

**Divergent Convergence:
IFRS and GAAP
The Long & Winding Road
of Fair Value Measurements**

James P. Catty

Chair

International Association of Consultants Valuators and Analysts

jimc@iacva.org

Speaker Biography

James P. Catty, MA, CPA/ABV (US), CA•CBV (Canada), CVA, CFA, CFE

- Jim Catty is President and founder of Corporate Valuation Services Limited (CVS), a Canadian firm that specializes in valuing technology-oriented businesses, their securities and assets throughout the world. He is also Chairman of the International Association of Valuators, Consultants and Analysts (IACVA) that transfers financial knowledge from North America and Western Europe to Africa, Asia, Eastern Europe, and the Middle East, and of Counsel to Hanlin Moss, PS, Certified Public Accountants of Seattle USA and X'ian, China. He holds BA and MA degrees from Oxford and has been active in the profession for over fifty years. Clients range from government departments and agencies to law firms, businesses and individuals – and nearly all are referred word-of-mouth. His valuation reports service multinational enterprises, as well as local start-ups. Jim has contributed numerous articles to various publications and made numerous presentations to professional groups in China, France, Germany, Israel, Romania, Taiwan, Turkey, UK and the USA. He is the general editor of “Guide to Fair Value under IFRS”, Wiley.

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Background

- Accounting is the language of Business with an elaborate vocabulary and grammar.
- As in my country, Canada, the profession has two official languages, GAAP and IFRS, together with a number of dialects and patois.
- The language police, FASB and IASB, have since 2002, been trying to converge their pronouncements into one internationally accepted, high quality set of standards.
- Let's hope it's not "franglais"

Background

IFRS = *Principles* GAAP = *Rules*

- As if telling a teenager when to come home:
- *Principle* = at a reasonable time using their judgment, for example:
 - 9:00 pm if homework not done
 - 10:00 pm if homework done
 - 10:30 pm if no school the next day
- *Rules* = 9:00 pm, with 10 exceptions

Background

- IFRS is not consolidated
- It contains a number of documents:
 - 9 International Reporting Standards
 - 30 International Accounting Standards (issued before 2001 but mainly revised since)
 - 24 Interpretations
- In total, about 2,800 pages in a single book
- GAAP, after the consolidation, is about 25,000 pages in four volumes

Background

Excerpts from speech by Christopher Cox, SEC chair, November 2008

- “In order for IFRS to fulfill the promise it holds to be a unitor of the world's capital markets and a powerful tool for investors everywhere, there are a handful of principles that are critical to its success. Every one of us here today needs to see to it that these principles are applied.”

Background

Excerpts from speech by Christopher Cox, SEC chair, November 2008

- First, the standards must be crafted in the interest of investors. That has to be their overarching purpose. We all know that a business's financial reports are relied upon by many other people for many purposes. Financial statements are used by the managers of the business as an important tool in making decisions. They are relied upon by many outside parties, such as commercial lenders who extend credit to the business.

Background

Excerpts from speech by Christopher Cox, SEC chair, November 2008

- And of course financial reports are important to analysts of all kinds for purposes that go far beyond investing, as for example when economists use them as a basis for reporting about an industry's size and other aggregate statistics. But above all, a public company's financial reports represent a direct communication between the company and its investors. And from the investor's standpoint, accounting standards should promote both clarity and comparability.

Background

Excerpts from speech by Christopher Cox, SEC chair, November 2008

- The second principle for the success of IFRS is that the standard setting process must be transparent. That is essential not only to maintain investor confidence, but to ensure the integrity and quality of the standards. Open due process is necessary so that investors and the many others who participate in our capital markets can be assured that their views will be thoughtfully considered.

Background

Excerpts from speech by Christopher Cox, SEC chair, November 2008

- Third, the standard setter must be independent. That means independent from special pleaders, from the political process, from favored industries or industry players, and from national or regional biases. An independent standard setter is best positioned to develop unbiased standards that foster investor confidence and transparency.

Background

Excerpts from speech by Christopher Cox, SEC chair, November 2008

- [Fourth] the standard setter must also be accountable. This means ensuring that IFRS actually meet the needs of investors and other stakeholders, and that they are updated in a timely way.

Background

Excerpts from speech by Christopher Cox, SEC chair, November 2008

- And finally, it is vitally important that all of the stakeholders themselves participate in the standard setting process in order to ensure the continued success of IFRS. The current dialogue among securities regulators over IFRS development is an essential ingredient in its steady progress.

Background

Excerpts from comments by European Central Bank Executive Board member Gertrude Tumpel-Gugerell, 27 April 2010

- "The ECB strongly opposes a full fair value approach"
- "In this context, convergence should not come at the expense of high-quality accounting standards."
- "The potential impact of fair value accounting on behaviour, asset price dynamics and subsequently on financial stability should not be underestimated"

Background

Excerpts from comments by European Central Bank Executive Board member Gertrude Tumpel-Gugerell, 27 April 2010

- "What is the use of marking-to-market when there is no market?"
- "With regard to recent assertions made by IASB and FASB that convergence is on track, I would like to highlight that we are not so optimistic"

GAAP to IFRS

The following 8 pages are excerpts from *Speech by SEC Chairman Mary L. Schapiro at the CFA Institute 2010 Annual Conference, Boston, May 18, 2010*

- Major financial reform legislation occasionally leads the national news.
- Issues like Repo 105, can make headlines in the business press or on CNBC.
- But a discussion of accounting standards, and the global convergence of those standards, is often limited to specialized journals and a handful of websites

GAAP to IFRS

- Perhaps because of this lack of coverage, and because of the complexity of a comprehensive accounting review and the resulting deliberate pace, a number of myths have sprung up, many suggesting that that our commitment to a single set of high quality accounting standards is not particularly strong.

GAAP to IFRS

- **Myth #1 The SEC's commitment to global accounting standards is not as strong as it should be**
 - The Commission continues to believe that a single set of high-quality globally accepted accounting standards will benefit U.S. investors and that this goal is consistent with our mission
 - We continue to encourage the convergence of GAAP and IFRS and expect the differences to become fewer and narrower

GAAP to IFRS

- **Myth #2: The U.S. may be committed, but it's dragging its feet regarding adoption of IFRS**
 - The convergence process is critical to the incorporation of IFRS into the US market.
 - IASB and FASB must remain vigilant that investors needs and protection remain paramount throughout the process.

GAAP to IFRS

- While the goal of convergence in a timely manner is important, a convergence effort that fails to take into account the due processes of the standard setting bodies will not serve investors well in the long run.
- Giving short shrift to process and testing, would increase the risk of poor decisions.
- We are committed, above all, to a convergence exercise that yields *high-quality* improvements to accounting standards.

GAAP to IFRS

- **Myth #3: The United States is fixated on process**
 - The US *understands the importance* of process to a successful conclusion.
 - We will not accept shortcuts that undermine our larger goals or risk compromising the achievement of high quality global standards.
 - A critical part of the standards-setting process is ensuring that IASB and FASB are shielded from undue political or commercial pressure.

GAAP to IFRS

- **Myth #4: America is protecting its parochial interests**
 - We are protecting the interests of the investors in our markets, and always will.
 - When investors from anywhere across the globe participate in our markets, they come under the SEC.
 - Accounting standards must provide transparency for investors, and must not obscure the truth, even if the truth is painful.

GAAP to IFRS

- Our goal is to ensure a neutral process that results in rules that give capital market participants everywhere access to information on the financial performance and position of companies, so that they are able to make informed economic decisions.

GAAP to IFRS

Summary of comments by Sir David Tweedie, Chairman IASB, on 25 May 2010, at AICPA Council meeting, San Diego

- There is enormous political pressure on the IASB/FASB to improve standards [on financial instruments] quickly
- Despite intense joint deliberations, the boards were unable to agree, IFRS 9 *Financial Instruments*, issued 12 November 2009 is only effective 1 January 2013
- Divergences were caused by the inherent problem of having two major standards setters

GAAP to IFRS

Summary of comments by Sir David Tweedie, Chairman IASB, on 25 May 2010, at AICPA Council meeting, San Diego

- “We’re not wedded to our model. If everyone said the FASB model is better, fine, let’s adopt it.”
- “Both of us are asking the others’ constituents to look at the opposite model. So this fall we can say the world in balance thinks this is the best approach.”

GAAP to IFRS

Summary of FASB / IASB 2 June letter to G20 group of industrialized and emerging countries

- Will keep June 2011 target date for many projects where convergence accounting rules are urgently required
- A few projects will extend into the second half of the year
- “Enabling all interested parties to review properly, evaluate, and provide views is essential to developing high quality standards that are durable and serve investors and the global economy.”

GAAP to IFRS

Excerpt from a statement by Mary Shapiro, on 2 June 2010

- “Quality financial reporting standards established through an independent process are threshold criteria against which the commission’s future consideration of the role of IFRS in the US reporting system will be based.”
- She is confident the regulator [SEC] will decide in 2011 whether to adopt IFRS [in the United States]

GAAP to IFRS

Comments by He Bangjing, President of the China Appraisal Society, to IACVA/NACVA/IBC conference, Miami Beach, 4 June 2010

- With the global integration and rapid growth of the Chinese economy the Chinese finance industry has also made great progress
- China is adopting IFRS
- The appraisal market in China is vast and foreign valuation firms have a brilliant future
- As economic ties pulls us together, we expect broader exchanges and cooperation among the global valuation community

GAAP to IFRS

Expected publications as of 26 May 2010:

Comment Period - C

Discussion Paper – D

Exposure Drafts – E

Final Documents – F

Roundtable Meetings - R

FASB/IASB Joint Projects	2010			2011	
	Q2	Q3	Q4	Q1	Q2
Conceptual Framework					
Objective and Qualitative Characteristics	F				
Reporting Entity		C	F		
Measurement				?	?
Elements and Recognition				?	?

GAAP to IFRS

FASB/IASB Joint Projects	2010			2011	
	2Q	3Q	4Q	Q1	Q2
Standards					
Fair Value Measurement	E	R	F		
Consolidation: Policy and Procedures	E	R		F	
Accounting for Financial Instruments		C	R		F
Financial Instruments with Characteristics of Equity	E	R		F	
Financial Statement Presentation	E	R		F	
Insurance Contracts	E	R			F
Leases	E	R		F	

GAAP to IFRS

FASB/IASB Joint Projects	2010			2011	
	2Q	3Q	4Q	Q1	Q2
Standards (continued)					
Revenue Recognition	E	R		F	
Statement of Comprehensive Income		C			F
Reporting Discontinued Operations	E				
Balance Sheet-Offsetting		E			F
Emissions Trading Schemes				?	?
Earnings Per Share	Not Active				
Income Taxes	Not Active				
Post Retirement Benefit Obligations	Not Active				
Financial Instruments: De-recognition				?	?

GAAP to IFRS

This presentation discusses

- Convergence
- Acquisitions
- Contingencies
- Impairment
- Inventory
- Long-lived Assets
- Fair Value
- Consolidation
- Financial Instruments
- Intangibles
- Leases
- Share-based Payments

Convergence

- Differences are constantly shrinking but even the final (converged) results are not identical
- IFRS is largely, but not entirely, grounded in the same basic principles as GAAP
- Conceptual frameworks are often the same
- Areas of divergence tend to overshadow these similarities

Convergence

- IFRS has the advantage of being able to draw on the latest thinking of standard setters around the world
- They contain elements from a variety of countries
- Even when an existing US standard was the starting point, IASB was able to take a fresh approach to avoid any perceived problems in FASB document

Convergence

- IFRS tend to be broader than GAAP, with limited interpretive guidance
- IASB has generally avoided issuing interpretations, preferring to leave this to preparers, auditors, and its official interpretive body, the International Financial Reporting Interpretations Committee (IFRIC)

Convergence

- Some differences are intentional, embodied in the standards themselves
- Others have emerged through interpretation
- Annually, in an “Improvements Project,” IASB reviews the current standards to enhance their clarity and consistency, taking advantage of the most current thinking and practice

Convergence

- The Boards publicly declared their commitment to convergence in 2002 and have made good strides toward that objective
- In February 2010, the SEC voted unanimously to publish a statement reaffirming its longstanding commitment to the goal of a single set of high-quality global accounting standards and expressing its continued support for the convergence efforts

Convergence

- Convergence will not eliminate all differences between GAAP and IFRS
- They still exist in standards for which convergence already has been completed, as well as in ones for which no additional work is planned
- For those currently on the Boards' agenda, unless the words are exactly the same, interpretational differences will almost certainly continue to arise

Convergence

- Early in May 2010, a joint statement IASB and FASB said that while they were making good progress on the vast majority of accounting rules, there was “no guarantee” they would resolve “all, or any, of our differences” on its financial instruments project
- The two boards are working towards a June 2011 deadline, imposed by G20 leaders last year
- Fundamental differences remain in their approaches to financial instruments

Convergence

- The Boards need to work together according to the same timetable, allowing constituents the best chance to understand and then comment on the drafts
- In June FASB will release its full fair value proposal, which will likely result in all company assets being valued at their market price (fair value)
- IASB released its model in November 2008 applying a mixed-measurement approach that allows some bank loans to be valued at amortized cost

Convergence

- FASB's timing has raised questions about its "sense of urgency"
- Progress is needed soon on key projects such as financial instruments to prevent missing the deadline

Convergence

- The quality of both sets of standards may suffer as the Boards struggle to keep up with the number of proposals being released in 2010
 - 11 for FASB, 8 on major projects
 - 11 for IASB, 7 on major projects
- The concern is not that that the standards setters will have to work harder but the risk of damaging their quality is magnified by having to deal with so many topics at once

Convergence

- Complete convergence is impossible as US lawyers will continue to force CPA's to look for **RULES**

PRINCIPLES =

JUDGMENTS =

RISKS

Fair Value

- Until now there were different definitions
 - GAAP = exit price
 - IFRS = willing seller (often entry price)
- New comprehensive standard coming
- Likely to have more affect on IFRS which has agreed to adopt GAAP's exit concept

Fair Value

- Fair value is market based reflecting the assumptions that market participants would use in pricing the item
- In January 2010, the Boards tentatively decided that an entity should consider observable transaction prices unless there is evidence that the transactions were not orderly

Fair Value

- A transaction price may not represent fair value on initial recognition if, for example
 - It is between related parties
 - Takes places under duress
 - The seller is forced to accept the price

Fair Value

- Market participants should be assumed to have a reasonable understanding about the asset or liability and the transaction based on all available information, including information that might be obtained through usual and customary due diligence
- Prices in related-party transactions may be used as inputs for fair value measurements if the transaction was entered into on market terms

Fair Value

In February 2010, the Boards tentatively decided:

Highest and Best Use

- Fair value of a nonfinancial asset considers its highest and best use by market participants
- To establish meanings for
 - “physically possible”
 - “legally permissible”
 - “financially feasible”

Fair Value

Incremental Value

- Not to require separation of the fair value of an asset group into two components when it is the asset is applied in a manner other than its highest and best use
- To require disclosure of information about when an asset is applied in a way that differs from its highest and best use (and the fair value is based on that concept)

Fair Value

Nonfinancial Assets

- Fair value of an individual asset is the price for a sale of the asset alone, not as part of a group of assets or business
- When the highest and best use of an asset is to form part of a group, its fair value presumes that the sale is to a market participant that has, or can obtain, the necessary “complementary assets” and “complementary liabilities.”

Fair Value

Nonfinancial Assets (continued)

- Complementary liabilities include working capital but not financing
- To describe the objective of the valuation premise without using the terms “in-use” and “in-exchange” because they are often misunderstood

Fair Value

Financial Instruments

- That the concepts of highest and best use and different valuation premises are relevant only for nonfinancial assets and not for financial assets or for liabilities
- To describe valuation adjustments that entities might need to undertake when using a valuation technique because market participants would make them when pricing a financial asset or liability under the then market conditions

Fair Value

Financial Instruments (continued)

- Those were described in IASB's Expert Advisory Panel Report *Measuring and Disclosing the Fair Value of Financial Instruments in Markets That Are No Longer Active*
- A future meeting will consider if the fair value of financial instruments within a portfolio should take into account offsetting positions including credit and market risks

Fair Value

Premiums and Discounts

- To clarify what a blockage factor is and to describe how it is different from other types of adjustments, such as a lack of marketability discount, for an individual financial instrument
- To prohibit applying a blockage factor at any level of the fair value hierarchy

Fair Value

Premiums and Discounts

- To specify that measurements in Levels 2 and 3 of the fair value hierarchy consider all premiums and discounts that market participants would apply in pricing an asset or liability at the unit of account specified in the relevant standard (except for a blockage factor)

Fair Value

- The converged fair value standard will not include
 - Additional guidance for measuring the fair value of difficult to value assets and liabilities (including unquoted equity instruments)
- In the future IASB will discuss educational materials to assist entities in applying fair value to such assets and liabilities

Fair Value

- Even when GAAP and IFRS result in the same assets appearing on a balance sheet, their attributed values may be different
- IFRS permits regular revaluations of property, plant and equipment to fair values
- An entity cannot pick and choose, if it revalues one item within a class of such assets, it must revalue all of them

Fair Value

- IFRS credits any increases in such values to a revaluation reserve in the equity section of the balance sheet
- Decreases are treated as impairment losses to the extent they exceed previous revaluation gains
- For investment properties, both GAAP and IFRS prefer historic cost less depreciation and impairment
- IFRS also permits accounting for such items at fair value, recognizing changes in profit or loss

Acquisitions

- ASC 805 *Business Combinations* and IFRS 3(R) *Business Combinations* represent the culmination of the first major convergence project
- All business combinations are now accounted for using the acquisition method
- Upon obtaining control of another entity, the underlying transaction and the assets, liabilities and non-controlling interests of the Target are measured at Fair Value
- However certain differences still exist

Acquisitions – Significant Differences

	GAAP	IFRS
Measurement of non-controlling interest	Non-controlling interest is measured at fair value, which includes its share of goodwill.	Non-controlling interest is measured either (i) at fair value including goodwill or (ii) at its proportionate share of the fair value of the Target's identifiable net assets, excluding goodwill.
Target's operating leases	If the terms of an operating lease are favorable or unfavorable relative to market terms, the Acquiror recognizes an intangible asset or liability, respectively, regardless of whether the Target is the lessor or the lessee.	Separate recognition of an intangible asset or liability is required only if the Target is a lessee. If it is the lessor, the terms of the lease are taken into account in estimating the fair value of the leased asset recognition of an intangible asset or liability is not required.

Acquisitions – Significant Differences

	GAAP	IFRS
Assets and liabilities arising from contingencies	<p><i>Initial Recognition</i></p> <p>Assets and liabilities arising from contingencies are recognized at fair value in accordance with ASC 820 <i>Fair Value Measurement and Disclosures</i>, if the fair value can be determined during the measurement period. If the fair value of a contingent asset or liability cannot be determined, it should be recognized at the acquisition date in accordance with ASC 450 <i>Contingencies</i> if it meets such criteria.</p> <p>Contingent assets and liabilities that do not meet the recognition criteria at the acquisition date are subsequently accounted for pursuant to other standards.</p>	<p><i>Initial Recognition</i></p> <p>Liabilities subject to contingencies are recognized as of the acquisition date if there is a present obligation that arises from past events and its fair value can be measured reliably. Contingent assets are not recognized.</p>

Acquisitions – Significant Differences

	GAAP	IFRS
Assets and liabilities arising from contingencies	<p><i>Subsequent Measurement</i></p> <p>If contingent assets and liabilities are initially recognized at fair value, an acquirer should develop a systematic and rational basis for subsequently measuring and accounting for them depending on their nature. If amounts are initially recognized and measured under ASC 450, the subsequent accounting and measurement should be based on that guidance.</p>	<p><i>Subsequent Measurement</i></p> <p>Liabilities subject to contingencies are subsequently measured at the higher of (i) the amount that would be recognized in accordance with IAS 37, or (ii) the amount initially recognized less, if appropriate, cumulative amortization recognized in accordance with IAS 18.</p>
Combination of entities under common control	<p>The receiving entity records the net assets at their carrying amounts in the accounts of the transferor (historical cost).</p>	<p>Outside the scope of IFRS 3(R). In practice, a policy election is made to either (i) follow an approach similar to GAAP or (ii) apply the acquisition method if there is substance to the transaction.</p>

Acquisitions – Significant Differences

- Additional variations arise due to requirements of other standards
 - identifying the acquirer
 - definition of control
 - definition of fair value
 - replacement of share-based payment awards
 - initial classification and subsequent measurement of contingent consideration
 - initial recognition and measurement of income taxes
 - initial recognition and measurement of employee benefits

Acquisitions - Convergence

- No further work is planned

Consolidation

- The principal GAAP guidance for consolidation is ASC 810 *Consolidations*
- IFRS relies on IAS 27 *Consolidated and Separate Financial Statements* and SIC 12 *Consolidation — Special Purpose Entities*
- Under either, whether an entity is consolidated or not, is based on control
- Differences exist in its definition

Consolidation

- Generally, all entities controlled by the reporting enterprise must be consolidated with limited exceptions in GAAP, for certain specialized industries
- Uniform accounting policies are used for all of the entities within a consolidated group, again with certain exceptions under GAAP, where a subsidiary within specific industries may retain its specialized accounting policies

Consolidation

- An equity investment that gives an investor significant influence over an investee (“an associate” in IFRS) unless consolidated, is accounted for by the equity method under both GAAP (ASC 323 *Investments — Equity Method and Joint Ventures*) and IFRS (IAS 28 *Investments in Associates*)

Consolidation – Significant Differences

	GAAP	IFRS
Consolidation model	Focus is on controlling financial interests. All entities are first evaluated as potential variable interest entities (VIEs). If a VIE, ASC 810 is followed. Entities controlled by votes are consolidated. Potential voting rights are not considered in practice. The concept of “effective control” is rarely applied.	Focus is on the concept of control, being the parent’s ability to govern the financial and operating policies of an entity to obtain benefits. Control is presumed to exist if parent owns more than 50% of the current and potential voting rights. “De facto control” must be considered.
Special purpose entities (SPE)	ASC 810 requires the primary beneficiary (determined based on considerations of power and benefits) must consolidate the VIE.	Under SIC 12, SPEs (entities created to accomplish a narrow and well-defined objective) are consolidated when the substance of the relationship indicates that an entity controls it.

Consolidation – Significant Differences

	GAAP	IFRS
Preparation of consolidated financial statements — general	Required, although certain industry- specific exceptions exist (for example, investment companies).	Generally required with a limited exemption for a parent that is itself a wholly-owned, or partially-owned if certain conditions are met.
Preparation of consolidated financial statements — different reporting dates of parent and subsidiary(ies)	The effects of significant events occurring between the reporting dates when different dates are used are disclosed in the financial statements.	The effects of significant events occurring between the reporting dates when different dates are used are adjusted for in the financial statements.

Consolidation – Significant Differences

	GAAP	IFRS
Changes in ownership interest in a subsidiary without change of control	Transactions that result in decreases in an ownership interest in a subsidiary in either of the following situations without a loss of control are accounted for as equity transactions (that is, no gain or loss is recognized): (1) a subsidiary that is a business or a nonprofit activity, except for either of the following — (a) a sale of in substance real estate and (b) a conveyance of oil & gas or mineral rights; (2) a subsidiary that is not a business or a nonprofit activity if the substance of the transaction is not addressed directly by other ASC.	Consistent with GAAP, except that this guidance applies to all subsidiaries under IAS 27(R), even those that are not businesses or nonprofit activities, those that involve sales of, in substance, real estate or conveyance of oil & gas or mineral rights. IAS 27(R) does not address whether that guidance should be applied to transactions involving non-subsidiaries that are businesses or nonprofit activities.

Consolidation – Significant Differences

	GAAP	IFRS
Loss of control of a subsidiary	In certain transactions that result in a loss of control of a subsidiary or a group of assets, any retained non-controlling investment in the former subsidiary or group of assets is re-measured to fair value on the date control is lost. The gain or loss on re-measurement is included in income along with any gain or loss on the ownership interest sold. This accounting is limited to the following transactions: (1) loss of control of a subsidiary that is a business or a nonprofit activity, except for either of the following — (a) a sale of in substance real estate, (b) a conveyance of oil & gas or mineral rights (2) loss of control of a subsidiary that is not a business or a nonprofit activity if the substance of the transaction is not addressed directly by other ASC (3) the de-recognition of a group of assets that is a business or a nonprofit activity, except for either of the following — (a) a sale of in substance real estate and (b) a conveyance of oil & gas or mineral rights.	<p>Consistent with GAAP, except that this guidance applies to all subsidiaries under IAS 27(R), even those that are not businesses or nonprofit activities or those that involve sales of in substance real estate or conveyance of oil & gas or mineral rights.</p> <p>In addition, IAS 27(R) does not address whether that guidance should be applied to transactions involving non-subsidiaries that are businesses or nonprofit activities. IAS 27(R) does not address the de-recognition of assets outside the loss of control of a subsidiary.</p>

Consolidation – Significant Differences

	GAAP	IFRS
Equity-method investments	ASC 825-10 <i>Financial Instruments</i> gives entities the option to account for equity method investments at fair value. For those for which management does not elect to use this, the equity method of accounting is required. Uniform accounting policies between investor and investee are not required.	IAS 28 generally requires investors (other than venture capital organizations, mutual funds, unit trusts, and similar entities) to use the equity-method of accounting for their investments in associates in consolidated financial statements. If separate financial statements are presented (that is, by a parent or investor), subsidiaries and associates can be accounted for at either cost or fair value. Uniform accounting policies between investor and investee are required.
Joint ventures	Generally accounted for using the equity method, with the limited exception of unincorporated entities in certain industries which may follow proportionate consolidation.	IAS 31 <i>Investments in Joint Ventures</i> permits either proportionate consolidation or equity accounting.

Consolidation – Convergence

- In September 2007, IASB issued Exposure Draft 9 *Joint Arrangements* amending IAS 31 to eliminate proportionate consolidation of jointly controlled entities
- In December 2008, IASB issued Exposure Draft 10 *Consolidated Financial Statements* to replace IAS 27 and SIC 12
- If adopted this would provide a single consolidation model

Consolidation – Convergence

- The Boards have agreed to jointly deliberate their respective consolidation projects
- This will hopefully address differences in
 - scope related to investment companies
 - kick-out rights
 - principal vs. agency relationships
 - “de facto” control
 - options and potential voting rights

Consolidation – Convergence

- FASB aims to publish an Exposure Draft in the second quarter of 2010
- Concurrently, IASB will seek practitioners' views on it with the aim of a final standard by the end of 2010

Contingencies

- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* provides overall guidance
- There is no equivalent single standard under GAAP, however ASC 450 *Contingencies*, ASC 410 *Asset Retirements and Environmental Obligations* and ASC 420 *Exit or Disposal Cost Obligations* are relevant
- While the guidance differs significantly the general recognition criteria are similar

Contingencies

- Two GAAP Concept Statements (CON 5 *Recognition and Measurement in Financial Statements of Business Enterprises* and CON 6 *Elements of Financial Statements*) have specific recognition criteria similar to those in IAS 37
- GAAP and IFRS require recognition of a loss based on the probability of occurrence but definitions differ
- GAAP is “likely” and IFRS is “more likely than not”

Contingencies

- Recognition of provisions for costs associated with future operating activities are allowed by neither
- Both require information to be disclosed in the Notes about any contingent liabilities whose occurrence is more than remote but do not meet the recognition criteria

Contingencies - Earn-outs

- Earn-outs are adjustments to purchase consideration, usually because of uncertainties over the value of a Target
- They relate to events or conditions that might trigger additional payments
 - post-acquisition earnings reach a certain level
 - additional consideration is due
- The reverse may also occur - consideration is reduced if certain conditions are not met

Contingencies - Earn-outs

- Under ASC 805 and IFRS 3®, all types of purchase consideration are measured at fair value on the date the acquirer takes control
- This includes estimated contingent consideration
- The probability of payment does not affect whether the earn-out should be recognized, only how much

Contingencies - Earn-outs

- Both GAAP and IFRS prohibit the acquirer from recording subsequent changes in earn-outs through goodwill other than measurement period adjustments
- Re-measurements for earn-outs classified as liabilities are recognized in income
- There could be a significant impact on the acquirer's subsequent Profit & Losses
- This is an incentive for accurate assessments of the initial value of earn-outs

Contingencies - Earn-outs

- The more the acquired business exceeds the projections underpinning the initial fair value, the greater the charge against post-acquisition profits
- The reverse is also true - poor performance results in a credit to income
- Those results may be counterintuitive, depending on how the earn-outs are structured
- Due to their nature it is hard to reliably measure the fair value of any earn-outs

Contingencies - Earn-outs

- Earn-outs settled through the acquirer's share may be liabilities or equities depending on their terms
- It is a liability if it fails to qualify as equity under the "fixed-for-fixed" criteria in IAS 32
- As a liability it is initially recognized at fair value
- Then re-measured at each reporting period with changes going to income

Contingencies - Earn-outs

- Earn-outs classified as equity are recognized at fair value and are not subject to re-measurement
- This reduces earnings volatility and may be a more palatable alternative to cash earn-outs
- But payment in shares may result in the transfer of more benefits to the seller than intended
- If the combination has a positive effect on the acquirer's share price, the seller will also gain from the market's assessment of post-combination synergies

Contingencies – Significant Differences

	GAAP	IFRS
Discounting provisions	Provisions may be discounted only when the amount of the liability and the timing of the payments are fixed or reliably determinable, or when the obligation is at fair value (for example, an asset retirement under ASC 410-20). Discount rate is dependent upon the nature of the provision, and may vary from that under IFRS. However, the time value of money and the risks specific to the liability should be considered.	Provisions should be recorded at the estimated amount to settle or transfer the obligation taking into consideration the time value of money. Discount rate to be used should be “a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.”

Contingencies – Significant Differences

	GAAP	IFRS
Measurement of provisions — range of possible outcomes	Most likely outcome within range should be accrued. When no one outcome is more likely than the others, the minimum amount should be chosen.	Best estimate of obligation should be accrued. For a large population, such as warranty costs, best estimate is typically expected value, although mid-point in the range may also be used when any amount is as likely as another. Best estimate for a single obligation may be the most likely outcome, although other possibilities should still be considered.

Contingencies – Significant Differences

	GAAP	IFRS
Restructuring costs	Under ASC 420, once management has committed to a detailed exit plan, each type of cost is examined to determine when recognized. Involuntary employee termination costs are recognized over future service period, or immediately if there is none. Others are expensed as incurred.	Once management has “demonstrably committed” (that is, a legal or constructive obligation) to a detailed exit plan, IAS 37 applies. Costs typically are recognized earlier than under GAAP because IAS 37 focuses on the exit plan as a whole, rather than individual costs.
Disclosure of contingency	No similar provision to that for reduced disclosure under IFRS.	Reduced disclosure permitted if it would be severely prejudicial to an entity’s position in a dispute.

Contingencies – Convergence

- Both Boards have current agenda items on this topic
- An exposure draft on IAS 37's measurement provisions was issued in January 2010, with a final standard expected later in the year
- This is expected to conform to GAAP

Contingencies – Convergence

- In June 2008, FASB issued proposed amendments to the disclosure requirements of ASC 450
- Many proposed changes are consistent with IAS 37
- A final standard is anticipated in 2010

Financial Instruments

- The complex GAAP for financial instruments is contained in ASC 310-10-35 *Receivables - Subsequent Measurement*, ASC 320 *Investments - Debt and Equity Securities*, ASC 470 *Debt*, ASC 480 *Distinguishing Liabilities from Equity*, ASC 815 *Derivatives and Hedging*, ASC 820 *Fair Value Measurements and Disclosures*, ASC 825-10-25 *Financial Instruments - Recognition*, ASC 825-10-50 *Financial Instruments - Disclosures*, ASC 860 *Transfers and Servicing* and ASC 948 *Financial Services - Mortgage Banking*

Financial Instruments

- IFRS guidance is limited to IAS 32 *Financial Instruments: Presentation*, IAS 39 *Financial Instruments: Recognition and Measurement*, IFRS 7 *Financial Instruments: Disclosures* and IFRS 9 *Financial Instruments*
- The latter, issued in November 2009, addresses classification and measurement of financial assets
- Since it is not effective until annual periods beginning on or after 1 January 2013, although early application is permitted, it is not dealt with in this presentation

Financial Instruments

- GAAP and IFRS both require financial instruments be classified into specific categories to:
 - determine their measurement
 - clarify when they should be recognized or derecognized
 - require the recognition of all derivatives on the Balance Sheet
 - require detailed disclosures in the Notes
- Both permit hedge accounting and use of a fair value option

Financial Instruments – Debt vs Equity

	GAAP	IFRS
Classification	GAAP specifically identifies certain instruments with characteristics of both debt and equity that must be classified as liabilities. Contracts that are indexed to, and potentially settled in, a company's own shares may be classified as equity if they: (1) require physical settlement or net-share settlement, or (2) give the issuer a choice of net-cash settlement or delivery of its own shares.	Classification of certain instruments with characteristics of both debt and equity focuses on the contractual obligation to deliver cash, assets or an entity's own shares. Economic compulsion does not constitute a contractual obligation. Contracts that are indexed to, and potentially settled in, a company's own shares are classified as equity if settled by only delivering a fixed number of shares for a certain amount of cash.
Compound (hybrid) financial instruments	Compound (hybrid) financial instruments (for example, convertible bonds) are not split into debt and equity elements unless specific conditions are met, but they may be divided into debt and derivative components, with the latter subjected to fair value accounting.	Compound (hybrid) financial instruments are required to be split into a debt and equity elements and, if applicable, also a derivative component. The latter may be subjected to fair value accounting.

Financial Instruments - Recognition & Measurement

	GAAP	IFRS
Impairment recognition – AFS debt instruments	<p>Declines in fair value below cost may result in an impairment loss being recognized on an AFS debt due solely to a change in interest rates (risk-free or otherwise) if the entity intends to sell it or it is more likely than not that a sale will be required before its anticipated recovery. The loss is the difference between the amortized cost and fair value.</p> <p>When a credit loss exists, but the entity does not intend to sell the debt, nor is it more likely than not that a sale will be required before the recovery of the remaining cost basis, the impairment is separated into (i) the credit loss and (ii) the amount related to all other factors. The credit loss is recognized in Profit & Loss and the balance in Other Comprehensive Income, net of applicable taxes.</p>	<p>Generally, only evidence of credit default results in an impairment loss. This is the difference between amortized cost and fair value.</p> <p>Such impairments may be reversed if the fair value subsequent increases and the gain can be objectively related to an event occurring after the impairment was recognized.</p>

Financial Instruments - Recognition & Measurement

	GAAP	IFRS
Impairment recognition - AFS debt instruments	When an impairment loss is recognized in P&L, a new cost basis is established equal to the previous cost amount less the recognized impairment. Such losses cannot be reversed for future recoveries.	
Impairment recognition - AFS equity instruments	For an AFS equity instrument, an impairment is recognized if it's fair value is not expected to recover sufficiently in the near-term to allow a full recovery of the cost basis. An entity must have the intent and ability to hold an impaired equity instrument until such near-term recovery; otherwise an impairment loss must be recognized. This is the difference between the cost basis and fair value.	For an AFS equity instrument, an loss is recognized when there is objective evidence that it is impaired and its cost may not be recovered. The loss is the difference between the cost basis and its fair value. A significant or prolonged decline in the fair value of an equity instrument below cost is considered evidence of impairment.

Financial Instruments - Recognition & Measurement

	GAAP	IFRS
Impairment recognition — Held-to-Maturity (HTM) debt instruments	<p>The impairment loss of an HTM debt is measured as the difference between its fair value and amortized cost basis. Because an entity has asserted its intent and ability to hold an HTM instrument to maturity (that is, the entity does not intend to sell the debt and it is not more likely than not a sale will be required before recovery of its amortized cost basis), the impairment related to the credit loss is recognized in P&L and the amount related to all other factors in Other Comprehensive Income. The carrying amount of an HTM debt after the recognition of an impairment is the fair value at the date of the impairment. The new cost basis is equal to the previous cost basis less the impairment recognized in P&L. The impairment recognized in Other Comprehensive Income is accreted to the carrying amount of the HTM debt.</p>	<p>The impairment loss of an HTM debt is the difference between the carrying amount and the present value of estimated future cash flows discounted at the original effective interest rate. The carrying amount is reduced either directly or through an allowance account. The impairment loss is recognized in P&L.</p>

Financial Instruments - Hedging

	GAAP	IFRS
Hedge effectiveness shortcut method for interest rate swaps	Permitted	Not permitted
Hedging a component of a risk in a financial instrument	The risk components that may be hedged are specifically defined by, with no additional flexibility.	Allows entities to hedge components (portions) of risk that give rise to changes in fair value.
Hedge effectiveness inclusion of option's time value	Permitted	Not permitted.

Financial Instruments – Derecognition

	GAAP	IFRS
Derecognition of financial assets	<p>Derecognition of financial assets occurs when effective control has been surrendered. This is only when:</p> <ul style="list-style-type: none"> (i) The transferred financial assets are legally isolated from the transferor. (ii) Each transferee (or, if the transferee is a securitization entity, each holder of its beneficial interests), has the right to pledge or exchange the transferred financial assets (or beneficial interests) (iii) The transferor does not maintain effective control over the transferred financial assets or beneficial interests (e.g., through a call option or repurchase agreement). The derecognition criteria may be applied to a portion of a financial asset only if it mirrors the characteristics of the original entire financial asset. 	<p>Derecognition of financial assets is based on a mixed model that considers both transfer of risks & rewards and control. Transfer of control is considered only when the transfer of risks & rewards assessment is not conclusive. Control is considered to be surrendered if the transferee has the practical ability to unilaterally sell the asset to a third party, without restrictions. There is no legal isolation test. The derecognition provisions may be applied to a portion of financial asset if the cash flows are specifically identified or represent a pro rata share of the financial asset.</p>

Financial Instruments – Loans & Receivables

	GAAP	IFRS
Measurement — effective interest method	Requires catch-up retrospective or prospective method of calculating the interest for amortized cost-based assets, depending on the type of instrument.	Requires the original effective interest rate to be used throughout the life of all financial assets and liabilities, except for certain reclassified items. In those cases the effect of increases in cash flows are recognized as prospective adjustments to the effective interest rate.
Measurement — loans and receivables	Unless the fair value option is elected, loans and receivables are classified as either (1) HTM at amortized cost, or (2) AFS at the lower of cost or fair value.	Loans and receivables are carried at amortized cost unless classified as “fair value through profit or loss” or AFS. Both are carried at fair value.

Financial Instruments – Fair Value

	GAAP	IFRS
Measurement	<p>One measurement model whenever fair value is used (with limited exceptions). This is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is an exit price, which may differ from the transaction (entry) price.</p>	<p>Various IFRS use slightly varying definitions. Under IAS 39, fair value is “the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction”. At inception, transaction (entry) price generally is considered fair value.</p>
Day one gains and losses	<p>Entities are not precluded from recognizing day one gains and losses on financial instruments reported at fair value even when all inputs to the measurement are not observable. For example, a day one gain or loss may occur when the transaction occurs in a market that differs from the entity’s exit market.</p>	<p>Day one gains and losses are recognized only when all inputs to the measurement are observable</p>

Financial Instruments – Fair Value

	GAAP	IFRS
Bid-ask spread	The price within the bid-ask spread that is the most representative amount in the circumstances. Mid- market pricing as a practical expedient is allowed.	The fair value of assets held (or liabilities to be issued) is generally determined using the bid price, while liabilities held (or assets to be acquired) are measured using the ask. When an entity has assets and liabilities with offsetting market risks, it may use mid-market prices for the offsets and the bid or ask price (as appropriate) for the net open position.

Financial Instruments – Significant Differences

- Other variations
 - application of fair value measurement principles, including:
 - prices in ‘principal’ versus ‘most advantageous’ markets
 - fair values of alternative investments
 - Using net assets as a practical expedient
 - definitions of derivatives and embedded derivatives

Financial Instruments – Significant Differences

- Other variations (continued)
 - cash flow hedges - basis adjustment and effectiveness testing
 - normal purchase and sale exception
 - foreign exchange gains or losses on AFS investments
 - recognition of basis adjustments when hedging
 - macro hedging

Financial Instruments – Significant Differences

- Other variations (continued)
 - hedging net investments
 - cash flow hedges of intercompany transactions
 - hedging with internal derivatives
 - impairment criteria for equity investments
 - puttable minority interests
 - netting and offsetting arrangements
 - unit of account for derecognition
 - servicing assets and liabilities

Financial Instruments - Convergence

- The Boards are engaged in projects to simplify and improve the accounting for financial instruments

Debt vs. Equity

- They continue to discuss and develop principles to classify financial instruments as liabilities or equity
- An Exposure Draft is expected during 2010 covering financial instruments with characteristics of equity

Financial Instruments - Convergence

Recognition and Measurement

- A current joint project on financial instruments addresses classification, measurement, impairment, and hedge accounting
- IFRS 9, effective 2013, gives some guidance
- There is also an IASB Exposure Draft “*Financial Instruments: Amortized Cost and Impairment*”
- An IASB Exposure Draft on hedge accounting is planned for 2010

Financial Instruments - Convergence

Recognition and Measurement (continued)

- A FASB Exposure Draft is also expected in 2010
- Separate deliberations have resulted in different conclusions on similar issues
- There is a stated commitment to achieve a converged solution providing comparability, transparency and reduced complexity for financial instruments accounting

Financial Instruments - Convergence

Derecognition

- The Boards have agreed to assess, in the first half of 2010, the differences between IFRS and GAAP and will then consider together the appropriate model

Fair Value

- ASC 820 has established a common US framework for measuring fair value for all financial instruments
- Does not address when fair value accounting should be used

Financial Instruments - Convergence

Fair Value (continued)

- In May 2009 IASB published an Exposure Draft with proposed guidance regarding how fair value should be measured when required
- This proposed guidance is largely consistent with ASC 820 and would eliminate many of the differences between GAAP and IFRS

Financial Instruments - Convergence

Fair Value (continued)

- Certain proposals differ as IASB believes some changes to ASC 820 are warranted
- The Boards are currently jointly deliberating their respective fair value measurement
- Expect a new standard in 2010

Impairment

- Goodwill and intangible assets with indefinite lives are tested for impairment at least annually and more frequently if any indicator of impairment is present
- Long-lived assets are tested only when there is a specific indicator
- Both sets of indicators are similar
- An asset found to be impaired is written down and an impairment loss recognized

Impairment

- *ASC 350 Intangibles — Goodwill and Other and the Impairment or Disposal of Long-Lived Assets* subsections of *ASC 360-10 Property, Plant and Equipment*, as well as *IAS 16 Property, Plant and Equipment* apply to most long-lived and intangible assets
- Similarity in overall objectives
- Some scope exceptions vary
- Significant differences in how impairment is reviewed, recognized and especially measured

Impairment – Significant Differences

	GAAP	IFRS
Method of determining impairment — long-lived assets	Two-step method with recoverability test performed first (carrying amount of the asset is compared to the sum of future undiscounted cash flows generated through use and eventual disposition). If the carrying amount is not recoverable, impairment testing is performed.	One-step method to be performed if indicators exist.

Impairment – Significant Differences

	GAAP	IFRS
Impairment loss calculation — long-lived assets	The amount by which the carrying amount of the asset exceeds its fair value, as calculated in accordance with ASC 820.	The excess of the carrying amount of the asset over its recoverable amount. This is the higher of (1) fair value less costs to sell, and (2) value in use (the present value of future cash flows including disposal value). The definition of fair value is different from that in ASC 820.
Allocation of goodwill	Goodwill is allocated to a reporting unit, which is an operating segment or one level below an operating segment (component).	Goodwill is allocated to a cash-generating unit (CGU) or group of CGUs which represents the lowest level within the entity at which the goodwill is monitored by management; it cannot be larger than an operating segment as defined in IFRS 8 <i>Operating Segments</i> .

Impairment - Convergence

- In 2008 the Boards deferred further work on impairment until other convergence projects are completed

Intangibles

- The definition of intangible assets as “non- monetary assets without physical substance” is the same under both ASC 805 *Business Combinations*, ASC 350 *Intangibles — Goodwill and Other*, IFRS 3(R) and IAS 38 *Intangible Assets*
- Their recognition criteria require that there be probable future economic benefits and costs that can be reliably measured
- Some, such as start-up costs, are never capitalized

Intangibles

- Goodwill is recognized only in a Business Combination in accordance with ASC 805 and IFRS 3(R)
- For an asset purchase, the intangible asset “assembled workforce”, may be recognized but it is specifically prohibited by ASC 805
- With the exception of development costs, internally created intangibles are never recognized as assets
- Costs related to the research phase of R&D are expensed as incurred

Intangibles

- Intangible assets must be amortized over their estimated useful lives
- *ASC 985-20 Costs of Computer Software to be Sold, Leased or Marketed* is a minor exception
- If there is no foreseeable limit to the period over which an intangible asset is expected to generate net cash inflows, the useful life is considered to be indefinite and the asset is not amortized
- Goodwill is never amortized

Intangibles – Significant Differences

	GAAP	IFRS
Development costs	<p>Development costs are expensed as incurred unless addressed by a separate standard. Those related to computer software for external use are capitalized once technological feasibility is established in accordance with specific criteria (ASC 985-20).</p> <p>With software for internal use, only costs during the application development stage (ASC 350-40 <i>Internal Use Software</i> may be capitalized.</p>	<p>Development costs are capitalized when technical and economic feasibility is shown in accordance with specific criteria, including: demonstrating technical feasibility, intent to complete and ability to sell the asset in the future. Although application is largely consistent with ASC 985-20 and ASC 350-40, there is no separate guidance on computer software development.</p>

Intangibles – Significant Differences

	GAAP	IFRS
Advertising costs	Advertising and promotional costs are either expensed as incurred or when the advertising takes place for the first time (policy choice). Direct response advertising may be capitalized under the specific criteria of ASC 340-20 <i>Capitalized Advertising Costs</i> .	Advertising and promotional costs are expensed as incurred. A prepayment may be recognized as an asset only when payment for the goods or services is made in advance of the entity' having access to the goods or receiving the services.
Revaluation	Not permitted	Revaluation to fair value of intangible assets other than goodwill is a permitted accounting policy election for a class of such items. Because revaluation requires reference to an active market for the specific type of intangible, this is relatively uncommon.

Intangibles - Convergence

- In 2007, both boards agreed not to deal with the convergence of standards for intangible assets.
- In 2008 FASB indicated that it will consider in the future whether to eliminate differences in the accounting for R&D costs by fully adopting IAS 38

Inventory

- *ASC 330 Inventory* and *IAS 2 Inventories* are based on the principle that the primary basis of accounting for inventory is cost
- Both standards include all assets:
 - held for sale in the ordinary course of business
 - in the process of production for such sale
 - to be consumed in the production of goods or services

Inventory

- The permitted measurement techniques, such as standard cost or the retail method, are similar
- Under both, cost includes all direct expenditures to ready inventory for sale, including allocable overhead
- Selling expenses are excluded, as are most storage and general administrative items

Inventory – Significant Differences

	GAAP	IFRS
Costing methods	LIFO is an acceptable method. Consistent cost formula for all inventories similar in nature are not explicitly required.	LIFO is prohibited. Same cost formula must be applied to all inventories similar in nature or use to the entity.
Measurement	Inventory is carried at the lower of cost or market. Market is defined as current replacement cost as long as it is not greater than net realizable value (estimated selling price less reasonable costs of completion and sale) are less than net realizable value reduced by a normal selling margin.	Inventory is carried at the lower of cost or net realizable value (best estimate of the net amounts inventories are expected to realize). This amount may or may not equal fair value.

Inventory

	GAAP	IFRS
Reversal of inventory write-downs	Any write-downs of inventory to the lower of cost or market create a new cost basis that subsequently cannot be reversed.	Previously recognized reductions are reversed, up to the amount of the original impairment when the reasons for it no longer exist.
Permanent inventory markdowns under the retail inventory method (RIM)	Permanent markdowns do not affect the gross margins used in applying the RIM. Rather, such markdowns reduce the carrying cost of inventory to net realizable value, less an allowance for an approximately normal profit margin, which may be less than both original cost and net realizable value.	Permanent markdowns affect the average gross margin used in applying RIM. Reduction of the carrying cost of inventory to below the lower of cost or net realizable value is not allowed.

Inventory - Convergence

- No further work is planned

Leases

- Treatments under ASC 840 *Accounting for Leases* and IAS 17 *Leases* are similar
- GAAP has more specific application guidance
- Both classify leases as either capital (IAS 17 “finance”) or operating
- Both separately discuss lessee and lessor accounting

Lease

Lessees

- Both require the party that bears substantially all the risks & rewards of ownership to recognize a lease asset and corresponding obligation, applying specific criteria (ASC 840) or indicators (IAS 17)
- Those are similar including
 - The transfer of ownership at the end of the term
 - A purchase option that, at inception, is reasonably expected to be exercised

Leases

Lessees

- ASC 840 requires capital lease treatment if
 - the term is equal to or greater than 75% of the asset's economic life (IAS 17 "major part")
 - the present value of the minimum lease payments exceeds 90% of the asset's fair value (IAS 17 "substantially all")

Leases

Lessee

- GAAP specifies bright lines while IAS 17's general principles are interpreted similarly
- Lease classification is still not the same under ASC 840 and IAS 17
- Under both a capital lease is recognized as an asset and a liability at the lower of
 - the present value of the minimum lease payments
 - fair value of the asset

Leases

Lessee

- An operating lease is recorded by recognizing expense on a straight-line basis over the lease term
- Incentives are amortized on a straight line basis

Leases – Significant Differences

	GAAP	IFRS
Lease of land and building	<p>A lease for land and buildings that transfers ownership to the lessee or contains a bargain purchase option is a capital lease, regardless of the relative value of the land.</p> <p>If the fair value of the land at inception represents 25% or more of the total fair value, the lessee must consider the land and building separately for other criteria. Only the building is subject to the 75% and 90% tests.</p>	<p>The land and building elements of the lease are considered separately when evaluating all indicators unless the amount for the land element is immaterial, in which case they are treated as a unit.</p>

Leases – Significant Differences

	GAAP	IFRS
Recognition of a gain or loss on a sale and leaseback when the leaseback is an operating leaseback	<p>If the seller does not relinquish more than a minor part of the right to use the asset, gain or loss is generally deferred and amortized over the lease term.</p> <p>If the seller relinquishes more, then part or all of the gain may be recognized depending on the amount relinquished.</p> <p>Does not apply if real estate is involved as the specialized rules are very restrictive with respect to the seller’s continuing involvement and may not allow recognition of the sale.</p>	<p>Gain or loss is recognized immediately, subject to adjustment if the sale price differs from fair value.</p>

Leases – Significant Differences

	GAAP	IFRS
Recognition of gain or loss on a sale leaseback when the leaseback is a capital leaseback	Generally, same as above for operating leaseback where the seller does not relinquish more than a minor part of the right to use the asset.	Gain or loss deferred and amortized over the lease term.

Leases – Significant Differences

- Other variations
 - Leveraged leases ASC 840 (not in IAS 17)
 - Real estate sale-leasebacks
 - Real estate sales-type leases
 - Leases of land
 - Rate to discount minimum lease payments

Leases - Convergence

- A long-term convergence project is underway to ensure that all assets and liabilities arising from leases are recognized on Balance Sheets
- An exposure draft is expected in 2010

Long-lived Assets

- GAAP does not have a comprehensive standard for long-lived assets
- Its definition of property, plant and equipment is similar to that of IAS 16 *Property, Plant and Equipment*, which deals with tangible assets held for use that are expected to be employed for more than one reporting period

Long-lived Assets

- Similar concepts
 - Recognition criteria requiring that expenditures be included in the cost of an asset if future economic benefits are probable and can be reliably measured
 - Costs to be capitalized not expensed
- Neither allows capitalization of
 - start-up costs
 - general, administrative & overhead expenses
 - regular maintenance

Long-lived Assets

- Both require the costs of dismantling an asset and restoring its site (asset retirement) be included under ASC 410-20 *Asset Retirement Obligations* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
- Applicable under GAAP when there is a legal obligation
- IFRS requires it also in other circumstances

Long-lived Assets

- *ASC 835-20 Capitalization of Interest* and *IAS 23 Borrowing Costs* deals with the capitalization of borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset
- Those assets are defined similarly and both require capitalization of the applicable interest
- There are differences in its measurement

Long-lived Assets

- Depreciation of long-lived assets is required on a systematic basis
- *ASC 250 Accounting Changes and Error Corrections* and *IAS 8 Accounting Policies, Changes in Accounting Estimates and Error Corrections* both treat modifications to the depreciation method, residual value or useful economic life as a change in accounting estimate requiring prospective treatment

Long-lived Assets

- Assets held for sale are discussed in the *Impairment or Disposal of Long-Lived Assets* subsections of ASC 360-10 *Property, Plant and Equipment* and IFRS 5 *Non- Current Assets Held for Sale and Discontinued Operations*
- Both have similar criteria
 - Measured at the lower of its carrying amount or fair value less costs to sell
 - Not depreciated
 - Presented separately on the Balance Sheet

Long-lived Assets

- Nonmonetary exchanges of comparable productive assets are treated similarly under ASC 845 *Nonmonetary Transactions* and IAS 16
- Both allow gain/loss recognition if the exchange has commercial substance and its fair value can be reliably measured

Long-lived Assets – Significant Differences

	GAAP	IFRS
Revaluation of assets	Not permitted	Revaluation is a permitted accounting policy election for an entire class of assets, requiring revaluation to fair value on a regular basis (after 3 years).
Depreciation of asset components	Permitted but not common.	Component depreciation required if components of an asset have differing patterns of benefit.

Long-lived Assets – Significant Differences

	GAAP	IFRS
Borrowing costs	<p>Eligible borrowing costs do not include exchange rate differences. Interest earned on the investment of borrowed funds generally cannot offset interest costs incurred during the period.</p> <p>For borrowings associated with a specific qualifying asset, borrowing costs equal to the weighted average accumulated expenditures times the borrowing rate are capitalized.</p>	<p>Eligible borrowing costs include exchange rate differences from foreign currency borrowings. Borrowing costs are offset by investment income earned on those borrowings.</p> <p>For borrowings associated with a specific qualifying asset, actual borrowing costs are capitalized.</p>

Long-lived Assets – Significant Differences

	GAAP	IFRS
Major overhauls	Multiple accounting models have evolved in practice, including expensed as incurred capitalize costs and amortize through the date of the next overhaul or follow IFRS.	Costs that represent a replacement of a previously identified component of an asset are capitalized if future economic benefits are probable and the costs can be reliably measured. Amortize it over the balance of its economic useful life.
Investment property	Investment property is not separately defined and, therefore, is accounted for as held for use or held for sale.	Investment property is separately defined in IAS 40 <i>Investment Property</i> as an asset held to earn rent or for capital appreciation (or both) and may include property held by lessees under a finance/operating lease. It may be accounted for on a historical cost basis or on at fair value as an accounting policy election. A capitalized operating lease classified as investment property must be accounted for at fair value.

Long-lived Assets – Significant Differences

- Other variations
 - hedging gains and losses related to the purchase of assets
 - constructive obligations to retire assets
 - the discount rate used to calculate asset retirement costs
 - accounting for changes in residual values

Long-lived Assets - Convergence

- No further work is planned

Share-based Payments

- *ASC 718 Compensation - Stock Compensation* and *IFRS 2 Share-Based Payment* are largely converged
- Both GAAP and IFRS require fair value accounting when an entity
 - acquires goods or services in exchange for issuing share options or other equity instruments (“Shares”)
 - incurs liabilities that are based, at least in part, on the price of its Shares or that may require settlement in them

Share-based Payments

- This applies to every transaction and all entities
- ASC 718 and IFRS 2 define the fair value of the transaction as the amount at which the asset or liability could be bought or sold in a current transaction between willing parties
- They require the fair value of the Shares be measured based on a market price (if available) or estimated using an option-pricing model

Share-based Payments

- In rare cases when fair value cannot be determined, both allow the use of intrinsic value, which is re-measured until settlement
- The treatments of modifications and settlements of share-based payments are mainly similar
- Both require comparable disclosures of sufficient information to understand the types and extent of the entity's share-based payments

Share-based Payments - Significant Differences

	GAAP	IFRS
Transactions with non-employees	<p>If using the fair value of the equity instruments, ASC 505-50 <i>Equity-Based Payments to Non-Employees</i> requires measurement at the earlier of (1) the date at which a “commitment for performance” by the counterparty is reached, or (2) the date at which the counterparty’s performance is complete.</p>	<p>IFRS has a more general definition of an employee that includes individuals who provide services similar to those rendered by employees.</p> <p>Fair value of the transaction should be based on the fair value of the goods or services received, and only on the fair value of the equity instruments if, in the rare circumstance, the fair value of the goods and services cannot be reliably estimated.</p> <p>Measurement date is the date the entity obtains the goods or the counterparty renders the services. No performance commitment concept exists.</p>

Share-based Payments - Significant Differences

	GAAP	IFRS
Measurement and recognition of expense — awards with graded vesting	Entities make an accounting policy election to recognize compensation cost for awards containing only service conditions either (i) on a straight-line basis or (ii) on an accelerated basis, regardless of whether the fair value is measured based on the award as a whole or for each individual tranche.	Must recognize compensation cost on an accelerated basis — each tranche is separately measured.
Equity repurchase at employee's election	Does not require liability classification if employee bears risks and rewards of ownership for at least six months from the date the Shares are issued or vest.	Liability classification is required (no six-month consideration).

Share-based Payments - Significant Differences

	GAAP	IFRS
Deferred taxes	<p>Calculated based on the cumulative GAAP expense recognized and trued up or down upon realization of the tax benefit.</p> <p>If the tax benefit exceeds the deferred tax asset, the excess (“windfall benefit”) is credited directly to shareholder equity. A shortfall of the tax benefit below the deferred tax asset is charged to equity to the extent of prior windfall benefits, and to tax expense otherwise.</p>	<p>Calculated based on the estimated tax deduction determined at each reporting date (for example, intrinsic value).</p> <p>If the tax deduction exceeds cumulative compensation cost, deferred tax based on the excess is credited to shareholder’s equity. If the tax deduction is less than or equal to cumulative compensation cost, deferred taxes are recorded in income.</p>

Share-based Payments - Significant Differences

	GAAP	IFRS
Modification of vesting terms that are improbable of achievement	If an award is modified such that the service or performance condition, which was previously improbable of achievement, is now probable, the compensation cost is based on the fair value of the modified award at the relevant date. Grant date fair value of the original award is not recognized.	Probability of achieving vesting terms before and after modification is not considered. Compensation cost is the grant-date fair value of the award, together with any incremental fair value on the modification.

Share-based Payments - Convergence

- No further work is planned

Questions ?

More information can be found in my
“Guide to Fair Value under IFRS”
available with a 20% discount
to conference attendees using code CAT10