting Standards Board (ASB) in the UK and the Financial Accounting Standards Board (FASB) in the US are working with the International Accounting Standards Board (IASB) to converge UK GAAP and US GAAP respectively with IFRS.

US Convergence

The following key initiatives aim to further the goal of convergence between IFRS and US GAAP, in addition to the IASB and the FASB’s monitoring of the activities of the other board and their explicit consideration of the other board’s agenda decisions:

Joint projects. Joint projects are the projects that both boards have agreed to conduct simultaneously in a co-ordinated manner. They involve sharing staff resources, and every effort is made to keep joint projects to a similar time schedule. The IASB and the FASB are currently conducting joint projects to address revenue recognition and business combinations.

The short-term convergence project. The short-term convergence project is an active project that is being conducted jointly between the IASB and the FASB. The scope of the short-term convergence project is limited to those differences between IFRS and US GAAP in which convergence around a high-quality solution appears achievable in the short-term. Because of the nature of the differences, it is expected that a high-quality solution can usually be achieved by selecting either existing IFRS or US GAAP.

The convergence research project. The FASB staff is currently working on a research project related to convergence. The project seeks to identify all of the substantive differences between US GAAP and IFRS and to catalogue those differences. The project’s scope includes differences in standards addressing recognition, measurement, presentation and disclosure. Any topic in which a specific accounting treatment would be permissible under one basis of accounting but would not be permissible under the other basis of accounting is included in the scope.

While significant progress towards international convergence is expected to be made in the next few years, the volume of differences and the complex nature of some issues means that many differences between IFRS and US GAAP will remain well beyond 2005.

UK Convergence

For UK listed companies, group accounts are required to be prepared under EU adopted IFRS for accounting periods beginning on or after 1 January 2005. Furthermore, other private UK companies and groups have the option to adopt IFRS. However, UK company law now requires consistency of application of IFRS or UK GAAP for all companies within these groups. The options for using EU-adopted IFRS operate separately for consolidated and individual financial statements. It is therefore permissible for companies to use EU-adopted IFRS in their consolidated financial statements whilst using UK GAAP in their individual financial statements or vice versa (except that listed companies must use EU-adopted IFRS in their consolidated financial statements).

All UK group companies must, however, adopt the same accounting framework in their individual accounts (unless there are good reasons for not doing so), except that the parent can use EU-adopted IFRS in its individual financial statements without this triggering a requirement for all the subsidiaries to use EU-adopted IFRS, but only if the parent has used EU-adopted IFRS in its consolidated financial statements.

The ASB intends to achieve convergence of UK standards with IFRS as quickly as possible whilst avoiding the burden of excessive changes in any one year and, in particular, minimising the cases in which an entity using UK standards may be required to make successive changes of accounting policy in respect of the same matter. The ASB proposes to adopt a phased approach to convergence, bringing standards based on IFRS into UK GAAP. In pursuing this strategy, the ASB will pay close attention to its responsibility to try to minimise the burdens of change.
In practical terms, this means:

- effective in 2005 and 2006, new standards that will enhance existing UK financial reporting requirements and keep them in step with changes in the law; and
- thereafter, a series of ‘step changes’ replacing one or more existing UK accounting standards with standards based on IFRS, as IASB projects are completed.

Given the present uncertainties in the international financial reporting climate, the ASB have not suggested a specific date by which total conformity may be achieved, but hopes that the period of convergence will not be unduly prolonged.

Summary of standards issued to date on Convergence

The ASB have issued a number of standards converging UK GAAP with IFRS. The table below summarises the applicability of the new standards, depending on the type of entity and timing of accounting period.

<table>
<thead>
<tr>
<th>UK standard</th>
<th>IAS equivalent</th>
<th>Listed 1</th>
<th>Unlisted, but applying Companies Act fair value accounting rules</th>
<th>Other unlisted</th>
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<tr>
<td>FRS 20 – Share-based payment</td>
<td>IFRS 2</td>
<td>Periods beginning on or after 1 January 2005</td>
<td>Periods beginning on or after 1 January 2006</td>
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<td>FRS 21 – Events after the balance sheet date</td>
<td>IAS 10</td>
<td>Periods beginning on or after 1 January 2005</td>
<td></td>
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<tr>
<td>FRS 22 – Earnings per share</td>
<td>IAS 33</td>
<td>Periods beginning on or after 1 January 2005</td>
<td>Application not mandatory</td>
<td></td>
</tr>
<tr>
<td>FRS 23 – The effects of changes in foreign exchange rates</td>
<td>IAS 21</td>
<td>Periods beginning on or after 1 January 2005</td>
<td>Periods beginning on or after 1 January 2006</td>
<td>Will apply if/when entity applies FRS 26</td>
</tr>
<tr>
<td>FRS 24 – Financial reporting in hyper-inflationary economies</td>
<td>IAS 29</td>
<td>Periods beginning on or after 1 January 2005</td>
<td>Periods beginning on or after 1 January 2006</td>
<td></td>
</tr>
<tr>
<td>FRS 25 – Financial instruments: Disclosure and presentation</td>
<td>IAS 32 – Presentation</td>
<td>Periods beginning on or after 1 January 2005</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>IAS 32 – Disclosure</td>
<td>Periods beginning on or after 1 January 2005</td>
<td>Periods beginning on or after 1 January 2006</td>
<td>Will apply if/when entity applies FRS 26</td>
</tr>
<tr>
<td>FRS 26 – Financial instruments: Measurement</td>
<td>IAS 39</td>
<td>Periods beginning on or after 1 January 2005</td>
<td>Periods beginning on or after 1 January 2006</td>
<td>To be confirmed (current proposal is for periods beginning 1 January 2007)</td>
</tr>
</tbody>
</table>

1A listed entity is one that has in issue debt, shares or other financial or similar instrument that is traded on a regulated market of any EU member state. Hence, AIM companies that only have their shares quoted on AIM are not listed nor are entities that have their securities traded only on a market outside of the EU (for example, New York Stock Exchange)

The ASB regards FRSs 23, 24 and 26, together with the disclosure requirements of FRS 25 as a package, whose application is determined by reference to an entity’s implementation of FRS 26. Entities applying the ‘Financial reporting standard for smaller entities’ (FRSSE) are to be exempt from the requirements contained in these standards. The transitional rules that apply when an entity applies these standards for the first time are based on the rules of the IAS equivalent standards. In addition, there are certain provisions contained in IFRS 1, ‘First-time adoption of International Financial Reporting Standards’, that have been incorporated into the UK standards.
## Summary of similarities and differences

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<tr>
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<th>IFRS</th>
<th>US GAAP</th>
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<td><strong>Accounting framework</strong></td>
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<tr>
<td>Historical cost</td>
<td>Uses historical cost, but intangible assets, property plant and equipment (PPE) and investment property may be revalued. Derivatives, biological assets and certain securities must be revalued.</td>
<td>No revaluations except some securities and derivatives at fair value.</td>
<td>Similar to IFRS, but derivatives are generally not recognised at fair value. Securities may be shown at fair value. Investment property must be revalued.</td>
<td>19</td>
</tr>
<tr>
<td>Fair presentation override</td>
<td>In extremely rare cases, entities may override the standards where essential to give a fair presentation.</td>
<td>Conceptually similar to IFRS, but not used in practice.</td>
<td>Similar to IFRS where essential to give a true and fair view. It typically applies in rare cases when it is necessary to override company law to give a true and fair view.</td>
<td>20</td>
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<tr>
<td>First-time adoption of accounting frameworks</td>
<td>Full retrospective application of all IFRSs effective at the reporting date for an entity’s first IFRS financial statements, with some optional exemptions and limited mandatory exceptions.</td>
<td>First-time adoption of US GAAP requires retrospective application. In addition, particular standards specify treatment for first-time adoption of those standards.</td>
<td>Similar to US GAAP.</td>
<td>20</td>
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<tr>
<td><strong>Financial statements</strong></td>
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<td></td>
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<tr>
<td>Components of financial statements</td>
<td>Two years’ balance sheets, income statements, cash flow statements, changes in equity and accounting policies and notes.</td>
<td>Similar to IFRS, except three years required for public companies for all statements except balance sheet.</td>
<td>Similar to IFRS.</td>
<td>21</td>
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<tr>
<td>Balance sheet</td>
<td>Does not prescribe a particular format; an entity uses a liquidity presentation of assets and liabilities, instead of a current/non-current presentation, only when a liquidity presentation provides more relevant and reliable information. Certain items must be presented on the face of the balance sheet.</td>
<td>Entities may present either a classified or non-classified balance sheet. Items on the face of the balance sheet are generally presented in decreasing order of liquidity. Public companies must follow SEC guidelines regarding minimum disclosure requirements.</td>
<td>Company Law specifies two alternative formats. Items presented are similar to IFRS, except shareholders’ funds are required to be analysed into equity and non-equity elements. In addition, separate presentation of fixed assets and current assets is required.</td>
<td>22</td>
</tr>
<tr>
<td>Income statement</td>
<td>Does not prescribe a standard format, although expenditure must be presented in one of two formats (function or nature). Certain items must be presented on the face of the income statement.</td>
<td>Present as either a single-step or multiple-step format. Expenditures must be presented by function.</td>
<td>Company law specifies four alternative formats.</td>
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### Financial statements (continued)

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<tr>
<td>Exceptional items</td>
<td>Does not use the term, but requires separate disclosure of items that are of such size, incidence or nature that require separate disclosure to explain the performance of the entity.</td>
<td>Similar to IFRS, but individually significant items should be presented on the face of the income statement.</td>
<td>Disclose by way of note, or where necessary to give a true and fair view, on the face of the income statement. Classify with related line item unless ‘super-exceptional’</td>
<td>24</td>
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<tr>
<td>Extraordinary items</td>
<td>Prohibited.</td>
<td>Defined as being both infrequent and unusual, and are rare. Negative goodwill is presented as an extraordinary item.</td>
<td>Extra-ordinary items are non-existent by virtue of their definition.</td>
<td>24</td>
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<tr>
<td>Statement of recognised gains and losses/Other comprehensive income</td>
<td>Present the statement of recognised gains and losses either in notes or highlight separately in primary statement of changes in shareholder equity (unless actuarial gains and losses are recognised in equity in which case an entity would be required to prepare a statement of recognised income and expense).</td>
<td>Disclose total comprehensive income and accumulated other comprehensive income, either as a separate primary statement or combined with income statement, or with statement of changes in stockholders’ equity.</td>
<td>Give primary statement of total recognised gains and losses (STRLGL).</td>
<td>24</td>
</tr>
<tr>
<td>Statement of changes in shareholders’ equity</td>
<td>Statement showing capital transactions with owners, the movement in accumulated profit and a reconciliation of all other components of equity. The statement must be presented as a primary statement.</td>
<td>Similar to IFRS. SEC rules allow such information to be included in the notes.</td>
<td>Requires a reconciliation of movements in shareholders’ funds, but this need not be a primary statement.</td>
<td>25</td>
</tr>
<tr>
<td>Cash flow statements – format and method</td>
<td>Standard headings, but limited flexibility of contents. Use direct or indirect method.</td>
<td>Similar headings to IFRS, but more specific guidance for items included in each category. Use direct or indirect method.</td>
<td>More standard headings than IFRS. Use direct or indirect method.</td>
<td>25, 26</td>
</tr>
<tr>
<td>Cash flow statements – definition of cash and cash equivalents</td>
<td>Cash includes overdrafts and cash equivalents with short-term maturities (less than three months).</td>
<td>Cash excludes overdrafts but includes cash equivalents with short-term maturities.</td>
<td>Cash includes overdrafts but excludes cash equivalents.</td>
<td>25</td>
</tr>
<tr>
<td>Cash flow statements – exemptions</td>
<td>No exemptions.</td>
<td>Limited exemptions for certain investment entities.</td>
<td>Limited exemptions for parent companies where consolidated accounts are prepared, certain subsidiaries and certain mutual funds.</td>
<td>25</td>
</tr>
<tr>
<td>Changes in accounting policy</td>
<td>Restate comparatives and prior-year against opening retained earnings.</td>
<td>Include effect in current-year income statement. Disclose pro-forma comparatives. Include retrospective adjustments for specific items.</td>
<td>Similar to IFRS.</td>
<td>27</td>
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<td>SUBJECT</td>
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<td>Financial statements (continued)</td>
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<tr>
<td>Correction of errors</td>
<td>Restate comparatives.</td>
<td>Similar to IFRS.</td>
<td>Similar to IFRS for fundamental errors. All other errors adjusted through current year income with disclosure.</td>
<td>27</td>
</tr>
<tr>
<td>Changes in accounting estimates</td>
<td>Reported in income statement in the current period.</td>
<td>Similar to IFRS.</td>
<td>Similar to IFRS.</td>
<td>27</td>
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<tr>
<td>Consolidated financial statements</td>
<td></td>
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</tr>
<tr>
<td>Definition of subsidiary</td>
<td>Based on voting control or power to govern. The existence of currently exercisable potential voting rights is also taken into consideration.</td>
<td>Controlling interest through majority ownership of voting shares or by contract. Consolidate variable interest entities (VIEs) in which a parent does not have voting control but absorbs the majority of losses or returns.</td>
<td>Similar to IFRS.</td>
<td>28</td>
</tr>
<tr>
<td>Special purposes entities (SPEs)</td>
<td>Consolidate where the substance of the relationship indicates control.</td>
<td>Consolidate SPEs if consolidation requirements for VIEs are met. To avoid consolidation, the SPE must be a qualifying SPE.</td>
<td>Requires consolidation of &quot;quasi subsidiaries&quot;.</td>
<td>28</td>
</tr>
<tr>
<td>Non-consolidation of subsidiaries</td>
<td>Dissimilar activities or temporary control are not a justification for non-consolidation.</td>
<td>Only if control does not rest with the majority owner and the owner is not the primary beneficiary of a VIE.</td>
<td>Company Law permits exclusion where the subsidiary is not material, where information cannot be gathered without undue expense or delay, where there are severe long-term restrictions or where the interest is held exclusively with a view to resale.</td>
<td>29</td>
</tr>
<tr>
<td>Definition of associate</td>
<td>Based on significant influence defined as ‘power to participate’; presumed if 20% interest or participation in entity’s affairs.</td>
<td>Similar to IFRS.</td>
<td>Requires evidence of exercise of significant influence.</td>
<td>31</td>
</tr>
<tr>
<td>Presentation of associate results</td>
<td>Use equity method. Show share of post-tax result as a single line item.</td>
<td>Similar to IFRS.</td>
<td>Use expanded equity method. Share of operating profit, exceptional items and tax shown separately.</td>
<td>31</td>
</tr>
<tr>
<td>Disclosures about significant associates</td>
<td>Give detailed information on significant associates’ assets, liabilities and results.</td>
<td>Similar to IFRS.</td>
<td>Similar to IFRS.</td>
<td>31</td>
</tr>
<tr>
<td>Presentation of joint ventures</td>
<td>Both proportional consolidation and equity method permitted.</td>
<td>Equity method required except in specific circumstances.</td>
<td>Use gross equity method. Proportional consolidation not permitted.</td>
<td>32</td>
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### Business combinations

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<tbody>
<tr>
<td>Types</td>
<td>All business combinations are acquisitions.</td>
<td>Similar to IFRS.</td>
<td>UK GAAP permits merger accounting where a business combination meets specified criteria. Mergers are rare.</td>
<td>35</td>
</tr>
<tr>
<td>Purchase method – fair values on acquisition</td>
<td>Fair value the assets, liabilities and contingent liabilities of acquired entity. Only recognise liabilities for restructuring activities when the acquiree has an existing liability at acquisition date. Prohibited from recognising liabilities for further losses or other costs expected to be incurred as a result of the business combinations.</td>
<td>Similar to IFRS. but specific rules for acquired in-process research and development (generally expensed) and contingent liabilities. Some restructuring liabilities relating solely to the acquired entity may be recognised in fair value exercise if specific criteria about restructuring plans are met.</td>
<td>Similar to IFRS.</td>
<td>35</td>
</tr>
<tr>
<td>Purchase method – contingent consideration</td>
<td>Include in cost of combination at acquisition date if adjustment is probable and can be measured reliably.</td>
<td>Not recognised until the contingency is resolved or the amount is determinable.</td>
<td>Similar to IFRS. Reasonable estimates of amounts expected to be paid should be included in the cost of acquisition.</td>
<td>36</td>
</tr>
<tr>
<td>Purchase method – minority interests at acquisition</td>
<td>State at minority’s proportion of the net fair value of acquired identifiable assets, liabilities and contingent liabilities.</td>
<td>Generally state at share of pre-acquisition carrying value of net assets.</td>
<td>State at share of fair value of net assets.</td>
<td>37</td>
</tr>
<tr>
<td>Purchase method - goodwill and intangible assets with indefinite useful lives</td>
<td>Capitalise but do not amortise. Review goodwill and indefinite-lived intangible assets for impairment at least annually at the cash-generating unit level.</td>
<td>Similar to IFRS; however, impairment measurement model is different.</td>
<td>Capitalise and amortise over useful life, normally not longer than 20 years. Indefinite life may be used in certain circumstances although an annual impairment review is required.</td>
<td>37</td>
</tr>
<tr>
<td>SUBJECT</td>
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<tr>
<td>Business combinations (continued)</td>
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</tr>
<tr>
<td>Purchase method – negative goodwill</td>
<td>Acquirer to reassess the identification and measurement of acquiree’s identifiable assets, liabilities and contingent liabilities. Any excess remaining after that reassessment is recognised in income statement immediately.</td>
<td>Reduce proportionately the fair values assigned to non-current assets (with certain exceptions). Any excess is recognised in the income statement immediately as an extraordinary gain.</td>
<td>Acquirer to reassess the identification and measurement of acquiree’s separable assets, liabilities and contingent liabilities. Any excess remaining is recognised as a negative asset and recognised in the income statement to match depreciation of non-monetary assets. Any excess over the fair value of such assets is recognised in the income statement over the period likely to benefit.</td>
<td>38</td>
</tr>
<tr>
<td>Purchase method – subsequent adjustments to fair values</td>
<td>Fair values can be adjusted against goodwill within 12 months of the acquisition date. Record subsequent adjustments in income statement unless they are to correct an error.</td>
<td>Similar to IFRS. Once the fair value allocation is finalised, no further changes are permitted except for the resolution of known pre-acquisition contingencies. Record against goodwill the adjustments made during the allocation period relating to data for which management was waiting to complete the allocation.</td>
<td>Similar to IFRS, although fair values can be adjusted against goodwill until the end of the first accounting period starting after the acquisition date.</td>
<td>38</td>
</tr>
<tr>
<td>Purchase method – disclosure</td>
<td>Disclosures include names and descriptions of combining entities, date of acquisition, cost of combination, summary of fair values and pre-acquisition IFRS values of assets and liabilities acquired, and impact on results and financial position of acquirer.</td>
<td>Similar to IFRS, with additional disclosures regarding the reasons for the acquisition, and details of allocations.</td>
<td>Similar to IFRS, but must also present table showing book values, accounting policy adjustments, fair value adjustments and fair values of acquired assets and liabilities.</td>
<td>39</td>
</tr>
<tr>
<td>Uniting of interests method</td>
<td>Prohibited.</td>
<td>Same as IFRS.</td>
<td>Permitted only where specified criteria are met. Criteria include size of entities and low-level limits on share consideration.</td>
<td>41</td>
</tr>
</tbody>
</table>
### Revenue recognition

<table>
<thead>
<tr>
<th>Subject</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Revenue recognition</td>
<td>Based on several criteria, which require the recognition of revenue when risks and rewards have been transferred and the revenue can be measured reliably.</td>
<td>Four key criteria. In principle, similar to IFRS. Extensive detailed guidance exists for specific transactions.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Construction contracts</td>
<td>Accounted for using the percentage of completion method. Completed contract method prohibited.</td>
<td>Percentage of completion method is preferable; however, completed contract method is permitted in rare circumstances.</td>
<td>Similar to IFRS.</td>
</tr>
</tbody>
</table>

### Construction contracts

- Accounted for using the percentage of completion method. Completed contract method prohibited.
- Percentage of completion method is preferable; however, completed contract method is permitted in rare circumstances.
- Similar to IFRS.

### Expense recognition

<table>
<thead>
<tr>
<th>Subject</th>
<th>IFRS</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Interest expense</td>
<td>Recognised on an accrual basis. Effective yield method used to amortise non-cash finance charges.</td>
<td>Similar to IFRS.</td>
<td>Similar to IFRS.</td>
</tr>
</tbody>
</table>

### Interest expense

- Recognised on an accrual basis. Effective yield method used to amortise non-cash finance charges.
- Similar to IFRS.
- Similar to IFRS.

### Employee benefits: pension costs – defined benefit plans

- Use projected unit credit method to determine benefit obligation. The surplus or deficit of the defined benefit obligation over plan assets may either be recognised in the income statement or within the statement of recognised income and expense.
- Similar to IFRS conceptually, although several differences in detail.
- New standard is similar to IFRS with some differences. The surplus or deficit of the defined benefit obligation over plan assets must be recognised immediately in equity.

### Employee share compensation

- Recognise expense for services acquired. The corresponding amount will be recorded either as a liability or as an increase in equity, depending on whether the transaction is determined to be cash – or equity-settled. The amount to be recorded is measured at the fair value of the shares or share options granted.
- Two alternative methods for determining cost: intrinsic value (market price at measurement date less any employee contribution or exercise price) or fair value at issue using option pricing model. Recognise cost of share awards or options over period of employee’s performance.
- New standard is similar to IFRS.

### Termination benefits

- Account for post-retirement benefits as pensions. Requirements also exist for termination benefits arising from redundancies and other post-employment and long-term employee benefits. Account for termination indemnity plans as pensions.
- Similar to IFRS for post-retirement benefits. More detailed guidance given for termination benefits. Termination indemnity accounted for as pension plans and calculated as either the vested benefit obligation or the actuarial present value of the vested benefits.
- New standard similar to IFRS for post retirement benefits. Other benefits not covered by standards, but practice generally similar to IFRS.
### Assets

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</thead>
<tbody>
<tr>
<td>Acquired intangible assets</td>
<td>Capitalise if recognition criteria are met; intangible assets must be amortised over useful life. Intangibles assigned an indefinite useful life must not be amortised but reviewed annually for impairment. Revaluations are permitted in rare circumstances.</td>
<td>Similar to IFRS. Revaluations not permitted.</td>
<td>Similar to IFRS. Intangible assets meeting the recognition criteria and acquired as part of a business combination are typically subsumed within goodwill as there is no requirement for separate recognition. There is a rebuttable presumption that the useful economic life is 20 years or less.</td>
<td>53</td>
</tr>
<tr>
<td>Internally generated intangible assets</td>
<td>Expense research costs as incurred. Development costs must be capitalised and amortised where stringent criteria are met.</td>
<td>Expense both research and development costs as incurred. Some software and website development costs must be capitalised.</td>
<td>Similar to IFRS, although development costs may be expensed as incurred. An entity may choose to capitalise internally generated assets, other than research and development expenditure, when a market exists.</td>
<td>54</td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>Use historical cost or revalued amounts. Regular valuations of entire classes of assets are required when revaluation option is chosen.</td>
<td>Revaluations not permitted.</td>
<td>Similar to IFRS.</td>
<td>55</td>
</tr>
<tr>
<td>Non-current assets held for sale</td>
<td>Non-current asset is classified as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. Measure a non-current asset classified as held for sale at the lower of its carrying amount and fair value less costs to sell.</td>
<td>Similar to IFRS.</td>
<td>There is currently no UK equivalent standard in relation to non-current assets held for sale.</td>
<td>57</td>
</tr>
<tr>
<td>Leases – classification</td>
<td>A lease is a finance lease if substantially all risks and rewards of ownership are transferred. Substance rather than form is important.</td>
<td>Similar to IFRS, but with more extensive form-driven requirements.</td>
<td>Similar to IFRS.</td>
<td>58</td>
</tr>
<tr>
<td>Leases – lessor accounting</td>
<td>Record amounts due under finance leases as a receivable. Allocate gross earnings to give constant rate of return based on (pre-tax) net investment method.</td>
<td>Similar to IFRS, but with specific rules for leveraged leases.</td>
<td>Presentation similar to IFRS, but measurement basis differs, use (post-tax) net cash investment method for allocating gross earnings.</td>
<td>58</td>
</tr>
</tbody>
</table>
## Impairment of assets

- **IFRS**: If impairment indicated, write down assets to higher of fair value less costs to sell and value in use based on discounted cash flows. If no loss arises, reconsider useful lives of those assets. Reversals of losses permitted in certain circumstances.

- **US GAAP**: Impairment is assessed on undiscounted cash flows for assets to be held and used. If less than carrying amount, measure impairment loss using market value or discounted cash flows. Reversals of losses prohibited.

- **UK GAAP**: For assets held for disposal, impairment is based on lower of carrying amount and fair value less cost to sell.

- **Similarity**: Similar to IFRS.

## Capitalisation of borrowing costs

- **IFRS**: Permitted for qualifying assets, but not required.

- **US GAAP**: Required.

- **UK GAAP**: Similar to IFRS.

## Investment property

- **IFRS**: Measure at depreciated cost or fair value, and recognise changes in fair value in the income statement.

- **US GAAP**: Treat the same as for other properties (depreciated cost).

- **UK GAAP**: Carry at open market value without depreciation. Changes in fair value recognised in the STRGL.

## Inventories

- **IFRS**: Carry at lower of cost and net realisable value. Use FIFO or weighted average method to determine cost. LIFO prohibited. Reversal is required for subsequent increase in value of previous write-downs.

- **US GAAP**: Similar to IFRS; however, use of LIFO permitted.

- **UK GAAP**: Similar to IFRS.

## Biological assets

- **IFRS**: Measured at fair value less estimated point-of-sale costs.

- **US GAAP**: Not specified. Generally historical cost used.

- **UK GAAP**: Not specified, however in practice use historical cost method as for inventories.

## Financial assets – measurement

- **IFRS**: Depends on classification of investment – if held to maturity or loan or receivable, then carry at amortised cost, otherwise at fair value. Unrealised gains/losses on fair value through profit or loss classification (including trading securities) recognised in the income statement and on available-for-sale investments recognised in equity.

- **US GAAP**: Similar to IFRS; however, no ability to designate any financial asset or liability as at fair value through profit or loss.

- **UK GAAP**: Carry long-term investments at cost, market value or other appropriate basis, such as net asset value. Carry current asset investments at lower of cost and net realisable value (NRV) or at current cost. Where FRS 26 is to be adopted, treatment is as under IFRS.

## Derecognition of financial assets

- **IFRS**: Derecognise financial assets based on risks and rewards first; control is secondary test.

- **US GAAP**: Derecognise based on control. Requires legal isolation of assets even in bankruptcy.

- **UK GAAP**: Recognise and derecognise assets based on risks and rewards, focusing on substance rather than just legal form.
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<tbody>
<tr>
<td>Liabilities</td>
<td></td>
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</tr>
<tr>
<td>Provisions – general</td>
<td>Record the provisions relating to present obligations from past events if outflow of resources is probable and can be reliably estimated.</td>
<td>Similar to IFRS, with rules for specific situations (employee termination costs, environmental liabilities, loss contingencies, etc.).</td>
<td>Similar to IFRS.</td>
<td>68</td>
</tr>
<tr>
<td>Provisions – restructuring</td>
<td>Recognise restructuring provisions if detailed formal plan announced or implementation effectively begun.</td>
<td>Recognition of a liability based solely on commitment to a plan is prohibited. Must meet the definition of a liability, including certain criteria regarding the likelihood that no changes will be made to the plan or that the plan will be withdrawn.</td>
<td>Similar to IFRS.</td>
<td>68</td>
</tr>
<tr>
<td>Contingencies</td>
<td>Disclose unrecognised possible losses and probable gains.</td>
<td>Similar to IFRS.</td>
<td>Similar to IFRS.</td>
<td>69</td>
</tr>
<tr>
<td>Deferred income taxes – general approach</td>
<td>Use full provision method (some exceptions) driven by balance sheet temporary differences. Recognise deferred tax assets if recovery is probable.</td>
<td>Similar to IFRS, but recognise all deferred tax assets and then provide valuation allowance if recovery is less than 50% likely. A number of specific differences in application.</td>
<td>Use full provision method (more extensive exceptions) based on timing differences between accounting and taxable profit. A number of specific differences in application.</td>
<td>70</td>
</tr>
<tr>
<td>Deferred income taxes – main exceptions</td>
<td>No temporary differences on non-deductible goodwill and initial recognition of assets and liabilities that do not impact on accounting or taxable profit.</td>
<td>Similar to IFRS regarding non-deductible goodwill. Initial recognition exemption does not exist.</td>
<td>These exceptions are treated as permanent differences.</td>
<td>70</td>
</tr>
<tr>
<td>Government grants</td>
<td>Recognise as deferred income and amortise. Entities may offset capital grants against asset values.</td>
<td>Similar to IFRS except long-lived asset contributions recorded as revenue.</td>
<td>Similar to IFRS, however Company Law does not allow the offset of capital grants against asset values.</td>
<td>73</td>
</tr>
<tr>
<td>Leases – lessee accounting</td>
<td>Record finance leases as asset and obligation for future rentals. Depreciate over useful life of asset. Apportion rental payments to give constant interest rate on outstanding obligation. Charge operating lease rentals on straight-line basis.</td>
<td>Similar to IFRS. Specific rules must be met to record a finance or capital lease.</td>
<td>Similar to IFRS.</td>
<td>74</td>
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<tr>
<td><strong>Liabilities (continued)</strong></td>
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</tr>
<tr>
<td><strong>Leases – lessee accounting: sale and leaseback transactions</strong></td>
<td>For a finance lease, defer and amortise profit arising on sale and finance leaseback over the lease term. If an operating lease arises, profit recognition depends on sale proceeds compared to fair value of the asset. Consider substance/linkage of the transactions.</td>
<td>Timing of profit and loss recognition depends on whether seller relinquishes substantially all or a minor part of the use of the asset. Immediately recognise losses. Consider specific strict criteria if a property transaction.</td>
<td>Similar to IFRS. For a finance lease, no profit should be recognised. For an operating lease, defer and amortise profit over the shorter of the lease term or the useful life.</td>
<td>75</td>
</tr>
<tr>
<td><strong>Financial liabilities – classification</strong></td>
<td>Classify capital instruments depending on substance of the issuer’s obligations. Mandatorily redeemable preference shares classified as liabilities.</td>
<td>Where an instrument is not a share, classify as liability when obligation to transfer economic benefit exists. Similar to IFRS.</td>
<td>New standard is similar to IFRS.</td>
<td>76</td>
</tr>
<tr>
<td><strong>Convertible debt</strong></td>
<td>Account for convertible debt on split basis, allocating proceeds between equity and debt.</td>
<td>Convertible debt is usually recognised as a liability.</td>
<td>New standard is similar to IFRS.</td>
<td>77</td>
</tr>
<tr>
<td><strong>Derecognition of financial liabilities</strong></td>
<td>Derecognise liabilities when extinguished. The difference between the carrying amount and the amount paid is recognised in the income statement.</td>
<td></td>
<td>Similar to IFRS.</td>
<td>77</td>
</tr>
<tr>
<td><strong>Equity instruments</strong></td>
<td></td>
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</tr>
<tr>
<td><strong>Capital instruments – purchase of own shares</strong></td>
<td>Show as deduction from equity.</td>
<td>Similar to IFRS.</td>
<td>Treasury shares and shares purchased by an employee benefit trust shown as a deduction from shareholders’ funds. By law, other shares purchased are cancelled directly and a capital redemption reserve is created.</td>
<td>78</td>
</tr>
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<tr>
<td>Derivatives and hedging</td>
<td>Measure derivatives and hedge instruments at fair value; recognise changes in fair value in income statement except for effective cash flow hedges, where the changes are deferred in equity until effect of the underlying transaction is recognised in the income statement. Gains/losses from hedge instruments that are used to hedge forecast transaction may be included in cost of non-financial asset/liability (basis adjustment).</td>
<td>Similar to IFRS, except no ‘basis adjustment’ on cash flow hedges of forecast transactions.</td>
<td>Similar to IFRS where FRS 26 is adopted. In all other cases, financial liabilities are measured at amortised net proceeds, with gains and losses from premature settlement recognised in the income statement. See also “Financial Assets”</td>
<td>81</td>
</tr>
<tr>
<td>Derivatives and other financial instruments – measurement of hedges of foreign entity investments</td>
<td>Gains/losses on hedges of foreign entity investments are recognised in equity, including hedge ineffectiveness on non-derivatives. For derivatives, record hedge ineffectiveness in the income statement. Gains/losses held in equity must be transferred to the income statement on disposal of investment.</td>
<td>Similar to IFRS, except all hedge ineffectiveness is recognised in the income statement.</td>
<td>Similar to IFRS, although where FRS 26 is not adopted, all hedge ineffectiveness is recognised in the income statement.</td>
<td>81</td>
</tr>
<tr>
<td>Functional currency definition</td>
<td>Currency of primary economic environment in which entity operates.</td>
<td>Similar to IFRS.</td>
<td>UK GAAP does not contain a definition of functional currency but makes reference to local currency which has a similar definition to functional currency. For companies applying FRS 23, the definition is as for IFRS.</td>
<td>83</td>
</tr>
</tbody>
</table>
### Functional currency – determination

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<tr>
<td>If indicators are mixed and functional currency is not obvious, use judgement to determine the functional currency that most faithfully represents the economic results of the entity’s operations by focusing on the currency of the economy that determines the pricing of transactions (not the currency in which transactions are denominated).</td>
<td>Similar to IFRS; however, no specific hierarchy of factors to consider. Generally the currency in which the majority of revenues and expenses are settled.</td>
<td>No similar guidance under UK GAAP unless FRS 23 is adopted, which reflects IFRS.</td>
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</tr>
</tbody>
</table>

### Presentation currency

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<tr>
<td>When financial statements are presented in a currency other than functional currency, assets and liabilities are translated at exchange rate at balance sheet date. Income statement items are translated at exchange rate at dates of transactions, or use average rates if rates do not fluctuate significantly.</td>
<td>Similar to IFRS.</td>
<td>No similar guidance under UK GAAP unless FRS 23 is adopted which reflects IFRS. In all other cases, financial statements must be prepared in the entity’s local currency. However, when preparing consolidated financial statements using the closing rate/net investment method of translating a foreign entity’s financial statements, the translation process is similar to IFRS with the exception of the option to translate income statement items at closing rate which is available under UK GAAP only.</td>
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</tr>
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</table>

### Hyperinflationary economy – definition

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<tbody>
<tr>
<td>Hyperinflation indicated by characteristics of economic environment of country, which include: population’s attitude towards local currency and prices linked to price index; and if cumulative inflation rate over three years is approaching, or exceeds, 100%.</td>
<td>Currency in highly inflationary environment (three-year inflation rate of approximately 100% or more).</td>
<td>Where FRS 24 is adopted, the definition is as for IFRS. Otherwise, it is defined as a country with a high rate of inflation although no definition of ‘high rate’ is given in UK GAAP. However, guidance is available to determine when the effects of hyper-inflation require adjustment.</td>
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</tr>
</tbody>
</table>

### Hyperinflationary economy – measurement

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<tbody>
<tr>
<td>Entities that have as functional currency the currency of a hyperinflationary economy must use it for measuring transactions. However, re-measurement of the measurement unit at the balance sheet date is required.</td>
<td>Generally does not permit inflation-adjusted financial statements; instead requires the use of a more stable currency as functional currency (usually the presentation currency). However, foreign issuers that use IFRS permitted to omit quantification of any differences that would have resulted from application of FAS 52.</td>
<td>Where FRS 24 is adopted, the option is not available under IFRS.</td>
<td>85</td>
</tr>
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</tr>
<tr>
<td>Other accounting and reporting topics (continued)</td>
<td></td>
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</tr>
<tr>
<td>Earnings per share – diluted</td>
<td>Use weighted average potential dilutive shares as denominator for diluted EPS.</td>
<td>Use ‘treasury share’ method for share options/warrants.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Related-party transactions – definition</td>
<td>Determine by level of direct or indirect control, joint control and significant influence of one party over another or common control of both parties.</td>
<td>Similar to IFRS.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Related-party transactions – disclosures</td>
<td>Disclose name of related party, nature of relationship and types of transaction. For control relationships, give disclosures regardless of whether transactions occur. Some exemptions available for separate financial statements of subsidiaries.</td>
<td>Similar to IFRS.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Segment reporting – scope and basis of formats</td>
<td>Public entities: report primary and secondary (business and geographic) segments based on risks and returns and internal reporting structure.</td>
<td>Public entities: report based on operating segments and the way the chief operating decision-maker evaluates financial information for purposes of allocating resources and assessing performance.</td>
<td>Public and very large private entities report based on classes of business and geographical areas.</td>
</tr>
<tr>
<td>Segment reporting – accounting policies</td>
<td>Use group accounting policies.</td>
<td>Use internal financial reporting policies (even if accounting policies differ from group accounting policy).</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Segment reporting – disclosures</td>
<td>Disclosures for primary segment include revenues, results, capex, total assets and liabilities, and other items. For secondary segment, report revenues, total assets and capex.</td>
<td>Similar disclosures to IFRS (primary segment) except liabilities and geographical capex not required. Depreciation, amortisation, tax, interest and exceptional/extraordinary items disclosed if reported internally. Disclosure of factors used to identify segments is required.</td>
<td>Disclose revenue, results and net assets. Equal prominence to disclosure by class of business and geographically.</td>
</tr>
<tr>
<td>Discontinued operations – definition</td>
<td>Operations and cash flows that can be clearly distinguished for financial reporting and represent a separate major line of business or geographical area of operations, or is a subsidiary acquired exclusively with a view to resale.</td>
<td>Similar to IFRS. Component that is clearly distinguishable operationally and for financial reporting can be a: reporting segment, operating segment, reporting unit, subsidiary or asset grouping.</td>
<td>Operation whose discontinuance has a material effect on the nature/focus of the business or represents a material reduction in its operating facilities resulting either from its withdrawal from a particular market or from a material reduction in continuing turnover.</td>
</tr>
</tbody>
</table>
### Other accounting and reporting topics (continued)

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<tbody>
<tr>
<td>Discontinued operations – measurement</td>
<td>Measured at the lower of carrying amount or fair value less costs to sell.</td>
<td>Similar to IFRS.</td>
<td>Write down assets to recoverable amount (higher of net realisable amount and value in use).</td>
<td>91</td>
</tr>
<tr>
<td>Discontinued operations – presentation and main disclosures</td>
<td>Disclose at a minimum a single amount on the face of the income statement with analysis further disclosed in the notes for both current and prior periods. Assets and liabilities of a discontinued operation to be presented separately from other assets and liabilities on the balance sheet.</td>
<td>Similar to IFRS. Report discontinued and held-for-sale operations as a separate line item on face of income statement before extraordinary items and cumulative effect of accounting changes. Assets and liabilities of held-for-sale disposal groups segregated on balance sheet.</td>
<td>Disclose on face of the income statement components of operating profit relating to discontinued operations.</td>
<td>91</td>
</tr>
<tr>
<td>Post-balance-sheet events</td>
<td>Adjust financial statements for subsequent events, providing evidence of conditions at balance sheet date and materially affecting amounts in financial statements (adjusting events). Disclose non-adjusting events.</td>
<td>Similar to IFRS.</td>
<td>Similar to IFRS.</td>
<td>92</td>
</tr>
<tr>
<td>Interim financial reporting</td>
<td>Not mandatory to prepare interim statements but must use the standard if prepared. Basis should be consistent with full year statements and include comparatives.</td>
<td>If issued, the contents of interim statements are prescribed and basis must be consistent with full year statements. Quarterly reporting required for SEC registrants (domestic US entities only).</td>
<td>Mandatory for listed entities (half-yearly); minimal contents specified by the London Stock Exchange. UK ASB non-mandatory statement is similar to IFRS.</td>
<td>93</td>
</tr>
</tbody>
</table>

<p>| Insurance and reinsurance contracts – definition | Provides definition of insurance and reinsurance contracts. | No single definition of insurance contract. The resulting population of insurance contracts is a subset of the IFRS classification due to stricter criteria for reinsurance. Accounting requirements for &quot;universal-life-type&quot; insurance contracts is deposit accounting rather than deferral and matching. | Definition of insurance contracts is provided within FRS 26 that details the extent of the scope exclusion from that standard. The ABI SORP also contains guidance on what should be regarded as reinsurance based on transfer of significant insurance risk. | 94 |</p>
<table>
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<tr>
<td>Other accounting and reporting topics (continued)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discretionary participation feature (DPF)</td>
<td>Provides definition of DPF and introduces certain requirements for financial instruments that contain such feature. Insurance contracts or financial instruments with DPF may have a compound nature and present a DPF equity component. Consideration received for financial instruments with DPF may be recognised as revenue with an expense representing the increase in the liability.</td>
<td>DPF not specifically covered, other than implicitly in SOP 95-1 for insurance contracts only. Insurance contracts and financial instruments with DPF are measured under existing GAAP and resulting equity component is not separately disclosed. Financial instruments with DPF are deposit accounted.</td>
<td>No equivalent general guidance under UK GAAP. DPF is not specifically covered, other than in terms of the statutory fund for future appropriations (FFA). There is guidance in company legislation and in FRS 27 for presentation of the FFA as part of reserves. Financial instruments with DPF are scoped out of FRS 26.</td>
<td>94</td>
</tr>
<tr>
<td>Subject to a few minimum requirements. The most important requirements are the tests on insurance liability adequacy and reinsurance asset impairment. Equalisation and similar provisions are prohibited.</td>
<td>Detailed measurement bases for the different types of insurance and reinsurance contracts. Also prescribes liability adequacy test and reinsurance impairment test and prohibits equalisation provisions.</td>
<td>Guidance is contained in various sources applicable to insurance companies including legislation, the ABI SORP and FRS 27 regarding measurement of insurance contracts.</td>
<td></td>
<td>95</td>
</tr>
<tr>
<td>Deposit accounting required when measurement of deposit component is reliable and rights and obligations arising from it are not reflected in balance sheet. Unbundling permitted if deposit is reliably measurable. If unbundling is not required, deposit components may be recognised as revenue.</td>
<td>Concept of policyholders’ account balance has been developed, and detailed rules require deposit accounting (under FAS 97). Deposit accounting for a component of a contract is covered by EITF 93-6. Reinsurance contracts that transfer only timing risk or only underwriting risk are deposit accounted.</td>
<td>The ABI SORP contains guidance regarding unbundling of reinsurance contracts. There is no equivalent general guidance on unbundling insurance contracts.</td>
<td></td>
<td>95</td>
</tr>
<tr>
<td>Eliminate and do not treat as plan assets in pension obligation accounting.</td>
<td>No specific guidance, however, practice is to treat such contracts as plan assets under FAS 87.</td>
<td>No equivalent guidance under UK GAAP.</td>
<td></td>
<td>96</td>
</tr>
<tr>
<td>Exemptions from separation and fair value are given for certain embedded derivatives. Persistency bonuses are considered embedded derivatives.</td>
<td>Embedded derivatives must be separated and fair valued unless they are clearly and closely related. Fixed dollar persistency bonuses are not embedded derivatives but a variation of interest rates.</td>
<td>Embedded derivatives contained in insurance contracts that are not themselves insurance contracts are treated similar to IFRS.</td>
<td></td>
<td>96</td>
</tr>
<tr>
<td>SUBJECT</td>
<td>IFRS</td>
<td>US GAAP</td>
<td>UK GAAP</td>
<td>PAGE</td>
</tr>
<tr>
<td>---------</td>
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<td>---------</td>
<td>---------</td>
<td>------</td>
</tr>
<tr>
<td><strong>Other accounting and reporting topics (continued)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Insurance and reinsurance contracts – disclosures</strong></td>
<td>Extensive disclosure requirements focussed on the accounting policies adopted, material amounts reported and factors that affect the uncertainty of the amounts and timing of insurance and reinsurance cash flows. Claims development tables are required.</td>
<td>Disclosure requirements are less demanding. However, a number of disclosure items are covered in the MD&amp;A and other non-audited sections of annual report. Claims development tables are disclosed outside financial statements.</td>
<td>A number of disclosures are required by legislation and the ABI SORP, including assumptions, sensitivities and policies. FRS 27, applicable to life assurance companies, does require disclosure of assumptions, sensitivities, and policies relating to certain life assurance contracts.</td>
<td>96</td>
</tr>
<tr>
<td><strong>Separate accounts</strong></td>
<td>Single line presentation not permitted.</td>
<td>FAS 60 and SOP 03-1 allow single line presentation in the balance sheet and offsetting of investment results with changes in policyholder liabilities in the income statement.</td>
<td>Guidance regarding the presentation of unit linked business is contained in company legislation and the ABI SORP.</td>
<td>97</td>
</tr>
</tbody>
</table>
Accounting framework

Conceptual framework

IFRS, US GAAP and UK GAAP each include a conceptual framework. The principles set out in the three frameworks provide a basis for setting accounting standards and a point of reference for the preparation of financial information where no specific guidance exists.

Qualitative characteristics of financial information

**IFRS**  
Financial information must possess certain characteristics for it to be useful. The IFRS Framework requires that financial information must be understandable, relevant, reliable and comparable.

**US GAAP**  
A series of concept statements set out similar characteristics to IFRS, with greater emphasis placed on the consistency of financial information.

**UK GAAP**  
The Accounting Standard’s Board (ASB’s) Statement of Principles is similar to the IFRS Framework, requiring financial information to be relevant, reliable, comparable and understandable. The Statement of Principles deals with several issues not covered by the IFRS Framework including: the boundaries of the reporting entity; discounting; presentation of financial information; offsetting rights and obligations; derecognition of assets and liabilities and subsequent measurement.

Reporting elements

**IFRS**  
The IFRS Framework presents five reporting elements: assets, liabilities, equity, income (includes revenues and gains) and expenses (includes losses).

Assets are resources controlled from a past event. Liabilities are present obligations arising from a past event. Assets and liabilities are recognised on the balance sheet when it is ‘probable’ that economic benefits will flow in to or out from the entity, and those benefits must be able to be measured reliably.

Equity is the residual interest in the assets after deducting the entity’s liabilities.

Income is increases in economic benefits that result in increases in equity other than those relating to contributions from equity participants. Expenses are decreases in economic benefits that result in decreases in equity other than those relating to distributions to equity participants.

**US GAAP**  
Reporting elements and the definition and recognition criteria are similar to IFRS. US GAAP concept statements contain additional elements: investments by and distributions to owners, comprehensive income and fair value measurements used in accounting. Other comprehensive income includes all changes in equity during a period, except those resulting from investments by and distributions to owners.

**UK GAAP**  
Reporting elements comprise assets, liabilities, equity, gains (including revenues) and losses (includes expenses) and investments by and distributions to owners.

There are some differences in emphasis from IFRS with regard to the definitions and recognition criteria. Assets and liabilities are recognised when there is sufficient evidence that economic benefits will flow to/from the entity. IFRS uses the term “probable”. Assets must be capable of being controlled independently from the business as a whole. This means that certain intangible assets might be recognised under IFRS, but not under UK GAAP.

Historical cost

**IFRS**  
Historical cost is the main accounting convention. However, IFRS permits the revaluation of intangible assets, property, plant and equipment (PPE) and investment property. IFRS also requires fair valuation of certain categories of financial instruments and certain biological assets.

**US GAAP**  
Prohibits revaluations except for certain categories of financial instrument, which have to be carried at fair value.
Conceptual framework (continued)

**UK GAAP** Similar to IFRS, except that derivatives, most investments and agricultural assets are not re-measured to fair value (unless an entity adopts fair value accounting as permitted for accounting periods commencing after 1 January 2005). Investment property must be shown at fair value.

**Fair presentation override**

**IFRS** Entities may depart from a standard in extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS or an Interpretation of a Standard would be so misleading that it would conflict with the objective of financial statements set out in the Framework for the Preparation and Presentation of Financial Statements. IFRS requires disclosure of the nature of and the reason for the departure and the financial impact of the departure. The override does not apply where there is a conflict between local company law and IFRS; in such a situation, the IFRS requirements must be applied.

**US GAAP** Extremely rare in practice. The SEC will not generally accept such an override.

**UK GAAP** Similar to IFRS. The override also applies in the rare cases where there is a conflict between company law and accounting standards e.g. revaluation of investment property and non-amortisation of goodwill when it is necessary to override company law to give a true and fair view.

**First-time adoption of accounting framework**

**IFRS** First-time adoption of IFRS as the primary accounting basis requires full retrospective application of all IFRSs effective at the reporting date for an entity’s first IFRS financial statements, with optional exemptions primarily for PPE and other assets, business combinations and pension plan accounting and limited mandatory exceptions. Comparative information must be prepared and presented on the basis of IFRS. Almost all adjustments arising from the first-time application of IFRS must be adjusted against opening retained earnings of the first period presented on an IFRS basis. Some adjustments are made against goodwill or against other classes of equity.

**US GAAP** Accounting principles must be consistent for financial information presented in comparative financial statements. US GAAP does not give any specific guidance on first-time adoption of its accounting framework. However, first-time adoption of US GAAP requires full retrospective application. Particular standards specify the transitional treatment upon first-time application of a standard. Specific rules apply for carve-out entities and first-time preparation of financial statements for the public.

**UK GAAP** Similar to US GAAP.


US GAAP: CON 1-7, APB 20, FAS 115, FAS 130, FAS 133.

UK GAAP: Statement of principles, SSAP 19, FRS 5, FRS 10, FRS 13, FRS 15, FRS 18.
Financial statements

General requirements

Compliance

IFRS  Entities must disclose that financial statements comply with IFRS. Compliance with IFRS should not be disclosed unless the financial statements comply with all the requirements of each applicable standard and each applicable interpretation.

US GAAP  US companies with registered securities must comply with US GAAP and the SEC’s rules and regulations and financial interpretations. Non-US companies with registered securities in the US may issue financial statements under US GAAP or another comprehensive basis of accounting principles (such as IFRS), provided that a reconciliation of net income and equity to US GAAP is given in the notes, together with US GAAP and SEC disclosures.

There is no regulatory reporting requirement for non-public US companies. However, certain regulated entities are subject to statutory reporting.

UK GAAP  Generally accepted accounting practice in the UK has its basis in company law as well as accounting standards. All companies must file full financial statements, except those designated as small or medium sized by reference to legal limits. These companies may file abbreviated accounts on the public register.

Company law requires entities to disclose whether the financial statements comply with applicable accounting standards and to give details of non-compliance. There is a presumption that compliance with accounting standards is necessary to give a true and fair view.

Components of financial statements

A set of financial statements under each of IFRS, US GAAP and UK GAAP comprises the following components.

<table>
<thead>
<tr>
<th>COMPONENT</th>
<th>PAGE</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
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<tr>
<td>Balance sheet</td>
<td>22</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Income statement</td>
<td>23</td>
<td>Required</td>
<td>Required</td>
<td>Profit and loss account</td>
</tr>
<tr>
<td>Statement of recognised gains and losses</td>
<td>24</td>
<td>Required¹</td>
<td>Other comprehensive income²</td>
<td>Required</td>
</tr>
<tr>
<td>Statement of changes in shareholders' equity</td>
<td>25</td>
<td>Required¹</td>
<td>Statement of changes in stockholders’ equity</td>
<td>Reconciliation of movements in shareholders’ funds</td>
</tr>
<tr>
<td>Cash flow statement</td>
<td>25</td>
<td>Required</td>
<td>Required</td>
<td>Required with some exceptions</td>
</tr>
<tr>
<td>Accounting policies</td>
<td>-</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Notes to financial statements</td>
<td>-</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
</tbody>
</table>

¹ Under IFRS, recognised gains and losses can be presented in a statement of recognised gains and losses with the changes in equity displayed in a note. Alternatively, the other recognised gains and losses can be separately highlighted in the statement of changes in equity, which is presented as a primary statement. Note, where an entity opts to recognise actuarial gains and losses in equity as permitted by an amendment to IAS 19, it must present a statement of recognised income and expense.

² Under US GAAP, other comprehensive income may also be presented as a separate component of either the income statement or the statement of changes in stockholders’ equity.
General requirements (continued)

Comparatives

IFRS Requires one year of comparatives for all numerical information in the financial statements, with small exceptions.

US GAAP SEC requirements specify that all registrants must give two years of comparatives (to the current year) for all statements except for the balance sheet, which requires one comparative year. This rule applies whichever accounting framework is used in the primary financial statements.

UK GAAP Similar to IFRS.

Balance sheet

Each framework requires prominent presentation of a balance sheet as a primary statement.

Format

IFRS Does not prescribe a particular balance sheet format, except that IFRS requires separate presentation of total assets and total liabilities. Management may use judgement regarding the form of presentation in many areas. Entities present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of their balance sheet except when a liquidity presentation provides more relevant and reliable information. In such cases, all assets and liabilities should be presented broadly in order of liquidity. However, as a minimum, IFRS requires presentation of the following items on the face of the balance sheet:

- Assets: PPE, investment property, intangible assets, financial assets, investments accounted for using the equity method, biological assets, inventories, trade and other receivables, tax assets and cash and cash equivalents; and
- Equity and liabilities: issued share capital and other components of parent shareholders’ equity, financial liabilities, provisions, tax liabilities and trade and other payables, and minority interests (presented within equity).

US GAAP Generally presented as total assets balancing to total liabilities and shareholders’ funds. Items presented on the face of the balance sheet are similar to IFRS, but are generally presented in decreasing order of liquidity. The balance sheet detail must be sufficient to enable identification of material components. Public entities must follow specific SEC guidance.

UK GAAP Company law prescribes two formats. The format usually adopted is total assets less liabilities, shareholders’ funds and minority interests. Items presented are similar to IFRS, except shareholders’ funds and minority interests are each required to be analysed into equity and non-equity elements.

Current/non-current distinction

IFRS The current/non-current distinction is not optional (except when a liquidity presentation is used). Where the distinction is made, assets must be classified as current assets where they are held for sale or consumption in the normal course of the operating cycle. Both assets and liabilities are classified as current where they are held for trading or expected to be realised within 12 months of the balance sheet date. Interest-bearing liabilities are classified as current when they are due to be settled within 12 months of the balance sheet date, even if the original term was for a period of more than 12 months; and when an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue.

US GAAP Management may choose to present either a classified or non-classified balance sheet. If a classified balance sheet is presented, the requirements are similar to IFRS. The SEC provides guidelines for the minimum information to be included by public companies.
Balance sheet (continued)

**UK GAAP** Separate presentation of fixed assets and current assets is required. The classification basis differs from **IFRS**. Fixed assets are those intended for use on a continuing basis. Also separate presentation of liabilities into amounts due within one year, or after one year. Refinancing of debt may be assumed provided that certain conditions are met.

**Offsetting assets and liabilities**

**IFRS** Assets and liabilities must not be offset, except where specifically permitted by a standard. Financial assets and financial liabilities may be offset where an entity has a legally enforceable right to offset the recognised amounts and intends to settle transactions on a net basis.

**US GAAP** Offset is permitted where the parties owe each other determinable amounts, where there is an intention of offset, and where the offset is enforceable by law.

**UK GAAP** Similar to **IFRS** and **US GAAP**, but an intention to settle transactions on a net basis is not required.

**Income statement**

Each framework requires prominent presentation of an income statement as a primary statement. **UK GAAP** permits, within consolidated accounts, the omission of an income statement for the parent entity. There are no equivalent exemptions under either **IFRS** or **US GAAP**. Further to this, **UK GAAP** also requires presentation of a note of historical cost profit for the period removing the effects of any revaluations of assets that have occurred with no equivalent requirement under the other two frameworks.

**Format**

**IFRS** **IFRS** does not prescribe a standard format for the income statement. The entity must analyse its expenditure by function or nature.

As a minimum, **IFRS** requires presentation of the following items on the face of the income statement:

- revenue,
- finance costs,
- share of after-tax results of associates and joint ventures accounted for using the equity method,
- tax expense,
- post-tax gain or loss attributable to the results and remeasurement of discontinued operations, and
- net profit or loss for the period.

The portion of the net income attributable to the minority interest should be disclosed separately in the income statement.

**US GAAP** Presented in one of two formats. Either:

- a single-step format where all expenses are classified by function and are deducted from total income to give income before tax; or
- in a multiple-step format where cost of sales is deducted from sales to show gross profit, then other income and expense are presented to give income before tax.

SEC regulations specify further line items.

**UK GAAP** Company Law permits four formats. Two formats are generally used in practice. One presents turnover less expenses by function and requires disclosure of gross profit. The second presents expenses by type and does not show gross profit. Further, FRS 3 requires operating profit to be disclosed.
### Income statement (continued)

#### Exceptional items

<table>
<thead>
<tr>
<th>Standard</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IFRS</strong></td>
<td>Does not use the term exceptional items but requires the separate disclosure of items of income and expense that are of such size, nature or incidence that their separate disclosure is necessary to explain the performance of the entity for the period. Disclosure may be on the face of the income statement or in the notes.</td>
</tr>
<tr>
<td><strong>US GAAP</strong></td>
<td>As under IFRS, the term exceptional items is not used, but significant material items must be disclosed separately on the face of the income statement in arriving at income from operations.</td>
</tr>
<tr>
<td><strong>UK GAAP</strong></td>
<td>Requires disclosure of exceptional items by way of note or, where necessary to give a true and fair view, on the face of the income statement under the appropriate statutory format headings to which the items relate. Certain ‘super-exceptional’ items (related to the sale or termination of an operation, fundamental restructuring or disposal of fixed assets) are disclosed on the face of the profit and loss account after operating profit but before interest.</td>
</tr>
</tbody>
</table>

#### Extraordinary items

<table>
<thead>
<tr>
<th>Standard</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IFRS</strong></td>
<td>Prohibited.</td>
</tr>
<tr>
<td><strong>US GAAP</strong></td>
<td>Are defined as being both infrequent and unusual. Extraordinary items are rare. Negative goodwill arising in a business combination is written off to earnings as an extraordinary gain, presented separately on the face of the income statement net of taxes. Disclosure of the tax impact is either on the face of the income statement or in the notes to the financial statements.</td>
</tr>
<tr>
<td><strong>UK GAAP</strong></td>
<td>Effectively prohibited.</td>
</tr>
</tbody>
</table>

#### Statement of recognised gains and losses/Other comprehensive income

##### Presentation

<table>
<thead>
<tr>
<th>Standard</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IFRS</strong></td>
<td>Recognised gains and losses can be presented either in the notes or separately highlighted within the primary statement of changes in shareholders’ equity.</td>
</tr>
<tr>
<td><strong>US GAAP</strong></td>
<td>One of three possible formats may be used:</td>
</tr>
<tr>
<td></td>
<td>• a single primary statement of income and comprehensive income containing both net income and other comprehensive income;</td>
</tr>
<tr>
<td></td>
<td>• a two-statement approach (as under IFRS); or</td>
</tr>
<tr>
<td></td>
<td>• a separate category highlighted within the primary statement of changes in equity (as under IFRS).</td>
</tr>
<tr>
<td></td>
<td>In addition, US GAAP requires the cumulative amounts for each item of comprehensive income. The SEC will accept the statement prepared in accordance with IFRS without any additional disclosures.</td>
</tr>
<tr>
<td><strong>UK GAAP</strong></td>
<td>Requires a primary statement, statement of total recognised gains and losses (&quot;STRGL&quot;).</td>
</tr>
</tbody>
</table>

##### Format

<table>
<thead>
<tr>
<th>Standard</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IFRS</strong></td>
<td>The total of gains and losses recognised in the period comprises net income and the following gains and losses recognised directly in equity:</td>
</tr>
<tr>
<td></td>
<td>• fair value gains/(losses) on land and buildings, intangible assets, available-for-sale investments and certain financial instruments;</td>
</tr>
<tr>
<td></td>
<td>• foreign exchange translation differences;</td>
</tr>
<tr>
<td></td>
<td>• the cumulative effect of changes in accounting policy; and</td>
</tr>
<tr>
<td></td>
<td>• changes in fair values on certain financial instruments if designated as cash flow hedges, net of tax, and cash flow hedges reclassified to income and/or the relevant hedged asset/liability.</td>
</tr>
</tbody>
</table>
Statement of recognised gains and losses/Other comprehensive income (continued)

**US GAAP**  Similar to IFRS, revaluations of land and buildings are prohibited under US GAAP and would therefore be excluded.

**UK GAAP**  Similar to IFRS.

**Statement of changes in shareholders’ equity**

**IFRS**  The statement must be presented as a primary statement. It should show capital transactions with owners, the movement in accumulated profit and a reconciliation of all other components of equity.

**US GAAP**  Similar to IFRS. SEC rules allow such information to be included in the notes.

**UK GAAP**  Similar to IFRS, but can be presented in the notes.

**Cash flow statement**

**Exemptions**

**IFRS**  No exemptions.

**US GAAP**  Limited exemptions for certain investment entities.

**UK GAAP**  Some exemptions. For example, subsidiary exempt if: (at least) 90% owned, and the parent’s consolidated financial statements (that include the subsidiary) are publicly available. In addition, a cash flow statement for the parent entity would not be required in the consolidated accounts. Like US GAAP, limited exemptions are available for certain mutual funds.

**Direct/indirect method**

**IFRS**  Requires the cash flow statement to report inflows and outflows of ‘cash and cash equivalents’. The cash flow statement may be prepared using either the direct method (cash flows derived from aggregating cash receipts and payments associated with operating activities) or the indirect method (cash flows derived from adjusting net income for transactions of a non-cash nature such as depreciation). The latter is more common in practice.

**US GAAP**  The purpose is to provide relevant information about ‘cash receipts’ and ‘cash payments’. The direct method is encouraged; however, the indirect method is permitted. If the direct method is used, a reconciliation of net income to cash flows from operating activities must be disclosed. The indirect method is more common in practice.

**UK GAAP**  Based on inflows and outflows of “cash” (not “cash and cash equivalents” as under IFRS). Either the direct or indirect method may be used.

**Definition of cash and cash equivalents**

**IFRS**  Cash includes overdrafts repayable on demand but not short-term bank borrowings, which are considered to be financing flows. 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. An investment normally qualifies as a cash equivalent only when it has a maturity of three months or less from its acquisition date.

**US GAAP**  The definition of cash equivalents is similar to that in IFRS, except that bank overdrafts are not included in cash and cash equivalents; accordingly, changes in the balances of overdrafts are classified as financing cash flows, rather than being included within cash and cash equivalents.

**UK GAAP**  Cash is defined as cash in hand and deposits receivable on demand, less overdrafts repayable on demand. Cash equivalents are not included in cash but are dealt with in the management of liquid resources section.
Cash flow statement (continued)

Format

**IFRS**  Requires separate classification of cash flows from operating, investing and financing activities.

**US GAAP**  Same as IFRS.

**UK GAAP**  Is more detailed and requires separate classification of cash flows from the following activities:
- operating;
- dividends from joint ventures and associates;
- returns on investment and servicing of finance (investment and finance);
- taxation;
- capital expenditure and financial investment;
- acquisitions and disposals;
- equity dividends paid;
- management of liquid resources; and financing.

Classification of specific items

**IFRS, US GAAP** and **UK GAAP** require the classification of interest, dividends and tax within specific categories of the cash flow statement. These are set out below.

<table>
<thead>
<tr>
<th>ITEM</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest paid</td>
<td>Operating or financing</td>
<td>Operating</td>
<td>Investment and finance.</td>
</tr>
<tr>
<td>Interest received</td>
<td>Operating or investing</td>
<td>Operating</td>
<td>Investment and finance.</td>
</tr>
<tr>
<td>Dividends received</td>
<td>Operating or investing</td>
<td>Operating</td>
<td>Generally investment and finance. Joint ventures and associates may be operating.</td>
</tr>
<tr>
<td>Taxes paid</td>
<td>Operating – unless specific identification with financing or investing</td>
<td>Operating</td>
<td>Taxation.</td>
</tr>
</tbody>
</table>
Changes in accounting policy

IFRS
Changes in accounting policy should be accounted for retrospectively, with comparative information restated and the amount of the adjustment relating to prior periods adjusted against the opening balance of retained earnings of the earliest year presented. An exemption applies when it is impracticable to change comparative information. Changes in policy are only permitted where this results in the financial statements providing reliable and more relevant information.

Policy changes made on the adoption of a new standard must be accounted for in accordance with that standard’s transition provisions. If transition provisions are not specified, the method described above must be used.

US GAAP
Requires recognition and disclosure of the cumulative amount of the change in the income statement for the period of the change. The entity discloses pro-forma comparatives as if the change had been applied to those periods. However, retrospective adjustments are required in certain cases: changes in the method of accounting for inventory valuation; depreciation in the rail industry; construction contracts and adoption of the full-cost method in the extractive industry. Unlike IFRS, US GAAP treats a change in the depreciation method for previously recorded assets as a change in accounting principle. A component of the IASB/FASB convergence project includes proposals by the FASB that would require retrospective application for all voluntary accounting policy changes and changes resulting from the adoption of a new pronouncement, except when impracticable or when allowed under the transition provision of a new pronouncement. This convergence project (if adopted) will converge the treatment of changes in depreciation methods as changes in estimates.

UK GAAP
Similar to IFRS, all changes in policy dealt with retrospectively by way of a prior year adjustment. Also requires the effect of the change on the current and prior year to be disclosed. Entities are required to review their policies on a regular basis to ensure that they remain appropriate.

Correction of errors

IFRS
Requires the same method as for policy changes. An entity must restate comparatives.

US GAAP
Reported as a prior-period adjustment; restatement of comparatives is mandatory.

UK GAAP
Restatement of comparatives is mandatory for fundamental errors. Other errors are dealt with in the current period profit and loss account with disclosure.

Changes in accounting estimates

IFRS
Changes in accounting estimates are accounted for in the income statement when identified. Changes in depreciation method and revised asset life are treated as a change in accounting estimate.

US GAAP
Similar to IFRS, but treats change in depreciation method for previously recorded assets as a change in accounting principle. However, a change in the estimated useful lives of depreciable assets is a change in estimate, which is accounted for prospectively in the period of change and future periods.

UK GAAP
Same as IFRS.

REFERENCES:
US GAAP: CON 1-7, FAS 3, FAS 16, FAS 52, FAS 95, FAS 130, FAS 141, APB 20, APB 28, APB 30, ARB 43, SEC Regulation S-X.
Consolidated financial statements

Preparation

**IFRS**
Requires the preparation of consolidated financial statements by a parent entity that includes all subsidiaries. An exemption applies to a parent that is wholly owned or if:
- the owners of the minority interests have been informed about and do not object to the parent not presenting consolidated financial statements and the parent’s securities are not publicly traded;
- it is not in the process of issuing securities in public securities markets; and
- the immediate or any intermediate parent publishes consolidated financial statements that comply with IFRS.

**US GAAP**
There is no exemption for general purpose financial statements. Consolidated financial statements are presumed to be more meaningful, and are required for public companies.

**UK GAAP**
Similar to IFRS. Requires the preparation of consolidated financial statements unless: the entity is a parent of a small or medium-sized group, by reference to legal limits; or the parent itself a wholly owned or majority-owned subsidiary of a parent, where no notice to prepare consolidated financial statements has been served by a minority shareholder and where the subsidiary is included in the consolidated financial statements of the parent; or, all of the entities are permitted or required to be excluded from consolidation by law.

Where an entity is a majority or wholly-owned subsidiary, the exemption only applies where specified criteria are met, including preparation of the parent’s financial statements in a manner equivalent to the EU Seventh Directive, for example, by applying IFRS.

Subsidiaries

**Definition**
The definition of a subsidiary, for the purpose of consolidation, is an important distinction between the frameworks.

**IFRS**
Focuses on the concept of the power to control in determining whether a parent/subsidiary relationship exists. Control is the parent’s ability to govern the financial and operating policies of a subsidiary to obtain benefits. Companies acquired (disposed of) are included in (excluded from) consolidation from the date on which control passes. Presently exercisable potential voting rights should also be considered.

**US GAAP**
A dual consolidation decision model is required. All consolidation decisions should be evaluated under variable interest and traditional consolidation models. Variable interest entities (VIEs) in which a parent does not have a controlling voting interest but absorbs the majority of the VIE's expected losses or returns must also be consolidated.

**UK GAAP**
Similar to IFRS. However, UK GAAP specifies certain factors that would provide an indication that an undertaking is a subsidiary over and above the concept of control under IFRS, for example, holding the majority of voting rights.

Special purpose entities

**IFRS**
Requires the consolidation of special purpose entities (SPEs) where the substance of the relationship indicates that an entity controls the SPE. Indicators of control arise where:
- the SPE conducts its activities on behalf of the entity; or
- the entity has the decision-making power; or
- the entity has other rights to obtain the majority of the benefits of the SPE; or
- the entity has the majority of the residual or ownership risks of the SPE, or of its assets.
Subsidiaries (continued)

**US GAAP** The consolidation of an SPE is required by its primary beneficiary only when the SPE meets the definition of a VIE and the primary beneficiary has a variable interest in the entity that will cause it to absorb a majority of the VIE’s expected losses, receive a majority of the VIE’s expected residual returns, or both.

Specific criteria permit the transfer of financial assets to an SPE that is not consolidated. The SPE must be a qualifying SPE (as defined) and the assets must be financial assets (as defined). The assets must not arise from a structured transaction.

**UK GAAP** The requirement to account for the substance of transactions requires the consolidation of ‘quasi subsidiaries’.

Recent amendments – IFRS

In November 2004, IFRIC issued an Interpretation to amend the scope of SIC-12 relating to employee compensation and post-employment benefit plans. The Interpretation removes the scope exception for equity compensation plans, thereby requiring an entity that controls an employee benefit trust (or similar entity) set up for the purpose of a share-based payment arrangement to consolidate that trust. It also amends the post-employment benefits plan exclusion to include other long-term employee benefit plans in order to ensure consistency with the requirements in IAS 19.

Subsidiaries excluded from consolidation

**IFRS** All subsidiaries are consolidated. If on acquisition a subsidiary meets the criteria to be classified as held for sale in accordance with IFRS 5, an entity will apply the presentation for assets held for sale (that is, separate presentation of assets and liabilities to be disposed of), rather than normal line-by-line consolidation presentation.

**US GAAP** Subsidiaries excluded from the consolidation are those for which control does not rest with the majority owner. There is no longer an exclusion based on temporary control under US GAAP. Unconsolidated subsidiaries are generally accounted for using the equity method unless overriding the presumption of significant influence.

**UK GAAP** Company law permits exclusion of a subsidiary from consolidation where: inclusion is not material for giving a true and fair view; information cannot be gathered without undue expense or delay; there are severe long term restrictions over control; or the interest is held exclusively with a view to re-sale within one year. Subsidiaries excluded from consolidation are accounted for using the rules for fixed asset investments, or if held for resale, as a current asset at the lower of cost and net realisable value.

Uniform accounting policies

**IFRS** Consolidated financial statements must be prepared using uniform accounting policies for all of the entities in a group, including joint ventures and associates.

**US GAAP** Similar to IFRS.

**UK GAAP** Similar to IFRS, uniform policies required but where there are special circumstances, differing policies may be followed with disclosure of the particulars and the effect.
Subsidiaries excluded from consolidation (continued)

Reporting periods

**IFRS**  The consolidated financial statements of the parent and the subsidiary are usually drawn up at the same reporting date. However, IFRS does permit the consolidation of subsidiary accounts drawn up at a different reporting date, provided the difference between the reporting dates is not more than three months. Adjustments must be made for significant transactions that occur in the gap period.

**US GAAP**  Similar to IFRS.

**UK GAAP**  Similar to IFRS. Permits the consolidation of subsidiary accounts drawn up to a different reporting date provided that it is not more than three months before the group reporting date.

REFERENCES:  IFRS: IAS 27, SIC-12, IFRS 5.
     US GAAP:  ARB 51, FAS 94, SAB 51, SAB 84, EITF 96-16, FIN 46.
Investments in associates

Definition

**IFRS**
An associate is an entity over which the investor has significant influence – that is, the power to participate in, but not control, the definition of an associate’s financial and operating policies. Participation in the entity’s financial and operating policies via representation on the entity’s board demonstrates significant influence. A 20% or more interest by an investor in an entity’s voting rights leads to a presumption of significant influence.

**US GAAP**
Similar to IFRS. Does not include unincorporated entities, although these would generally be accounted for in a similar way.

**UK GAAP**
An associate is an entity where the investor has a participating interest (presumes through a 20% or more shareholding). However, unlike IFRS the investor must actually exercise significant influence for an associate relationship to exist.

Equity method

**IFRS**
An investor must account for an investment in an associate using the equity method. The investor presents its share of the associate’s profits and losses in the income statement. IFRS specifies that this must be shown at a post-tax level. The investor recognises in equity its share of changes in the associate’s equity that have not been recognised in the associate’s profit or loss. The investor must account for the difference, on acquisition of the investment, between the cost of the acquisition and investor’s share of fair value of the net identifiable assets, as goodwill. The goodwill is included in the carrying amount of the investment.

The investor’s investment in the associate is stated at cost, plus its share of post-acquisition profits or losses, plus its share of post-acquisition movements in reserves, less dividends received. Losses that reduce the investment below zero are applied against any long-term interests that, in substance, form part of the investor’s net investment in the associate; for example, preference shares and long-term receivables and loans. Losses recognised in excess of the investor’s investment in ordinary shares are applied to the other components in reverse order of seniority. Further losses are provided for as a liability only to the extent that the investor has incurred legal or constructive obligations to make payments on behalf of the associate.

Disclosure of information is required about the results, assets and liabilities of significant associates.

**US GAAP**
Similar to IFRS.

**UK GAAP**
Similar to IFRS, the investor’s share of the associate’s operating profit, non-operating exceptional items, interest and tax are all presented separately. The carrying amount of the investment is adjusted by the investor’s share of the results of the associate less any amortisation of goodwill. Also requires the separate disclosure of goodwill within the carrying amount.

Requires separate disclosure of information about the results, assets and liabilities of significant associates.

Losses recognised in excess of the investor’s investment in ordinary shares are presented as a liability.

Impairment

**IFRS**
Apply the general impairment requirements of IFRS. In estimating future cash flows the investor may use its share of the future net cash flows in the underlying entity, or the cash flows expected to arise from dividends.

**US GAAP**
The methodology of determining impairment is different from IFRS. A loss in the value of an investment that is other than a temporary decline should be recognised. Many factors must be considered to determine whether a decline is other than temporary, including the significance and duration of the decline.
Investments in associates (continued)

UK GAAP  Similar to IFRS, although estimated cash flows would normally be based on the net cash flows of the underlying entity and not the anticipated dividend flows.

Investments in joint ventures

Definition

IFRS  Defines a joint venture as a contractual agreement whereby two or more parties undertake an economic activity that is subject to joint control. Joint control is the contractually agreed sharing of control of an economic activity.

US GAAP  Defines a corporate joint venture as a corporation owned and operated by a small group of businesses as a separate and specific business or project for the mutual benefit of the members of the group.

UK GAAP  Similar to IFRS. A joint venture is an entity in which the reporting entity holds an interest on a long-term basis and which is jointly controlled, with one or more other venturers, under a contractual arrangement. Joint control exists where no one party can control the financial or operating policy decisions of the venture, but together they do so.

Types of joint venture

IFRS  Distinguishes between three types of joint venture:

- jointly controlled entities – the arrangement is carried on through a separate entity (company or partnership);
- jointly controlled operations – each venturer uses its own assets for a specific project; and
- jointly controlled assets – a project carried on with assets that are jointly owned.

US GAAP  Only refers to jointly controlled entities, where the arrangement is carried on through a separate corporate entity.

UK GAAP  Similar to IFRS. Distinguishes between three types of joint ventures/arrangements: jointly controlled entities; joint arrangements that are not entities (JANE) and contractual arrangements with the form but not substance of a joint venture. The latter two are not often seen in practice. A jointly controlled entity may be a body corporate, a partnership or an unincorporated business carrying on its own business.

Jointly controlled entities

IFRS  Requires either the proportionate consolidation method or the equity method. Proportionate consolidation requires the venturer’s share of the assets, liabilities, income and expenses to be combined on a line-by-line basis with similar items in the venturer’s financial statements, or reported as a separate line item in the venturer’s financial statements.

US GAAP  Does not permit proportionate consolidation for corporate joint ventures. Venturers apply the equity method to recognise the investment in a jointly controlled entity. Equity accounting is also appropriate for investments in unincorporated joint ventures.

UK GAAP  Does not permit proportionate consolidation. The investor applies the “gross equity” method to investments in jointly controlled entities. This method is an expansion of the equity method used to account for associates and requires additional presentation of the investor’s share of gross assets and liabilities and turnover on the face of the balance sheet and income statement.
Investments in joint ventures (continued)

Contributions to a jointly controlled entity

IFRS  Where a venturer contributes non-monetary assets, such as shares or fixed assets, to a jointly controlled entity in exchange for an equity interest in the jointly controlled entity, the venturer must recognise in the income statement the portion of the gain or loss attributable to the equity interests of the other venturers, except when:

• the significant risks and rewards of the contributed assets have not been transferred to the jointly controlled entity; or
• the gain or loss on the assets contributed cannot be measured reliably; or
• the asset is similar to those contributed by other venturers. Where a venturer receives assets dissimilar to those it contributed, it must recognise an appropriate proportion of the gain in the income statement.

US GAAP  Little authoritative guidance exists regarding what basis to use in recording contributions to a jointly controlled entity. Practice has moved over time from a primarily step-up basis to a primarily predecessor basis. For joint ventures whose financial statements are filed with the SEC (or when one or more venturers are SEC registrants), step-up to fair value is only allowed when certain strict criteria are met. The formation of an entity that does not meet the definition of a joint venture should be accounted for as a business combination and not as the formation of a joint venture.

UK GAAP  The following treatment is specified in UK GAAP:

• To the extent that the venturer retains an ownership interest in a business or non-monetary assets exchanged for an interest in the entity after such a transaction, that retained interest, including any related goodwill, should be included at its pre-transaction carrying amount.
• The venturer’s share of net assets acquired through its new interest in the entity should be accounted for at fair value, with the difference between these and the fair value of the consideration given being accounted for as goodwill.
• To the extent that the fair value of the consideration received by the venturer exceeds the book value of the non-monetary assets no longer owned by the entity, the venturer should recognise a gain. Any gain arising on the exchange that is not realised should be reported in the venturer’s STRGL.
• To the extent that the fair value is less than the book value should be recognised either as an impairment loss in accordance with FRS 11 or in the income statement.
Investments in joint ventures (continued)

Jointly controlled operations

**IFRS**  
Similar to jointly controlled entities without a specific incorporated structure. A venturer must recognise in its financial statements:

- the assets that it controls;
- the liabilities it incurs;
- the expenses it incurs; and
- its share of income from the sale of goods or services by the joint venture.

**US GAAP**  
Not specified. However, certain industry practice would permit a venturer to account for its proportionate share of the assets, liabilities, revenues and expenses in its financial statements.

**UK GAAP**  
Similar to **IFRS**, but must also recognise share of cash flows.

Jointly controlled assets

**IFRS**  
A venturer must account for its share of the jointly controlled assets and any liabilities it has incurred.

**US GAAP**  
Not specified. However, proportionate consolidation is used in certain industries to recognise investments in jointly controlled assets.

**UK GAAP**  
Similar to **IFRS**.

**REFERENCES:**  
**IFRS:** IAS 1, IAS 28, IAS 31, SIC-13.  
**US GAAP:** APB 18, FIN 35.  
**UK GAAP:** FRS 9, UITF 31, Companies Act 1985.

Employee share ownership plans

Employee share ownership plans (ESOPs) are designed to facilitate employee shareholdings. Often they are combined with separate trusts that buy shares to be given or sold to employees.

**Accounting**

**IFRS**  
The requirements of SIC-12 to consolidate SPEs apply to ESOPs. Own shares held in an ESOP should be deducted from equity in line with the treatment of treasury shares.

**US GAAP**  
An ESOP trust’s assets and liabilities are included in the sponsoring entity’s balance sheet where the arrangements are such that the sponsoring entity has de facto control and bears the benefits and risks of the shares held by the ESOP trust.

Loans to ESOPs from outside lenders, often guaranteed by the sponsoring entity, are reported as liabilities in the sponsoring entity’s balance sheet, with related interest costs recognised in the sponsoring entity’s income statement. The entity charges the finance costs and administrative expenses of the trust as they accrue and not as funding payments are made to the ESOP trust.

**UK GAAP**  
Similar to **US GAAP**. Own shares held in an ESOP trust should be presented as a deduction in arriving at shareholders’ funds rather than as an asset, consistent with the treatment of treasury shares.

**REFERENCES:**  
**IFRS:** IAS 32, SIC-12.  
**US GAAP:** SOP 76-3, SOP 93-6.  
**UK GAAP:** FRS 5, UITF 17, UITF 38, Companies Act 1985.
Business combinations

Types

A business combination involves the bringing together of separate entities or businesses into one reporting entity. Three types of business combination occur in practice. An acquisition is where one of the combining entities obtains control over the other, enabling an acquirer to be identified; this is the most common type of combination. A uniting of interests (referred to as a pooling or merger) occurs where the shareholders of the combining entities join in substantially equal arrangements to share control. A group reorganisation can arise from transactions among entities that operate under common control.

IFRS

Business combinations are always accounted for as acquisitions. IFRS requires the purchase method of accounting to be used to portray the financial effect of an acquisition. The specific IFRS guidance about business combinations excludes from its scope transactions among entities under common control. Where such transactions occur, IFRS allows entities to develop a reliable accounting policy that is relevant to the decision-making needs of users. Entities should first consider requirements and guidance in other international standards and interpretations dealing with similar issues and then the content of the IASB’s Framework. Entities may consider the pronouncements of other standard-setting bodies that use a similar conceptual framework to the IASB’s, so long as they do not conflict with the IASB’s sources of guidance.

US GAAP

Requires the use of the purchase method of accounting for all business combinations. Transfers of net assets or shares of entities under common control are accounted for at predecessor book basis.

UK GAAP

UK GAAP allows merger accounting where a business combination meets the specified criteria of a merger. In addition, there is specific guidance for group reorganisations.

Acquisitions

Date of acquisition

IFRS

The date on which the acquirer obtains control over the acquired entity or business.

US GAAP

The date on which assets are received or securities are issued (that is, the transaction closes).

UK GAAP

Similar to IFRS.

Cost of acquisition

The cost of acquisition is the amount of cash or cash equivalents paid (or fair value of non-monetary assets exchanged). Where consideration comprises an exchange of shares, specific guidance applies under each framework.

IFRS

Shares issued as consideration are recorded at their fair value as at the date of the exchange – the date on which the acquirer obtains control over the acquiree’s net assets and operations. When the acquisition occurs in stages, the fair value of the shares issued as purchase consideration is determined at each exchange date.

In an active market, the published price of a share at the date of exchange is the best evidence of fair value.

US GAAP

Shares issued as consideration are measured at their market price over a reasonable period of time (interpreted to be a few days) before and after the parties reach an agreement on the purchase price and the proposed transaction is announced. The date for measuring the value of marketable securities should not be influenced by the need to obtain shareholder or regulatory approval.

UK GAAP

Similar to IFRS, except in exceptional circumstances if the market price on one particular day is not a reliable indicator of value. UK GAAP suggests considering market prices for a reasonable period before the date of acquisition.
Acquisitions (continued)

Contingent consideration

**IFRS**
If part of the purchase consideration is contingent on a future event, such as achieving certain profit levels, **IFRS** requires an estimate of the amount to be included as part of the cost at the date of the acquisition where it is probable that it will be paid and it can be reliably measured. Any revision to the estimate is subsequently adjusted against goodwill.

**US GAAP**
Generally excluded from the initial purchase price. The additional cost is not recognised until the contingency is resolved or the amount is determinable. Any additional revision to the estimate is recognised as an adjustment to goodwill. Additional consideration to be paid on the condition of continued employment by former owner/manager is generally not included in the cost of the acquisition but is recognised as compensation expense.

**UK GAAP**
Similar to **IFRS**.

Recognition and measurement of identifiable assets and liabilities acquired

**IFRS, US GAAP** and **UK GAAP** require separate recognition, by the acquirer, of the acquiree’s identifiable assets, liabilities and contingent liabilities that existed at the date of acquisition. These assets and liabilities must be recognised at fair value at the date of acquisition. However, the two frameworks apply different criteria to the recognition of acquisition restructuring provisions.

Restructuring provisions

**IFRS**
The acquirer may recognise restructuring provisions as part of the acquired liabilities only when the acquiree has at the acquisition date an existing liability for restructuring recognised in accordance with IAS 37.

**US GAAP**
As of the acquisition date, management, having the appropriate level of authority, must begin to assess and formulate a plan to exit an activity of the acquired entity. The plan must be completed in detail as soon as possible, but no more than one year after the consummation date, and management must communicate the termination or relocation arrangements to the employees of the acquired company. The restructuring provision must meet the definition of a liability in order to be recorded.

**UK GAAP**
Much more restrictive than **IFRS** and **US GAAP**. Restructuring provisions may only be recognised as fair value adjustments if the acquired entity already had an irrevocable commitment to restructure that was not conditional on the completion of the acquisition.

Intangible assets

**IFRS**
An intangible asset must be recognised separately from goodwill if it represents contractual or legal rights or is capable of being separated or divided and sold, transferred, licensed, rented or exchanged. Acquired in-process research and development (R&D) is recognised as a separate intangible asset if it meets the definition of an intangible asset and its fair value can be measured reliably. Non-identifiable intangible assets are subsumed within goodwill.

**US GAAP**
In practice, similar intangible assets may be recognised under both **IFRS** and **US GAAP**. **US GAAP** similarly requires the fair value exercise to include acquired in-process R&D. However, the acquired in-process R&D must be expensed immediately unless it has an alternative future use.

**UK GAAP**
Record separable intangible assets if they meet the definition of and recognition criteria for an intangible asset. Otherwise, intangible assets are subsumed within goodwill.

Contingent liabilities

**IFRS**
Recognise separately the acquiree’s contingent liabilities at the acquisition date as part of allocating the cost, provided their fair values can be measured reliably.
Acquisitions (continued)

**US GAAP** If fair value can be determined during the allocation period, the contingent liabilities are included in the allocation of purchase price. If the fair value cannot be determined, the contingent liability should be included if it is probable and reasonably estimable.

**UK GAAP** Similar to IFRS.

**Deferred tax recognised in purchase accounting**

**IFRS** The recognition of a deferred tax asset of the acquirer not previously recognised that becomes recognisable because of a business combination is reported in income as a tax benefit.

**US GAAP** The recognition of a deferred tax asset of either the acquirer or the acquiree not previously recognised that becomes recognisable because of a business combination results in an adjustment to goodwill.

**UK GAAP** Similar to IFRS.

**Minority interests at acquisition**

**IFRS** Where an investor acquires less than 100% of a subsidiary, any minority interest should be stated at the minority’s proportion of the net fair value of acquired assets, liabilities and contingent liabilities assumed.

**US GAAP** Fair values are assigned only to the parent company’s shares of the net assets acquired. The minority interest is valued at its historical book value.

**UK GAAP** Similar to IFRS.

**Goodwill**

Goodwill arises as the difference between the cost of the acquisition and the fair value of identifiable assets, liabilities and contingent liabilities acquired. Purchased goodwill is capitalised as an intangible asset.

**IFRS** Goodwill should not be amortised but should be reviewed for impairment at least annually at the cash-generating-unit level.

**US GAAP** Similar to IFRS. Goodwill should not be amortised but must be reviewed for impairment at least annually at the reporting unit level. A reporting unit can be an operating segment, as defined in guidance on the disclosure of segments (see page 88), if it meets the definition of a reporting unit, or one level below an operating segment.

**UK GAAP** Goodwill is amortised over its useful life. There is a rebuttable presumption that the useful life will not exceed 20 years, but an indefinite useful life is permitted. Extensive disclosures are required where an indefinite life is used. Systematic amortisation is not required if the goodwill has an indefinite life.

**Impairment**

**IFRS** Requires an impairment review of goodwill annually or whenever an indication of impairment exists. If some of the goodwill allocated to a CGU was acquired in a business combination during the current annual period, that CGU is required to be tested for impairment before the end of the current period. A one-step impairment test is performed. The recoverable amount of the CGU (that is, the higher of its asset’s net selling price and its value in use) is compared to its carrying amount. The impairment loss is recognised as the excess of the carrying amount over the recoverable amount. If the impairment loss exceeds the book value of goodwill, allocation must be made on a pro rata basis.

**US GAAP** Goodwill is reviewed for impairment, at the reporting unit level, at least annually or whenever events or changes in circumstances indicate that the recoverability of the carrying amount must be assessed.
**Goodwill (continued)**

A two-step impairment test is required:

1) the fair value and the carrying amount of the reporting unit including goodwill should be compared. If the fair value of the reporting unit is less than the book value, goodwill would be considered to be impaired; then

2) the goodwill impairment should be measured as the excess of the carrying amount of goodwill over its implied fair value. The implied fair value of goodwill should be determined by allocating fair value to the various assets and liabilities included in the reporting unit in the same manner as goodwill is determined in a business combination. The impairment charge should be included in operating income.

**UK GAAP**

Annual impairment reviews are required if an indefinite life is used. A first year review is required at the end of the year following acquisition. Impairment test is similar to **IFRS**.

**Negative goodwill**

**IFRS**

If any excess of fair value over the purchase price arises, the acquirer should reassess the identification and measurement of the acquiree’s identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination, and should recognise immediately in profit or loss any excess remaining after that assessment.

**US GAAP**

Any excess of fair value over the purchase price must be allocated on a pro-rata basis to all assets other than:

- current assets;
- financial assets (other than equity method investments);
- assets to be sold;
- prepaid pension assets; and
- deferred taxes.

Any negative goodwill remaining is recognised as an extraordinary gain. If the business combination includes contingent consideration, the lesser of the maximum contingent consideration or the negative goodwill remaining is recorded as if it was a liability.

**UK GAAP**

As with **IFRS**, the acquirer should reassess the identification and measurement of the acquiree’s identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination. Negative goodwill up to the aggregate fair value of the non-monetary assets acquired should then be recognised in the income statement to match the depreciation of those assets. The balance, if any, is recognised in the income statement over the period likely to benefit. Negative goodwill is presented as a “negative asset” alongside positive goodwill.

**Subsequent adjustments to assets and liabilities**

**IFRS**

Permits adjustments against goodwill to the provisional fair values recognised at acquisition provided those adjustments are made within 12 months of the acquisition date. Adjustments after the 12 months must be recognised in the income statement.

**US GAAP**

Similar to **IFRS**. However, favourable adjustments to restructuring provisions if made are always recognised as changes to goodwill, with unfavourable adjustments recognised as changes to goodwill if made during the allocation period, or charged to expense if made after the allocation period. The allocation period, which cannot extend beyond one year following the date of the acquisition, is for adjustments relating to information that management has been waiting for to complete its purchase price allocation. Adjustments related to pre-acquisition contingencies that are finalised after the allocation period or events occurring after the acquisition date should be recognised in the income statement.
Goodwill (continued)

UK GAAP  Similar to IFRS except adjustments to goodwill may be made until the end of the first full accounting period after acquisition (as opposed to 12 months after the acquisition date as in IFRS).

Subsequent adjustments to deferred tax

IFRS  If a deferred tax asset relating to the acquiree is identified but not recognised at the time of the acquisition and is subsequently recognised in the acquirer’s consolidated financial statements, the deferred tax income is recognised in the income statement. The acquirer must also adjust goodwill as if the deferred tax asset had been recognised at the acquisition date. The subsequent reduction in the net carrying amount of goodwill is recognised in the income statement as an expense.

US GAAP  Subsequent recognition of a deferred tax asset for which a valuation allowance was established on the acquisition date reduces goodwill, then reduces intangible assets, and finally reduces tax expense. Subsequent establishment of a valuation allowance (after the allocation period) related to a deferred tax asset recognised on an acquisition is recorded as expense.

UK GAAP  Not specified.

Disclosure

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<td>goodwill by reportable segment</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Reconciliation of the</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>goodwill between opening and</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>closing amount</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
If the purchase price had not been finalised, disclose that fact and the reasons. Adjustments made to the initial allocations in subsequent periods must be disclosed.

Summary of fair value and pre-acquisition IFRS amounts of assets and liabilities acquired with separate disclosure of cash equivalents

<table>
<thead>
<tr>
<th>ITEM</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Factors giving rise to goodwill and a list of unrecognised intangible assets</td>
<td>Required</td>
<td>Only description of factors giving rise to goodwill required</td>
<td>Not specified</td>
</tr>
<tr>
<td>Summary of fair value and pre-acquisition IFRS amounts of assets and liabilities acquired with separate disclosure of cash equivalents</td>
<td>Required unless impracticable</td>
<td>Provide condensed balance sheet disclosing amounts assigned to each balance sheet caption of the acquired entity.</td>
<td>A table is required showing the book values, adjustments and fair values at the date of acquisition and the goodwill arising. Disclose effects of acquisitions on major cash flow headings.</td>
</tr>
<tr>
<td>Provisions for terminating or reducing activities of acquiree</td>
<td>Required, subject to meeting IAS 37 recognition criteria</td>
<td>Required</td>
<td>Disclosure of post-acquisition, re-organisation, restructuring and integration costs required.</td>
</tr>
<tr>
<td>Effect of acquisition on the financial position at the balance sheet date and on the results since the acquisition</td>
<td>Required unless impracticable</td>
<td>Not required, but pro-forma income statement information is presented instead (see below).</td>
<td>More prescriptive than IFRS. Current year income statement must highlight, as a component of continuing operations, the post acquisition results. For material acquisitions, disclose profit after tax and minority interest for current year up to the date of acquisition and prior year. For substantial acquisitions also provide summary profit and loss account and STRGL.</td>
</tr>
<tr>
<td>Amount of purchased research and development assets acquired and written off in the period</td>
<td>Not applicable</td>
<td>Required</td>
<td>Not specified</td>
</tr>
<tr>
<td>If the purchase price had not been finalised, disclose that fact and the reasons. Adjustments made to the initial allocations in subsequent periods must be disclosed</td>
<td>Required</td>
<td>Required</td>
<td>Not specified</td>
</tr>
<tr>
<td>Details of amounts allocated to intangible assets including total amounts, amortisable/non-amortisable, residual values and amortisation period by assets</td>
<td>Required</td>
<td>Required</td>
<td>Not specified</td>
</tr>
<tr>
<td>Pro-forma income statement including comparatives</td>
<td>Not required; however, the revenue and profit or loss for the period should be disclosed as though the acquisition date had been the beginning of that period, unless impracticable</td>
<td>Required only for public entities</td>
<td>Not specified</td>
</tr>
</tbody>
</table>
### Uniting of interests

Both IFRS and US GAAP prohibit the use of this method. However, UK GAAP permits the use of this method where specific criteria that focus on the substance of the transaction are met. A uniting of interests (merger) only applies where an acquirer cannot be identified. Control must not pass from one entity to another; the parties must come together in substance to create a new reporting entity and to share in its future risks and benefits.

The uniting of interests does not involve an acquisition but a continuation of the business that existed before the transaction. The financial statements of the combining parties are simply added together. The combined assets, liabilities and reserves are recognised at their existing carrying amounts (after adjustments necessary to conform the accounting policies and practices). The results are combined from the earliest year reported and comparatives are restated. No goodwill is recognised on the transaction; any difference arising is adjusted against equity. Expenses relating to a uniting of interests are recognised in the income statement in the period incurred.

### Common control transactions

#### IFRS
There are two basic methods of accounting for business combinations – the purchase method and the pooling-of-interests (merger) method. IFRS does not require or prohibit the application of either method. Management can therefore elect to apply purchase accounting or the pooling-of-interests method to a transaction among entities under common control. Once selected, the accounting policy can be changed only when the criteria in IAS 8 are met. Related-party disclosures are used to explain the impact of transactions with related parties on the financial statements.

#### US GAAP
Specific rules exist for accounting for combinations of entities under common control. Such transactions are generally recorded at predecessor cost, reflecting the transferor’s carrying amount of the assets and liabilities transferred. The use of predecessor values or fair values depends on a number of individual criteria.

#### UK GAAP
Includes rules to address group reconstructions, which are generally accounted for using the merger method.

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**ITEM** | IFRS | US GAAP | UK GAAP
--- | --- | --- | ---
Other financial disclosures (continued) | Required | Required | Names of businesses acquired and acquisition dates required for each business combination. Other disclosure required for each material acquisition (as above) should be given for other acquisitions in aggregate.

For a series of individually immaterial business combinations that are material in the aggregate:
- the number of entities and brief description
- the aggregate cost, the number of entity interests issued or issuable and value
- the aggregate amount of any contingent payments options or commitments

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Similarities and Differences – A comparison of IFRS, US GAAP and UK GAAP – August 2005
Purchase and sale of non-controlling interest

**IFRS**
Does not specifically address such transactions. Entities must develop and consistently apply an accounting policy either based on the economic entity concept or the parent company approach.

**US GAAP**
The acquisitions of some or all of the non-controlling interest in a subsidiary should be accounted for using the purchase method. A gain from the reduction of an interest in a subsidiary may be recognised for a public offering only if the transaction is not part of a group re-organisation.

**UK GAAP**
Similar to IFRS.

Step acquisitions

**IFRS**
The acquiree’s identifiable assets, liabilities and contingent liabilities are remeasured to fair value at the acquisition date. Each significant transaction is treated separately for the purpose of determining the cost of the acquisition and the amount of goodwill. Any existing goodwill is not remeasured. The adjustment to any previously held interests of the acquirer in the acquiree’s identifiable assets, liabilities and contingent liabilities is treated as a revaluation.

**US GAAP**
Similar to IFRS, each significant transaction is treated separately for the purposes of determining the cost of the acquisition and the amount of the related goodwill. Any previous interest in the acquirer’s net assets is not restated, resulting in the accumulation of fair values at different dates.

**UK GAAP**
The calculation of goodwill is based on the fair values of the acquired subsidiary’s identifiable assets and liabilities at the acquisition date, that is, the date it becomes a subsidiary. When a group increases its interest in a subsidiary undertaking, the subsidiary’s identifiable assets and liabilities should be revalued to fair value and goodwill arising on the increase in interest should be calculated by reference to those fair values. If the share of tangible fixed assets previously owned is revalued, it has generally been considered that the group would then have to adopt a policy of regularly revaluing these assets.

**Recent proposals – IFRS**
The IASB issued exposure drafts to amend IFRS 3 and IAS 27 in June 2005. A wide range of amendments have been proposed to both standards within these exposure drafts as part of Business Combinations Phase 2, the IASB’s joint project with the FASB.

**REFERENCES:**

**IFRS:** IAS 12, IFRS 3, SIC-9.
**US GAAP:** FAS 38, FAS 121, FAS 141, FAS 142, EITF 95-3.
**UK GAAP:** FRS 2, FRS 6, FRS 7, FRS 10, FRS 15, Companies Act 1985.
Revenue recognition

Revenue

Definition

IFRS  Income is defined in the Framework to include revenues and gains. A specific standard on revenue recognition defines revenue as the gross inflow of economic benefits during the period arising from the ordinary activities of an enterprise when the inflows result in an increase in equity, other than increases relating to contributions from equity participants.

US GAAP  Revenue is defined by the Concept Statement to represent actual or expected cash inflows (or the equivalent) that have occurred or will result from the entity’s major ongoing operations.

UK GAAP  The UK Statement of Principles defines gains, which include revenues, as increases in ownership interest not resulting from contributions from owners.

Measurement

All three frameworks require measurement of revenues at the fair value of the consideration received or receivable. This is usually the amount of cash or cash equivalents received or receivable. Where the inflow of cash or cash equivalents is deferred, discounting to a present value is required under IFRS and, in limited situations, under US GAAP. Under UK GAAP discounting is required where the effect is material to reported revenue.

Revenue recognition

IFRS  IFRS is the only one of the three frameworks to contain a specific standard on revenue recognition. The standard describes specific revenue recognition criteria for the sale of goods and for the rendering of services and interest, royalties and dividends. The revenue recognition criteria common to each of these are: the probability that the economic benefits associated with the transaction will flow to the entity, and that the revenue and costs can be measured reliably.

Additional recognition criteria apply to revenue arising from the sale of goods. IFRS requires that the seller has transferred the significant risks and rewards of ownership to the buyer and retains neither management involvement in, nor control over, the goods. Revenue from the rendering of services must be recognised by reference to the state of completion of the transaction at the balance sheet date. Interest revenue must be recognised on a basis that takes into account the asset’s effective yield. Royalties are recognised on an accrual basis, and dividends are recognised when the shareholder’s right to receive payment is established.

US GAAP  The guidance under US GAAP is extensive. There are a number of different sources of revenue recognition guidance, such as SFAS, SABs, SOPs, EITFs and AAERs. US GAAP focuses more on revenues being realised (either converted into cash or cash equivalents or the likelihood of its receipt being reasonably certain) and earned (no material transaction pending and the related performance has occurred). Revenue recognition involves an exchange transaction – that is, there should be no revenue recognition unless and until an exchange has taken place. Additional guidance for SEC registrants sets out criteria that an entity must meet before revenue is realised and earned (compared to IFRS in the table below). In addition, SEC pronouncements provide guidance related to specific revenue recognition situations.

UK GAAP  Guidance under UK GAAP is in the form of an application note to FRS 5. The application note sets out basic principles for revenue recognition and a number of areas of specific guidance. The basic principle is that a seller recognises revenue when it obtains the right to consideration in exchange for its performance.
Revenue recognition criteria

<table>
<thead>
<tr>
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<th>US GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is probable that economic benefits will flow to the entity.</td>
<td>Vendor’s price to the buyer is fixed or determinable. Collectability is reasonably assured.</td>
</tr>
<tr>
<td>The amount of revenue can be measured reliably.</td>
<td>Vendor’s price to the buyer is fixed or determinable.</td>
</tr>
<tr>
<td>The entity has transferred to the buyer the significant risks and rewards of ownership of the goods.</td>
<td>Persuasive evidence that an arrangement exists, and delivery has occurred or services have been rendered.</td>
</tr>
<tr>
<td>The entity retains neither continuing managerial involvement nor effective control over the goods.</td>
<td>Delivery has occurred or services have been rendered.</td>
</tr>
<tr>
<td>The costs incurred or to be incurred in respect of the transaction can be measured reliably.</td>
<td>Vendor’s price to the buyer is fixed or determinable, and collectability is reasonably assured.</td>
</tr>
<tr>
<td>The stage of completion of the transaction can be measured reliably.</td>
<td>Vendor’s price to the buyer is fixed or determinable.</td>
</tr>
</tbody>
</table>

There are no equivalent recognition criteria in UK GAAP. Application note G provides the underlying principles of revenue recognition being the right to consideration in exchange for performance.

Specific revenue recognition issues

Warranty and product maintenance contracts

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>When a product’s selling price includes an identifiable component for subsequent servicing, the latter is deferred and recognised over the warranty period.</td>
<td>Similar to IFRS, revenue must be recognised on a straight-line basis unless the pattern of costs indicates otherwise. Consistent with IFRS, a loss must be recognised immediately if the expected cost to provide services during the warranty period exceeds unearned revenue.</td>
</tr>
<tr>
<td>US GAAP</td>
<td>Similar to IFRS.</td>
</tr>
</tbody>
</table>

Barter transactions – advertising

<table>
<thead>
<tr>
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<th>US GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>An advertising barter arrangement exists when two companies enter into a non-cash transaction to exchange advertising services. Under IFRS, revenue may generally be recognised on the exchange of dissimilar goods and services if the amount of revenue can be measured reliably. The transaction must be measured at the fair value of goods or services received; however, where the fair value of goods or services received cannot be measured reliably, the fair value of the goods and services given up is used. The fair value of advertising received or provided in a barter transaction is generally measured by reference to equivalent non-barter transactions.</td>
<td>Revenue and expense must be recognised at the fair value of the advertising given. Fair value must be based on the entity’s own historical practice of receiving cash for similar advertising from unrelated entities. Similar transactions used as a guide to fair value must not be older than six months prior to the date of the barter transaction. If the fair value of the advertising given cannot be determined within these criteria, the carrying amount of the advertising surrendered, which is likely to be zero, must be used.</td>
</tr>
<tr>
<td>US GAAP</td>
<td>Turnover and costs in respect of barter transactions for advertising must not be recognised unless there is persuasive evidence of the value at which, if the advertising had not been exchanged, it would have been sold for cash in a similar transaction. The satisfaction of this criterion is likely to be rare.</td>
</tr>
<tr>
<td>UK GAAP</td>
<td>Similar to IFRS.</td>
</tr>
</tbody>
</table>
Specific revenue recognition issues (continued)

Multiple-element arrangements

IFRS  No detailed guidance for multiple-element revenue recognition arrangements exists. The recognition criteria are usually applied separately to each transaction. However, they are applied to two or more transactions together when they are linked in such a way that the whole commercial effect cannot be understood without reference to the series of transactions as a whole.

US GAAP  Revenue arrangements with multiple deliverables should be divided into separate units of accounting if the deliverables in the arrangement meet specified criteria outlined in EITF 00-21. The arrangement’s consideration should be allocated among the separate units of accounting based on their relative fair values. Applicable revenue recognition criteria should be considered separately for separate units of accounting.

UK GAAP  Multiple-element arrangements should be accounted for as separate transactions where the commercial substance is that the individual components operate independently of each other and the consideration can be allocated to each transaction reliably.

Multiple-element arrangements – software revenue recognition

IFRS  No specific software revenue recognition guidance exists. Fees from the development of customised software are recognised as revenue by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

US GAAP  Provides specific guidance on software revenue recognition for software vendors, and in particular for multiple-element arrangements. For these arrangements, a value is established for each element based on vendor-specific objective evidence (VSOE) or other evidence of fair value. VSOE is generally limited to the price charged when elements are sold separately. Consideration is allocated to separate units based on their relative fair values, and revenue is recognised as each unit is delivered.

UK GAAP  Guidance is provided on recognition of revenue where there are multiple components to a contractual arrangement and this can be applied to software revenue recognition. Where elements operate independently of each other, revenue is recognised when the right to consideration is achieved for each component. If components do not operate independently, they are considered together when determining the right to consideration. In the latter case, the arrangement may meet the definition of a long-term contract, hence, the accounting treatment would be prescribed by SSAP 9.

Construction contracts

Scope

IFRS  Applies to fixed-price and cost-plus construction contracts of contractors (not defined), for the construction of a single asset or combination of assets. The standard does not apply to contracts for services that are unrelated to a construction contract where IAS 18 would apply.

US GAAP  Guidance is defined from the perspective of the contractor rather than the contractee, as in IFRS. Scope is not limited to construction-type contracts, guidance is also applicable to unit-price and time-and-materials contracts.

UK GAAP  Similar to IFRS, but standard applies to both construction contracts and contracts for services.

Recognition method

IFRS  Requires the percentage of completion method to recognise revenue and expenses if the outcome can be measured reliably. The criteria necessary for a cost-plus contract to satisfy reliable measurement is less restrictive than for a fixed-price contract. When final outcome cannot be estimated reliably, IFRS requires the use of the zero-profit method, which recognises revenue only to the extent of contract costs incurred that are expected to be recovered. Provides limited guidance on the use of estimates.
Construction contracts (continued)

**US GAAP**
The percentage of completion method is preferred. However, in rare circumstances, when the extent of progress towards completion is not reasonably measurable, the completed contract method should be used. Provides detailed guidance on the use of estimates.

**UK GAAP**
Prescribes a method similar to the percentage of completion method, with turnover being recognised when, and to the extent that, the entity obtains the right to consideration. This is derived from an assessment of the fair value of the goods or services provided to the reporting date as a proportion of the total fair value of the contract. Also permits the zero profit method which is required when the outcome cannot be reliably measured.

**Applying the percentage of completion method**

**IFRS**
When the outcome of the contract can be estimated reliably, revenue and costs must be recognised by reference to the stage of completion of the contract activity at the balance sheet date. When it is probable that total contract costs will exceed total contract revenue, the expected loss must be recognised as an expense immediately.

**US GAAP**
Permits two different approaches:
- the revenue cost approach (similar to IFRS) multiplies the estimated percentage of completion by the estimated total revenues to determine earned revenue, and multiplies the estimated percentage of completion by the estimated total contract cost to determine the cost of earned revenue; and
- the gross-profit approach (different from IFRS) multiplies the estimated percentage of completion by the estimated gross profit to determine the estimated gross profit earned to date.

Losses are recognised when incurred or when the expected contract costs exceed the expected contract revenue, regardless of which accounting method is used.

**UK GAAP**
Similar to IFRS, but specifically only permits turnover to be derived from the proportion of costs incurred where these provide evidence of the entity’s performance and, hence the extent to which it has obtained the right to consideration.

**Completed contract method**

**IFRS**
Prohibited.

**US GAAP**
The percentage of completion method is preferred. However, the completed contract method is allowed in rare circumstances where estimates of costs to completion and the extent of progress towards completion cannot be determined with enough certainty. Revenue is recognised only when the contract is completed or substantially so. Losses are recognised when incurred or when the expected contract costs exceed the expected contract revenue, regardless of which accounting method is used.

**UK GAAP**
Prohibited.

**Combining contracts and segmenting a contract**

**IFRS**
Requires contracts to be combined when part of a package, or segregated when each contract is part of a separate proposal and when revenues and costs can be clearly identified.

**US GAAP**
Combining contracts is permitted but not required.

**UK GAAP**
Similar to IFRS. Long-term contracts should be assessed on a contract by contract basis. However, a contract should be accounted for as separate components where the commercial substance is that individual components operate independently of each other.

**REFERENCES:**
- **IFRS:** IAS 11, IAS 18.
- **US GAAP:** CON 5, SAB 104, SOP 81-1, SOP 97-2, EITF 99-17, EITF 00-21, FTB 90-1.
- **UK GAAP:** SSAP 9, FRS 5, FRS 12, FRS 18, UITF 26, Companies Act 1985, Statement of Principles.
Expense recognition

Expenses
Definition

**IFRS**  Expenses are defined in the Framework to include losses. Expenses are decreases in economic benefits that result in a decrease in equity.

**US GAAP**  Expenses are defined by the Concept Statement to represent actual or expected cash outflows, or the equivalent, that have occurred or will result from the entity’s ongoing major operations.

**UK GAAP**  The Statement of Principles defines losses, which include expenses, as decreases in ownership interest not resulting from distributions to owners.

Specific expense recognition issues
Interest expense

**IFRS**  Interest expense is recognised on an accruals basis. Where interest expense includes a discount or premium arising on the issue of a debt instrument, the discount or premium is amortised using the effective interest rate method. The effective interest rate is the rate that discounts the estimated future cash payments through the expected life of the debt instrument to the carrying amount of the debt instrument.

**US GAAP**  Similar to IFRS.

**UK GAAP**  Similar to IFRS.

Employee benefits – pensions

All three frameworks require the cost of providing these benefits to be recognised on a systematic and rational basis over the period during which employees provide services to the entity. All three frameworks separate pension plans into defined contribution plans and defined benefit plans, and define them in similar ways.

**Defined contribution plans**

defined contribution plans are post-employment benefit plans that require the entity to pay fixed contributions into a fund. The entity is under no legal or constructive obligation to make further contributions to the fund even if losses are sustained. Under these plans it is the employee who is exposed to the risk attributable to the plan assets. All three frameworks require pension cost to be measured as the contribution payable to the fund on a periodic basis.

**Defined benefit plans**

Defined benefit plans oblige the employer to provide defined post-employment benefits of set amounts to employees. The risks associated with plan assets rest with the employer.

The methodology for accounting for defined benefit plans is similar under all three frameworks. The key features are:

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<tbody>
<tr>
<td>Determination of pension and post-retirement expense</td>
<td>Use projected unit credit actuarial method.</td>
<td>Similar to IFRS.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Discount rate for obligations</td>
<td>Based on market yields for high-quality corporate bonds. Government bond yields should be used when there is no deep market in high-quality corporate bonds.</td>
<td>Similar to IFRS, except that government bonds are not used.</td>
<td>Similar to IFRS. High quality corporate bonds are specified as being AA rated or equivalent.</td>
</tr>
<tr>
<td>ITEM</td>
<td>IFRS</td>
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<td>UK GAAP</td>
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<tr>
<td>------------------------------------</td>
<td>-------------------------------------------</td>
<td>-------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Valuation of plan assets</td>
<td>Measure at fair value or using discounted cash flows if market prices unavailable.</td>
<td>Similar to IFRS, except for differences resulting from the rate applied to market related value of plan assets (see expected return on plan assets below).</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Recognition of actuarial gains and losses</td>
<td>Immediate recognition in the income statement or amortise over expected remaining working lives of participating employees. At a minimum, a net gain/loss in excess of 10% of the greater of the defined benefit obligation or the fair value of plan assets at the beginning of year should be recognised. However, entities also have the option to recognise actuarial gains and losses in full as they arise, outside profit or loss, in a statement of recognised income and expense.</td>
<td>Similar to IFRS, except that if all or almost all plan participants are retired, actuarial gains and losses are amortised over the remaining life expectancy of the plan participants.</td>
<td>Recognised immediately in the STRGL.</td>
</tr>
<tr>
<td>Expected return on plan assets</td>
<td>Based on market expectations at the beginning of the period for returns over the entire life of the related obligation. Reflects changes in the fair value of plan assets as a result of actual contributions and benefits paid. The rate is applied to the fair value.</td>
<td>Based on market conditions and nature of the assets. Includes changes in plan assets due to contributions and benefit payments. The rate is applied to the market-related value of the plan assets, which is either the fair or a calculated value (which incorporates asset-related gains and losses over a period of no more than five years).</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Balance sheet asset limitation</td>
<td>Asset limited to the lower of: a) the asset resulting from applying the standard, and b) the net total of any unrecognised actuarial losses and past service cost and the present value of any available refunds from the plan or reduction in future contributions to the plan.</td>
<td>No similar requirement.</td>
<td>Asset is the difference between the value of scheme assets and value of scheme liabilities (net of deferred tax). However, asset amount is restricted to recoverable surplus.</td>
</tr>
<tr>
<td>Recognition of minimum pension liability</td>
<td>Not required.</td>
<td>Additional minimum liability is required when the accumulated benefit obligation exceeds the fair value of the plan assets and the amount of the accrued liability.</td>
<td>Not required.</td>
</tr>
</tbody>
</table>
### Multi-employer plans

Use defined benefit accounting unless sufficient information is not available. Use defined contribution accounting. Similar to IFRS.

### Curtailment/settlement (calculation of gains and losses)

Gains and losses on curtailments/settlements include changes in the present value of the defined benefit obligation, any resulting changes in the fair value of the plan assets and any related actuarial gains and losses and past-service cost that had not previously been recognised. Gains and losses on curtailments/settlements include unrecognised prior-service cost for which services are no longer expected to be rendered, and changes in the projected benefit obligation (net of any unrecognised gains or losses and remaining transition asset).

The maximum gain or loss on settlements to be recognised in profit or loss is equal to unrecognised net gain or loss plus any unrecognised transitional asset. The gain or loss on settlement/curtailment reflects the change in the present value of scheme liabilities and the fair value of plan assets.

### Curtailment/settlement (timing of recognition)

Gains and losses on curtailments are recognised when curtailments/settlements occur. Curtailment losses are recognised when it is probable that a curtailment will occur and the effect of the curtailment is reasonably estimable. Curtailment gains are deferred until realised and are recognised in earnings, either when the related employees terminate, or the plan suspension or amendment is adopted. Settlement gains or losses are recognised when the event of settlement occurs.

Losses on settlements/curtailments are recognised when the employer becomes demonstrably committed to the transaction. Gains are recognised when all parties whose consent is required are irrevocably committed to the transaction.

### Subsidiary’s defined benefit pension plan forming part of a group plan

The subsidiary should account for participation as defined benefit where there is a contractual agreement or stated policy for charging the net defined benefit cost for a group plan. Otherwise, account for plan as defined contribution.

The subsidiary should account for its participation in an overall group plan as a participant in a defined contribution (multi-employer) plan. Similar to US GAAP.

### Past-service cost

Positive and negative past-service cost recognised over remaining vesting period. Where benefits have already vested, recognise past-service cost immediately. Positive prior-service cost for current and former employees recognised over remaining service lives of active employees. Negative prior-service costs are used first to offset previous positive prior-service costs. Recognise excess as for positive prior-service cost. Similar to IFRS.

### Expense recognition

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<td>Past-service cost</td>
<td>Positive and negative past-service cost recognised over remaining vesting period. Where benefits have already vested, recognise past-service cost immediately.</td>
<td>Positive prior-service cost for current and former employees recognised over remaining service lives of active employees. Negative prior-service costs are used first to offset previous positive prior-service costs. Recognise excess as for positive prior-service cost.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Multi-employer plans</td>
<td>Use defined benefit accounting unless sufficient information is not available.</td>
<td>Use defined contribution accounting.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Subsidiary’s defined benefit pension plan forming part of a group plan</td>
<td>The subsidiary should account for participation as defined benefit where there is a contractual agreement or stated policy for charging the net defined benefit cost for a group plan. Otherwise, account for plan as defined contribution.</td>
<td>The subsidiary should account for its participation in an overall group plan as a participant in a defined contribution (multi-employer) plan.</td>
<td>Similar to US GAAP.</td>
</tr>
<tr>
<td>Curtailment/settlement (timing of recognition)</td>
<td>Gains and losses on curtailments are recognised when curtailments/settlements occur.</td>
<td>Curtailment losses are recognised when it is probable that a curtailment will occur and the effect of the curtailment is reasonably estimable. Curtailment gains are deferred until realised and are recognised in earnings, either when the related employees terminate, or the plan suspension or amendment is adopted. Settlement gains or losses are recognised when the event of settlement occurs.</td>
<td>Losses on settlements/curtailments are recognised when the employer becomes demonstrably committed to the transaction. Gains are recognised when all parties whose consent is required are irrevocably committed to the transaction.</td>
</tr>
<tr>
<td>Curtailment/settlement (calculation of gains and losses)</td>
<td>Gains and losses on curtailments/settlements include changes in the present value of the defined benefit obligation, any resulting changes in the fair value of the plan assets and any related actuarial gains and losses and past-service cost that had not previously been recognised.</td>
<td>Gains and losses on curtailments include unrecognised prior-service cost for which services are no longer expected to be rendered, and changes in the projected benefit obligation (net of any unrecognised gains or losses and remaining transition asset). The maximum gain or loss on settlements to be recognised in profit or loss is equal to unrecognised net gain or loss plus any unrecognised transitional asset.</td>
<td>The gain or loss on settlement/curtailment reflects the change in the present value of scheme liabilities and the fair value of plan assets.</td>
</tr>
</tbody>
</table>
Recent proposals – IFRS

IFRIC issued draft Interpretation D9 on IAS 19 in July 2004. It confirms that an employee benefit plan with a promised return on contributions is a defined benefit plan and proposes how to measure cash balance and similar types of plans.

US GAAP: APB 21, FAS 87, FAS 88.
UK GAAP: FRS 4; FRS 17.

Employee share compensation

Recognition

IFRS
Requires recognition of the fair value of shares and options awarded to employees over the period to which the employees’ services relate. The award is presumed to be for past services if the award is unconditional without any performance criteria.

US GAAP
Similar to IFRS.

UK GAAP
Similar to IFRS.

Measurement

IFRS
Shares and share options are often granted to employees as part of their remuneration package, in addition to salary and other employment benefits. IFRS 2 requires an entity to measure the fair value of the employee services received by reference to the fair value of the equity instruments granted. Extensive disclosures are also required.

US GAAP
Entities have a choice of accounting methods for determining the costs of benefits arising from employee share compensation plans. They may either follow an intrinsic value method or a fair value method.
Under the intrinsic value method, the compensation cost is the difference between the market price of the share at the measurement date and the price to be contributed by the employee (exercise price). Usually the measurement date is the date of grant. This method is widely used in practice.
The fair value method is based on the fair value of the option at the date of grant. This is estimated using an option-pricing model. If an entity chooses to follow the intrinsic value method, it must make, with comparable prominence and clarity, pro-forma disclosures of net income and earnings per share as if the fair value method had been applied.

UK GAAP
Similar to IFRS.

Employer’s payroll tax payable on exercise of share options by employees

IFRS
Employers’ social security liability arising from share-based payment transactions should be recognised over the same period or periods as the share-based payment charge.

US GAAP
Employer payroll taxes due on the exercise of share options should be recognised as an expense at the option’s exercise date.

UK GAAP
Requires that employers’ national insurance liability arising from the payment of stock options is accrued based on the latest enacted national insurance rate and current market value of the gain on the awards expected to vest. This charge is spread over the performance period.

1 The information here for UK GAAP is based on FRS 20, which is applicable for accounting periods of listed entities beginning on or after 1 January 2005 and periods beginning on or after 1 January 2006 for unlisted entities although early adoption is encouraged. UITF 17 applies until the relevant application dates.
**Employee share compensation (continued)**

**Non-employee share-based payment transactions**

**IFRS**

Goods or services acquired in a share-based payment transaction should be recognised when they are received. An expense or an asset arises out of a share-based payment transaction. The credit side of the entry will be a liability if the entity has an obligation to settle the transaction in cash. However, if there is no possibility of settling in cash, and the consideration for goods and services will therefore be achieved through the issuance of equity instruments, the credit entry is an increase in equity. IFRS 2 requires the fair value of the goods or services acquired by an entity to be determined and used as the value for an equity-settled share-based payment transaction.

**US GAAP**

Similar to IFRS, except that the expense should be measured based on the fair value of either the goods and services received or the fair value of securities issued, whichever is more reliably measurable.

**UK GAAP**

Similar to IFRS.

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**Recent proposals – US GAAP**

The FASB issued an exposure draft on share-based payments, in 31 March 2004. The ED proposed that the cost of all forms of equity-based compensation granted to employees, excluding employee stock ownership plans, be recognised in a company’s income statement. The award’s cost would be measured at fair value. The ED resulted in APB 25 being superseded and an amendment being made to FAS 123 in December 2004.

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**References:**

**IFRS:** IAS 19, IAS 37, IFRS 2.

**US GAAP:** APB 25, FAS 123, FAS 148, EITF D-83, EITF 00-16.

**UK GAAP:** UITF 25, UITF 3, FRS 20.

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**Compensated absences**

Includes long-term compensated absences such as long-term disability, long service and sabbatical. These benefits typically accumulate over the employee’s service period. All three frameworks recognise the liability as the employee provides the service that gives rise to the right to the benefit.

**Termination benefits**

**IFRS**

Termination benefits arising from redundancies are accounted for similarly to restructuring provisions.

If an offer is made to encourage voluntary redundancy, the measurement of termination benefits should be based on the number of employees expected to accept the offer.

Termination indemnities are generally payable regardless of the reason for the employee’s departure. The payment of such benefits is certain (subject to any vesting or minimum service requirements) but the timing of their payment is uncertain. IFRS requires that termination indemnities be accounted for consistently with pension obligations (that is, including a salary progression element and discounting).

**US GAAP**

Sets out specific guidance addressing post-employment benefits, for example salary continuation, termination benefits, training and counselling. US GAAP distinguishes between four types of termination benefits with three different timing methods for recognition:

1) Special termination benefits – generally additional benefits offered for a short period of time to certain employees electing to accept an offer of voluntary termination, recognised at the date on which the employees accept the offer and the amount can be reasonably estimated;
Termination benefits (continued)

2) Contractual termination benefits – which are benefits provided to employees when employment is terminated due to a specified event under an existing plan, recognised at the date when it is probable that employees will be entitled to the benefits and the amount can be reasonably estimated;

3) Termination benefits that are paid for normal severances pursuant to an ongoing termination benefit plan. Costs are recognised for probable and reasonably estimable payments as employee services are rendered, if the benefit accumulates, or when the obligating event occurs; and

4) One-time termination benefits – benefits provided to current employees that are involuntarily terminated under the terms of a one-time benefit arrangement.

A one-time benefit arrangement is one that is established by a termination plan that applies for a specified termination event or for a specified future period. These one-time benefits are recognised as a liability when the termination plan meets certain criteria and has been communicated to employees (the communication date). If employees are required to render future service in order to receive the one-time benefits, the liability is recognised rateably over the future service period.

Termination indemnity plans are considered to be defined benefit plans under US GAAP. Entities may choose whether to calculate the vested benefit obligation as the actuarial present value of the vested benefits to which the employee is entitled if the employee separates immediately, or as the actuarial present value of the vested benefits to which the employee is currently entitled, based on the employee’s expected date of separation or retirement.

UK GAAP There is no specific standard at present covering these areas (except termination benefits arising from redundancies where the rules for restructuring provisions apply as in FRS 12), but practice is generally similar to IFRS.

UK GAAP: FRS 12.
Assets

Intangible assets

Definition

**IFRS**
An intangible asset is an identifiable non-monetary asset without physical substance controlled by the entity and held for use in the production or supply of goods or services, for rental to others, or for administration purposes. It may be acquired or internally generated.

**US GAAP**
Similar to IFRS.

**UK GAAP**
Similar to IFRS, except that the asset has to be capable of being disposed of separately from the business in order to meet the definition.

Recognition – acquired intangibles

**IFRS**
General IFRS asset recognition criteria apply. Recognise if future economic benefits attributable to the asset are probable and the cost of the asset can be measured reliably.

**US GAAP**
Similar to IFRS.

**UK GAAP**
Internally generated intangible assets, other than development expenditure, may only be capitalised where there is a readily ascertainable market value.

Recognition – additional criteria for internally generated intangibles

**IFRS**
Requires classification of the costs associated with the creation of intangible assets by research phase and development phase. Costs in the research phase must always be expensed. Costs in the development phase are expensed unless the entity can demonstrate all of the following:

- the technical feasibility of completing the intangible asset;
- the intention to complete the intangible asset;
- the ability to use or sell it;
- how the intangible asset will generate future economic benefits – the entity must demonstrate the existence of a market or, if for internal use, the usefulness of the intangible asset;
- the availability of adequate resources to complete the development; and
- the ability to measure reliably the expenditure attributable to the intangible asset during its development.

Development costs initially recognised as an expense cannot be capitalised in a subsequent period.

**US GAAP**
Applies stricter recognition criteria than IFRS. Research and development costs should be expensed as incurred, making the recognition of internally generated intangible assets rare. However, separate rules apply to development costs for computer software that is to be sold. Here, capitalisation (and amortisation) applies once technological feasibility is established. Capitalisation ceases when the product is available for general release to customers. Similar rules apply to certain elements of development costs for computer software developed for internal use.

**UK GAAP**
Internally developed intangible assets (excluding research and development) may only be capitalised when there is an active market for the asset. Specific rules apply to research and development expenditure (as defined). The recognition criteria, for research and development, are similar to IFRS, except, under UK GAAP, an entity can chose not to capitalise development costs. Where capitalisation is selected, the recognition criteria are less strict than IFRS in that there can be a “reasonable expectation” of future benefits rather than “demonstration” of them (as for IFRS).

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2 See page 36 for accounting for intangible assets acquired in a business combination.
Intangible assets (continued)

Recognition – website development costs

**IFRS**  
Costs incurred during the planning stage must be expensed. Costs incurred for activities during the website’s application and infrastructure development stages must be capitalised, and costs incurred during the operation stage must be expensed as incurred.

**US GAAP**  
Similar to IFRS.

**UK GAAP**  
Costs incurred to develop a website must be capitalised if certain criteria are met. In particular, **UK GAAP** requires a discrete flow of revenue to result from the development of the website. This precludes the capitalisation of development costs for websites used only for advertising or promotion.

Measurement – acquired intangibles

**IFRS**  
The cost of a separately acquired intangible asset at the date of acquisition is usually self-evident, being the fair value of the consideration paid.

**US GAAP**  
Similar to IFRS.

**UK GAAP**  
Similar to IFRS.

Measurement – internally generated intangibles

**IFRS**  
The cost comprises all expenditure that can be directly attributed or allocated to creating, producing and preparing the asset from the date when the recognition criteria are met.

**US GAAP**  
Costs that are not specifically identifiable and that have indeterminable lives or that are inherent in a continuing business and related to an entity as a while should be recognised as an expense when incurred.

**UK GAAP**  
Not specified but practice as for IFRS.

Subsequent measurement – acquired and internally generated intangibles

**IFRS**  
Intangible assets subject to amortisation, are carried at historical cost less accumulated amortisation/impairment, or at fair value less subsequent amortisation/impairment. Intangible assets not subject to amortisation are carried at historical cost unless impaired. Subsequent revaluation of intangible assets to their fair value must be based on prices in an active market. Where an entity adopts this treatment (extremely rare in practice), the revaluations must be regularly performed and the revaluation of the entire class of intangible assets must take place at the same time.

**US GAAP**  
Initial recognition is similar to IFRS. Revaluation is not allowed. Intangible assets subject to amortisation are carried at amortised cost unless impaired. Intangible assets not subject to amortisation are carried at historical cost unless impaired.

**UK GAAP**  
Similar to IFRS.

Amortisation – acquired and internally generated intangibles

**IFRS**  
Amortised if the asset has a finite life. Do not amortise if the asset has an indefinite life, but test at least annually for impairment. There is no presumed maximum life.

**US GAAP**  
Similar to IFRS.

**UK GAAP**  
Similar to IFRS, however, there is a rebuttable presumption that the useful life does not exceed 20 years from the date of acquisition. In very rare cases an entity may demonstrate that an intangible asset has a finite useful life in excess of 20 years or has an indefinite useful life and in both these cases an annual impairment review would be required.
Intangible assets (continued)

Impairment – acquired and internally generated intangibles

IFRS  Requires impairment reviews whenever changes in events or circumstances indicate that an intangible asset’s carrying amount may not be recoverable. Annual reviews required, for intangible assets with indefinite useful lives and for assets not yet ready for use. Reversals of impairment losses are allowed under specific circumstances.

US GAAP  Similar to IFRS, except reversals of impairment losses are prohibited.

UK GAAP  Similar to IFRS, except UK GAAP requires a first year impairment review for intangible assets with a useful life of 20 years or less.

US GAAP: FAS 86, FAS 142, APB 17, SOP 98-1.

Property, plant and equipment

Definition

IFRS  Property, plant and equipments (PPE) are 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. They are expected to be used during more than one period.

US GAAP  Similar to IFRS.

UK GAAP  Similar to IFRS.

Recognition

IFRS  General IFRS asset recognition criteria apply. Recognise if future economic benefits attributable to the asset are probable and the cost of the asset can be measured reliably.

US GAAP  Similar to IFRS.

UK GAAP  Similar to IFRS.

Initial measurement

IFRS  Comprises the costs directly attributable to bringing the asset to the location and working condition necessary for it to be capable of operating in the way management intends, including costs of testing whether the asset is functioning properly. Start-up and pre-production costs must not be capitalised unless they are a necessary part of bringing the asset to its working condition. The following are also included in the initial measurement of the asset:

- the costs of site preparation;
- initial delivery and handling costs;
- installation and assembly costs;
- costs of employee benefits arising from construction or acquisition of the asset;
- costs of testing whether the asset is functioning properly;
- professional fees; and
- fair value gains/losses on qualifying cash flow hedges relating to the purchase of PPE in a foreign currency (see page 81).

The entity has the policy option to include the borrowing costs incurred during the period of acquiring, constructing or producing the asset for use (see page 60).
Property, plant and equipment (continued)

Government grants received in connection with acquisition of PPE may be offset against the cost (see page 73).

In respect of exploration and evaluation of mineral resources, an entity must develop an accounting policy with regard to capitalising these costs. The policy may be based on existing IFRS standards or those set by other bodies.

**US GAAP**  Similar to IFRS, except that hedge gains/losses on qualifying cash flow hedges are not included. Relevant borrowing costs must be included if certain criteria are met. Consistent with IFRS, the fair value of a liability for an asset retirement obligation must be recognised in the period incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalised as part of the asset’s carrying amount.

**UK GAAP**  Similar to IFRS, except that UK GAAP does not address the measurement of gains/losses on qualifying cash flow hedges. Company law prohibits netting of grants against the cost of an asset. There is no guidance in UK GAAP in respect of capitalisation of costs related to the exploration and evaluation of mineral resources.

**Recent proposals – US GAAP**

The FASB issued an exposure draft of an Interpretation of FAS 143 in June 2004. The ED proposes accounting for conditional asset retirement obligations (for example, obligations to remove and dispose of asbestos). In particular, it would clarify that a legal obligation to perform an asset retirement activity that is conditional on a future event is within the scope of FAS 143.

**Subsequent expenditure**

**IFRS**  Subsequent maintenance expenditure is expensed as incurred. Replacement of parts can be capitalised when new criteria are met. The cost of a major inspection or overhaul occurring at regular intervals is capitalised where the recognition criteria are satisfied. The net book value of any replaced component would be expensed at the time of overhaul.

**US GAAP**  Similar to IFRS.

**UK GAAP**  Similar to IFRS.

**Depreciation**

**IFRS**  The depreciable amount of an item of PPE must be allocated on a systematic basis over its useful life, reflecting the pattern in which the entity consumes the asset’s benefits. Any change in the depreciation method used is treated as a change in accounting estimate reflected in the depreciation charge for the current and prospective periods.

**US GAAP**  Similar to IFRS, except that US GAAP classifies a change in the depreciation method for previously recorded assets as a change in accounting principle. The cumulative effect of the change is then reflected in the current year’s income statement. However, a change in the estimated useful lives of depreciable assets is a change in estimate, which is accounted for prospectively in the period of change and future periods.

**UK GAAP**  Similar to IFRS.

**Subsequent measurement**

**IFRS**  The cost model requires an asset to be carried at cost less accumulated depreciation and impairment. However, revaluation of PPE at fair value is permitted under the alternative treatment.

The revaluation model must be applied to an entire class of assets.
Property, plant and equipment (continued)

The increase of an asset’s carrying amount as a result of a revaluation must be credited directly to equity under the heading ‘revaluation surplus’, unless it reverses a revaluation decrease for the same asset, previously recognised as an expense; then it must be recognised in the income statement. A revaluation decrease must be charged directly against any related revaluation surplus for the same asset, with any excess being recognised as an expense.

Disclosures of the historical cost equivalent (cost and accumulated depreciation) of assets carried at revalued amounts are required.

**US GAAP**

PPE should be carried at cost less accumulated depreciation and impairment losses. Revaluation to fair value is not permitted. Consistent with IFRS, impairment testing is performed whenever events or changes in circumstances suggest the carrying value of an asset is not recoverable.

**UK GAAP**

Revaluation recognised as for IFRS. However, fair value of an asset is defined as the lower of the recoverable amount and the replacement cost of the asset. Recoverable amount is the higher of the value in use and net realisable value. Existing use (and not highest and best use) is used as the basis of fair value.

**Frequency of revaluations**

**IFRS**

Revaluations must be kept sufficiently up to date so that the carrying amount does not differ materially from the fair value. This requires regular revaluations of all PPE when the revaluation policy is adopted. Management must consider at each year-end whether fair value is materially different from carrying value.

**US GAAP**

Not applicable.

**UK GAAP**

Similar to IFRS, except that UK GAAP provides more guidance regarding the frequency and reliability of the revaluations. In particular a full valuation is required at least every five years with interim valuations at year three.

**Impairment of revalued PPE**

**IFRS**

An impairment loss (downward revaluation) may be offset against revaluation surpluses to the extent that it relates to the same asset; any uncovered deficit must be accounted for in the income statement.

**US GAAP**

All impairments should be recognised in the income statement.

**UK GAAP**

Impairment losses on revalued assets are recognised in the income statement if they are caused by a clear consumption of economic benefits. Otherwise, they are recognised in the STRGL (against the revaluation reserve) until the carrying amount of the asset reaches its depreciated historical cost and in the income statement thereafter, unless it can be demonstrated that the asset’s recoverable amount is higher than its revalued amount.

**REFERENCES:** IFRS: IAS 16, IAS 23, IAS 36, IFRS 6.

US GAAP: FAS 34, FAS 143, FAS 144, ARB 43, APB 6.


**Non-current assets held for sale**

**IFRS**

An entity should classify a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. The asset must be available for immediate sale in its present condition and its sale must be highly probable. For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset, and an active programme to locate a buyer and complete the plan must have been initiated. The asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value. The sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. Once classified as held for sale, the asset should be measured at the lower of its carrying amount and fair value less costs to sell.
Leases – lessor accounting

Classification

The concepts behind lease classification are similar in all three frameworks. However, substance rather than legal form is applied under IFRS and UK GAAP, while extensive form-driven requirements are present in US GAAP.

A finance (capital) lease exists if the agreement transfers substantially all the risks and rewards associated with ownership of the asset to the lessee. All three frameworks provide indicators for determining the classification of a lease. These are presented in the table below.

<table>
<thead>
<tr>
<th>INDICATOR</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Normally leads to a finance lease</td>
<td>Indicator of a finance lease</td>
<td>Indicator of a finance lease</td>
<td>Indicator of a finance lease</td>
</tr>
<tr>
<td>Ownership is transferred to the lessee at the end of the lease term</td>
<td>Indicator of a finance lease</td>
<td>Indicator of a finance lease</td>
<td>Indicator of a finance lease</td>
</tr>
<tr>
<td>A bargain purchase option exists</td>
<td>Indicator of a finance lease</td>
<td>Indicator of a finance lease</td>
<td>Indicator of a finance lease</td>
</tr>
<tr>
<td>The lease term is for the majority of the leased asset’s economic life</td>
<td>Indicator of a finance lease</td>
<td>Specified as equal to or greater than 75% of the asset’s life.</td>
<td>Indicator of a finance lease</td>
</tr>
<tr>
<td>The present value of minimum lease payments is equal to substantially all the fair value of the leased asset</td>
<td>Indicator of a finance lease</td>
<td>Specified as 90% of the fair value of the property less any investment tax credit retained by the lessor.</td>
<td>A present value of 90% is suggested as an indicator of a finance lease.</td>
</tr>
<tr>
<td>The leased assets are of a specialised nature such that only the lessee can use them without major modification</td>
<td>Indicator of a finance lease</td>
<td>Not specified.</td>
<td>Not specified.</td>
</tr>
<tr>
<td>Could lead to a finance lease</td>
<td>Indicator of a finance lease</td>
<td>Not specified.</td>
<td>Not specified.</td>
</tr>
<tr>
<td>On cancellation, the lessor’s losses are borne by the lessee</td>
<td>Indicator of a finance lease</td>
<td>Not specified.</td>
<td>Not specified.</td>
</tr>
<tr>
<td>Gains and losses from the fluctuation in the fair value of the residual fall to the lessee</td>
<td>Indicator of a finance lease</td>
<td>Not specified.</td>
<td>Not specified.</td>
</tr>
<tr>
<td>The lessee has the ability to continue the lease for a secondary period at below market rental</td>
<td>Indicator of a finance lease</td>
<td>Not specified.</td>
<td>Indicator of a finance lease</td>
</tr>
</tbody>
</table>

Furthermore, under IFRS and UK GAAP, in cases where an arrangement does not take the legal form of a lease, but conveys a right to use an item (for example, an item of PPE) for an agreed period of time in return for a payment or series of payments, it should be accounted for as a lease in accordance with the relevant standard.
Leases – lessor accounting (continued)

Recognition of the investment in the lease

All three frameworks require the amount due from a lessee under a finance lease to be recognised as a receivable at the amount of the net investment in the lease. At any point in time, this will comprise the total of the future minimum lease payments less gross earnings allocated to future periods. Minimum lease payments for a lessor include guarantees from a third party related to the leased assets under IFRS and UK GAAP. US GAAP excludes these guarantees. The present value of minimum lease payments would generally use the implicit rate in the lease for discounting under IFRS and UK GAAP. Under US GAAP, the lessor would also use the implicit rate.

The gross earnings are allocated between receipt of the capital amount and receipt of finance income on a basis so as to provide a constant rate of return. Initial direct costs should be amortised over the lease term. IFRS and US GAAP require use of the net investment method to allocate gross earnings, which excludes the effect of cash flows arising from taxes and financing relating to a lease transaction. An exception to this is for leveraged leases under US GAAP where tax cash flows are included. UK GAAP requires use of the net cash investment method, which includes tax cash flows.

Operating leases

All three frameworks require an asset leased under an operating lease to be recognised by a lessor as PPE and depreciated over its useful life. Rental income is generally recognised on a straight-line basis over the lease term.

Incentives

IFRS, US GAAP and UK GAAP all require the lessor to recognise the aggregate cost of incentives given as a reduction of rental income over the lease term on a straight-line basis (or the period ending on a date from which it is expected the prevailing market rental will be payable under UK GAAP where this is shorter), unless another systematic basis is more representative of the time pattern over which the benefit of the leased asset is diminished.

REFERENCES: IFRS: IAS 17, IFRIC 4
UK GAAP: SSAP 21, FRS 5, UITF 28.

Impairment of assets

Recognition

IFRS
An entity should assess annually whether there are any indications that an asset may be impaired. If there is any such indication, the assets must be tested for impairment. An impairment loss must be recognised in the income statement when an asset’s carrying amount exceeds its recoverable amount. Assets classified as held for disposal must be measured at the lower of the carrying amount or fair value less selling costs.

For exploration and evaluation assets, an impairment test need only be carried out if ‘facts and circumstances’ indicate that the asset may be impaired.

US GAAP
Management should consider each period whether there is reason to suspect that long-lived assets (asset groups) might not be recoverable. Several impairment indicators exist for making this assessment.

For assets to be held and used, impairment is first measured by reference to undiscounted cash flows. If impairment exists, the entity must measure impairment by comparing the asset’s carrying value to its fair value. If there is no impairment by reference to undiscounted cash flows, no further action is required but the useful life of the asset must be reconsidered. Assets classified as held for disposal must be measured at the lower of the carrying amount or fair value less selling costs.
Impairment of assets (continued)

UK GAAP  Similar to IFRS. Assets classified as held for disposal should be written down to recoverable amount (being the higher of net realisable value and value in use). There is no equivalent guidance in UK GAAP for exploration and evaluation assets.

Measurement

IFRS  The impairment loss is the difference between the asset’s carrying amount and its recoverable amount. The recoverable amount is the higher of the asset’s fair value less costs to sell and its value in use. Value in use is the future cash flows to be derived from the particular asset, discounted to present value using a pre-tax market-determined rate that reflects the current assessment of the time value of money and the risks specific to the asset.

US GAAP  The impairment loss is measured as the excess of the carrying amount over the asset’s fair value, being either market value (if an active market for the asset exists), the best information available in the circumstances including the price for similar assets, or the sum of discounted future cash flows or other valuation techniques, using market assumptions. For assets to be disposed of, the loss recognised is the excess of the asset’s carrying amount over its fair value less cost to sell. Costs to sell include incremental direct costs to transact the sale that would not have been incurred except for the decision to sell. Such assets are not depreciated or amortised during the selling period.

UK GAAP  Similar to IFRS. UK GAAP defines recoverable amount as the higher of net realisable value and value in use.

Reversal of impairment loss

IFRS  Requires reversal of impairment losses when there has been a change in economic conditions or in the expected use of the asset.

US GAAP  Prohibits reversals of impairment losses for assets to be held and used, as the impairment loss results in a new cost basis for the asset. Subsequent revisions to the carrying amount of an asset to be disposed of must be reported as adjustments to the asset’s carrying amount, but limited by the carrying amount at the date on which the decision to dispose of the asset is made.

UK GAAP  Similar to IFRS.

US GAAP: FAS 143, 144.

Capitalisation of borrowing costs

Recognition

IFRS  An entity can choose to capitalise borrowing costs where they are directly attributable to the acquisition, construction or production of a qualifying asset. The choice should be applied consistently. A qualifying asset is one that necessarily takes a substantial period of time to get ready for its intended use or sale.

US GAAP  Requires capitalisation of borrowing costs, including the amortisation of discount premium and issue costs on debt, if applicable. US GAAP defines a qualifying asset in a similar manner to IFRS, except that investments accounted for using the equity method meet the criteria for a qualifying asset while the investee is actively preparing for its planned principal operations, provided that the investee’s activities include the use of funds to acquire qualifying assets for its operations.

UK GAAP  Similar to IFRS.
Capitalisation of borrowing costs (continued)

Measurement

IFRS The amount of interest eligible for capitalisation is either the actual costs incurred on a specific borrowing or an amount calculated using the weighted average method, considering all the general borrowings outstanding during the period for that entity. Interest can include foreign exchange differences, but under tightly defined conditions. Any interest earned on temporary investment of funds borrowed to finance the asset’s production is netted with the interest to be capitalised. Capitalisation of interest must cease once the asset is ready for its intended use or sale.

US GAAP Similar to IFRS, except that foreign exchange differences and interest earned on funds borrowed to finance the production of the asset cannot be netted against interest as appropriate for IFRS, except for certain governmental or private enterprises that finance qualifying assets through tax-exempt borrowings. In these cases, the interest costs to be capitalised are required to be reduced by the interest income.

UK GAAP Similar to US GAAP. Finance costs are capitalised on a gross basis before the deduction of tax relief (no equivalent guidance is provided in IFRS in this respect).

REFERENCES: IFRS: IAS 23.
US GAAP: FAS 34, FAS 62.

Investment property

Definition

IFRS Property (land and buildings) held in order to earn rentals and/or for capital appreciation. Does not include owner-occupied property or property held for sale.

US GAAP There are no specific guidance for investment property, other than specific rules relating to entities qualifying as investment companies under the Investment Companies Act of 1940. For entities that are not investment companies, such property is accounted for in the same way as PPE.

UK GAAP Similar to IFRS.

Initial measurement

IFRS The same cost-based measurement should be used for both acquired and self-constructed investment property. The cost of a purchased investment property comprises its purchase price and any directly attributable costs such as professional fees for legal services, property transfer taxes and other transaction costs. Self-constructed property must be accounted for as PPE until construction is complete, when it becomes an investment property. Property under finance or operating lease can also be classified as investment property.

US GAAP No specific rules for investment property. Such property is accounted for in the same way as PPE.

UK GAAP Similar to IFRS.

Subsequent measurement

IFRS The entity can choose between the fair value model or depreciated cost for all investment property. When fair value is applied, the gain or loss arising from a change in the fair value is recognised in the income statement and the carrying amount is not depreciated.

US GAAP The depreciated cost model must be applied.

UK GAAP All investment property is recognised at fair value. A gain or loss arising from a change in fair value is recognised in the STRGL and the revaluation reserve unless a deficit on an individual investment property is expected to be permanent, in which case it is recognised in the income statement.
Investment property (continued)

Transfers to/from investment property

IFRS Where there is a change in use of the investment property, there is detailed guidance for subsequent classification. Investment property to be sold is re-classified as inventories, and investment property to be owner-occupied is reclassified as PPE.

US GAAP Not applicable.

UK GAAP No specific guidance.

Frequency and basis of revaluations

IFRS The fair value of investment property must reflect the actual market conditions and circumstances as of the balance sheet date. The standard does not require the use of an independent and qualified valuer, but the use is encouraged. Revaluations must be made with sufficient regularity that the carrying amount does not differ materially from fair value.

US GAAP Not applicable.

UK GAAP Similar to IFRS. Investment properties should be included in the balance sheet at open market value. Where they represent a substantial proportion of the total assets of a major enterprise, the valuation would normally be carried out annually by qualified valuers and at least every 5 years by an external valuer.

REFERENCES: IFRS: IAS 40.
UK GAAP: SSAP 19, Companies Act 1985

Inventories

Definition

All three frameworks define inventories as assets that are: held for sale in the ordinary course of business; in the process of production or for sale in the form of materials; or supplies to be consumed in the production process or in rendering services.

Measurement

IFRS Carried at the lower of cost or net realisable value (sale proceeds less all further costs to bring the inventories to completion). Reversal (limited to the amount of the original write-down) is required for a subsequent increase in value of inventory previously written down. Inventories of producers and dealers of agricultural and forest products and mineral ores are allowed at net realisable value even if above cost.

US GAAP Broadly consistent with IFRS, in that the lower of cost and market value is used to value inventories. Market value is defined as being current replacement cost subject to an upper limit of net realisable value (that is, estimated selling price in the ordinary course of business less reasonably predictable costs of completion and disposal) and a lower limit of net realisable value less a normal profit margin. Reversal of a write-down is prohibited, as a write-down creates a new cost basis. Similar for inventories of agricultural and forest products and mineral ores. Mark-to-market inventory accounting is allowed for refined bullion of precious metals.

UK GAAP Similar to IFRS with the exception of use of net realisable value for agricultural and forest products and mineral ores where there is no similar exclusion from scope in SSAP 9.
Inventories (continued)

**Formula for determining cost**

<table>
<thead>
<tr>
<th>METHOD</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>LIFO</td>
<td>Prohibited</td>
<td>Permitted</td>
<td>Prohibited</td>
</tr>
<tr>
<td>FIFO</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
</tr>
<tr>
<td>Weighted average cost</td>
<td>Permitted</td>
<td>Permitted</td>
<td>Permitted</td>
</tr>
</tbody>
</table>

**Consistency of the cost formula for similar inventories**

**IFRS** Requires an entity to use the same cost formula for all inventories that have a similar nature and use to the entity.

**US GAAP** Similar to IFRS.

**UK GAAP** Not specified, but consistency is a fundamental principle.

**Allocation of fixed overheads**

**IFRS** Any allocation of fixed production overheads is based on normal capacity levels, with unallocated overheads expensed as incurred.

**US GAAP** Idle capacity costs may also be absorbed into inventory costs in limited circumstances.

**UK GAAP** Similar to IFRS.

**REFERENCES:** IFRS: IAS 2; US GAAP: ARB 43; UK GAAP: SSAP 9.

**Biological assets**

**IFRS** Should be measured on initial recognition and at each balance sheet date at its fair value less estimated point-of-sale costs. All changes in fair value should be recognised in the income statement in the period in which they arise.

**US GAAP** Not specified, historical cost is generally used.

**UK GAAP** Not specified, historical cost rules would apply as for inventories.

**REFERENCES:** IFRS: IAS 41.

**Financial assets**

**IFRS** outlines the recognition and measurement criteria for all financial assets defined to include derivatives. The guidance in **IFRS** is broadly consistent with **US GAAP**. For entities adopting FRS 26, the requirements are as for **IFRS**.

**Definition**

**IFRS, US GAAP** and **UK GAAP** define a financial asset in a similar way, to include: cash; a contractual right to receive cash or another financial asset from another entity or to exchange financial instruments with another entity under conditions that are potentially favourable; and an equity instrument of another entity. Financial assets include derivatives (under **IFRS**, these include many contracts that will or may be settled in the entity’s own equity instruments). See page 79 for accounting for derivatives.

**Recognition and initial measurement**

**IFRS, US GAAP** and **UK GAAP** require an entity to recognise a financial asset when and only when the entity becomes a party to the contractual provisions of a financial instrument. The initial measurement of the financial asset is its fair value, which is normally the consideration given, including directly related transaction costs.
## Financial assets (continued)

<table>
<thead>
<tr>
<th>CLASSIFICATION</th>
<th>IFRS and companies adopting FRS 26</th>
<th>US GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial assets at fair value through profit or loss</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>This category has two sub-categories: financial assets held for trading, and those designated to the category at inception. Any financial asset may, on initial recognition, be classified as fair value through profit or loss.</td>
<td>An irrevocable decision to classify a financial asset as fair value through profit or loss.</td>
<td>No such option.</td>
</tr>
<tr>
<td><strong>Held-for-trading financial assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt and equity securities held for sale in the short term. Includes derivatives.</td>
<td>The intention must be to hold the financial asset for a relatively short period, or as part of a portfolio for the purpose of short-term profit-taking. Subsequent measurement at fair value. Unrealised and realised gains and losses recognised in the income statement.</td>
<td>Similar to IFRS, and frequent buying and selling usually indicates a trading instrument. Similar to IFRS.</td>
</tr>
<tr>
<td><strong>Held-to-maturity investments</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial assets held with a positive intent and ability to hold to maturity. Includes assets with fixed and determinable payments and maturities. Does not include equity securities because they have an indefinite life.</td>
<td>Entity must have the ‘positive intent and ability’ to hold a financial asset to maturity not simply a present intention. When an entity sells more than an insignificant amount of assets, classified as held-to-maturity, it is prohibited from using the held-to-maturity classification for two full annual reporting periods (known as tainting). The entity must also reclassify all its held-to-maturity assets as available-for-sale assets. Recognised at amortised cost using the effective-yield method.</td>
<td>Similar to IFRS, although US GAAP is silent about when assets cease to be tainted. However, for listed companies, the SEC believes that the taint period for sales or transfers of held-to-maturity securities should be two years.</td>
</tr>
<tr>
<td><strong>Loans and receivables</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial assets with fixed or determinable payments not quoted in an active market. May include loans and receivables purchased, provided their intention is similar but not interests in pools of assets (for example, mutual funds).</td>
<td>Recognised at amortised cost.</td>
<td>All debts receivable that are not securities are recognised at amortised cost.</td>
</tr>
<tr>
<td><strong>Available-for-sale financial assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All debt/equity financial assets not covered by above categories. Includes equity securities, except those classified as held-for-trading.</td>
<td>Recognised at fair value. Changes in fair value are recognised net of tax effects in equity and recycled to the income statement when sold, impaired or collected.</td>
<td>As for IFRS, includes debt/equity securities not covered by above categories, but excludes unlisted equity securities that are carried at cost. Changes in fair value reported in other comprehensive income.</td>
</tr>
</tbody>
</table>
Financial assets (continued)

**UK GAAP**  Where companies do not adopt FRS 26, the accounting treatment of investments is addressed in company law. Long-term investments must be carried at cost (less impairment losses) or revalued amount. The revalued amount is based on market value or another appropriate value, e.g. underlying net asset value. Surpluses on revaluation are recognised in the STRGL. An entity must transfer any attributable revaluation surplus to the income statement.

Current asset investments are carried at the lower of cost and net realisable value or at current cost. If the latter, then revaluations are accounted for as long-term investments. Financial assets originated by the enterprise are accounted for similarly to **IFRS** and **US GAAP** regardless of adoption of FRS 26.

**Reclassification of assets between categories**

**IFRS**  Reclassifications between categories are relatively uncommon under **IFRS** and are prohibited into and out of the fair value through profit or loss category.

Reclassifications from the held-to-maturity category as a result of a change of intent or ability are treated as sales and, other than in exceptional circumstances, result in the whole category being ‘tainted’. The most common reason for a reclassification out of the category, therefore, is when the whole category is tainted and has to be reclassified as available-for-sale for two years. In such circumstances, the assets are remeasured to fair value, with any difference recognised in equity.

An instrument may be reclassified into the category where the tainted held-to-maturity portfolio has been ‘cleansed’. In this case, the financial asset’s carrying value at the date of reclassification is recharacterised becomes its amortised cost. Any unrealised gains and losses already recognised remain in equity until the asset is impaired or derecognised.

**US GAAP**  The following rules apply under **US GAAP** to the transfer of financial assets between categories:

- **Held-to-maturity investments**
  
  An entity must reclassify a financial asset from the held-to-maturity category when there has been a change of intent or ability, or there has been evidence of short-term profit-taking. Where the reclassification is to held-for-trading, the asset must be re-measured to fair value with the difference recognised in the income statement. Where the financial asset is reclassified from held-to-maturity to available-for-sale, the asset must be re-measured to fair value with the difference recognised in equity. Similar to **IFRS**, such a transfer may trigger tainting provisions.

  If an entity transfers an asset into the held-to-maturity category, the asset’s fair value at the date of reclassification becomes its amortised cost. Any previous gain or loss recognised in equity must be amortised over the remaining life of the held-to-maturity investment. Any difference between the new amortised cost and the amount due at maturity must be treated as an adjustment of yield.

- **Available-for-sale financial assets**
  
  Transfers from (to) available-for-sale into (or out of) trading should be rare. The phrase ‘should be rare’ has been interpreted by the SEC as ‘never should occur’.

**UK GAAP**  Same as **IFRS** where a company adopts FRS 26.

**Impairment**

**IFRS, US GAAP** and **UK GAAP** all have similar requirements for the impairment of financial assets. **IFRS** and **UK GAAP** require an entity to consider impairment when there is an indicator of impairment, such as: the deterioration in the creditworthiness of a counterparty; an actual breach of contract; a high probability of bankruptcy; the disappearance of an active market for an asset, or in the case of an investment in an equity instrument, whether there has been a significant or prolonged decline in the fair value of that investment below its cost.
Financial assets (continued)

US GAAP requires the write-down of financial assets when an entity considers a decline in fair value to be ‘other than temporary’. Indicators of impairment are: the financial health of the counterparty; whether the investor intends to hold the security for a sufficient period to permit recovery in value, the duration and extent that the market value has been below cost and the prospects of a forecasted market price recovery.

Recent proposals – IFRS

The IASB issued an exposure draft of proposed amendments to IAS 39, Financial Instruments: Recognition and Measurement – The Fair Value Option, in April 2004. This exposure draft proposes to limit the use of the fair value option available in IAS 39.

Recent proposals – US GAAP

The FASB issued an exposure draft on fair value measurements in June 2004. The ED will enhance the current guidance on fair value measurements by establishing a measurement framework for financial and non-financial assets and liabilities that are measured at fair value under other authoritative pronouncements.

Both IFRS and US GAAP require that, for financial assets carried at amortised cost, the impairment loss is the difference between the asset’s carrying amount and its estimated recoverable amount (present value of expected future cash flows discounted at the instrument’s original effective interest rate). For financial assets carried at fair value, the recoverable amount is usually based on quoted market prices or, if unavailable, the present value of the expected future cash flows discounted at the current market rate. If a loss has been deferred in equity, it must be recycled to the income statement on impairment.

Under US GAAP, market recoveries on available-for-sale debt securities are not recognised as they occur, rather the changes in market value are treated as a basis adjustment and amortised. US GAAP prohibits the reversal of an impairment charge on available-for-sale equity securities. IFRS requires changes in value of available-for-sale debt securities, identified as reversals of previous impairment, to be recognised in the income statement. Similar to US GAAP, IFRS prohibits reversals of impairment on available-for-sale equity securities.

Derecognition

IFRS

A financial asset (or part) is derecognised when:

- the rights to the asset’s cash flows expire;
- the rights to the asset’s cash flows and substantially all risks and rewards of ownership are transferred;
- an obligation to transfer the asset’s cash flows is assumed, substantially all risks and rewards are transferred and the following conditions are met:
  - no obligation to pay cash flows unless equivalent cash flows from the transferred asset collected,
  - prohibition from selling or pledging the asset other than as security to the eventual recipients for the obligation to pass through cash flows,
  - obligation to remit any cash flows without material delay; or
- substantially all the risks and rewards are neither transferred nor retained but control of the asset is transferred.

If an entity transfers substantially all the risks and rewards of ownership of the asset (for example, an unconditional sale of a financial asset), the entity derecognises the asset. If an entity retains substantially all the risks and rewards of ownership of the asset, it continues to recognise the asset (the transaction is accounted for as a collateralised borrowing). If an entity neither transfers nor retains substantially all the risks and rewards of ownership of the asset, the entity has to determine whether it has retained control of
Financial assets (continued)

the asset. Control is based on the transferee’s practical ability to sell the asset. The asset is derecognised if the entity has lost control. If the entity has retained control, it continues to recognise the asset to the extent of its continuing involvement.

If the asset is derecognised on sale to a special purpose entity (SPE), there may be a requirement to consolidate that SPE.

On derecognition, the difference between the amount received and the carrying amount of the asset is recognised in the income statement. Any fair value adjustments on the assets formerly reported in equity are recycled to the income statement. Any new assets or liabilities arising from the transaction are recognised at fair value.

**US GAAP**

Similar to **IFRS**, where an entity surrenders control over all or a portion of a financial asset sold, the asset may be derecognised. Otherwise, the transfer is accounted for as a borrowing secured by the asset ‘sold’.

In certain circumstances, **US GAAP** requires legal isolation of financial assets from the transferor (even in bankruptcy or receivership) as a necessary condition for derecognition.

**UK GAAP**

Adopts a “risks and rewards” approach to derecognition of assets, focussing on the substance of a transaction rather than its legal form. The asset is derecognised where the transaction transfers to others the significant rights or other access to benefits relating to that asset, and the significant exposure to the risks inherent in those benefits. For example, receivables “sold” to a financing institution in order to realise cash resources may only be removed from the balance sheet where all of the following criteria are met:

- transfer of the debts is for a single non-returnable fixed sum;
- there is no recourse to the seller for losses; and
- the financing institution is paid all amounts received from the receivables (and no more) with the seller having no further rights to further sums from the financing institution.

Where the seller continues to bear the credit risk, the debts continue to be treated as an asset of the seller with the cash advance classified as an obligation to repay the finance. In certain situations where the financing is “ring fenced” without recourse, a linked presentation applies – the finance is shown separately but deducted from the asset to which it relates on the face of the balance sheet.

**REFERENCES:**

- **IFRS:** IAS 39, SIC-12.
- **US GAAP:** FAS 115, FAS 133, FAS 140, EITF 03-01.
- **UK GAAP:** FRB 5, FRS 26, Companies Act 1985.
Liabilities

Provisions

IFRS and UK GAAP have specific and very similar standards on accounting for provisions generally, while US GAAP has several standards addressing specific provisions – for example, environmental liabilities and restructuring costs. All three frameworks prohibit recognition of provisions for future costs, including costs associated with compliance with proposed but not yet effective legislation.

Recognition

IFRS

Requires recognition of a provision only when:

- the entity has a present obligation to transfer economic benefits as a result of past events;
- it is probable that such a transfer will be required to settle the obligation; and
- a reliable estimate of the amount of the obligation can be made.

A present obligation arises from an obligating event and may take the form of either a legal obligation or a constructive obligation. An obligating event leaves the entity no realistic alternative to settle the obligation created by the event. If the entity can avoid the future expenditure by its future actions, it has no present obligation, and a provision is not recognised.

US GAAP

Similar to IFRS. However, the meaning of probable conveys a higher threshold than ‘more likely than not’.

UK GAAP

Similar to IFRS.

Measurement

IFRS

The amount recognised as a provision must be the best estimate of the minimum expenditure required to settle the present obligation at the balance sheet date. The entity must discount the anticipated cash flows using a pre-tax discount rate (or rates) that reflect(s) current market assessments of the time value of money and those risks specific to the liability if the effect is material. If a range of estimates is predicted and no amount in the range is more likely than any other amount in the range, the ‘mid-point’ of the range must be used to measure the liability.

US GAAP

Similar to IFRS. However, if a range of estimates is present and no amount in the range is more likely than any other amount in the range, the ‘minimum’ (rather than the mid-point) amount must be used to measure the liability. (Differences may arise in the selection of the discount rate, particularly in the area of asset retirement obligations.)

UK GAAP

Similar to IFRS.

Restructuring provisions

IFRS

In the case of a restructuring, a present obligation exists only when the entity is ‘demonstrably committed’ to the restructuring. An entity is usually demonstrably committed when there is a binding sale agreement (legal obligation), or when the entity has a detailed formal plan for the restructuring and is unable to withdraw because it has started to implement the plan or announced its main features to those affected (constructive obligation). However, a current provision is unlikely to be justified if there will be a delay before the restructuring begins, or the restructuring will take an unreasonably long time to complete.
Provisions (continued)

**US GAAP**  Similar to IFRS. However, management is not allowed to update or withdraw from the plan. **US GAAP** prohibits the recognition of a liability based solely on an entity’s commitment to a plan. Recognition of a provision for one-time termination benefits requires communication of the details of the plan to the affected employees. Initial liabilities for restructurings that meet the definition of a liability are measured at fair value and must be evaluated each reporting period, with subsequent changes in fair value measured using an interest allocation approach.

**UK GAAP**  Similar to IFRS.

Onerous contracts

**IFRS**  Prohibits provisions for future operating losses. However, if an entity is party to a contract that is onerous (the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under the contract), the present obligation under the contract must be recognised and measured as a provision. One of the most common examples relates to leasehold property that has been left vacant.

**US GAAP**  A liability for costs to terminate a contract before the end of its term should be recognised and measured at fair value when the entity terminates the contract in accordance with the contract terms (for example, when the entity gives written notice to the counterparty within the notification period specified by the contract or has otherwise negotiated a termination with the counterparty). A liability for costs that will continue to be incurred under a contract for its remaining term without economic benefit to the entity should be recognised and measured at its fair value when the entity ceases to use the right conveyed by the contract. A common example relates to leasehold property that is no longer being used. The liability must be reduced by estimated sub-lease rentals that could reasonably be obtained for the property (consistent with IFRS).

**UK GAAP**  Similar to IFRS.

**REFERENCES:**
- IFRS: IAS 37.
- **US GAAP:** FAS 5, EITF 88-10, FAS 143, FAS 146, SOP 96-1.
- **UK GAAP:** FRS 12.

Contingencies

Contingent asset

**IFRS**  A possible asset that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the entity’s control. The item is recognised as an asset when the realisation of the associated benefit, such as an insurance recovery, is virtually certain.

**US GAAP**  Similar to IFRS, but the threshold for recognising insurance recoveries is lower. The recovery is required to be probable (the future event or events are likely to occur) rather than virtually certain as under IFRS.

**UK GAAP**  Similar to IFRS.

Contingent liability

**IFRS**  A possible obligation whose outcome will be confirmed only on the occurrence or non-occurrence of uncertain future events outside the entity’s control. It can also be a present obligation that is not recognised because it is not probable that there will be an outflow of economic benefits, or the amount of the outflow cannot be reliably measured. Contingent liabilities are disclosed unless the probability of outflows is remote.
Contingencies (continued)

**US GAAP**  Similar to IFRS, requiring an accrual for a loss contingency if it is probable (defined as likely) that there is a present obligation resulting from a past event and an outflow of economic resources is reasonably estimable.

**UK GAAP**  Similar to IFRS.

**REFERENCES:**
- IFRS: IAS 37.
- US GAAP: FAS 5, SOP 96-1.
- UK GAAP: FRS 12.

Recent proposals – US GAAP

The FASB issued an exposure draft of an Interpretation of FAS 143 in June 2004. The ED proposes accounting for conditional asset retirement obligations (for example, obligations to remove and dispose of asbestos). In particular, it would clarify that a legal obligation to perform an asset retirement activity that is conditional on a future event is within the scope of FAS 143.

Deferred tax

Although all three frameworks require full provision for deferred tax, there are differences in the methodology, as set out in the table below.

<table>
<thead>
<tr>
<th>ISSUE</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General considerations</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General approach</td>
<td>Full provision.</td>
<td>Similar to IFRS.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Basis for deferred tax assets and liabilities</td>
<td>Temporary differences – that is, the difference between carrying amount and tax base of assets and liabilities (see exceptions below).</td>
<td>Similar to IFRS.</td>
<td>Obligation to pay tax arising from timing differences, being the differences between accounting and taxable profit.</td>
</tr>
</tbody>
</table>
| Exceptions (that is, deferred tax is not provided on the temporary difference) | Goodwill, which is not deductible for tax purposes, does not give rise to a taxable temporary difference. Similarly, negative goodwill does not give rise to a deductible temporary difference. Initial recognition of an asset or liability in a transaction that: 
(i) is not a business combination, and 
(ii) affects neither accounting profit nor taxable profit at the time of the transaction. | Similar to IFRS. Since negative goodwill is not carried on the balance sheet under US GAAP, it does not create a book/tax difference. | The exceptions are more extensive and include permanent differences on which deferred tax is not recognised. |

Similarities and Differences – A comparison of IFRS, US GAAP and UK GAAP – August 2005
<table>
<thead>
<tr>
<th>ISSUE</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Specific applications</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrealised intra-group profits – for example, on inventory</td>
<td>Deferred tax recognised at the buyer’s tax rate.</td>
<td>The buyer is prohibited from recognising deferred taxes. Any income tax effects to the seller (including taxes paid and tax effects of any reversal of temporary differences) as a result of the inter-company sale are deferred and then recognised upon ultimate sale to a third party.</td>
<td>The seller’s tax rate is used.</td>
</tr>
<tr>
<td>Revaluation of PPE and intangible assets</td>
<td>Deferred tax recognised in equity.</td>
<td>Not applicable, as revaluation is prohibited.</td>
<td>Recognise deferred tax for fair value changes on non-monetary assets which are recognised in the income statement. For revaluations recognised in equity, deferred tax is not recognised unless the entity has a binding agreement to sell the assets and has recognised the expected gains and losses on sale.</td>
</tr>
<tr>
<td>Revaluation of financial assets</td>
<td>Deferred tax is recognised in the income statement unless changes in the carrying amount of available-for-sale assets are taken to equity, in which case deferred tax is taken to equity.</td>
<td>All changes in the carrying amount of available-for-sale assets are taken to equity; therefore, deferred tax is taken to equity. Subsequent statutory rate changes and certain valuation allowance changes are recognised in the income statement.</td>
<td>As for revaluation of PPE and intangible assets.</td>
</tr>
<tr>
<td>Foreign non-monetary assets/liabilities when the reporting currency is the functional currency</td>
<td>Deferred tax is recognised on the difference between the carrying amount determined using the historical rate of exchange and the tax base determined using the balance sheet date exchange rate.</td>
<td>No deferred tax is recognised for differences related to assets and liabilities that are remeasured from local currency into the functional currency resulting from changes in exchange rates or indexing for tax purposes.</td>
<td>No deferred tax is recognised in these circumstances as there is no timing difference.</td>
</tr>
<tr>
<td>Investments in subsidiaries – treatment of undistributed profit</td>
<td>Deferred tax is recognised except when the parent is able to control the distribution of profit and if it is probable that the temporary difference will not reverse in the foreseeable future.</td>
<td>Deferred tax is required on temporary differences arising after 1992 relating to investments in domestic subsidiaries unless such amounts can be recovered tax-free and the entity expects to use that method. No deferred taxes are recognised on undistributed profits of foreign subsidiaries that meet the indefinite reversal criterion.</td>
<td>Deferred tax is recognised only to the extent that dividends have been accrued as receivable, or there is a binding agreement to distribute earnings.</td>
</tr>
</tbody>
</table>
### Specific applications (continued)

<table>
<thead>
<tr>
<th>ISSUE</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investments in joint ventures – treatment of undistributed profit</strong></td>
<td>Deferred tax is recognised except when the venture can control the sharing of profits and if it is probable that the temporary difference will not reverse in the foreseeable future.</td>
<td>Deferred tax is required on temporary differences arising after 1992 relating to investment in domestic corporate joint ventures. No deferred taxes are recognised on undistributed profits of foreign corporate joint ventures that meet the indefinite reversal criterion.</td>
<td>As for subsidiaries.</td>
</tr>
<tr>
<td><strong>Investments in associates – treatment of undistributed profit</strong></td>
<td>Deferred tax is recognised except when the investor can control the sharing of profits and it is probable that the temporary difference will not reverse in the foreseeable future.</td>
<td>Deferred tax is always recognised on temporary differences relating to investment in associates (whether domestic or foreign).</td>
<td>As for subsidiaries.</td>
</tr>
<tr>
<td><strong>Share-based compensation</strong></td>
<td>If a tax deduction exceeds cumulative share-based compensation expense, deferred tax calculations based on the excess deduction are recorded directly in equity. If the tax deduction is less than or equal to cumulative share-based compensation expense, deferred taxes arising are recorded in income.</td>
<td>If the ultimate actual tax benefit available to the issuer exceeds the deferred tax asset recorded, the excess benefit (known as a ‘windfall’ tax benefit) is credited directly to shareholders’ equity. If the ultimate tax benefit is less than the deferred tax asset, the shortfall is recorded as a direct charge to shareholders equity to the extent of prior windfall tax benefits, and as a charge to the tax expense thereafter.</td>
<td>Not comparable as the excess tax deduction does not give rise to a timing difference.</td>
</tr>
</tbody>
</table>

### Measurement of deferred tax

| Tax rates | Tax rates and tax laws that have been enacted or substantively enacted. | Use of substantive enacted rates not permitted. Tax rate and tax laws must have been enacted. | Similar to IFRS. |
|**Recognition of deferred tax assets** | A deferred tax asset must be recognised if it is probable that sufficient taxable profit will be available against which the temporary difference can be utilised. | A deferred tax asset is recognised in full but is then reduced by a valuation allowance if it is more likely than not that some or all of the deferred tax asset will not be realised. | Similar to IFRS. Probable is regarded as more likely than not. |

### Business combinations – acquisitions

| Step-up of acquired assets/liabilities to fair value | Deferred tax is provided unless the tax base of the asset is also stepped up. | Similar to IFRS. | Deferred tax is not provided unless there is an agreement to sell assets at re-valued amount. |
| Previously unrecognised tax losses of the acquirer | A deferred tax asset is recognised if, as a result of the acquisition, the recognition criteria for the deferred tax asset is met. Offsetting credit is recorded in income. | Similar to IFRS, except the offsetting credit is recorded against goodwill. | Deferred tax is not recognised. |
### Government grants

**IFRS**

Government grants (or contributions) received as compensation for expenses already incurred are recognised in the income statement once the conditions for their receipt have been met and there is reasonable assurance that the grant will be received. Revenue-based grants are deferred in the balance sheet and released to the income statement to match the related expenditure that they are intended to compensate. Capital-based grants must be deferred and matched with the depreciation on the asset for which the grant arises.

Grants that relate to recognised assets must be presented in the balance sheet either as deferred income or by deducting the grant in arriving at the asset’s carrying amount, in which case the grant is recognised as a reduction of depreciation. Specific rules apply for agricultural assets.

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**REFERENCES:**
- IFRS: IAS 12.
- UK GAAP: FRS 16, FRS 19.

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**Similarities and Differences – A comparison of IFRS, US GAAP and UK GAAP – August 2005**
Government grants (continued)

**US GAAP** Similar to IFRS, except of government grants should be recognised as revenue when there are conditions attached to the grant. Revenue recognition is delayed until such conditions are actually met under US GAAP. Contributions of long-lived assets or for the purchase of long-lived assets are reported in the period received.

**UK GAAP** Similar to IFRS, however, company law does not permit the offset of the grant against the carrying amount of the asset.

Grants – agricultural assets

**IFRS** An unconditional government grant related to a biological asset measured at its fair value must be recognised in the income statement when the grant becomes receivable. If a government grant relating to a biological asset measured at its fair value is conditional, the grant must be recognised when the conditions are met. If a grant relates to a biological asset measured at cost, the accounting treatment specified for government grants generally is applied.

**US GAAP** Not specified.

**UK GAAP** Not specified.


Leases – lessee accounting

**Finance leases**

**IFRS** Requires recognition of an asset held under a finance lease (see classification criteria on page 58) with a corresponding obligation to pay future rentals, at an amount equal to the lower of the fair value of the asset and the present value of the minimum lease payments (MLPs) at the inception of the lease. The asset is depreciated over its useful life or the lease term if shorter. However, the latter is only permitted if there is no reasonable certainty of the lessee obtaining ownership of the asset. The interest rate implicit in the lease must normally be used to calculate the present value of the MLPs. If the implicit rate is unknown, the lessee’s incremental borrowing rate may be used.

**US GAAP** Similar to IFRS, except that the lessee’s incremental borrowing rate must be used to calculate the present value of the MLPs, excluding the portion of payments representing executory costs unless it is practicable to determine the rate implicit in the lease and the implicit rate is lower than the incremental borrowing rate. If the incremental borrowing rate is used, the amount recorded as the asset and obligation is limited to the fair value of the leased asset. Asset amortisation is consistent with IFRS.

**UK GAAP** Similar to IFRS, but the fair value of the asset may be used if this is sufficiently close approximation to the present value of the MLP’s, even if it is slightly higher than the latter.

**Operating leases**

Under IFRS, US GAAP and UK GAAP, the rental expense under an operating lease must generally be recognised on a straight-line basis over the lease term.

**Incentives**

A lessor often provides lease incentives to encourage the lessee to renew a lease arrangement. Under IFRS and US GAAP, the lessee must recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term. Under UK GAAP, the benefit of the incentive is recognised over the shorter of the lease term and a period ending on a date from which it is expected the prevailing market rental will be payable. The incentive must be amortised on a straight-line basis unless another systematic basis is representative of the pattern of the lessee’s benefit from the use of the leased asset.
Leases – lessee accounting (continued)

Sale and leaseback transactions

In a sale and leaseback transaction, the seller-lessee sells an asset to the buyer-lessor and leases the asset back. There are certain differences in the rules on dealing with profits and losses arising on sale and leaseback transactions across the three frameworks. These are highlighted in the table below.

<table>
<thead>
<tr>
<th>ISSUE</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance lease</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit or loss on sale</td>
<td>Deferred and amortised over the lease term.</td>
<td>Timing of profit or loss recognition depends on whether the seller relinquishes substantially all or a minor part of the use of the asset. If substantially all, then profit/loss is generally recognised at date of sale. If seller retains more than a minor part, but not substantially all of the use of the asset, any profit in excess of either the present value of MLPs (for operating leases) or the recorded amount of the leased asset (for finance leases) is recognised at date of sale. A loss on a sale-leaseback must be recognised immediately by the seller-lessee to the extent that net book value exceeds fair value. Special rules apply for sale-leasebacks involving property relating to continuing involvement and transfer of risks and rewards of ownership.</td>
<td>No profit should be recognised on entering into the arrangement and no adjustment made to the carrying value of the asset.</td>
</tr>
<tr>
<td>Operating lease</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sale at fair value</td>
<td>Immediate recognition.</td>
<td>See above.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Sale at less than fair value</td>
<td>Immediate recognition unless the difference is compensated by lower future rentals, then defer the difference over the period over which the asset is expected to be used.</td>
<td>See above.</td>
<td>Similar to IFRS. However, any apparent profit or loss should be deferred and amortised over the remainder of the lease term, or if shorter, the period during which the reduced rentals are chargeable.</td>
</tr>
<tr>
<td>Sale at more than fair value</td>
<td>Defer the difference over the period for which the asset is expected to be used.</td>
<td>See above.</td>
<td>Excess of the sale price over fair value must be deferred and amortised over the shorter of the lease term or the period to the next rent review.</td>
</tr>
</tbody>
</table>

US GAAP: FAS 13, FAS 28, FAS 66, FAS 98.
UK GAAP: SSAP 21, FRS 5, UITF 28.
Financial liabilities

Definition

IFRS, US GAAP and UK GAAP define a financial liability in a similar manner to include a contractual obligation to deliver cash or a financial asset to another entity, or to exchange financial instruments with another entity under conditions that are potentially unfavourable. Financial liabilities include derivatives (under IFRS, these include many contracts that will or may be settled in the entity’s own equity instruments). Derivatives are covered on page 79.

Classification

IFRS Where there is a contractual obligation (either explicit or indirectly through its terms and conditions) on the issuer of an instrument to deliver either cash or another financial asset to the holder, that instrument meets the definition of a financial liability, regardless of the manner in which the contractual obligation will be settled.

Preferred shares that are not redeemable, or that are redeemable solely at the option of the issuer and where distributions are at the discretion of the issuer, are classified as equity. However, preferred shares requiring the issuer to redeem for a fixed or determinable amount at a fixed or determinable future date, or where the holder has the option of redemption, are classified as liabilities.

Where the settlement of a financial instrument, such as a preferred share, is contingent on uncertain future events beyond the control of both the issuer and the holder, the issuer must classify the financial instrument as a liability. However, an instrument that is settled using an entity’s own equity shares is classified as a liability if the number of shares varies in such a way that the fair value of the shares issued equals the obligation.

Puttable instruments (financial instruments that give the holder the right to put the instrument back to the issuer for cash or another asset) are liabilities.

Further guidance is also available for classification of members’ shares in co-operatives where treatment as equity or financial liability is determined by reference to the characteristics of the shares.

Split accounting is applied to convertible debt – see overleaf.

US GAAP Where an instrument includes a conditional or unconditional obligation to transfer economic benefits (assets or issuance of equity shares), the instrument is generally classified as a liability.

Examples include:

- A financial instrument issued in the form of shares that is mandatorily redeemable, that is, that embodies an unconditional obligation requiring the issuer to redeem it by transferring its assets at a specified or determinable date (or dates) or on an event that is certain to occur.

- A financial instrument that, at inception, embodies an obligation to repurchase the issuer’s equity shares, or is indexed to such an obligation, and that requires or may require the issuer to settle the obligation by transferring assets (for example, a forward purchase contract or written put option on the issuer’s equity shares that is to be physically settled or net cash settled).

A financial instrument that embodies an unconditional obligation or a financial instrument other than an outstanding share that embodies a conditional obligation that the issuer must or may settle by issuing a variable number of its equity shares.

US GAAP does not make specific reference to classification of instruments where contingent settlement provisions exist.

UK GAAP Similar to IFRS.
Financial liabilities (continued)

Convertible debt

**IFRS**  ‘Split accounting’ is used, whereby the proceeds of issuing debt are allocated between the two components: the equity conversion rights (recognised in equity); and the liability, recognised at fair value calculated by discounting at a market rate for a non-convertible debt (recognised in liabilities).

**US GAAP**  For conventional convertible debt, the instrument is treated as a unit and recorded as a liability (no recognition is given to the equity component); otherwise an analysis is performed to determine if the equity component should be separated and accounted for as a derivative. Unlike IFRS, detachable warrants that are issued with mandatorily redeemable preferred stock are recorded at the residual amount (that is, the amount left over after the preferred stock has been valued at fair value). However, detachable warrants issued with debt are still recorded using a relative fair value approach.

**UK GAAP**  Similar to US GAAP where FRS 26 is not adopted. Where FRS 26 is applied, the relevant requirements triggered in FRS 25 are as for IFRS.

**Measurement**

**IFRS**  Initial measurement is at fair value, which is usually the consideration received, less transaction costs. There are only two categories of financial liabilities: those at fair value through profit or loss (includes trading) and other. All derivatives that are liabilities (except qualifying hedging instruments) are trading liabilities. Other trading liabilities may include a short position in securities. Financial liabilities at fair value through profit or loss (including trading) are measured at fair value (the change is recognised in the income statement for the period). All other (non-trading) liabilities are carried at amortised cost.

**US GAAP**  Generally similar to IFRS. However, there are certain specific measurement criteria for financial instruments and entities cannot designate at initial recognition any financial liability as at fair value through profit or loss.

**UK GAAP**  Where FRS 26 is not adopted, initial measurement at fair value of the consideration received less issue costs. Subsequent measurement at amortised cost. No specific rules for trading items, derivatives or hedge accounting. Otherwise, treatment is as under IFRS.

**Derecognition of financial liabilities**

**IFRS**  A financial liability must be derecognised when: the obligation specified in the contract is discharged, cancelled or expires; or the primary responsibility for the liability is legally transferred to another party. A liability is also considered extinguished if there is a substantial modification in the terms of the instrument such that the discounted present value of new cash flows is 10% different from the old cash flows. The difference between the carrying amount of a liability (or a portion thereof) extinguished or transferred and the amount paid for it must be recognised in net profit or loss for the period.

**US GAAP**  Similar to IFRS, a financial liability should be derecognised only if it has been extinguished. Extinguished means paying the creditor and being relieved of the obligation or being legally released of the liability either judicially or by the creditor, or as a result of a substantial modification in terms (10% or greater charge in discounted present value of cash flows).

**UK GAAP**  Does not have detailed requirements about derecognition of financial liabilities. However, practice is similar to IFRS.

**REFERENCES:**


US GAAP: CON 6, ASR 268(SEC), APB 6, APB 14, FAS 140, FAS 150.

Equity

Equity instruments

Recognition and classification

IFRS
An instrument is classified as equity when it does not contain an obligation to transfer economic resources. Preference shares that are not redeemable, or that are redeemable solely at the option of the issuer, and for which distributions are at the issuer’s discretion, are classified as equity. Only derivative contracts that result in the delivery of a fixed amount of cash, or other financial asset for a fixed number of an entity’s own equity instruments, are classified as equity instruments. All other derivatives on own equity are treated as derivatives.

US GAAP
Similar to IFRS. Shareholders’ equity is analysed between capital stock (showing separate categories for non-redeemable preferred stock and common stock) and other categories of shareholders’ equity. Mandatorily redeemable financial instruments, obligations to repurchase own shares by transferring assets, and certain obligations to issue a variable number of shares are not classified as equity, but are considered to be liabilities.

UK GAAP
Similar to IFRS.

Purchase of own shares

IFRS
When an entity’s own shares are repurchased, the shares are shown as a deduction from shareholders’ equity. Any profit or loss on the subsequent sale of the shares is shown as a change in equity.

US GAAP
When treasury stock is acquired with the intention of retiring the stock, an entity has the option to: charge the excess of the cost of treasury stock over its par value entirely to retained earnings; allocate the excess between retained earnings and additional paid-in-capital (APIC); or charge the excess entirely to APIC. When treasury stock is acquired for purposes other than retirement, the cost of the acquired stock may be shown separately as a deduction from equity or may be treated the same as retired stock.

UK GAAP
Public entities may purchase their own shares and hold them as treasury shares, treatment of treasury shares is similar to IFRS. Private entities may purchase their own shares provided that legal requirements are adhered to which require the shares to be cancelled.

Dividends on ordinary equity shares

IFRS
Presented as a deduction in the statement of changes in shareholders’ equity.

US GAAP
Similar to IFRS.

UK GAAP
Similar to IFRS.

Derivatives and hedging

Derivatives

IFRS and US GAAP both specify rules for the recognition and measurement of derivatives.

UK GAAP prescribes the accounting treatment for capital instruments. Where entities adopt FRS 26, this standard reflects the requirements of IFRS with respect to recognition and measurement of derivatives. For entities that do not apply this standard, UK GAAP only provides guidance on disclosure of such items. The UK GAAP comments below assume adoption of FRS 26.

Definition

IFRS and UK GAAP define a derivative as a financial instrument: whose value changes in response to a specified variable or underlying rate (for example, interest rate); that requires no or little net investment; and that is settled at a future date. US GAAP sets out similar requirements, except that the terms of the derivative contract must require or permit net settlement. There are therefore some derivatives, such as option and forward agreements to buy unlisted equity investments, that fall within the IFRS definition, not the US GAAP definition.

Initial measurement

Under IFRS, US GAAP and UK GAAP all derivatives are recognised on the balance sheet as either financial assets or liabilities. They are initially measured at fair value on the acquisition date.

Subsequent measurement

IFRS, US GAAP and UK GAAP require subsequent measurement of all derivatives at their fair value, regardless of any hedging relationship that might exist. Changes in a derivative’s value are recognised in the income statement as they arise, unless they satisfy the criteria for hedge accounting outlined below. Under IFRS and UK GAAP, a derivative whose fair value cannot be measured reliably is carried at cost less impairment or amortisation until settlement.

Hedge accounting

Under IFRS, US GAAP and UK GAAP detailed guidance is set out in the respective standards dealing with hedge accounting.

Criteria for hedge accounting

Under IFRS, US GAAP and UK GAAP, hedge accounting is permitted provided that an entity meets stringent qualifying criteria in relation to documentation and hedge effectiveness. All three frameworks require documentation of the entity’s risk management objectives and how the effectiveness of the hedge will be assessed. Under all three frameworks, hedge instruments must be highly effective in offsetting the exposure of the hedged item to changes in the fair value or cash flows, and the effectiveness of the hedge must be measured reliably on a continuing basis.

Under all three frameworks, a hedge qualifies for hedge accounting if the expectation is that changes in fair values or cash flows of the hedged item are highly effective in offsetting changes in the fair value or cash flows of the hedging instrument (‘prospective’ test) and ‘actual’ results are within a range of 80% to 125% (‘retrospective’ test). Unlike IFRS and UK GAAP, US GAAP also allows, assuming stringent conditions are met, a ‘short-cut’ method that assumes perfect effectiveness for certain hedging relationships involving interest-rate swaps.
Hedge accounting (continued)

Hedged items

In addition to the general criteria for hedge accounting, IFRS, US GAAP and UK GAAP outline rules for the designation of specific financial assets and liabilities as hedged items. These are outlined in the table below.

<table>
<thead>
<tr>
<th>IFRS and UK GAAP</th>
<th>US GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Held-to-maturity investments cannot be designated as a hedged item with respect to interest-rate risk or prepayment risk, because held-to-maturity investments require an intention to hold to maturity without regard to changes in fair value or cash flows due to changes in interest rates.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>If the hedged item is a financial asset or liability, it may be a hedged item with respect to the risks associated with only a portion of its cash flows or fair value provided that effectiveness can be measured.</td>
<td>The designated risk should be the risk of changes in: the overall fair value or cash flow; market interest rates; foreign currency exchange rates; or the creditworthiness of the ‘obligor’.</td>
</tr>
<tr>
<td>If the hedged item is a non-financial asset or liability, it may be designated as a hedged item only for foreign currency risk, or in its entirety because of the difficulty of isolating other risks.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>If similar assets or similar liabilities are aggregated and hedged as a group, the change in fair value attributable to the hedged risk for individual items must be proportionate to the change in fair value for the group.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Not specified.</td>
<td>An asset or liability that is re-measured to fair value with changes recognised in earnings – for example, a debt security classified as trading – is not permitted as a hedged item.</td>
</tr>
<tr>
<td>Not specified.</td>
<td>The hedged item cannot be related to: a business combination; the acquisition or disposition of subsidiaries; a minority interest in one or more consolidated subsidiaries; or investments accounted for using the equity method.</td>
</tr>
</tbody>
</table>

Hedging instruments

In most cases, only a derivative instrument can qualify as a hedging instrument. However, IFRS and UK GAAP permit a non-derivative (such as a foreign currency borrowing) to be used as a hedging instrument for foreign currency risk. US GAAP provides that a non-derivative can hedge currency risk only for a net investment in a foreign entity or a firm commitment.

Under IFRS and UK GAAP, a written option cannot be designated as a hedging instrument unless it is combined with a purchase option and a net premium is paid. US GAAP provides a broadly similar restriction, and in most cases written options will not qualify for hedge accounting.

Hedge relationships

Exposure to risk can arise from: changes in the fair value of an existing asset or liability; changes in the future cash flows arising from an existing asset or liability; or changes in future cash flows from a transaction that is not yet recognised.
Hedge accounting (continued)

IFRS  Recognises the following types of hedge relationships: a fair value hedge where the risk being hedged is a change in the fair value of a recognised asset or liability; a cash flow hedge where the risk being hedged is the potential volatility in future cash flows; and a hedge of a net investment in a foreign entity, where a hedge instrument is used to hedge the currency risk of a net investment in a foreign entity. A forecasted transaction must be highly probable to qualify as a hedged item.

US GAAP  Similar to IFRS, except forecasted transactions only need to be probable.

UK GAAP  Similar to IFRS.

Hedging instruments

In most cases, only a derivative instrument can qualify as a hedging instrument. However, IFRS and UK GAAP permit a non-derivative (such as a foreign currency borrowing) to be used as a hedging instrument for foreign currency risk. US GAAP provides that a non-derivative can hedge currency risk only for a net investment in a foreign entity or a firm commitment.

Under IFRS and UK GAAP, a written option cannot be designated as a hedging instrument unless it is combined with a purchase option and a net premium is paid. US GAAP provides a broadly similar restriction, and in most cases written options will not qualify for hedge accounting.

Hedge relationships

Exposure to risk can arise from: changes in the fair value of an existing asset or liability; changes in the future cash flows arising from an existing asset or liability; or changes in future cash flows from a transaction that is not yet recognised.

IFRS  Recognises the following types of hedge relationships: a fair value hedge where the risk being hedged is a change in the fair value of a recognised asset or liability; a cash flow hedge where the risk being hedged is the potential volatility in future cash flows; and a hedge of a net investment in a foreign entity, where a hedge instrument is used to hedge the currency risk of a net investment in a foreign entity. A forecasted transaction must be highly probable to qualify as a hedged item.

US GAAP  Similar to IFRS, except forecasted transactions only need to be probable.

UK GAAP  Similar to IFRS.

Fair value hedges

IFRS  Hedging instruments are measured at fair value. The hedged item is adjusted for changes in its fair value, but only due to the risks being hedged. Gains and losses on fair value hedges, for both the hedging instrument and the item being hedged, are recognised in the income statement.

US GAAP  Similar to IFRS.

UK GAAP  Similar to IFRS.

Cash flow hedges

IFRS  Hedging instruments are measured at fair value, with gains and losses on the hedging instrument, where they are effective, initially deferred in equity and subsequently released to the income statement concurrent with the earnings recognition pattern of the hedged item. Gains and losses on financial instruments used to hedge forecasted asset and liability acquisitions may be included in the cost of the non-financial asset or liability – a ‘basis adjustment’ – but this is not permitted for financial assets or liabilities.

US GAAP  The basis adjustment approach is not permitted. All gains and losses are subsequently released to the income statement concurrent with the deferred recognition of the hedged item.

UK GAAP  Similar to IFRS.
Hedge accounting (continued)

Hedges of net investments in foreign operations

**IFRS**
Similar treatment to cash flow hedges; the hedging instrument is measured at fair value with gains/losses deferred in equity, to the extent that the hedge is effective, together with exchange differences arising on the entity’s investment in the foreign operation. These gains/losses are transferred to the income statement on disposal of the foreign operation.

**US GAAP**
Similar to IFRS.

**UK GAAP**
Similar to IFRS. However, if FRS 23 is not adopted, where an entity has used foreign currency borrowings to finance, or provide a hedge against its foreign equity investments and certain conditions are met, the equity investments may be treated as foreign currency items and the carrying amounts translated at closing rates. Any exchange differences must be recognised in reserves together with exchange gains or losses arising on the foreign currency borrowings. Hedge ineffectiveness must be recognised in the income statement.

Fair value hedge accounting for a portfolio hedge of interest rate risk

**IFRS**
Permits an entity to designate an amount of assets or liabilities in a given ‘time bucket’, scheduled based on expected repricing dates of a portfolio. The changes in the fair value of this hedged item are reflected in a single separate line item within assets or liabilities. The carrying amounts of the individual assets or liabilities in the portfolio are not adjusted.

**US GAAP**
Prohibited.

**UK GAAP**
Similar to IFRS.

Disclosure

The extensive disclosure requirements in IFRS and US GAAP apply to all entities except that under US GAAP, fair value disclosures are not required for certain small non-public entities. Where FRS 26 is adopted and the entity does not fall within the disclosure exemptions in FRS 25, the disclosure requirements are as for IFRS. Where FRS 26 is not adopted entities, other than insurance companies, with listed or publicly traded debt or equity and all banks and similar institutions are required to present disclosures that are similar to IFRS.

The disclosures under all three frameworks are similar and include general information about the entity’s use of financial instruments, fair value information, details of hedging activities and liquidity information. However, there are numerous differences in the detailed requirements (such as those for disclosures of interest-rate risk, credit risk and market risk), as well as industry-specific disclosures, which are outside the scope of this publication. Additionally, disclosures in IFRS are required to be presented in the notes to the financial statements, while many similar disclosures in US GAAP are presented in the MD&A for SEC registrants.

**Recent proposals – IFRS**

The IASB has issued an exposure draft of proposed amendments to IAS 39, Financial Instruments: Recognition and Measurement, on cash flow hedge accounting of forecast intra-group transactions. The exposure draft proposes that, in the consolidated financial statements, a group can designate as the hedged item a highly probable forecast external transaction denominated in the functional currency of the entity (for example, a subsidiary) provided that the transaction gives rise to an exposure that will have an effect on consolidated profit or loss. There is currently a difference on hedges of foreign currency risk of forecast intra-group transactions, which are permitted under US GAAP but prohibited under IFRS.

**REFERENCES:**
- UK GAAP: FRS 4, FRS 25, FRS 26, SSAP 20.
Foreign currency translation

For UK GAAP, where companies apply FRS 23 and FRS 24 (see page 2 for further details relating to adoption rules), the standards are similar to IAS 21 and IAS 29 respectively, therefore, there are no differences between UK GAAP and IFRS in these instances. Differences noted below are, thus, only relevant for companies that are not applying these new standards.

Functional currency – definition and determination

IFRS  The currency of the primary economic environment in which an entity operates. If the indicators are mixed and the functional currency is not obvious, management should use its judgment to determine the functional currency that most faithfully represents the economic results of the entity’s operations by focusing on the currency of the economy that determines the pricing of transactions (not the currency in which transactions are denominated).

Additional evidence (secondary in priority) may be provided from the currency in which funds from financing activities are generated or receipts from operating activities are usually retained.

In determining the functional currency of a foreign operation (that is, whether its functional currency is the same as that of the reporting entity), the degree of autonomy and the foreign operation’s ability to operate as a separate unit should be established.

US GAAP  Similar to IFRS; however, there is less guidance in determining the functional currency of an entity and more guidance as to whether an entity should have the same functional currency as its parent.

The functional currency is generally the currency in which the majority of the revenues and expenses are settled.

UK GAAP  UK GAAP does not contain a definition of functional currency but makes reference to local currency which has a similar definition to functional currency as in IFRS.

Translations – the individual entity

IFRS and US GAAP have similar requirements regarding the translation of transactions by an individual entity (as shown below). However, the requirements under UK GAAP provide a number of variances to IFRS:

- Translation of transactions denominated in foreign currency is at the exchange rate in operation on the date of the transaction. UK GAAP treatment is similar.
- Monetary assets and liabilities denominated in a foreign currency are translated at the closing (year-end) rate. UK GAAP permits translation at a contracted rate where there are related forward contracts in respect of trading transactions.
- Non-monetary foreign currency assets and liabilities are translated at the appropriate historical rate. UK GAAP treatment is similar, however, subsequent translation may be permitted under the net investment rules (see page 82).
- Income statement amounts are translated using historical rates of exchange at the date of transaction or a weighted average rate as a practical alternative, provided the exchange rate does not fluctuate significantly. UK GAAP treatment is similar.
- Non-monetary items denominated in a foreign currency and carried at fair value are reported using the exchange rate that existed when the fair value was determined (IFRS only).
- Exchange gains and losses arising on an entity’s own foreign currency transactions are reported as part of the profit or loss for the year from ordinary activities. This includes long-term loans, which in substance form part of an entity’s net investment in a foreign operation. Refer to the section ‘Derivatives and hedging’ (page 79) for the hedge of a net investment. UK GAAP treatment is similar with exception for the hedge of a net investment as detailed on page 82.
Foreign currency translation (continued)

Translation – consolidated financial statements

IFRS and US GAAP require that where the operations of a foreign operation are largely independent of the investing entity’s reporting currency, amounts in the foreign operation’s balance sheet are translated using the closing (year-end) rate, with the exception of equity balances, for which the historical rate is used. Amounts in the income statement are usually translated using the average rate for the accounting period. The translation differences arising are reported in equity (other comprehensive income).

UK GAAP also permits use of the closing rate for translating the income statement amounts when applying the closing rate/net investment method of translation. Balance sheet items are translated at the closing rate.

Where a foreign operation is integral to the reporting entity, its accounts are translated as if all the transactions had been carried out by the reporting entity itself.

The treatment is similar under UK GAAP an is referred to as the temporal method.

Tracking of translation differences in equity

IFRS These must be separately tracked and the cumulative amounts disclosed. On disposal of a foreign operation, the appropriate amount of cumulative translation difference relating to the entity is transferred to the income statement and included in the gain or loss on sale. The cumulative translation difference relating to a foreign operation and deferred in equity may be released through the income statement in its entirety upon a complete disposal of that foreign operation or for a partial disposal on a pro rata basis relative to the portion disposed. The proportionate share of the related cumulative translation difference is included in the gain or loss. The payment of a dividend out of pre-acquisition profits constitutes a return on the investment and is regarded as a partial disposal.

US GAAP Similar to IFRS.

UK GAAP UK GAAP does not permit ‘recycling’ of exchange gains and losses through the income statement on disposal of a foreign operation. There is no requirement to track exchange gains and losses after initial recognition.

Translation of goodwill and fair value adjustments on acquisition of foreign entity

IFRS Translate at closing rates.

US GAAP Similar to IFRS.

UK GAAP UK GAAP does not specifically address this point, although current practice has, increasingly, been to regard goodwill as a currency asset, similar to the requirements of IFRS.

Presentation currency

IFRS When financial statements are presented in a currency other than the functional currency, assets and liabilities are translated at the exchange rate at the balance sheet date. Income statement items are translated at the exchange rate at the date of the transaction or are permitted to use average rates if the exchange rates do not fluctuate significantly.

US GAAP Similar to IFRS.

UK GAAP No similar guidance under UK GAAP. Financial statements are prepared in the entity’s ‘local’ currency. However, when preparing consolidated financial statements using the closing rate/net investment method of translating a foreign entity’s financial statements, the translation process is similar to the translation into a presentation currency under IFRS with the exception of the additional option available under UK GAAP to translate income statement items at closing rate.
Foreign currency translation – hyperinflationary economy

Definition

**IFRS**
Hyperinflation is indicated by characteristics of the economic environment of a country. These characteristics include: the general population’s attitude towards the local currency; prices linked to a price index; and the cumulative inflation rate over three years is approaching or exceeds 100%.

**US GAAP**
Similar to IFRS, except the only indicator is whether the cumulative three-year inflation rate is approximately 100% or more.

**UK GAAP**
Defined as a country with a high rate of inflation although no definition of ‘high rate’ is given in UK GAAP. However, under UK GAAP, adjustments are required where the distortions caused by hyper-inflation are such that they affect the true and fair view given by the group financial statements. In any event adjustments must be made where the cumulative inflation rate over three years is approaching, or exceeds, 100 per cent and the operations in the hyper-inflationary economies are material.

Functional currency

**IFRS**
Entities that have the currency of a hyperinflationary economy as the functional currency should use that currency for measuring their transaction. The financial statements for current and prior periods should then be remeasured at the measurement unit current at the balance sheet date in order to present current purchasing power.

**US GAAP**
Does not generally permit inflation-adjusted financial statements; instead it requires the use of a more stable currency as the functional currency (usually the presentation currency). However, SEC rules provide an accommodation allowing foreign issuers that use IFRS to omit quantification of any differences that would have resulted from the application of FAS 52.

**UK GAAP**
Entities may either present inflation-adjusted financial statements or use a relatively stable currency as the functional currency. The latter option is not available under IFRS.

Presentation currency

**IFRS**
The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy should be translated into a different presentation currency using the following procedures:

- all items, including comparatives are translated at the closing rate at the date of the most recent balance sheet; except,
- when amounts are translated into the currency of a non-hyperinflationary economy, comparative amounts are those that were presented as current year amounts in the relevant prior-year financial statements.

**US GAAP**
Not applicable, because the currency of a hyperinflationary economy is not used for measuring its transactions in the currency of the hyperinflationary economy.

**UK GAAP**
The local currency financial statements should be adjusted where possible to reflect current price levels before the translation process is undertaken. UK GAAP does not include the concept of presentation currency.
Foreign currency translation – hyperinflationary economy (continued)

Recent proposals – IFRS

IFRIC issued draft interpretation D5, Applying IAS 29 in Hyperinflationary Economies for the First Time, in March 2004. It contains proposed guidance on how to apply the requirements of IAS 29, Financial Reporting in Hyperinflationary Economies, in the first year in which an entity identifies the existence of hyperinflation in the economy of its functional currency and restates its financial statements in accordance with IAS 29.

US GAAP: FAS 52, FIN 37.
UK GAAP: SSAP 20, UITF 9, FRS 11, FRS 23, FRS 24

Earnings per share

Earnings per share (EPS) must be disclosed by entities whose ordinary shares are publicly traded, and by entities in the process of issuing such shares under IFRS and US GAAP frameworks. Under UK GAAP EPS must be disclosed for all listed entities. IFRS, US GAAP and UK GAAP are substantially the same in their methods of calculating EPS amounts.

Basic EPS

IFRS Basic EPS is calculated as profit available to common shareholders, divided by the weighted average number of shares in issue during the period. Shares issued as a result of a bonus issue are treated as if in issue for the whole year. Bonus issues occurring after the year-end must be incorporated into the calculations. For rights issues, a theoretical ex-rights formula is used to calculate the bonus element. Comparative EPS is adjusted for bonus issues and rights issues.

US GAAP Similar to IFRS.

UK GAAP Similar to IFRS.

Diluted EPS – basis

IFRS There is no ‘de minimis’ dilution threshold below which diluted EPS need not be disclosed. For diluted EPS, earnings are adjusted for the after-tax amount of dividends, and interest is recognised in the period in respect of the dilutive potential ordinary shares and for any other changes in the income statement or expense that would result from the conversion of the dilutive potential ordinary shares. The conversion is deemed to have occurred at the beginning of the period or, if later, the date of the issue of potential dilutive ordinary shares.

US GAAP Similar to IFRS.

UK GAAP Similar to IFRS.

Diluted EPS – share option

IFRS The ‘treasury share’ method is used to determine the effect of share options and warrants. The assumed proceeds from the issue of the dilutive potential ordinary shares are considered to have been used to repurchase shares at fair value. The difference between the number of shares issued and the number of shares that would have been issued at fair value is treated as an issue of ordinary shares for no consideration (that is, a bonus issue) and is factored into the denominator used to calculate the diluted EPS. The earnings figure is not adjusted for the effect of share options/warrants.
Earnings per share (continued)

**US GAAP** Similar to IFRS. However, US GAAP guidance for applying the treasury stock (share) method in year to date computations states that the number of incremental shares to be included in the denominator is determined by computing a year-to-date weighted average of the number of incremental shares included in each quarterly diluted EPS computation. A component of the IASB/FASB Convergence project includes proposals that would require the dilutive effect of potential ordinary shares be reflected by applying the treasury stock method for the year-to-date period independently from any interim computation.

**UK GAAP** Similar to IFRS.

**REFERENCES:**
- **IFRS:** IAS 33.
- **US GAAP:** FAS 128.
- **UK GAAP:** FRS 22.

Related-party transactions

The objective of the disclosures required by **IFRS, US GAAP** and **UK GAAP** in respect of related-party relationships and transactions is to ensure that users of financial statements are made aware of the extent to which those statements might be influenced by the existence of related parties.

Related-party relationships are generally determined by reference to the control or indirect control of one party by another, or by the existence of joint control or significant influence by one party over another. The accounting frameworks are broadly similar as to which parties would be included within the definition of related parties, including subsidiaries, joint ventures, associates, directors and shareholders.

If the relationship is one based on control, certain disclosures are always required (regardless of whether transactions between the parties have taken place). These include the existence of the related-party relationship, the name of the related party and the name of the ultimate controlling party.

There are some exemptions from disclosure available for certain subsidiaries and transactions.

**Disclosures and exemptions**

**IFRS** There is no specific requirement to disclose the name of the related party (other than the ultimate parent entity). There is a requirement to disclose the amounts involved in a transaction, as well as the balances for each major category of related parties. However, these disclosures would appear to be needed in order to present meaningfully the 'elements' of the transaction, which is a disclosure requirement.

IFRS also requires disclosure of the compensation of key management personnel in total and by category of compensation.

Exemptions from disclosures about related-party transactions in the financial statements of subsidiaries are limited. The subsidiary must be wholly owned and the parent must be incorporated in the same country and provide consolidated financial statements.

State-controlled entities are required to disclose related-party transactions under IFRS.

**US GAAP** The nature and extent of any transactions with all related parties and the nature of the relationship must be disclosed, together with the amounts involved. Unlike IFRS, all material related-party transactions (other than compensation arrangements, expense allowances and similar items) must be disclosed in the separate financial statements of wholly-owned subsidiaries, unless these are presented in the same financial report that includes the parent’s consolidated financial statements (including those subsidiaries).
UK GAAP  The nature and extent of transaction with all related parties must be disclosed, together with the amounts involved. There is no requirement to disclose transactions with other group entities in the financial statements of (at least) 90% owned subsidiaries, provided the parent’s consolidated financial statements in which those subsidiaries are included are publicly available. Further, there are no requirements to include any disclosure regarding key management personnel.

REFERENCES:  
US GAAP: FAS 57.  

Segment reporting
All three frameworks have specific requirements about the identification, measurement and disclosure of segment information. The similarities and differences are reflected in the table below.

<table>
<thead>
<tr>
<th>ISSUE</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>General requirements</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scope</td>
<td>Listed entities and entities in the process of listing. Non-listed entities may choose full compliance.</td>
<td>Listed entities. Non-listed entities are encouraged but not required to comply.</td>
<td>Applies to listed and very large unlisted entities with additional requirements for listed entities, banks and insurance entities and large entities. Exclusion permitted if disclosures prejudicial (disclose this fact).</td>
</tr>
<tr>
<td>Format</td>
<td>Business and geographical reporting, one as primary format other as secondary. The choice will depend on the impact on business risks and returns. The secondary format requires less disclosure.</td>
<td>Based on operating segments and the way the chief operating decision-maker evaluates financial information for the purposes of allocating resources and assessing performance.</td>
<td>Business and geographical segments. Does not distinguish between primary and secondary reporting formats.</td>
</tr>
<tr>
<td>Identification of segment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General approach</td>
<td>Based on profile of risks and returns and internal reporting structure.</td>
<td>Based on the internally reported operating segments.</td>
<td>Based on profile of risks and returns, rate of growth, size and potential for development.</td>
</tr>
<tr>
<td>Aggregation of similar business/operating segments</td>
<td>Five factors given to determine whether products and services are similar.</td>
<td>The same criteria apply for the aggregation of similar operating segments.</td>
<td>Similar to IFRS, six factors given.</td>
</tr>
<tr>
<td>Aggregation of similar geographical segments</td>
<td>As for business/operating segments: six factors as given, focusing on economic and political conditions, special risks, exchange control regulations and currency risks.</td>
<td>Not specified. Certain disclosures (revenues and assets) are required, on a consolidated GAAP basis, of domestic operations, foreign countries in total and each material country.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Threshold for reportable segments</td>
<td>Revenue, results or assets are 10% or more of all segments. If revenue of reported segments are below 75% of the total, report additional segments until the 75% threshold is reached.</td>
<td>Similar to IFRS.</td>
<td>Similar to IFRS, except that 10% and 75% tests do not apply.</td>
</tr>
</tbody>
</table>
### Identification of segment (continued)

<table>
<thead>
<tr>
<th>ISSUE</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Segments not reported</td>
<td>Segments not identified as above are included as unallocated items.</td>
<td>Included in ‘all other’ category, with sources of revenue disclosed.</td>
<td>Similar to IFRS.</td>
</tr>
<tr>
<td>Maximum number of reported segments</td>
<td>No limits.</td>
<td>Practical limit suggested at no greater than 10 segments.</td>
<td>Similar to IFRS.</td>
</tr>
</tbody>
</table>

### Measurement

| Accounting policies for segments           | Those adopted for consolidated financial statements. Entities may disclose additional segment data based on internal accounting policies. | Those adopted for internal reporting to the chief operating decision-maker for the purposes of allocating resources and assessing performance. | Similar to IFRS. |
| Symmetry of allocation of assets/liabilities, revenues/ expenses | Symmetry required.                                                      | Not required, but asymmetrical allocations must be disclosed.                          | Allocation on a reasonable basis.                                           |

### Main disclosures

| Factors used to identify reportable segments | No specific disclosure required.                                      | Required, including basis of organisation (for example, based on products and services, geographic areas, regulatory environments) and types of product and service from which each segment derives its revenues. | Similar to IFRS. |
| Composition of segments                     | Disclose types of products and services included in each reported business segment and composition of each geographical segment. | Similar to IFRS.                                                                 | Similar to IFRS. |
| Profit                                      | Required.                                                            | Required.                                                                              | Required.                                                              |
| Assets and liabilities                       | Assets required. Liabilities for primary segment format only.         | Assets required. Liabilities not required.                                             | Net assets required.                                                   |
| External and inter-segment revenue          | External revenue required. Inter-segment revenue in primary segment format only. | Required on a consolidated GAAP basis, and on a segment GAAP basis but only if included in the measurement of segment profit/loss for internal reporting. | Same as IFRS. |
### Main disclosures (continued)

<table>
<thead>
<tr>
<th>ISSUE</th>
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<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation and amortisation expense and other significant non-cash expense</td>
<td>Required only for primary segment format.</td>
<td>Required for reportable segments on segment GAAP basis, but only if included in the measurement of segment profit/loss in internal reporting or otherwise regularly reported to chief operating decision-maker.</td>
<td>Not required.</td>
</tr>
<tr>
<td>Exceptional item</td>
<td>Encouraged but not required for primary segment format only.</td>
<td></td>
<td>Required.</td>
</tr>
<tr>
<td>Interest revenue and interest expense</td>
<td>Not required.</td>
<td>Not required.</td>
<td>Not required.</td>
</tr>
<tr>
<td>Income tax</td>
<td>Not required.</td>
<td>Not required.</td>
<td>Not required.</td>
</tr>
<tr>
<td>Capital expenditure on an accrual basis</td>
<td>Required.</td>
<td></td>
<td>Not required.</td>
</tr>
<tr>
<td>Profit/loss from investments in equity method investees, and amount of investment in equity method investees</td>
<td>Required if operations of associate are substantially all within a single segment.</td>
<td>Disclose total revenue and the relevant segment that reported the revenues for each external customer greater than or equal to 10% of consolidated revenue.</td>
<td>Similar to IFRS, except that UK GAAP specifies that information is to be given for significant associated undertakings.</td>
</tr>
<tr>
<td>Major customers</td>
<td>Not required.</td>
<td>Not required.</td>
<td>Not required.</td>
</tr>
<tr>
<td>Reconciliation of total segment revenue, total segment measures of profit or loss, total segment assets, total segment liabilities and any other significant segment totals to the corresponding totals of the entity</td>
<td>Required.</td>
<td>Required, except for segment liabilities.</td>
<td>Required.</td>
</tr>
</tbody>
</table>

Note, under **UK GAAP**, outside the above requirements, the Companies Act requires that where any company carries on two or more different types of business, it should disclose a description of and turnover for each type of business.

**REFERENCES:**
- **IFRS**: IAS 14.
- **US GAAP**: FAS 131.
- **UK GAAP**: SSAP 25, FRS 3, FRS 9, Companies Act 1985.
Discontinued operations

All three frameworks contain requirements for the measurement and disclosures of ‘discontinued’ operations.

<table>
<thead>
<tr>
<th>ISSUE</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>UK GAAP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definition</td>
<td>Operations and cash flows that can be clearly distinguished operationally and for financial reporting and represent a separate major line of business or geographical area of operations, or is a subsidiary acquired exclusively with a view to resale.</td>
<td>A component that can be clearly distinguished operationally and for financial reporting. May be a reportable segment, operating segment, reporting unit, subsidiary or an asset grouping.</td>
<td>Operation whose discontinuance has material effect on nature/focus of business or represents a material reduction in its operating facilities resulting either from its withdrawal from a particular market (whether class of business or geographical) or from a material reduction in turnover in the reporting entity’s continuing markets.</td>
</tr>
<tr>
<td>How discontinued</td>
<td>Operations and cash flows that have been disposed of or classified as held for sale.</td>
<td>Similar to IFRS. Operations and cash flows have been or will be eliminated, and entity will not have significant continuing involvement.</td>
<td>Sold or otherwise terminated permanently.</td>
</tr>
<tr>
<td>Envisaged timescale</td>
<td>Completed within a year, with limited exceptions.</td>
<td>Similar to IFRS.</td>
<td>Completed within the period or within 3 months after period end (or before date of approval of financial statements, if sooner).</td>
</tr>
<tr>
<td>Starting date for disclosure</td>
<td>From the date on which a component has been disposed of or, if earlier, is classified as held for sale.</td>
<td>Similar to IFRS.</td>
<td>No start date given.</td>
</tr>
<tr>
<td>Measurement</td>
<td>Lower of carrying value or fair value less costs to sell.</td>
<td>Similar to IFRS.</td>
<td>Write down assets to recoverable amount (higher of net realisable value and value in use). Provide for losses on sale or termination when demonstrably committed to the sale or termination.</td>
</tr>
<tr>
<td>Presentation</td>
<td>Present a single amount on the face of the income statement comprising the post-tax profit or loss of discontinued operations and an analysis of this amount either on the face of the income statement or in the notes for both current and prior periods. Separate classification on the balance sheet for assets and liabilities for the current period only.</td>
<td>Similar to IFRS. From measurement date, present result from operations of discontinued component (and gain or loss on disposal) as separate lines in the income statement, net of tax, after income from continuing operations. Balance sheet consolidation as normal, if discontinuance not completed by period end, with segregation of assets and liabilities (current and non-current) related to the disposal groups classified as held for sale.</td>
<td>On the face of the income statement the minimum that should be disclosed in respect of discontinued operations is turnover and operating profit.</td>
</tr>
<tr>
<td>Ending date of disclosure</td>
<td>Until completion of the discontinuance.</td>
<td>Similar to IFRS.</td>
<td>Similar to IFRS.</td>
</tr>
</tbody>
</table>
### Post-balance-sheet events

All three frameworks have similar standards on post-balance-sheet events.

#### Adjusting events after the balance sheet date

**IFRS**

Adjusting events that occur after the balance sheet date are defined as events that provide additional evidence of conditions that existed at the balance sheet date and that materially affect the amounts included. The amounts recognised in the financial statements must be adjusted to reflect adjusting events after the balance sheet date.

**US GAAP**

Similar to IFRS.

**UK GAAP**

Similar to IFRS.

#### Non-adjusting events after the balance sheet date

**IFRS**

Non-adjusting events that occurred after the balance sheet date are defined as events that are indicative of conditions that arose after the balance sheet date. The nature and estimated financial effects of such events are disclosed to prevent the financial statements from being misleading.

**US GAAP**

Similar to IFRS.

**UK GAAP**

Similar to IFRS.
The announcement of a dividend relating to the financial year just ended

**IFRS**
This is a non-adjusting event.

**US GAAP**
The declaration of a cash dividend is a non-adjusting event; but a stock dividend is an adjusting event.

**UK GAAP**
Similar to **IFRS**.

\(^{1}\)This only applies for financial years beginning on or after 1 January 2005. Prior to this, announcement of a dividend is regarded as an adjusting event.

**REFERENCES:**
- **IFRS:** IAS 10.
- **US GAAP:** AU Section 560.
- **UK GAAP:** FRS 21, SSAP 17, Companies Act 1985, Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004.

Interim financial reporting

**Stock exchange requirements**

**IFRS**
The IASB does not require public entities to produce interim statements but does encourage interim reporting – see additional guidance below.

**US GAAP**
Similar to **IFRS**, the FASB does not mandate interim statements. However, if required by the SEC, domestic US SEC registrants must follow APB 28 and comply with the specific financial reporting requirements in Regulation S-X applicable to quarterly reporting, including publication within 40 days (phasing to 35) of the quarter-end. SEC registrants must also include an abbreviated management discussion and analysis of financial condition and results of operations.

**UK GAAP**
The Financial Services Authority Listing Rules require: income statement, balance sheet, cash flow statement and earnings per share information in respect of the first six months of each financial year, use of accounting policies consistent with the current annual financial statements and an explanatory statement to shareholders. In practice, many listed companies in the UK go further than the minimum requirements and comply with the ASB’s non-mandatory Statement on Interim Reports.

**Additional guidance**

Additional guidance under all three frameworks is similar and includes the following:

- Consistent and similar basis of preparation of interim statements, with previously reported annual data and from one period to the next;
- Use of accounting policies consistent with the previous annual financial statements, together with adoption of any changes to accounting policies that it is known will be made in the year-end financial statements (for example, application of a new standard);
- Preparation of the interim statements using a ‘discrete approach’ to revenue and expenditure recognition; that is, viewing the interim period as a distinct accounting period, rather than part of the annual cycle. Incomplete transactions must therefore be treated in the same way as at the year end. However, **US GAAP** allows allocation between interim periods of certain costs benefiting more than one of those periods, and deferral of certain cost variances expected to be absorbed by year end. The tax charge in both frameworks is based on an estimate of the annual effective tax rate applied to the interim results;
- Summarised income statement (including segment revenue/profit), balance sheet, cash flow statement, selected notes and statement of recognised gains and losses; and
- A narrative commentary.
Interim financial reporting (continued)

Under all three frameworks, comparatives for the balance sheet are taken from the last annual financial statements. Under UK GAAP, comparatives for the income statement, cash flow statement and STRGL are for the previous full financial year in addition to the same interim period of the preceding year. Under IFRS and US GAAP, quarterly interim reports must contain comparatives (other than for the balance sheet) for the cumulative period to date and the corresponding period of the preceding year.

REFERENCES:  IFRS: IAS 34.
US GAAP: APB 28, FAS 130, FAS 131.
UK GAAP: Financial Services Authority Listing Rules (Chapter 12), ASB’s Statement on Interim Reports.

Insurance

Insurance and reinsurance contracts – definition

IFRS introduces a definition of an insurance contract based on the concept of insured event and significant insurance risk transfer. This definition applies to both insurance contracts issued and reinsurance contracts held.

US GAAP does not provide a single definition of insurance contract. The classification of contracts is performed by reference to the combined requirements of FAS 60, FAS 97 and FAS 120. Reinsurance contracts are subject to the definition contained in FAS 113. FAS 97 also covers investment contracts that would be accounted for under IAS 39 in IFRS financial statements.

The resulting population of insurance contracts under US GAAP is a subset of the IFRS classification. In addition, ‘universal life-type contracts’ within FAS 97 contain significant insurance risk under IFRS but are required to be accounted for under US GAAP using the deposit method of accounting rather than the deferral and matching accounting model used for all other insurance contracts (see below).

Reinsurance contracts that compensate the ceding party for losses but contain a timing delay in reimbursement (that is, the loss will certainly occur but its timing is uncertain) are subject to deposit accounting under FAS 113 but are classified as insurance contracts under IFRS.

One of the results of applying the IFRS insurance contract definition is that companies can no longer analogue to FAS 97 measurement principles with respect to their accounting for deferred acquisition costs (DAC). IFRS preparers with investment contracts under IAS 39 must look to IAS 18 for accounting guidance related to the recognition and measurement of DAC. IFRS also recognises that the fair value of an investment contract cannot be less than the amount payable on demand (the ‘deposit floor’); under US GAAP, the account value may fall below this level.

UK GAAP uses the IFRS definition of insurance contracts contained in FRS 25 and FRS 26. These are the equivalent standards to IAS 32 and 39 respectively and, therefore, the definition is mostly used to determine classification of financial instruments that are in or outside the scope of those standards. For insurance companies there are specific definitions in the ABI SORP.

Discretionary participation feature (DPF)

This is a new term under IFRS relating to the right of holders of certain insurance contracts and/or financial instruments to receive a supplemental return (in addition to guaranteed benefits) arising from certain components of the residual interest of the entity that has issued contracts with DPF as compound instruments. IFRS defines insurance contracts and financial instruments with DPF as compound instruments. IFRS does not require but permits the separation of the DPF equity component. The use of hybrid categories classified between equity and liabilities is prohibited.

IFRS requires entities to perform an adequacy test for those financial instruments with DPF. This liability adequacy test is different for those financial instruments with DPF that have an equity component. In this case, the liability adequacy test is based on IAS 39. In all other cases, IFRS 4 applies.
Insurance (continued)

This type of participation is described under US GAAP as policyholder dividends, and guidance is provided on accounting for dividends paid out of insurance contracts.

Entities must recognise a liability for the expected dividend payout based on an estimate of the amount to be paid. There are no requirements to disclose the portion of equity that arises from contracts that pay dividends. However, any dividend payments or declarations in excess of the liability are charged to profit or loss when paid or declared.

The possibility of such dividends being paid on financial instruments is not contemplated in US GAAP. Current US GAAP reporters have adopted the insurance accounting guidelines for measuring the obligations under such contracts.

UK GAAP uses the IFRS definition of DPF contained in FRS 25 and FRS 26. These are the equivalent standards to IAS 32 and 39 respectively and, therefore, the definition is mostly used to determine classification of financial instruments that are in or outside the scope of those standards.

For insurance companies, there is a statutory classification of the fund for future appropriations (FFA) for contracts with a DPF. Companies’ legislation and FRS 27 specify the presentation of the FFA as part of reserves.

Insurance and reinsurance contracts – measurement

The existing accounting policies for insurance contracts issued and reinsurance contracts held (including related intangible assets like deferred acquisition costs) are exempt from IFRS hierarchy and need not be changed on adoption of IFRS 4, except for the following five requirements:

1. Provisions for possible claims under contracts that are not in existence at the reporting date (such as catastrophe and equalisation provisions) are prohibited;
2. Insurance liabilities must be tested for adequacy;
3. Reinsurance assets must be tested for impairment;
4. Insurance liabilities can be de-recognised only when they are discharged or cancelled or expire;
5. Insurance liabilities and income should not be offset against related reinsurance assets and expenses.

US GAAP has specific measurement guidance for insurance contracts and reinsurance contracts. As explained above, IFRS allows entities to continue with their accounting policies developed under another GAAP. There are several differences between US GAAP and IFRS and the entity’s insurance and reinsurance accounting policies that have been developed from another GAAP basis. These are not covered by this publication.

Under IFRS the asset liability adequacy test requirement is met by the FAS 60 premium deficiency test. However, any deficiency resulting from the assumed realisation of unrealised gains or losses is reflected through the income statement under IFRS because IFRS does not have the option to reflect this type of liability adequacy loss through equity. This type of loss is known in US GAAP as a ‘shadow’ premium deficiency adjustment. In addition, IFRS requires guaranteed options to be considered in the liability adequacy test. In US GAAP, these are provided for under SOP 03-01 and are not explicitly considered in the premium deficiency test.

UK GAAP has no general guidance on the measurement of insurance contracts. Insurance companies are subject to specific guidance relating to the measurement of their insurance and reinsurance contracts.

Insurance and reinsurance contracts – deposit accounting and unbundling of deposit components

IFRS requires the unbundling and separate measurement of the deposit component bundled in an insurance contract if and only if the deposit can be reliably measured and the entity’s accounting policies do not recognise all rights and obligations arising from it. This requirement is limited in practice to situations in which the insurer or reinsurer has established experience accounts that refund the policyholder or cedant but has not appropriately reflected this obligation in its balance sheet.
Insurance (continued)

IFRS also allows the unbundling of deposit components on a voluntary basis if the deposit component can be reliably measured. This right would allow preparers to use the FAS 97 deposit accounting approach for universal life-type contracts (these contracts most likely qualify as insurance contracts under IFRS because they usually transfer significant insurance risk). For these contracts, US GAAP requires the recognition of the liability representing the policyholder’s account balance with the insurer. The account balance concept is equivalent to the deposit component concept in IFRS.

UK GAAP has no equivalent guidance relating to insurance contracts. However, treatment of deposit components within non insurance financial instruments is similar to IFRS. For insurance companies, the ABI SORP provides guidance on reinsurance contracts requiring unbundling where there are separate elements that do not result in the transfer of significant insurance risk.

Insurance contracts sold by an insurer to its own defined benefit plan

Insurance contracts sold by an insurer to its own defined benefit plan will generally be eliminated on consolidation, as outlined in IFRS 4 implementation guidance. The financial statements will then include:

- the full amount of the pension obligation under IAS 19, Employee Benefits, with no deduction for the plan’s rights under the contract;
- no liability to policyholders under the contract; and
- the assets backing the contract.

Under US GAAP, these contracts are recorded by including the value of the insurance contract as plan assets in the calculation of the company’s net defined benefit liability, and reflecting the insurance contract liability in accordance with the applicable insurance accounting guidance.

Under UK GAAP, there is no equivalent guidance.

Insurance and reinsurance contracts – embedded derivatives

Under IFRS, embedded derivatives that also meet the definition of insurance contracts are not required to be separated and fair valued. Options to surrender the insurance contract are exempted from separation and fair value measurement if the option price is a fixed amount or a fixed amount plus interest. This exemption also applies to derivatives embedded in financial instruments with DPF. Under US GAAP, these embedded derivatives are not subject to exemptions from the general principle of separation and fair value measurement when they are not closely related to the host contract.

IFRS classifies persistency bonuses as embedded derivatives; US GAAP treats them as an effective yield adjustment and does not require them to be separated and fair valued.

Under UK GAAP, embedded derivatives contained in insurance contracts that are not themselves insurance contracts are treated in a similar manner to IFRS.

Disclosures

IFRS requires extensive disclosures to allow the users of financial statements to understand the measurement bases adopted, the materiality of the reported amounts arising from insurance contracts and the factors that affect the uncertainty of amount and timing of the cash flows arising from insurance and reinsurance contracts.

US GAAP disclosures are less demanding than IFRS. However, similar disclosures are included in other sections of the annual report (for example in the MD&A section). An example of such disclosure is the claims development table.
Insurance (continued)

**UK GAAP**
There is no equivalent general guidance relating to disclosures of insurance contracts. Insurance companies are subject to specific guidance regarding disclosures. In particular, FRS 27 applicable to life assurance companies and the ABI SORP applicable to insurance companies require disclosures of policies, assumptions and sensitivities.

**Separate accounts**

**IFRS**
Does not permit a single line presentation.

**US GAAP**
FAS 60 and SOP 03-01 allow single line presentation in the balance sheet and offsetting of investment results, with changes in policyholder liabilities in the income statement.

**UK GAAP**
For insurance companies, the ABI SORP and companies’ legislation specify the separate presentation of unit linked assets and liabilities.

**REFERENCES:**
IFRS: IFRS 4,
US GAAP: FAS 60, 97, 120 and 113, SOP 03-1, SOP 95-1 for insurance contracts, and FAS 91 for financial instruments, FAS 133.
UK GAAP: FRS 25, FRS 26, FRS 27, ABI SORP
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