PRICEWATERHOUSECOOPERS

International Accounting Standards

Similarities and Differences

IAS, US GAAP and UK GAAP

February 2000

PricewaterhouseCoopers (www.pwcglobal.com), is the world's largest professional services organisation. Drawing on the knowledge and skills of 150,000 people in 150 countries, we help our clients solve complex business problems and measurably enhance their ability to build value, manage risk and improve performance. PricewaterhouseCoopers refers to the member firms of the worldwide PricewaterhouseCoopers organisation.

Introduction

This publication by PricewaterhouseCoopers is for those who wish to gain a broad understanding of the key similarities and differences between three accounting frameworks: International Accounting Standards (IAS), US Generally Accepted Accounting Principles (US GAAP) and UK Generally Accepted Accounting Practice (UK GAAP). The first section provides a summary of the similarities and differences and then refers to individual sections where key divergences are highlighted and the likely impact of recent proposals explained.

No summary publication can, of course, do justice to the many differences of detail which exist between International Accounting Standards and those in the USA and UK. We have, in particular, focused on the differences most commonly found in practice; detailed rules may apply very differently in the case of specific transactions. 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, such as the US Securities and Exchange Commission requirements or the London Stock Exchange Listing rules.

International harmonisation of accounting is a much-debated issue. This publication demonstrates that although progress is being made towards comparability between the underlying principles of IAS, US GAAP and UK GAAP, important differences remain to be addressed. The International Accounting Standards Committee (IASC), the US Financial Accounting Standards Board (FASB) and the UK Accounting Standards Board (ASB) have current projects to focus on most of these differences.

The structure of this publication is as follows:

	Page
Summary of similarities and differences	2
Financial statements - general requirements	11
Group reporting	12
Foreign currency translation	13
Business combinations	14
Main accounting principles	18
Other accounting and reporting issues	37
Index	44
Glossary	45

Summary of similarities and differences

SUBJECT	IAS	US GAAP	UK GAAP	PAGE
Financial statements - general requirements				
Contents of financial statements	Two years' balance sheets, income, recognised gains and losses and cash flow statements, changes in equity, accounting policies and notes.	Comparable to IAS, except three years required by SEC for all statements except balance sheet.	Comparable to IAS.	11
True and fair view override	In very rare cases, override standards where essential to give "true and fair view".	No override of standards permitted.	Comparable to IAS.	11
Accounting convention	Historical cost, but increasingly assets may be revalued.	No revaluations except some securities and derivatives at fair value.	Comparable to IAS.	11
Changes in accounting policies	Either restate comparatives and prior year opening retained earnings or include effect in current year income.	Generally include effect in current year income statement.	Restate comparatives and prior year opening retained earnings.	11
Correction of fundamental errors	Either restate comparatives or include effect in current year income.	Restate comparatives.	Comparable to US GAAP.	11
Changes in accounting estimates	Account for in income in the current and future periods, as appropriate.	Comparable to IAS.	Comparable to IAS.	11
Group reporting				
Definition of subsidiary	Based on voting control.	Controlling interest through majority of voting shares or by contract. Recent proposals comparable to IAS.	Comparable to IAS.	12
Exclusion of subsidiaries from consolidation	Only if severe long-term restrictions or acquired and held for re-sale in the near future. Dissimilar activities are not a justification.	Comparable to IAS.	Comparable to IAS.	12
Definition of associate	Based on significant influence: presumed if 20% interest or participation in entity's affairs.	Broadly comparable to IAS.	Requires evidence of exercise of significant influence.	12
Presentation of associate results	Use equity method. Show share of profits and losses.	Use equity method. Show share of post-tax result.	Use expanded equity method. Share of operating profit, exceptional items and tax shown separately.	12
Disclosures about significant associates	Minimal.	Give detailed information on significant associates' assets, liabilities and results.	Comparable to US GAAP.	12
Equity method or proportional consolidation for joint ventures	Both proportional consolidation and equity method permitted. Consolidate own assets/ liabilities in limited circumstances such as oil and gas joint operations.	Predominantly use equity method. Use proportional consolidation in limited circumstances, such as oil and gas ventures.	Generally use gross equity method. Consolidate own assets/ liabilities in limited circumstances such as oil and gas joint arrangements.	12

SUBJECT	IAS	US GAAP	UK GAAP	PAGE
Foreign currency translation				
Individual company	Translate at rate on date of transaction; monetary assets/ liabilities at balance sheet rate; non-monetary items at historical rate.	Comparable to IAS.	Comparable to IAS.	13
Foreign entities within consolidated financial statements	Use closing rate for balance sheets; average rate for income statements. Take exchange differences to equity and include in gain on disposal of subsidiary.	Comparable to IAS.	Use closing rate for balance sheets; either average or closing rate for income statements. Take exchange differences to statement of recognised gains/losses (STRGL). Not included in gains on disposal.	13
Hyperinflation – foreign entity	Adjust local statements of foreign entity to current price levels prior to translation.	Remeasure local currency statements using the reporting currency as the functional currency.	Either adopt IAS or US GAAP method.	13
Business combinations				
Purchase method – fair values on acquisition	Fair value assets and liabilities of acquired entity.	Broadly comparable to IAS. but specific rules for acquired in-process research and development.	Comparable to IAS.	14
	Some plant closure and restructuring liabilities relating to the acquired entity may be provided in fair value exercise if specific criteria met.	Broadly comparable to IAS.	Few acquisitions provisions allowed.	
Purchase method – subsequent adjustments to fair values	Fair values can be corrected against goodwill up to the end of the year after acquisition if additional evidence of values becomes available. Record subsequent adjustments in income statement.	In practice, broadly comparable to IAS.	Broadly comparable to IAS, except investigation of values must have been ongoing.	14
	Reversals of acquisition provisions always adjust goodwill.	Comparable to IAS.	Few acquisition provisions allowed.	
Purchase method – contingent consideration	Estimated at acquisition then subsequently corrected against goodwill.	Not recognised until the contingency is resolved or the amount is determinable.	Comparable to IAS.	15
Purchase method – minority interests at acquisition	State at share of fair value of net assets or at share of pre-acquisition carrying value of net assets.	Usually state at share of pre-acquisition carrying value of net assets.	State at share of fair value of net assets.	15
Purchase method – disclosure	Disclosures include names and descriptions of combining entities, method of accounting for acquisition, date of acquisition and impact on results and financial position of acquirer.	Broadly comparable to IAS, but must also present pro-forma income statement information as if acquisition occurred at start of comparative period.	Broadly comparable to IAS, but must also present table showing book values, fair value adjustments and fair values of acquired assets and liabilities.	15
Purchase method – goodwill	Capitalise and amortise over useful life, normally not longer than 20 years.	Capitalise and amortise over useful life, with maximum of 40 years. Recent proposals include 20 year maximum.	Comparable to IAS, although indefinite life may be used in certain circumstances.	16

SUBJECT	IAS	US GAAP	UK GAAP	PAGE
Business combinations – continued				
Purchase method – negative goodwill	If relates to expected future losses/costs recognise in income when these occur. Otherwise record as negative asset and recognise over useful lives of identifiable, non-monetary assets. Any excess over the fair values of such assets is recognised in income immediately.	Reduce proportionately the fair values assigned to non-current assets (except marketable securities). Record any excess as deferred income and recognise in income over no longer than 40 years. Recent proposals similar, but any excess is recognised in income immediately.	Record as negative asset and recognise in income to match depreciation of non-monetary assets; any excess over the fair values of such assets is recognised in income over period likely to benefit.	16
Pooling of interests method	Severely restricted to "true mergers of equals". Rules focus on lack of identification of an acquirer.	Rules focus predominantly on attributes of combining entities and manner of transaction. US poolings more common in practice than under IAS or UK GAAP. Recent proposals to prohibit this method.	Restrictions similar to IAS. Criteria include size of entities and low-level limits on non-share consideration.	17
Main accounting principles				
Intangible assets	Capitalise if recognition criteria met; intangible assets must be amortised over useful life, normally no longer than 20 years. Revaluations are permitted in rare circumstances.	Capitalise purchased intangible assets and amortise over useful life, no longer than 40 years. Revaluations are not permitted. Recent proposals for useful lives similar to UK GAAP.	Broadly comparable to IAS, although may use indefinite life in certain circumstances.	18
Research and development costs	Expense research costs as incurred. Capitalise and amortise development costs only if stringent criteria are met.	Expense both research and development costs as incurred. Some software development costs must be capitalised.	Comparable to IAS, except optional to capitalise and amortise development costs if criteria met.	19
Property, plant and equipment	Use historical cost or revalued amounts. Frequent valuations of entire classes of assets necessary when revalued amounts used.	Revaluations not permitted.	Comparable to IAS.	20
Investment properties	Either treat as investment or property, plant and equipment. Recent proposal to measure at historical cost or fair value and recognise changes in fair value in income statement.	Treat as for other properties (use historical cost).	Carry at open market value without depreciation.	21
Impairment of assets	If impairment indicated, write down assets to higher of net selling price 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.	Impairment trigger based on undiscounted cash flows. If less than carrying amount, measure impairment loss using market value or discounted cash flows. If no loss arises, reconsider useful lives of those assets. Reversals of losses prohibited.	Comparable to IAS.	21

SUBJECT	IAS	US GAAP	UK GAAP	PAGE
Main accounting principles – continued				
Capitalisation of borrowing costs	Permitted for qualifying assets.	Compulsory when relates to construction of certain assets.	Comparable to IAS.	21
Leases – classification	Finance lease if substantially all risks and rewards of ownership transferred. Substance rather than form is important.	Similar to IAS, but considerably more extensive form-driven requirements.	Comparable to IAS.	22
Leases – lessee accounting	Record finance leases as asset and obligation for future rentals. Normally depreciate over useful life of asset. Apportion rental payments to give constant interest rate on outstanding obligation. Generally charge operating lease rentals on straight-line basis.	Comparable to IAS.	Comparable to IAS.	22
Leases – lessor accounting	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.	Comparable to IAS but specific rules for leveraged leases.	Presentation comparable to IAS, but measurement basis differs: use (post-tax) net cash investment method for allocating gross earnings.	23
Leases – sale and leaseback transactions	Defer and amortise profit arising on sale and finance leaseback. If an operating lease arises then profit recognition depends on sale proceeds compared to fair value of the asset.	Defer and amortise profits up to certain limits. Immediately recognise losses. Consider specific strict criteria if a real estate transaction.	Broadly comparable to IAS.	23
Investments	Depends on classification of investment – if held to maturity then carry at amortised cost, otherwise at fair value. Unrealised gains/losses on trading securities go to income statement and on available-for-sale investments can go either to equity or income.	Comparable to IAS, except unrealised gains/losses on available-for-sale securities go to other comprehensive income.	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.	24
Inventories and long-term contracts	Carry at lower of cost and NRV. Use FIFO, LIFO or weighted average method to determine cost. Recognise long-term contract revenues and profits using percentage of completion method.	Broadly comparable to IAS – more common use of LIFO. Use completed contract method for long-term contract accounting in limited circumstances.	Comparable to IAS, except that LIFO method not permitted.	25
Revenue recognition	Recognise revenue if meets specific criteria.	Broadly comparable to IAS. Numerous accounting standards for specific industries and situations.	No detailed standard on revenue recognition but practice similar to IAS.	25

SUBJECT	IAS	US GAAP	UK GAAP	PAGE
Main accounting principles – continued				
Derecognition of financial assets	Recognise and derecognise assets based on control.	Comparable to IAS. Legal isolation of assets even in bankruptcy necessary for derecognition.	Recognise and derecognise assets based on risks and rewards, focusing in part on substance rather than just legal form.	26
Derecognition of financial liabilities	Derecognise liabilities when extinguished.	Comparable to IAS.	Comparable to IAS.	26
Provisions – general	Record provisions relating to present obligations from past events if probable outflow of resources can be reliably estimated.	Comparable to IAS, with rules for specific situations (employee termination costs, environmental liabilities, loss contingencies etc).	Comparable to IAS.	27
Provisions – restructuring	Make restructuring provisions if detailed formal plan announced or implementation effectively begun.	Comparable to IAS.	Comparable to IAS.	27
Contingencies	Disclose unrecognised possible losses and probable gains.	Comparable to IAS.	Comparable to IAS.	27
Employee benefits – pension costs – defined benefit plans	Must use projected unit credit method to determine benefit obligation. Use current market high-quality bond rate to discount benefit obligation. Value assets at fair value or using discounted cash flows if market prices unavailable. Actuarial gains/losses outside a 10% "corridor" are amortised over the average remaining service lives of participating employees. Faster recognition permitted using any systematic method (including immediate recognition) if consistently applied. Extensive disclosures.	Broadly comparable to IAS, although several minor differences.	Wider choice of actuarial methods than IAS, but recent proposals comparable to IAS. Discount benefit obligation at long-term risk-adjusted rate. Recent exposure draft proposals comparable to IAS. Value assets on actuarial basis. Recent exposure draft comparable to IAS. Recognise actuarial gains and losses over average remaining service lives of current employees – no corridor approach. Recent exposure draft proposes detailed rules on the recognition of all actuarial gains and losses immediately in the STRGL. Fewer disclosures than IAS, although exposure draft proposes more extensive disclosure.	28

SUBJECT	IAS	US GAAP	UK GAAP	PAGE
Main accounting principles – continued				
Employee benefits – other	Account for post-retirement benefits as pensions. Rules also given for termination benefits arising from redundancies and other post-employment and long-term employee benefits. Account for termination indemnity plans as pensions.	Comparable to IAS for post-retirement benefits. Accrue for post-employment costs if criteria met. Choice of measurement methods for termination indemnity plans.	Comparable to IAS for post-retirement benefits. Other benefits not covered by standards, but practice generally comparable to IAS. Recent exposure draft covers other employee benefits.	29
Employee stock compensation	Disclosures required but no standard or proposals on measurement.	Two alternative methods available for cost: intrinsic value (market price at measurement date less any employee contribution or exercise price) or fair value using option pricing model. Charge cost of share awards or options over period of employee's performance.	Cost is based on intrinsic value (market value at date of grant less any employee contribution or exercise price). Charge cost of share awards or options immediately unless there are future performance conditions.	30
Employee share option plans – presentation in balance sheet of sponsor	No standard and no proposals.	Classify ESOP shares as deduction from equity. Include debt of ESOP on balance sheet.	Classify ESOP shares as assets ("own shares"). Include debt of ESOP on balance sheet.	31
Government grants	Recognise as deferred income and amortise. May offset capital grants against asset values.	Comparable to IAS.	Comparable to IAS except may not offset capital grants against asset values.	31
Deferred income taxes	Use full provision method, driven by balance sheet temporary differences. Recognise deferred tax assets if recovery is probable.	Comparable to IAS, but recognise all deferred tax assets and then provide valuation allowance if recovery is less than 50% likely.	Use partial provision method, driven by future income statement aggregate timing differences. Recognise deferred tax assets if recoverable without replacement by equivalent timing differences. Full asset recognisable for deferred tax relating to pension costs. Recent exposure draft proposes "incremental liability" approach, including discounting.	32
Capital instruments – categorisation of shares	Classify capital instruments depending on substance of obligations of the issuer. Mandatorily redeemable preference shares are generally liabilities not equity.	Analyse shareholders' equity between common stock and other categories. Redeemable preference shares normally mezzanine category (between debt and equity).	Present all shares within shareholders' funds; analyse between equity and non-equity interests. All preference shares are shown as non-equity within shareholders' funds.	33
Capital instruments – purchase of own shares	Show as deduction from equity.	Comparable to IAS.	By law, cancel directly purchased shares (unless held in a trust); create capital redemption reserve.	33

SUBJECT	IAS	US GAAP	UK GAAP	PAGE
Main accounting principles – continued				
Capital instruments – convertible debt	Account for convertible debt on split basis, allocating proceeds between equity and debt.	Convertible debt is usually a liability.	Comparable to US GAAP.	33
Derivatives and other financial instruments – measurement of hedges of foreign entity investments	Gains/losses on hedges of foreign entity investments recorded 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 income statement on disposal of investment.	Broadly comparable to IAS, except all hedge ineffectiveness recorded in the income statement.	Broadly comparable to US GAAP, except no transfer to income statement of exchange gains/losses previously recorded in equity.	34
Derivatives and other financial instruments – measurement of financial instruments and hedging activities	Measure derivatives and hedges at fair value; take changes in fair value to income statement except for effective cash flow hedges where they are taken to equity until effect of transaction goes through income, then transferred to income statement. Deferred amount recognised in initial measurement of asset/liability for cash flow hedges of future transactions (basis adjustment).	Comparable to IAS, except no "basis adjustment" on cash flow hedges of future transactions. Hedges of firm commitments are fair value hedges (cash flow hedges under IAS).	No comprehensive guidance currently. Financial liabilities measured at amortised net proceeds, with gains and losses from premature settlement taken to income statement. See also "Investments".	34
Derivatives and other financial instruments – proposals for the future	Participating in long-term project with Joint Working Group – preferred approach is to measure all financial assets and liabilities at fair value.	Participating in long-term project with Joint Working Group.	Participating in long-term project with Joint Working Group.	36
Other accounting and reporting issues				
Related party transactions – definition	Determine by level of direct or indirect control and significant influence of one party over another, or common control of both parties.	Broadly comparable to IAS.	Broadly comparable to IAS.	37
Related party transactions – disclosures	Disclose name of related party and nature of relationship and types of transactions. For control relationships, give disclosures regardless of whether transactions occur. Some exemptions available for separate financial statements of subsidiaries.	Broadly comparable to IAS. Exemptions are narrower than under IAS.	Broadly comparable to IAS. Exemptions are more widely available than under IAS.	37

SUBJECT	IAS	US GAAP	UK GAAP	PAGE
Other accounting and reporting issues – continued				
Post balance sheet events	Adjust financial statements for subsequent events providing evidence of conditions at balance sheet date and materially affecting amounts in financial statements. Disclose non-adjusting events.	Comparable to IAS.	Comparable to IAS.	37
Discontinuing/discontinued operations – measurement	Make provisions for some costs if considered a restructuring and criteria for recognising a provision met. Write down assets to higher of net selling price and value in use based on discounted cash flows.	Accrue at measurement date for estimated operating loss in wind-down period and on disposal. Carry assets at lower of carrying amount and net realisable value.	Comparable to IAS.	38
Discontinuing/discontinued operations – presentation and main disclosures	Give details of discontinuing operation. Disclose (on face of income statement) pre-tax gain or loss from discontinuance.	Report discontinued operations as a separate line item on face of income statement (net of tax and below net income from continuing operations).	Disclose (on face of income statement) components of operating profit relating to discontinued operations.	38
Earnings per share – diluted	Use weighted average potential dilutive shares as denominator for diluted EPS. Use "treasury stock" method for share options/warrants.	Comparable to IAS.	Comparable to IAS.	39
Extraordinary and exceptional items	Extraordinary items limited to a few events outside control of company. Exceptional items usually shown in the notes.	Broadly comparable to IAS. Do not show subtotals of income from operations before exceptional items.	Extraordinary items are non-existent. Must disclose certain exceptional items on face of income statement.	39
Segment reporting – scope and basis of formats	Public entities. Report primary and secondary segment formats based on risks and returns and internal reporting structure.	Public entities. Report based on internal operating segments.	Public and very large private entities. Report based on classes of business and geographical areas.	40
Segment reporting – accounting policies	Use consolidated GAAP accounting policies.	Use internal financial reporting policies (even if accounting policies may differ from consolidated GAAP).	Comparable to IAS.	40
Segment reporting – disclosures	Disclosures for primary segment format include revenues, results, capex, total assets and liabilities. For secondary segment format, report revenues, total assets and capex.	Similar disclosures to IAS, except liabilities and geographical capex not required. Depreciation, amortisation, tax, interest and exceptional/extraordinary items disclosed if reported internally.	Disclose revenue, results and net assets. Equal prominence to disclosures by class of business and geographically.	40

SUBJECT	IAS	US GAAP	UK GAAP	PAGE
Other accounting and reporting issues – continued				
Cash flow statements – format and method	Standard headings, but flexibility of contents. Use direct or indirect method.	Similar headings to IAS, but more specific guidance given for items to include in each. Use direct or indirect method.	Many standard headings and required contents of each. Use direct or indirect method.	41
Cash flow statements – definition of cash and cash equivalents	Cash includes overdrafts and cash equivalents with short-term maturities (less than 3 months).	Cash excludes overdrafts but includes cash equivalents with short-term maturities.	Cash includes overdrafts but excludes cash equivalents.	41
Cash flow statements – exemptions	No exemptions available.	Limited exemptions for certain investment enterprises.	Limited exemptions for certain subsidiaries and mutual funds.	41
Statement of recognised gains and losses/comprehensive income	Give statement of recognised gains and losses either as separate primary statement or separately highlighted in primary statement of movements in equity.	Disclose total comprehensive income, either combined with income statement or as under IAS. Also track and disclose cumulative amounts.	Give primary statement of total recognised gains and losses.	42
Operating and financial review	No mandatory standard – suggested features include analytical discussion of business and financial information.	Public entities must prepare MD&A with SEC mandating the contents, focusing on liquidity, capital resources and results of operations.	Not mandatory, but given in practice by major listed companies. Contents broadly comparable to IAS.	42
Interim financial reporting	Not mandatory to prepare interim statements but must use standard if do prepare. Basis should be consistent with full year statements and include comparatives.	If issued, the contents of interim statements are prescribed and basis should be consistent with full year statements. Quarterly reporting also necessary for SEC registrants (domestic US enterprises only).	Mandatory for listed entities (half-yearly); minimal contents specified by the London Stock Exchange. ASB non-mandatory statement is similar to IAS.	43

Pre-requisites for financial statements

IAS Compliance with International Accounting Standards is not mandatory, unless and until the individual entity or country chooses to adopt the standards.

US GAAP US Companies with registered securities must comply with US GAAP and various filing requirements of the Securities and Exchange Commission ("SEC"). 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 IAS) provided a reconciliation to US GAAP is given in the notes.

There is no federal reporting requirement for non-public companies.

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

Under all three frameworks, an enterprise should not describe itself as complying with IAS, US GAAP or UK GAAP unless it complies with all of that framework's standards and legal requirements applicable to it.

Contents of financial statements

The contents of financial statements are broadly consistent under each framework: balance sheets; income statements; cash flow statements; statements of recognised gains and losses/comprehensive income; accounting policies and notes. Movements in shareholders' equity are required under all three frameworks and are presented as a primary statement under US SEC regulations.

IAS is flexible in the formats and headings to be used in the primary financial statements, whereas UK law and US SEC regulations are more prescriptive. Comparatives must be provided; in the USA, under SEC rules, two years of comparatives must be given for all statements except the balance sheet.

True and fair override

Under **IAS** and **UK GAAP** (but not US GAAP) entities may depart from a standard (and from company law in the case of UK entities) in those very rare cases where its application would lead to misleading financial statements. Disclosures are required of the nature of and reason for the departure and its financial impact.

Accounting convention

Historical cost is the main accounting convention adopted by all three frameworks. However, both **IAS** and **UK GAAP** permit revaluations, notably for property, plant and equipment and IAS requires derivatives to be carried at fair value. **US GAAP** generally prohibits revaluations but does require certain securities (investments) and derivatives to be carried at fair value. The basic assumptions of going concern and accrual are presumed to underlie financial statements prepared under each framework, with understandability, relevance, reliability and comparability as the main attributes to be considered in selecting accounting policies.

Changes in accounting policies/correction of fundamental errors/changes in accounting estimates

Under **IAS**, comparatives and prior year opening retained earnings are restated (if practicable) for the effects of changes in accounting policies. Alternatively the cumulative amount of the change is accounted for and separately disclosed in income for the period of the change and the entity discloses pro-forma comparatives as if the change had been applied retrospectively to those periods. The first approach is that adopted under **UK GAAP** whereas the second is that used in most cases under **US GAAP**. UK GAAP also requires the effect of the change on the current year to be given.

IAS allows the same choice for the correction of fundamental errors – either restatement of comparatives or correction in income of the period in which the errors are identified. Restatement of comparatives is mandatory under both **US** and **UK GAAP**.

In all three frameworks, changes in accounting estimates are accounted for in the income statement when identified.

REFERENCES: **IAS**: IAS 1 (Revised), IAS 8. **US GAAP**: ARB 43, APB 20, SEC Regulation S-X. **UK GAAP**: Companies Act 1985, SSAP 2, FRS 3, UITF 14, FRED 21.

Accounting for Subsidiaries

Consolidated financial statements must generally be produced if a parent has one or more subsidiaries, although some exemptions from preparing consolidated financial statements are available under **IAS** and **UK GAAP** for intermediate holding companies.

The definition of a subsidiary is an important distinction between the frameworks. **IAS** and **UK GAAP** focus on the concept of control in determining whether a parent/subsidiary relationship exists, including control arising without a legal shareholding, but **US GAAP's** main criterion currently is majority ownership, coupled with control.

Companies acquired (disposed of) are included in (excluded from) consolidation from the date control passes. Certain subsidiaries may be excluded from consolidation, typically if there are severe restrictions on the exercise of the parent's rights or if the subsidiary is acquired and held exclusively for subsequent re-sale in the near future. A dissimilar activity of a subsidiary is not a justification for non-consolidation.

Recent proposals – US GAAP

An exposure draft from the FASB proposes to align the definition of a subsidiary under **US GAAP** more closely with **IAS** and **UK GAAP**. The concept of control is expanded beyond a primarily legal view (i.e. majority ownership), to incorporate the substance of a parent's non-shared decision-making ability.

Accounting for Associates

IAS and **US GAAP** consider that an associate is an entity over which the investor is in a position to exercise significant influence. This is presumed through a 20% or more shareholding or through participation in the financial and operating policies of the entity and/or representation on the entity's board. Under **UK GAAP** the investor must have a participating interest (presumed through a 20% or more shareholding) and the actual exercise of significant influence must be demonstrated.

The equity method is used to account for associates in consolidated financial statements. The investor presents its share of the associate's profits and losses. **IAS** is not clear at what level this should be shown – at a post-tax level as under **US GAAP** or at an operating profit level with separate disclosure of its share of the associate's interest and tax as under **UK GAAP.** The investor's balance sheet includes its share of the associate's net assets including any unamortised goodwill from the acquisition of the associate. Under **UK GAAP** the goodwill element should be separately identified. If an entity with no subsidiaries is preparing standalone financial statements, **IAS** and **UK GAAP** do not require use of the equity method to account for investments in associates, although both require disclosure of the impact if the equity method had been used.

US GAAP and **UK GAAP** require disclosure of detailed information about the results, assets and liabilities of significant associates. **IAS** does not require such detailed disclosures.

Accounting for Joint ventures

Under **US GAAP** the equity method is predominantly used to account for joint ventures. This method is also permitted under **IAS**, although the benchmark treatment is proportional consolidation. Joint ventures are accounted for under **UK GAAP** using the gross equity method. Under **UK GAAP** separate disclosure is required of a) inclusive turnover on the face of the income statements and b) on the face of the balance sheet the investor's share of the gross assets and liabilities of the joint venture, as well as the unamortised goodwill.

Some joint ventures such as those found in the extractive industries (oil and gas) are effectively a dedicated extension of an entity's own business. Such arrangements are, in practice, commonly accounted for using proportional consolidation (**US GAAP**) or by accounting for the entity's own assets and liabilities used in the arrangement (**IAS** and **UK GAAP**).

Recent proposals – all three frameworks

The IASC, FASB and ASB may in due course revise their standards on joint ventures. A discussion paper published in 1999 by a working group from the standard setters in Australia, Canada, New Zealand, the UK and the USA together with the IASC ("G4+1"), proposes that joint ventures (as defined in the paper) would be accounted for using the equity method.

REFERENCES: **IAS**: IAS 27, IAS 28, IAS 31. **US**: ARB 51, APB 18, FAS 94, ED 194-B, EITF 96-16. **UK**: FRS 2, FRS 9.

The Individual Company

Translation of transactions denominated in foreign currency is at the exchange rate in operation on the date of the transaction. At each balance sheet date, monetary assets and liabilities denominated in a foreign currency are translated at the closing (year end) rate or, under UK GAAP, at a forward contract rate where applicable. Non-monetary foreign currency assets and liabilities are translated at the appropriate historical rate. Income statement amounts are translated using historical rates of exchange at the date of transactions or a weighted average rate as a practical alternative. Where a non-monetary item denominated in a foreign currency is carried at fair value, it is reported using the exchange rate that existed when the fair value was determined.

Exchange gains and losses arising on a company's own foreign currency transactions are reported as part of the profit or loss for the year from ordinary activities. An exception to this is certain long-term loans which in substance are part of an entity's net investment in a foreign entity and foreign currency borrowings or other instruments hedging such net investment – see page 34 for details.

Consolidated Financial Statements

Where the operations of a foreign enterprise are largely independent of the reporting currency of the investing company, amounts in the balance sheet of the foreign enterprise 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 (UK GAAP also permits the closing rate to be used). The translation differences arising are taken to equity via the statement of recognised gains and losses/other comprehensive income.

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

Tracking of translation differences in equity

IAS
US GAAP These must be separately tracked and the cumulative amounts disclosed. On disposal of a foreign entity the appropriate amount of cumulative translation difference is transferred to the income statement and included in the gain or loss on sale.

UK GAAP There is no equivalent requirement.

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

IAS Either translate at closing or historical rates.

US GAAP Translate at closing rates.

UK GAAP Normally translate at historical rate, although it is possible to denominate goodwill as effectively being in the foreign currency (with translation at closing rate).

Foreign entity in hyperinflationary economy

IAS Restate to current purchasing power prior to translation into the reporting currency of the reporting enterprise.

US GAAP Remeasure using the reporting currency as the functional currency.

UK GAAP Either use the IAS or US GAAP approach.

Where the reporting entity itself reports in the currency of a hyperinflationary economy, under **IAS** and **US GAAP** the financial statements should be stated in terms of the measuring unit current at the balance sheet date. There is no equivalent standard under **UK GAAP**, but a similar procedure would be followed in practice.

REFERENCES: **IAS**: IAS 21, IAS 29. **US GAAP**: FAS 52, FAS 133. **UK GAAP**: SSAP 20, UITF 9.

Purchase Method

Depending on the circumstances, either the purchase (acquisition) method or the pooling of interests (merger) method is used to portray the financial effect of a business combination. However, the use of the pooling of interests method is severely restricted, with **US GAAP** proposing to prohibit its use – see page 17.

Under the purchase method the cost of the acquisition is measured at fair value and the acquirer's interests in identifiable assets and liabilities of the acquiree are restated to their fair values at the date of acquisition. Some differences exist in applying fair value principles but no account should generally be taken of the acquirer's intentions.

Cost of acquisition – date of valuation of marketable securities issued by the acquirer

US GAAP Measured at their market price over a reasonable period of time (interpreted to be a few days) before and after the enterprises have reached 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.

IAS
UK GAAP Measured at their market price as at the date of the acquisition (the exchange transaction). In exceptional circumstances, if the market price on one particular day is not a reliable indicator of value, **UK GAAP** recommends considering market prices for a reasonable period before the date of acquisition. In contrast **IAS** calls for consideration of price movements for a reasonable period before and after the announcement of the terms of the acquisition.

Intangible assets

IAS
UK GAAP Only record intangibles as an acquired asset if they meet the definition of and recognition criteria for an intangible asset – see page 18. Otherwise intangibles should be subsumed within goodwill and amortised accordingly.

US GAAP Allocate value to all intangibles based on appraised values, including acquired in-process research and development. However, in-process research and development with no alternative future use is immediately expensed.

Provisions

IAS The acquirer should recognise certain liabilities relating to the acquired entity's business that came into existence at the date of the acquisition as a direct consequence of it, for example employee redundancy benefits. A detailed formal plan must exist at or soon after the acquisition and must meet the conditions under IAS for recognising a restructuring provision – see page 27.

US GAAP If certain strict criteria (similar to IAS) are met, costs for plant closure, compulsory employee redundancies and restructuring are provided in the fair value calculations.

UK GAAP Only include restructuring provisions in fair value calculations if the acquired entity already has an irrevocable commitment to restructure which is not conditional on the completion of the acquisition.

Subsequent adjustments to fair values

Under **IAS and UK GAAP** adjustments to fair values are permitted as additional evidence becomes available in estimating those values. However, **UK GAAP** only permits such changes if it has not been possible to complete the investigations necessary to determine fair values by the date on which the first post-acquisition financial statements are approved and the changes arise from further investigations. **US GAAP** only contains specific guidance on adjustments arising from pre-acquisition contingencies, such as litigation, but practice for other changes is similar to **UK GAAP**.

Adjustments are recognised as changes to goodwill, provided they are made before the end of the first full accounting period beginning after the acquisition (**IAS** and **UK GAAP**) or as a maximum within one year of the acquisition (**US GAAP**). Any subsequent adjustments should be recorded in the income statement. An exception to the above arises under **IAS** and **US GAAP** for provisions made on acquisitions, for which any reversals must always be recognised as changes to goodwill.

Purchase Method (continued)

Contingent consideration

If part of the purchase consideration is contingent on a future event, such as achieving profit levels, then under **IAS** and **UK GAAP** an estimate of the amount is generally included as part of the cost at the date of the acquisition. Under **US GAAP**, this cost is not recognised until the contingency is resolved or the amount is determinable. In all cases any revision is recorded as an adjustment to goodwill. Separate rules apply under **US GAAP** for consideration contingent on the market price of a specified security issued to effect the acquisition.

Minority interests at acquisition

Where less than 100% of the entity is acquired, under **IAS** the minority interest is stated at either: (a) its share of the pre-acquisition carrying value of net assets; or (b) its share of the fair value of the net assets. Whichever method is followed, no goodwill is attributed to the minority interest. **US GAAP** generally follows the first method; **UK GAAP** is consistent with the alternative basis.

Disclosure

Certain disclosures about business combinations accounted for using the purchase method are common to all three frameworks, such as:

- the names and descriptions of the combining entities;
- the method of accounting for the business combination (i.e. purchase method or pooling of interests method);
- the date of acquisition or period for which results of the acquired entity are included in the consolidated financial statements;
- details of the cost of the acquisition and the form of consideration given, including any contingent consideration; and
- details of any provisional fair valuations and subsequent changes to those.

IAS requires disclosure of the effect of acquisitions on the financial position at the balance sheet date, the results and comparatives. Under **UK GAAP** the revenue and result from acquisitions must be included within continuing operations on the face of the income statement. A summary income statement is required for the acquired entity for its last accounting period up to the date of acquisition. **US GAAP** requires the most detailed disclosures on the effect of acquisitions: pro-forma income statement information must be presented as if the combination had occurred at the beginning of the period, including comparatives.

Under **IAS** the cash flow effects of an acquisition must be disclosed, including the amount of assets and liabilities acquired. **UK GAAP** requires more detail with a table to be given showing the book values, fair value adjustments and fair values of the net assets acquired – provisions for reorganisations within the acquired entity must be separately identified in this table. Similar information need not be disclosed under **US GAAP**.

The costs of integration and reorganisation relating to the acquisition in the period and subsequent periods must also be separately disclosed under **UK GAAP**.

REFERENCES: **IAS**: IAS 7, IAS 22 (Revised), IAS 27. **US GAAP**: APB 16, FIN 4, FASB TB 85-5, EITF 95-3, EITF 95-19. **UK GAAP**: FRS 3, FRS 6, FRS 7.

Goodwill

Purchased goodwill is capitalised as an intangible asset and amortised over its useful economic life. There are differences in the limits for useful lives:

IAS
UK GAAP There is a rebuttable presumption that the useful life of goodwill does not exceed 20 years. In very rare cases goodwill may be demonstrated to have a finite useful life in excess of 20 years or, under **UK GAAP**, to have an indefinite useful life. If the finite useful life does exceed 20 years then amortisation is still mandatory and the reasons for rebutting the presumption should be disclosed. Under **UK GAAP** systematic amortisation would not be required if the goodwill has an indefinite life. Amortisation and impairment charges should be recognised in arriving at operating profit.

US GAAP The maximum useful life is 40 years. Amortisation charges should be recognised in arriving at operating profit.

Goodwill is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, and under **IAS** and **UK GAAP** annually if the estimated useful life exceeds 20 years or, under **UK GAAP**, is indefinite. See page 21 for details of standards on impairment.

On subsequent disposal of the acquired entity, any attributable goodwill not yet amortised must be transferred to the income statement and included in the gain or loss on sale.

Recent proposals – US GAAP

An exposure draft issued by the FASB on Business Combinations and Intangible Assets brings the requirements for amortisation of goodwill closer to those under IAS and UK GAAP. It proposes that goodwill has a useful life not exceeding 20 years. In contrast to IAS and UK GAAP, the ED proposes that goodwill amortisation and impairment charges should be recorded on a net of tax basis as a separate line item at the foot of the income statement. The ED also includes guidance on impairment reviews for goodwill.

Negative Goodwill

IAS Negative goodwill relating to expected future losses/expenses identified in the acquirer's plan for the acquisition should be recognised in income when those losses/expenses occur. Otherwise the negative goodwill not exceeding the fair values of acquired identifiable, non-monetary assets should be recognised in income on a systematic basis over the useful lives of such assets, and any excess negative goodwill should be immediately recognised in income.

Negative goodwill should be presented as a "negative" asset, alongside positive goodwill.

US GAAP The fair values of non-current, non-monetary assets acquired (except long-term investments in marketable securities) should be reduced proportionately. If any negative goodwill remains after the balance of non-current, non-monetary assets has been reduced to nil, it is presented as deferred income and amortised, using the same amortisation rules as for positive goodwill.

UK GAAP Negative goodwill up to the aggregate fair value of the non-monetary assets should be recognised in the income statement to match the depreciation of those assets. The balance, if any, is recognised in income over the period likely to benefit.

Negative goodwill is presented as a "negative asset" alongside positive goodwill.

Recent proposals – US GAAP

The FASB's exposure draft proposes that negative goodwill should first be recognised as a pro-rata reduction of the fair values of acquired intangible assets, followed by a similar adjustment to other acquired depreciable non-financial assets. If any negative goodwill remains after the balance of these acquired assets has been reduced to nil, it is immediately recognised in the income statement as an extraordinary gain.

REFERENCES: **IAS**: IAS 22 (Revised). **US GAAP**: APB 17, FAS 121, ED 201-A. **UK GAAP**: FRS 10.

Pooling of Interests

The use of pooling of interests (merger) accounting to portray a business combination is severely restricted in all three frameworks, although the criteria for an acceptable pooling differ. As a result of revisions to the International and UK standards in the early 1990s, pooling of interests is currently more common under US GAAP even though its criteria are more prescriptive. However see recent proposals below. Once the relevant criteria for a pooling are met, use of the pooling method is mandatory under all three frameworks.

The criteria under **IAS** and **UK GAAP** focus on the substance of the transaction, requiring a true merger of equals and the inability to identify an acquirer. Control must not appear to pass from one enterprise to another; the parties must come together in substance to create a new reporting entity and to share in its future risks and benefits. In contrast, **US GAAP** criteria focus predominantly on the attributes of the combining enterprises.

The **IAS** and **UK GAAP** criteria for pooling of interests accounting are relatively similar and include the following:

- the shareholders of each enterprise maintain substantially the same voting rights and interest in the combined entity, relative to each other, after the combination as before;
- the fair value of one enterprise is not significantly different from that of the other and no premium for control is paid by one party;
- the substantial majority, if not all, of the voting common shares of the combining enterprises are exchanged or pooled;
- no party to the combination is portrayed either as acquirer or acquired, either by its own board or management or by another party to the combination;
- non-equity consideration or shares with reduced rights represent an immaterial proportion of the fair value of the total consideration received by each party; and
- no material interest is retained by one party in the future performance of only part of the combined entity.

In addition **UK** law includes specific requirements about the percentages of shares exchanged and the amount of non-equity consideration. An Interpretation of **IAS** issued in 1998 has clarified that a business combination should not be accounted for as a pooling of interests unless all of the first three of these criteria are present and, even then, only if an acquirer cannot be identified.

Under **US GAAP** there are detailed criteria focusing on three main areas:

- attributes of the combining companies, for example issues such as autonomy and independence;
- the manner of combination, for example a single transaction with a substantial exchange of shares; and
- the absence of transactions made in contemplation of the combination.

The SEC provides extensive interpretative guidance in the area of pooling.

Accounting for a pooling of interests follows the same approach under all three frameworks. The combined assets, liabilities and reserves are recorded at their existing carrying amounts (after adjustments necessary to conform the accounting policies and practices). The results are combined from the beginning of the year in which the transaction occurred and comparatives are restated. No goodwill is recognised on the transaction; any difference arising is adjusted against equity. Expenses relating to a pooling are charged to the income statement in the period incurred.

Under US GAAP, specific – and separate – rules deal with the combination of entities under common control, whilst UK GAAP includes rules to address group reconstructions. IAS does not address such transactions.

Recent proposals – US GAAP

The FASB's exposure draft on Business Combinations and Intangible Assets proposes that all business combinations be accounted for using the purchase method. Use of the pooling of interests method would be prohibited. The proposals include guidance for determining the acquiring enterprise.

REFERENCES: **IAS**: IAS 22 (Revised), SIC 9. **US GAAP**: APB 16, ED 201-A. **UK GAAP**: Companies Act 1985, FRS 6.

Intangible Assets

All three frameworks require capitalisation and amortisation of purchased intangible assets, provided that they meet the definition of an asset, are capable of reliable measurement and can be clearly identified.

The cost of a separately acquired intangible asset is usually self-evident. If an intangible asset is acquired in a business combination (acquisition) its cost is determined as follows:

IAS
UK GAAP Based on its fair value at the date of acquisition, where possible determined by reference to an active market in such assets. However, certain techniques developed by enterprises for estimating fair values of intangible assets may be used in the absence of an active market. If such techniques are used the resulting assets are only recognised provided that negative goodwill is not created or increased by their recognition.

US GAAP Normally based on fair values.

Internally developed intangible assets must also meet the recognition criteria. It is unlikely that many internally developed intangible assets will be capable of recognition because of their uniqueness and therefore the lack of ability to determine their cost reliably (e.g. by reference to an active market). However, see page 19 on development costs.

IAS and **UK GAAP** allow intangible assets to be subsequently revalued to their fair value based upon prices on an active market. Where this treatment is adopted (thought to be extremely rare), the revaluations should be regularly performed and the entire class of intangible assets should be revalued at the same time. **US GAAP** does not permit revaluations of intangible assets.

Useful lives for amortisation purposes

IAS There is a rebuttable presumption that the useful life does not exceed 20 years from the date the asset is available for use. In very rare cases an intangible asset may be demonstrated to have a finite useful life in excess of 20 years but not an indefinite useful life.

US GAAP The maximum useful life of an intangible asset is 40 years.

UK GAAP There is a rebuttable presumption that the useful life does not exceed 20 years from the date of acquisition. In very rare cases an intangible asset may be demonstrated to have a finite useful life in excess of 20 years or to have an indefinite useful life.

Impairment

Impairment reviews are required whenever changes in events or circumstances indicate that the carrying amount of an intangible asset may not be recoverable. Reviews are also required annually under **IAS** and **UK GAAP** if the 20 year useful life presumption is rebutted and also under **UK GAAP**, if the asset is considered to have an indefinite useful life. Under IAS, intangible assets not yet available for use should also be reviewed annually for impairment. See page 21 for further details on impairment of assets.

Recent proposals – US GAAP

The exposure draft issued by the FASB on Business Combinations and Intangible Assets brings the requirements for amortisation of intangible assets closer to those under IAS and UK GAAP. It proposes a rebuttable presumption that they have a useful life not exceeding 20 years and would permit an indefinite useful life in certain restricted circumstances. The proposed requirements for impairment reviews of intangible assets are the same as for property, plant and equipment – see page 21.

REFERENCES: **IAS**: IAS 36, IAS 38. **US GAAP**: APB 17, FAS 121, ED 201-A. **UK GAAP**: FRS 10, FRS 11.

Research and Development Costs

Research costs must always be expensed as incurred under all three frameworks. Development costs must be or may be capitalised and amortised in specified circumstances under **IAS** and **UK GAAP** respectively (see further details below), but must be expensed as incurred under **US GAAP**, with the exception of certain computer software development costs.

The rules under US GAAP on accounting for acquired in-process research and development differ from those under IAS and UK GAAP – see page 14.

Capitalisation, amortisation and impairment of development costs

IAS Development costs must be capitalised as an asset where all of the criteria for recognition as an internally generated intangible asset are met. The enterprise must be able to demonstrate:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete the intangible asset and use or sell it;
- its ability to use or sell it;
- how it will generate probable future economic benefits;
- that adequate resources are available to complete the development and to use or sell the intangible asset; and
- its ability to measure reliably the expenditure attributable to the asset.

Where development costs meet the criteria for capitalisation as internally generated intangible assets, there is a rebuttable presumption that the useful life does not exceed 20 years; impairment reviews are required under the circumstances noted on page 18. Costs written off prior to development expenditure meeting the criteria for recognition as an asset may not be capitalised if those criteria are subsequently met.

UK GAAP Provided certain stringent criteria (similar to IAS – see above) are met, development expenditure may be capitalised and amortised systematically over the expected life of the product or process beginning when it is available for sale or use. The unamortised balance is reviewed for recoverability at each accounting period end and written off to the extent necessary. Development costs initially recognised as an expense cannot be capitalised in a subsequent period.

US GAAP Development costs are expensed as incurred. However, separate rules apply to development costs for computer software that is to be sold; 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 for internal use.

REFERENCES: **IAS**: IAS 36, IAS 38. **US GAAP**: FAS 2, FAS 86, SOP 98-1. **UK GAAP**: SSAP 13.

Property, Plant and Equipment

Under all three frameworks property, plant and equipment is initially recorded at cost.

Components of cost

The components included in the cost of property, plant and equipment are similar under all three frameworks; costs directly attributable to acquiring the asset and costs necessary to bring such an asset to working condition for its intended use. Start-up and pre-production costs should not be capitalised unless they are a necessary part of bringing the asset to its working condition, for example direct costs in an essential commissioning period. **US GAAP** has more specific and detailed rules for the real estate industry.

Depreciation

The depreciable amount of an item of property, plant and equipment should be allocated on a systematic basis over its useful life, reflecting the pattern in which the asset's benefits are consumed by the entity. Changes in the depreciation method used or the expected useful life are treated as changes in accounting estimate under **IAS** and **UK GAAP** (reflected in the depreciation charge for the current and prospective periods). Under **US GAAP** these are treated as changes in accounting principle and the cumulative effect of the change is reflected in the current year's income statement.

Revaluations

IAS and **UK GAAP** permit the subsequent use of revalued amounts in accounting for property, plant and equipment. An entity must revalue all of a class of assets at the same time. Any surplus arising from a revaluation is credited to a revaluation reserve in equity via the statement of recognised gains and losses. Revaluations are not permitted under **US GAAP**.

Frequency of revaluations

IAS The revaluations must be kept sufficiently up to date so that the carrying amount does not differ materially from the fair value. Otherwise a revaluation by a professionally qualified valuer every three to five years is regarded as sufficient.

UK GAAP Revaluations should be performed on a regular basis. Full external professional valuations are required at least every five years. Interim valuations in year three are also required.

Revalued amount

IAS Revalue at current value, which is considered to be fair value.

UK GAAP Valuation basis is more specific than IAS, requiring valuations to be at the lower of replacement cost and recoverable amount.

Where an item of property, plant and equipment has been revalued, depreciation should be based on the revalued amount. The full charge should be recognised in the income statement; an amount equivalent to the depreciation of the revaluation surplus can be transferred within equity from the revaluation reserve to retained earnings. The gain or loss on disposal of an asset is calculated by reference to the asset's net carrying amount (not original cost). Any remaining attributable revaluation surplus is normally transferred directly to retained earnings. Both **IAS** and **UK GAAP** require supplementary disclosures of the historical cost equivalent (cost and accumulated depreciation) of assets carried at revalued amounts.

Impairment of revalued property, plant and equipment

IAS 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.

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 statement of recognised gains and losses until the carrying amount of the asset reaches its historical cost and in the income statement thereafter.

REFERENCES: **IAS**: IAS 16, IAS 36. **US GAAP:** ARB 43, APB 6. **UK GAAP**: Companies Act 1985, FRS 3, FRS 11, FRS 15.

Investment Properties

IAS Investment properties are treated either as property under IAS 16 (valued at historical cost or revalued amount (changes in value going to equity) and depreciated) or as long-term investments under IAS 25. A recent proposal suggests investment properties should be valued either at historical cost (the benchmark treatment under IAS 16) or at fair value with changes in the fair value recognised in the income statement.

US GAAP Such properties are treated in the same way as property, plant and equipment.

UK GAAP Such properties are valued at open market value with no depreciation being charged.

REFERENCES: **IAS**: IAS 16, IAS 25, E 64. **US GAAP**: ARB 43, APB 6. **UK GAAP**: SSAP 19.

Impairment of Assets

Specific standards on impairment reviews exist under all three frameworks and provide similar examples of indicators of when an asset may be impaired, although **US GAAP** requires an initial numerical assessment. Under all three frameworks, if impairment is indicated but no loss arises, the entity should reconsider the useful life of that asset.

IAS
UK GAAP If there is an indication of impairment the assets should be tested for impairment and, if necessary written down to their recoverable amount – the higher of net selling price or value in use, calculated based on discounted future pre-tax cash flows related to the asset or the income generating unit to which the asset belongs. The discount rate should be pre-tax and reflect the risks specific to that asset or group of assets. Unlike **US GAAP**, there are no separate rules for assets to be disposed of.

Impairment losses are recognised in the income statement unless they relate to revalued assets. Under **IAS** such losses are accounted for in accordance with the standard relating to that asset, for example property, plant and equipment – see page 20. Under **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 statement of recognised gains and losses until the carrying amount of the asset reaches its depreciated historical cost and in the income statement thereafter. Impairment losses are reversed only when there has been a change in economic conditions or the expected use of the asset.

US GAAP An entity assesses whether impairment has occurred based on the future cash flows (undiscounted and excluding interest) expected to result from use and eventual disposal of the asset. An impairment loss is triggered if the sum of these cash flows is less than the carrying amount of the asset.

The impairment loss recognised in the income statement is based on the asset's fair value, being either market value (if an active market for the asset exists) or the sum of discounted future cash flows. The discount rate reflects the risk specific to that asset. 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. Such assets are not depreciated or amortised during the selling period. Reversals of impairment losses are prohibited.

REFERENCES: **IAS**: IAS 36. **US GAAP**: FAS 121. **UK GAAP**: Companies Act 1995, FRS 11, FRS 15.

Capitalisation of Borrowing Costs

IAS and **UK GAAP** require an entity to choose between capitalising or not capitalising interest on specific or general borrowings to finance the construction of certain tangible fixed assets. Under **US GAAP** such interest must be capitalised. The criteria for determining a qualifying asset, the limits on capitalising interest and the period of capitalisation are similar in all three frameworks.

Assets qualifying for capitalisation of borrowing costs are typically produced under a discrete project and necessarily take a substantial period of time to get ready for their intended use or sale. The amount of interest eligible for capitalisation is determined as either the actual costs incurred on a specific borrowing or based on a weighted average method considering all the general borrowings outstanding during the period for that entity. Under **IAS** any interest earned on funds borrowed to finance the production of the asset is netted with the interest to be capitalised. Under **US GAAP** and **UK GAAP** such interest income is included within the income statement. Under all three frameworks capitalisation of interest should cease once the asset is ready for its intended use or sale.

REFERENCES: **IAS**: IAS 23. **US GAAP:** FAS 34, FAS 62. **UK GAAP**: Companies Act 1985, FRS 15.

Leases – Classification

The concepts behind lease classification in US standards are similar to those in IAS and UK GAAP. However, whilst extensive form-driven requirements are present in **US GAAP**, substance rather than legal form is followed under **IAS** and **UK GAAP**.

Broadly, a finance (capital) lease exists if the agreement transfers substantially all the risks and rewards associated with ownership of the asset, other than legal title, to the lessee. One key indication of a finance lease is that the present value of the minimum lease payments (MLPs) is equal to substantially all of the fair value of the asset at the inception of the lease. "Substantially all" is often taken to be 90% or higher and this is a mandatory threshold in the US rules. Other factors to consider in determining the substance of an agreement include:

- the length of the lease period compared to the asset's useful economic life;
- which party bears the risks or rewards of a fall or increase in the asset's value;
- whether the asset has been specifically developed for the lessee's use;
- the transfer of ownership of the asset to the lessee by the end of the lease term; or
- the existence of a bargain purchase option.

Recent proposals – all three frameworks

The IASC, FASB and ASB may in due course revise their standards on lease accounting. A discussion paper published in late 1999 by a working group from the standard setters in Australia, Canada, New Zealand, the UK and the USA together with the IASC ("G4+1"), proposes a single approach to be applied to all leases, abolishing the current distinction between finance and operating leases. All material leases would give rise to assets and liabilities for lessees, measured with reference to the payments required by the lease and any other liabilities incurred. Lessors would report financial assets (amounts receivable from the lessee) and non-financial assets (residual interests) as separate assets, reflecting the different property rights arising.

Lessee Accounting

Finance leases

Under **IAS** and **US GAAP**, finance leases are recorded as an asset and an 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 MLPs at the inception of the lease. Under **UK GAAP** the fair value of the asset may be used if this is a sufficiently close approximation to the present value of the MLPs, even if it is slightly higher than the latter. In all three frameworks the interest rate implicit in the lease should normally be used to calculate the present value of the MLPs. Under US GAAP the lessee's incremental borrowing rate should be used if it is lower than the rate implicit in the lease. If the implicit rate is unknown then IAS also permits the lessee's incremental borrowing rate to be used.

The asset is normally depreciated over its useful life or the lease term if shorter. However, under IAS the latter is only permitted if there is no reasonable certainty of the lessee obtaining ownership of the asset.

Rental payments are apportioned between the outstanding obligation and the finance charge in the income statement, so as to produce a constant rate of charge on the remaining balance of the obligation for each accounting period.

Operating leases

Under all three frameworks the rental under an operating lease should generally be charged on a straight-line basis over the lease term.

Lessor Accounting

Finance leases

The amount due from a lessee under a finance lease is recorded 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 minimum lease payments less gross earnings allocated to future periods.

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. **IAS** 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 such cash flows are included. **UK GAAP** requires use of the net cash investment method, which includes such cash flows.

Operating leases

An asset held for use in operating leases by a lessor is recorded as property, plant and equipment and depreciated over its useful life. Rental income is generally recognised on a straight-line basis over the lease term.

Sale and Leaseback Transactions

There are certain differences in the rules on dealing with profits and losses arising on sale and leaseback transactions.

IAS
UK GAAP If a sale and leaseback transaction results in a finance lease, any profit or loss is deferred and amortised over the lease term (or, under **UK GAAP**, the useful life of the asset, if shorter). If the transaction results in an operating lease then the following rules apply, depending on the sale price:

- if at fair value, immediate recognition of the profit or loss;
- if less than fair value, then immediate recognition of the profit or loss, unless the loss is compensated by future rentals at less than market price in which case deferral and amortisation of the loss over the period for which the asset is expected to be used (**IAS**) or over the shorter of remaining lease term and the period during which the reduced rentals are chargeable (**UK GAAP**); and
- if greater than fair value, deferral of the excess over fair value and amortisation over the period for which the asset is expected to be used (**IAS**) or over the shorter of the remaining lease term and the period to the next rent review (if any) (**UK GAAP**).

US GAAP Profits on sale and leaseback transactions are deferred to the extent of the present value of the minimum lease payments under the leaseback (operating leases) or the recorded amount of the leased asset (finance leases). Deferred profit is amortised in proportion to the related gross rental charged to the income statement over the lease term (operating lease) or in proportion to the amortisation of the leased asset (finance lease). Losses are normally recognised immediately.

REFERENCES: **IAS**: IAS 17 (Revised). **US GAAP**: FAS 13. **UK GAAP**: SSAP 21, FRS 5, UITF 12.

Investments

IAS Investments in securities are classified and accounted for as follows:

- debt and equity securities which are bought and held principally with the intention of selling them in the short term are classified as "held for trading" and reported at fair value with unrealised gains and losses recorded in the income statement;
- debt securities which management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" securities and reported at amortised cost;
- financial assets created by the enterprise by providing money/goods/services directly to a debtor (and not held for trading) are classified as "loans and receivables originated by the enterprise" and reported at amortised cost; and
- debt and equity securities not covered by the above are classified as "available-for-sale" securities and carried at fair value with unrealised gains and losses reported either (a choice of accounting policy) a) in the income statement or b) in the statement of recognised gains and losses with recycling to the income statement when sold, impaired or collected.

Sales or transfers from the held-to-maturity portfolio generally cause the entire portfolio to be reclassified as either trading or available-for-sale.

In general, permanent declines in value of securities (whether carried at amortised cost or fair value) should be recognised in the income statement.

US GAAP Similar to IAS, except that the "loans and receivables originated by the enterprise" category does not exist. These items are typically classified as "held-to-maturity".

Amounts reported in equity are shown as a separate component of other comprehensive income.

Debt and equity securities which are classified as "available-for-sale" are also reported at fair value but unrealised gains and losses are only recorded in equity (other comprehensive income).

UK GAAP Long-term investments are carried at cost (less impairment losses) or revalued amounts. The revalued amount is based on market value or another appropriate value, e.g. underlying net asset value. Surpluses on revaluation are taken to the statement of recognised gains and losses. An enterprise transfers any attributable revaluation surplus recorded in prior accounting periods directly to retained earnings when the asset is sold, and does not recycle to the income statement.

Investments in subsidiaries, associates and joint ventures (but not other financial assets included within the scope of FRS 13) are subject to the standards on impairment – see page 21. Permanent declines in the carrying amount of other financial assets are recorded in 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 for long-term investments.

REFERENCES: **IAS**: IAS 39. **US GAAP**: FAS 115. **UK GAAP**: Companies Act 1985, FRS 3.

Inventories and Long-Term Contracts

Inventories

Under both **IAS** and **UK GAAP**, inventories are carried at the lower of cost or net realisable value (being sale proceeds less all further costs to bring the inventories to completion). **US GAAP** is also broadly consistent, 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 and a lower limit of net realisable value less a normal profit margin.

The basis of calculating cost varies. First-In-First-Out (FIFO) or weighted average bases are permitted under each framework. Use of the Last-In-First-Out (LIFO) method is widespread in the **US** and is permitted under **IAS** but prohibited under **UK GAAP**. Under **IAS** and **UK GAAP**, any allocation of fixed production overheads is based on normal capacity levels, with unallocated overheads expensed as incurred. Under **US GAAP**, in certain circumstances idle capacity costs may also be absorbed into inventory costs.

Long-term contracts

Under **IAS** and **UK GAAP** revenue and profits on long-term contracts are recognised using the percentage of completion method. Under **US GAAP**, the percentage of completion method is also generally used. **US GAAP** allows two alternative methods for calculating the components of income earned; the revenue-cost approach, which is consistent with **IAS**, or the gross-profit approach. **UK GAAP** does not prescribe a particular method, requiring only consistency in application of the chosen one.

The completed contract method is used under **US GAAP** in circumstances when estimates of costs to completion and the extent of progress towards completion are not reasonably dependable.

IAS requires contracts to be combined or segregated in some circumstances – this is permitted but not required under **US GAAP**, whereas **UK GAAP** requires each contract to be considered separately.

REFERENCES: **IAS**: IAS 2, IAS 11. **US GAAP**: ARB 45, SOP 81-1. **UK GAAP**: SSAP 9.

Revenue Recognition

IAS is the only one of the three frameworks to contain one specific standard on revenue recognition. However, numerous **US** accounting standards provide guidance related to specific situations or industries and **UK GAAP** contains guidance on derecognition of an asset matching the point that a sale takes place.

For revenue to be recorded in the income statement under **IAS**, it must be probable that the economic benefits associated with the transaction will flow to the enterprise and the amount must be reliably measurable. **UK GAAP** is similar.

US GAAP focuses more on revenues being realised (either converted into cash or cash equivalents or the likelihood of its receipt is reasonably certain) and earned (no material transaction pending and the related performance has occurred). Additional recent guidance for SEC registrants sets out four criteria to be met before revenue is considered to be realised and earned:

- persuasive evidence of an arrangement exists;
- delivery has occurred or services have been rendered;
- the seller's price to the buyer is fixed or determinable; and
- collectability is reasonably assured.

The guidance also addresses specific revenue recognition issues such as bill and hold arrangements, non-refundable fees and services, gross versus net presentation (agency versus principal), delivery and acceptance, and contingent rental income.

Under all three frameworks revenues should be measured 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 appropriate, with the difference between the fair value and the nominal amount of the consideration being recognised as interest income.

REFERENCES: **IAS**: IAS 18. **US GAAP**: CON 5, SAB 101. **UK GAAP**: SSAP 2, FRS 5.

Derecognition of Financial Assets

IAS and **US GAAP** focus on the notion of control; an entity recognises on the balance sheet assets that it controls whilst assets not controlled are removed from the balance sheet. **UK GAAP** adopts a more “risks and rewards” approach to transfers of assets (e.g. securitisations), focusing partly on the substance of a transaction rather than just purely its legal form.

“Control” versus “risks and rewards”

IAS A financial asset (or a portion thereof) should be removed from the balance sheet when the enterprise realises the rights to benefits specified in the contract, the rights expire or the enterprise surrenders or otherwise loses control of the contractual rights that comprise the financial asset. The following evidences surrender of control:

- the transferee has the right, free from any constraints, to pledge or exchange the assets; and
- the transferor does not maintain effective control over the assets transferred, i.e. there are no repurchase clauses (unless the asset is readily obtainable in the market or the re-acquisition price is fair value at the time of reacquisition).

If the asset is derecognised into a Special Purpose Entity (SPE), however, there may be a requirement for that SPE to be consolidated into the financial statements of the originating entity.

On derecognition, the difference between the amount received and the carrying amount of the asset is included in the income statement. Any fair value adjustments on the assets formerly reported in equity are “recycled” to the income statement. Any retained interests or benefits are valued at an allocation of the previous carrying amount and recognised as separate assets. Any new assets or liabilities arising from the transaction are valued at fair value.

US GAAP Sale accounting is achieved if an entity has surrendered control over all or a portion of a financial asset sold, otherwise the transfer is accounted for as a borrowing secured by the assets. The rules under **US GAAP** are similar to those under **IAS**. The guidance in **US GAAP** is more detailed and includes the legal isolation of financial assets from the transferor (even in bankruptcy or receivership) as a necessary condition for derecognition.

UK GAAP The “risks and rewards” approach to the recognition and derecognition of assets focuses in part on the substance of a transaction rather than purely its legal form. The asset is removed from the balance sheet only where the transaction transfers to others all significant rights or other access to benefits relating to that asset, and all 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 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.

Derecognition of Financial Liabilities

For **IAS** and **US GAAP** a financial liability should be removed from the balance sheet when it is extinguished i.e. the obligation specified in the contract is discharged, cancelled or expires, or the primary responsibility for the liability is transferred to another party. The difference between the carrying amount of a liability (or a portion thereof) extinguished or transferred and the amount paid for it should be included in net profit or loss for the period.

UK GAAP does not have specific detailed requirements on the derecognition of financial liabilities. However practice is similar to IAS and US GAAP.

REFERENCES: **IAS:** IAS 39. **US GAAP:** FAS 125. **UK GAAP:** FRS 5.

Provisions

IAS and **UK GAAP** have specific and very similar standards on provisions, whilst **US GAAP** has several standards addressing specific provisions situations, e.g. environmental liabilities and restructuring costs. All three frameworks prohibit recognition of provisions for future costs such as those associated with proposed but not yet effective legislation (i.e. such costs should be recognised as incurred).

IAS
UK GAAP
Provisions should be recognised when and only when:

- an enterprise has a present obligation (legal or constructive) as a result of a past event;
- it is probable that an outflow of resources will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

This approach restricts the circumstances in which a provision is recognised; an enterprise is not able to recognise a provision based solely on intent to incur expenditure in the future. The amount recognised should be the best estimate of expenditure required to settle the present obligation at the balance sheet date. Expected gains from the disposal of assets and any recoveries are dealt with separately. Discounting, at a pre-tax rate, should be applied if the effect is material.

US GAAP Broadly comparable to IAS and UK GAAP, although contained within several standards.

Restructuring provisions

IAS
UK GAAP
A provision for some "past" costs (e.g. lease termination and redundancy) is recorded where the entity has a constructive obligation to restructure. This arises when an enterprise has a detailed formal plan for the restructuring, identifying the business concerned, the main locations and employees affected, the expenditures to be made and an expected timescale. The enterprise should also have raised a valid expectation in those affected that the restructuring will be carried out, either by commencing implementation or by announcing its main features to those affected. Restructuring provisions should only include incremental costs not associated with ongoing or new activities of the entity (e.g. not retraining costs).

US GAAP Separate rules apply for provisions relating to discontinued operations – see page 38. Provisions are also made for those costs which are directly associated with a plan to exit an activity not meeting the definition of a discontinued operation (such as employee termination benefits and other restructuring costs), provided there is a clear commitment to the exit plan. The criteria to be met and the types of costs to be included are comparable to those under IAS and UK GAAP.

Contingencies

IAS and **UK GAAP** focus on present and possible obligations resulting from past events in determining the accounting for contingent liabilities. Present obligations where an outflow of economic benefits is probable (defined as more likely than not) and reliably measurable should be accounted for as provisions – see above. Those where the outflow is not probable but not remote should be disclosed but no liability recorded, as should possible obligations which will be confirmed by future events.

US GAAP is broadly comparable, 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 resources is probable.

Under all three frameworks, contingent assets should be disclosed if an inflow of economic benefits is probable.
If realisation of the associated gain is virtually certain, then the asset is not contingent and should be recognised.

REFERENCES: **IAS**: IAS 37. **US GAAP**: FAS 5, EITF 93-5, EITF 94-3, SAB 92, SOP 96-1. **UK GAAP**: FRS 3, FRS 7, FRS 12.

Employee Benefits

All three frameworks have standards for the recognition and measurement of the cost of pensions and other post-retirement benefits. US GAAP also includes a standard on post-employment benefits.

Pension and other post-retirement benefit costs

The objective of the standards on pension and post-retirement benefit costs under all three frameworks is to recognise the cost of providing those benefits on a systematic and rational basis over the period during which employees provide services. For defined contribution pension schemes the cost is purely the contributions payable to the scheme.

Differences arise in accounting for defined benefit schemes – for example the actuarial methods and discount rates to be used and the method of valuing plan assets. The most significant are set out below.

ISSUE	IAS	US GAAP	UK GAAP (see also "Recent proposals")
Determination of pension and post-retirement expense	Use projected unit credit actuarial method.	Comparable to IAS.	Some flexibility in choice of methods.
Discount rate for obligations	Based on market yields on high quality corporate bonds.	Comparable to IAS.	Use a long-term risk-adjusted rate.
Valuation of plan assets	Measure at fair value or using discounted cash flows if market prices unavailable.	Measure at fair value or market-related value.	Measure on an actuarial basis (i.e. projected future income streams discounted at long-term stable rate).
Frequency of actuarial valuations	Sufficiently regularly that financial statement amounts are not materially different from amounts determined at balance sheet date.	Annual valuation required.	Not specified but in practice at least every three years.
Recognition of actuarial gains and losses	Amortise over expected remaining working lives of participating employees, the net gain/loss in excess of 10% of greater of defined benefit obligation or fair value of plan assets at beginning of year. Faster recognition permitted using systematic methods if consistently applied.	Comparable to IAS.	Amortise over the expected remaining service lives of current employees.
Balance sheet asset limitation	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 funds from the plan or reduction in future contributions to the plan.	No similar requirement.	Broadly comparable to IAS. Balance sheet asset limited to the present value of any refunds from the plan or reduction in future contributions to the plan.
Recognition of minimum liability	No requirement.	Minimum liability is amount that plan is underfunded (ignore projected future salary increases).	No requirement.

Employee Benefits (continued)

Pension and other post-retirement benefit costs (continued)

ISSUE	IAS	US GAAP	UK GAAP
Positive plan amendments	Past service cost for active employees recognised over average remaining vesting period. For other employees and former employees recognise past service cost immediately.	Past service cost for current and former employees generally recognised over remaining service lives of active employees.	Should be allowed for in actuarial assumptions and therefore recognised over expected remaining service lives of current employees.
Negative plan amendments	Account for similarly to positive plan amendments.	Defer and use first to offset previous positive past service costs. Recognise excess as for positive plan amendments.	Not directly addressed. In practice, amortised over the expected remaining service lives of current employees.
Multi-employer plans	Use defined benefit accounting unless sufficient information not available.	Use defined contribution accounting.	Broadly comparable to IAS.

Post-employment benefits, termination benefits and other employee benefits

Under **IAS** post-employment benefits should generally be accounted for consistently with pensions, including termination indemnity plans where the benefit is payable regardless of the reasons for the employee's departure. However there are different rules for termination benefits arising from redundancies which should be accounted for similarly to restructuring provisions (see page 27). Long-term employee benefits such as incentive plans should be accounted for similarly to pensions, except that actuarial gains and losses and past service costs should be recognised immediately. There is no specific standard at present under **UK GAAP** covering these areas (except termination benefits arising from redundancies where the rules for restructuring provisions apply), but practice is generally comparable to IAS.

Under **US GAAP** there is a specific standard addressing post-employment benefits, for example salary continuation, termination benefits, training and counselling. A liability for the potential cost of post-employment benefits should be accrued during the employment period of the employees if certain conditions are met. Otherwise the liability should be recognised when the event causing it occurs. Although termination indemnity plans are considered to be defined benefit plans under US GAAP, entities may choose whether to use an actuarial method to measure that obligation.

Recent proposals – UK GAAP

In November 1999 the ASB issued an exposure draft (FRED 20) "Retirement benefits". The main issues aired include the valuation of pension scheme assets, the discount rate to be applied to pension and other benefit obligations, the treatment of actuarial gains and losses and the treatment of past service costs.

Some of the proposals are comparable to IAS and US GAAP, for example, measuring pension scheme assets at market values and the use of a high quality corporate bond rate to discount pension liabilities.

The proposed methods of recording actuarial gains and losses are as follows:

- movements in actuarial assumptions including certain investment gains and losses are recognised in the statement of recognised gains and losses;
- current costs, past service costs from benefit improvements, settlements and curtailments are recognised in the income statement; and
- the unwinding of the discount on the employee liability and a notional return on assets are recognised in the interest line of the income statement.

The ASB rejected the "corridor" approach adopted by IAS and US GAAP.

REFERENCES: **IAS**: IAS 19 (Revised). **US GAAP**: FAS 43, FAS 87, FAS 88, FAS 106, FAS 112, FAS 132. **UK GAAP**: SSAP 24, UITF 6, FRED 20.

Employee Stock Compensation

There are no rules under **IAS** for measuring employee stock compensation. Under both **US GAAP** and **UK GAAP**, the "cost" of providing shares or rights to shares to an employee under share schemes is generally charged to the income statement over the period to which the employee's performance relates. However, the measurement of "cost" can differ between the two frameworks as detailed below.

Determination of the cost of stock compensation plans

US GAAP The cost of shares/options awarded to employees, whether conditional upon performance criteria or not, should be recognised over the period to which the employee's service relates. Entities have a choice of accounting methods for determining the costs of benefits arising from employee stock compensation plans. They may either follow the intrinsic value method (APB 25) or a fair value method (FAS 123).

Under APB 25 the compensation cost is the difference between the market price of the stock at the measurement date and the price to be contributed by the employee/exercise price; this is similar to UK GAAP. The measurement date is the first date on which are known both (a) the number of shares that an individual employee is entitled to receive and (b) the stock option or purchase price, if any. Commonly this will be the date of grant, but if later then the cost should be measured using the market price at the end of each intervening period.

Under FAS 123 the compensation cost is based on the fair value of the option at the date of grant. This is estimated using an option pricing model taking into account the following factors: the stock price at the grant date, the exercise price and expected life of the option, any expected price volatility, the expected dividend yield and a risk-free interest rate during the expected life of the option.

If an entity chooses to follow APB 25 then it must make pro-forma disclosures of net income and earnings per share had FAS 123 been applied.

UK GAAP The cost of shares/options awarded to employees are recognised immediately if they are unconditional on performance criteria (unless clearly unrelated to past performance e.g. on initial recruitment). If the award of shares/options is conditional upon future performance criteria, the cost should be recognised over the period to which the employee's service relates. The minimum cost is the intrinsic value of the award/option: i.e. the difference between the fair value of the shares at the date of grant less any contribution required from the employee or exercise price. The cost should be based on a reasonable expectation of the extent that the performance criteria will be met. Any subsequent changes in that expectation are reflected in the income statement as necessary.

The rules need not be applied to Save As You Earn schemes.

Disclosures

All three frameworks require certain general disclosures about stock compensation plans to be given; the requirements of IAS and US GAAP are more extensive than those under UK GAAP, although under UK GAAP numerous disclosures must be given relating to Directors.

REFERENCES: **IAS**: IAS 19 (Revised). **US GAAP**: APB 25, FAS 123. **UK GAAP**: UITF 17.

Employee Share Option Plans

Employee share option plans (ESOPs) are designed to facilitate employee shareholdings and are often used as a vehicle for distributing shares to employees under employee participation and remuneration schemes. There is no current guidance under **IAS** for such plans. Under both **US** and **UK GAAP**, an ESOP trust's assets and liabilities are included in the balance sheet of the sponsoring company where the arrangements are such that the sponsoring company has de facto control and bears the benefits and risks of the shares held by the ESOP trust. The two frameworks differ in the treatment of the shares held by the ESOP in the sponsoring employer's financial statements and of the dividends received from those shares – see below.

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

Presentation of ESOP shares and dividends

US GAAP The issuance or sale of the sponsoring company's shares to the ESOP is a debit balance within equity and described as "unearned ESOP shares". This account is subsequently credited as the shares are committed for release based on the cost of the shares to the ESOP. For ESOP shares that are committed to be released to compensate employees, the sponsoring company recognises a compensation cost equal to the fair value of the shares.

Dividends on unallocated ESOP shares are accounted for as a reduction of either debt interest payable or compensation cost. For the purposes of computing earnings per share (EPS), ESOP shares are only included in the calculation of outstanding shares once they are committed to be released.

UK GAAP Where, as is generally the case, the ESOP shares are held for the continuing benefit of the sponsoring company's business, they are classified as "own shares" within fixed assets; otherwise they are classified as "own shares" within current assets. Cost is written down to residual amount (the option proceeds) over the employee's service period. Once the shares vest unconditionally in the employees, they are no longer recognised as assets of the sponsoring company.

Dividend income from ESOP shares should be excluded in arriving at profit before tax and deducted from dividends paid and proposed. The shares should also be excluded from EPS calculations until they have been unconditionally vested in the employees.

REFERENCES: **US GAAP**: SOP 93-6. **UK GAAP**: FRS 5, UITF 13.

Government Grants

Under all three frameworks, government grants (or contributions) are recognised in the income statement once the conditions for their receipt have been complied with 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 should also be deferred. **IAS** and **US GAAP** allow two approaches; either treat the grant in the balance sheet as deferred income, amortising the income over the useful life of the asset or offset it against the cost of the asset to which the grant relates. Under **UK GAAP** the first approach is adopted, as the second is contrary to the law.

REFERENCES: **IAS**: IAS 20. **US GAAP**: FAS 116. **UK GAAP**: Companies Act 1985, SSAP 4.

Deferred Income Taxes

IAS and **US GAAP** require full provision for deferred taxes, calculated on balance sheet temporary differences using the liability method (i.e. using tax rates at which the taxes are expected to be paid). By contrast, **UK GAAP** uses the partial provision method to determine deferred taxes based on future income statement timing differences, and therefore takes account only of those deferred taxes which are expected to crystallise in the foreseeable future.

Accounting for deferred tax

IAS
US GAAP Full provision for deferred tax is made, adopting a "balance sheet" approach. Deferred tax is calculated on temporary differences, being the differences between the tax and book values of assets and liabilities (with differing limited exemptions under each framework). The deferred tax charge or credit is the change in the period in deferred tax liabilities and assets other than those relating to equity items (tax effect recorded directly in equity) or to a business combination accounted for as an acquisition (tax effect recorded in goodwill calculation). A particular feature of the balance sheet approach is that it requires deferred tax to be calculated on revaluations and on fair value adjustments made in acquisition accounting. Enacted or, under IAS, also substantially enacted tax rates should be used.

There are some differences in the application of the **IAS** and **US GAAP** standards, including prior year acquisitions, tax base of a foreign branch and the presentation of deferred tax balances. In addition, under IAS a deferred tax asset must be recognised on the elimination of unrealised profits arising from intra group transactions (using the buyer's tax rate). Such deferred tax assets are prohibited under US GAAP. This gives rise to a difference between **IAS** and **US GAAP** when tax rates differ between the buyer and seller.

UK GAAP The partial provision method is used for deferred taxes, whereby tax is provided for to the extent that it is probable that the tax will become payable i.e. to the extent that timing differences between taxable and accounting income will reverse in the foreseeable future. However, entities should record the full deferred tax benefit of funding pension costs and other post-retirement benefits (subject to recoverability). In addition, disclosure is required of the full potential deferred tax liability. The current tax rate is used but known future changes to tax rates (e.g. announced in the Budget) would be incorporated.

Deferred tax assets

IAS Recognise when it is probable that future taxable profits will be available against which the deferred tax asset can be utilised. The carrying amount of the deferred tax asset is reviewed at each balance sheet date and reduced if appropriate.

US GAAP Recognise in the balance sheet at full value, but reduce by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion, or all, of the deferred tax asset will not be realised.

UK GAAP Record to the extent that they are expected to be recoverable without replacement by equivalent debit balances, and in the case of tax losses, provided that it is assured beyond reasonable doubt that future taxable profits will be sufficient to offset the current loss during the legal carry-forward period of the tax loss. Deferred tax assets relating to pension provisions can however be recognised in full subject to recoverability.

Recent proposals - UK GAAP

In November 1999 the ASB issued an exposure draft (FRED 19) "Accounting for Deferred Tax" which proposes an "incremental liability" approach. Tax is provided for on timing differences recognised by the balance sheet date but only when an entity has an obligation to pay more tax in the future. No deferred tax is provided on permanent differences or on revaluation surpluses unless the entity is contractually committed to selling the asset at the balance sheet date.

The ASB has proposed that deferred tax balances should be discounted if the effect is material. However, it is expected that the final standard will only include discounting if there is significant support for it in comments on the exposure draft.

REFERENCES: **IAS:** IAS 12 (Revised). **US GAAP:** FAS 109. **UK GAAP:** SSAP 15, FRED 19.

Capital Instruments

Categorisation of shares

IAS The critical feature in differentiating whether an instrument is classified as a financial liability or as an equity instrument is the existence of a contractual obligation (or economic compulsion) on the issuer either to deliver cash or another financial asset to the holder or to exchange another financial instrument with the holder under conditions that are potentially unfavourable to the issuer. When such a contractual obligation exists, that instrument meets the definition of a financial liability regardless of the manner in which the contractual obligation will be settled.

Preferred shares which are not redeemable or redeemable solely at the option of the issuer or where distributions are at the discretion of the issuer, are therefore 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 shown as liabilities rather than equity.

Where the instruments are shown as liabilities, any associated dividends are included in interest expense in the income statement.

US GAAP Shareholders' equity is analysed between capital stock (showing separate categories for non-redeemable preferred stock and common stock) and other categories of shareholders' equity. Redeemable preferred stock is not classified in equity but normally in a "mezzanine" category between shareholders' equity and liabilities.

UK GAAP Shareholders' equity and minority interests are analysed between equity and non-equity interests (as required by the law); all preference shares are treated as a "non-equity shares" component of share capital.

Purchase of own shares

IAS
US GAAP When a company's own shares are repurchased the shares are shown as a deduction from shareholders' equity. Any profit or loss on subsequent sale of the shares is shown as a change in equity.

UK GAAP A company may purchase its own shares provided the laws on capital maintenance are adhered to. The shares must be cancelled on redemption or repurchase; where the redemption or repurchase is paid for from profits, an amount equivalent to the nominal value is transferred from share capital to a non-distributable capital redemption reserve. An exemption is available for shares purchased by an employee benefit trust, where such shares are shown as an asset rather than a deduction from equity.

Convertible debt

IAS "Split accounting" is used; the proceeds are allocated between the two components: the equity conversion rights (shown in equity) and the liability (recorded at fair value calculated by discounting at a market rate for a non-convertible debt and shown in liabilities).

US GAAP Show as a liability, although a few instruments such as those with detachable warrants may require split accounting.

UK GAAP Comparable to US GAAP.

REFERENCES: **IAS:** IAS 32, IAS 39. **US GAAP**: ASR 268(SEC), APB 6, APB 14. **UK GAAP**: Companies Act 1985, FRS 4.

Derivatives and other Financial Instruments – Measurement

The **IASC** has issued a standard on recognition and measurement of financial instruments (effective for periods beginning after 1 Jan 2001 with earlier application permitted). Although seen by the IASC as an interim solution until the long-term project (see recent proposals) has been completed, it will most likely be in place for some time. Current **US GAAP** guidance is not as broad as the **IAS** standard which addresses all financial instruments, not just derivatives and hedging activities. The **US GAAP** standard that covers accounting for derivative instruments and hedging activities is effective for accounting periods beginning after 15 June 2000 with earlier application permitted. Other financial assets and liabilities are addressed by other standards, for example those on debt and equity securities.

There is currently no specific accounting standard within **UK GAAP** dealing with the recognition and measurement of all financial instruments, including derivatives, although some financial instruments are addressed by other standards.

Hedges of net investments in foreign entities

IAS and **US GAAP** require and **UK GAAP** allows special presentation of gains and losses on financial instruments designated as hedges of a net investment in a foreign entity. Gains and losses on these hedging instruments are recorded in equity (via the statement of recognised gains and losses/other comprehensive income). Under **IAS** and **US GAAP** these gains/losses are transferred to the income statement on disposal of the foreign entity. **UK GAAP** does not require subsequent "recycling" to the income statement.

Under **US GAAP** and **UK GAAP** any hedge ineffectiveness is taken to the income statement. IAS allows the full gains and losses on hedges of a net investment in a foreign entity to be deferred in equity (including any hedge ineffectiveness), provided the hedging instrument is a non-derivative (e.g. a borrowing). For derivative instruments any hedge ineffectiveness must be recorded in the income statement.

Non-hedged financial instruments – measurement and recognition of gains and losses

IAS Most financial assets, including derivatives, are carried in the balance sheet at fair value. Exceptions to this rule are those financial assets that cannot be reliably measured, those fixed term securities that the enterprise has the intent and the ability to hold to maturity, and those originated by the enterprise and not intended to be sold immediately or in the short term. Most financial liabilities are measured at amortised cost, except derivative and trading liabilities which are measured at fair value.

An entity makes a one-time selection of its accounting policy for the treatment of gains and losses on non-hedged financial assets and liabilities measured at fair value. These are either all reported in the income statement, or gains or losses on available-for-sale financial assets are recorded in equity and "recycled" to the income statement once the asset is sold, collected, disposed of or impaired.

US GAAP Comparable to **IAS**, except:

- the category "originated by the enterprise and not intended to be sold immediately or in the short term" is not contained in US GAAP;
- there is no selection of policy available for gains and losses on non-hedged financial assets and liabilities measured at fair value. Under US GAAP, gains and losses on instruments held for short term trading are reported in the income statement; all other gains and losses are recorded in other comprehensive income and "recycled" to the income statement once the asset is sold or the liability extinguished.

UK GAAP No specific guidance covering all financial assets – see page 24 for details on measuring investments – although there are extensive disclosure requirements. Financial liabilities are measured at amortised net proceeds. Gains and losses on all financial liabilities are recognised in the income statement when the liability is extinguished.

Derivatives and other Financial Instruments – Measurement (continued)

Derivative instruments and hedging activities

IAS All derivatives are measured at fair value.

To qualify for hedge accounting treatment, hedge relationships must meet certain qualifying criteria (e.g. documentation requirements and hedge effectiveness). Gains and losses from the ineffective portion of hedges and from other derivatives are included in the income statement. The gains and losses from effective hedges are treated as follows:

- gains and losses on fair value hedges, for both the hedging instrument and the item being hedged, are reported in the income statement. Hence any ineffectiveness of the hedge impacts net profit or loss; and
- for cash flow hedges, including foreign currency forecasted transactions, gains and losses are initially recognised in equity and subsequently amortised 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 must be included in the cost of the asset or liability – so-called "basis adjustment".

US GAAP All derivatives must be reported on the balance sheet at fair value, regardless of any hedging relationship that may exist. As with **IAS**, to qualify for hedge accounting treatment, hedge relationships need to meet certain qualifying criteria.

Included within fair value hedges under **US GAAP** are hedges of foreign currency firm commitments and the foreign currency risk associated with available-for-sale securities.

For cash flow hedges, including foreign currency forecasted transactions, gains and losses are initially recognised in other comprehensive income and subsequently amortised 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 are left in other comprehensive income when the asset is acquired and subsequently amortised from there. There is no "basis adjustment" as required under **IAS.**

Hedge accounting rules are comparable to those under **IAS**, with the following exceptions:

- **IAS** requires hedges of firm commitments to be treated as cash flow hedges whereas **US GAAP** considers these to be fair value hedges. **US GAAP** requires the commitment to be measured at fair value and recorded on the balance sheet as a "quasi-asset". Gains and losses in the fair value of the commitment are recorded in the income statement together with gains and losses arising on the instrument hedging the commitment (which is also recorded at fair value on the balance sheet); and
- under **IAS**, a held-to-maturity security cannot be hedged with respect to interest rate risk, but can be hedged with respect to foreign currency exchange rate risk. **US GAAP** does not allow either risk to be hedged.
- **IAS** is more flexible in what can be designated as the hedged risk. The **US** standards restrict this to the entire risk of changes in fair value, or the entire interest rate risk, currency risk or counterparty credit risk in a hedged item. **IAS** does not specify what can qualify as hedged risk, so that any sub-component of each type of risk could be hedged.

Derivatives and other Financial Instruments – Measurement (continued)

Recent proposals – all three frameworks

A Joint Working Group (JWG) is working on the development of a long-term solution to recognising and measuring all financial instruments. The JWG comprises national standard setters from around the world including the IASC, FASB and ASB. Their aim is to complete an exposure draft during the second half of 2000. The JWG is considering if all financial instruments should be measured at fair value and whether specific rules would apply to financial instruments that serve as a hedge. Gains and losses arising from changes in the fair value would generally be included in the income statement.

REFERENCES: **IAS**: IAS 21, IAS 39. **US GAAP**: FAS 52, FAS 133, FAS 137. **UK GAAP**: SSAP 20, FRS 4, UITF 19, Discussion paper - Derivatives and other financial instruments.

Derivatives and other Financial Instruments - Disclosures

The extensive disclosure requirements in **IAS** and **US GAAP** apply to all companies, except that under **US GAAP** fair value disclosures are not required for certain small non-public entities. The **UK** disclosure standard is limited to entities with publicly traded debt or equity and all banks. The disclosures under all three frameworks are broadly 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.

REFERENCES: **IAS:** IAS 7, IAS 32, IAS 39. **US GAAP**: FAS 47, FAS 105, FAS 107, FAS 119, FAS 133, SEC FRR 48, SEC ASR 148. **UK GAAP**: FRS 13.

Related Party Transactions

The objective of the disclosures required by IAS, 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 significant influence by one party over another. The three accounting frameworks are broadly similar as to which parties would be included within the definition of related parties, for example subsidiaries, 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

IAS Unlike the UK and US standards, there is no specific requirement in IAS to disclose the name of the related party (other than the ultimate parent entity) or the amounts involved in a transaction. However, these disclosures would appear to be needed in order to present meaningfully the “elements” of the transaction, which is a disclosure requirement.

Exemptions from disclosures about related party transactions in the financial statements of subsidiaries are rather more limited than under UK GAAP: the subsidiary must be wholly owned and their parent must be incorporated in the same country and provide consolidated financial statements.

US GAAP The nature and extent of any transactions with all related parties should be disclosed, together with the amounts involved. Unlike the International and UK standards, 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 which includes the parent’s consolidated financial statements (including those subsidiaries).

UK GAAP The nature and extent of any transactions with all related parties should 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.

REFERENCES: **IAS**: IAS 24. **US GAAP**: FAS 57. **UK GAAP**: Companies Act 1985, FRS 8.

Post Balance Sheet Events

Under all three frameworks events occurring after the balance sheet date are reflected in the financial statements to the extent that they provide additional evidence of conditions which existed at the balance sheet date and materially affect the amounts included. Such events are adjusting events and relevant amounts are changed accordingly.

Non-adjusting events are material events occurring after the balance sheet date which concern conditions that did not exist at the balance sheet date. The nature and estimated financial effects of such events are disclosed to prevent the financial statements being misleading.

Dividends proposed or declared after the balance sheet date must be treated as non-adjusting events under **IAS**. Under **UK GAAP** they are adjusting events, whereas under **US GAAP** the declaration of a cash dividend is non-adjusting but a stock dividend is adjusting.

REFERENCES: **IAS**: IAS 10 (Revised). **US GAAP**: AU Section 560. **UK GAAP**: Companies Act 1985, SSAP 17.

Discontinuing/Discontinued Operations

US and **UK GAAP** contain rules on both the measurement and disclosures required for discontinued operations. **IAS** only includes requirements for disclosures of discontinuing operations, stating that the measurement rules contained in other standards, for example on impairment and provisions, should be followed.

ISSUE	IAS	US GAAP	UK GAAP
Definition	Separate major component.	Identifiable component representing major class of business.	Operation whose discontinuance has material effect on nature/focus of business.
How discontinued	Either substantially in its entirety or piecemeal or through abandonment.	Has been or will be sold, abandoned or otherwise disposed of.	Sold or otherwise terminated.
Envisaged timescale	Over several months or longer but pursuant to a single plan.	Completed within a year of measurement date (date of management's commitment to discontinuance plan).	Completed within the period or within earlier of 3 months after period end or date of approval of financial statements.
Measurement	Follow other IASs e.g. on provisions and impairment.	Measure gain or loss on discontinuance at measurement date, including provisions for operating losses and estimated loss on disposal. Recognise gains when realised.	Broadly comparable to IAS, but include effects of future operating profits of discontinued operation and direct costs of discontinuance in measurement of provision.
Presentation	Continue to consolidate as normal until discontinuance completed, with additional disclosures on face of income statement or in notes – see below.	Present result from operations of discontinued component and gain or loss on disposal as separate lines in income statement, net of tax. Show after income from continuing operations. Balance sheet consolidation as normal, if discontinuance not completed by period end.	Show revenue and operating profit separately on face of income statement. Balance sheet consolidation as normal, if discontinuance not completed by period end.
Disclosures – when	From period including initial disclosure event (earlier of agreement of binding sale or management approval/ announcement of detailed formal discontinuance plan) to completion of discontinuance.	Period including measurement date until period including disposal date (completion of sale or termination).	Period of discontinuance until completed.
Disclosures – where	Face of income statement or notes.	Notes.	Face of income statement or notes.
Disclosures – what	• Description of component and which segment it is part of; • date and nature of initial disclosure event; • expected timescale for completion of discontinuance; • carrying value of total assets/ liabilities to be disposed of; and • revenue, expenses, pre-tax result, tax and cash flows for current period.	• Identity of segment; • expected date and manner of discontinuance; • description of remaining assets/liabilities to be disposed of; • revenues/taxes for that segment; and • income/loss of segment since measurement date.	Amounts related to statutory income statement headings between revenue and operating profit.
Disclosures once completed	Pre-tax gain or loss (face of income statement).	Gain on disposal (losses recognised earlier).	Comparable to IAS.
Comparatives	Restate for effects of discontinuing operations.	Comparable to IAS.	Comparable to IAS.

REFERENCES: **IAS:** IAS 35, IAS 36, IAS 37. **US GAAP:** APB 30. **UK GAAP:** FRS 3, FRS 12.

Earnings Per Share

Earnings per share (EPS) must be disclosed for listed companies. All three frameworks are substantially the same in their methods of calculating EPS.

Basic EPS

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. Comparative EPS is adjusted for bonus issues and rights issues.

Diluted EPS

There is no "de minimus" 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 recognised in the period in respect of the dilutive potential ordinary shares and for any other changes in income 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 ordinary shares.

The "treasury stock" method is used for determining 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 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.

REFERENCES: **IAS**: IAS 33. **US GAAP**: FAS 128. **UK GAAP**: FRS 3, FRS 14.

Extraordinary and Exceptional Items

Extraordinary items are very rare under **IAS** and **US GAAP**, being restricted for example to losses arising from natural disasters and expropriation of assets, and, additionally for US GAAP, gains/losses on the early extinguishment of debt. Extraordinary items do not arise under **UK GAAP**.

Exceptional items are those material items which derive from events or transactions within the ordinary activities of the entity which by virtue of their size or incidence need to be separately disclosed for a proper understanding of the financial statements. There are some minor differences in the disclosure requirements under each framework.

Disclosure requirements

IAS Disclosure of individual extraordinary items can be made either on the face of the income statement or in the notes, provided the total of all such items is shown on the face of the income statement.

Exceptional items are usually disclosed in the notes, although it is acceptable to present them on the face of the income statement.

US GAAP Extraordinary items are 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.

Items of an exceptional nature are treated separately in arriving at income from operations. Importantly, subtotals of income from operations before such items are prohibited.

UK GAAP Exceptional items are disclosed 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 they relate.

Significant gains/losses on the sale or termination of an operation or on the disposal of property, plant and equipment and the costs of a fundamental reorganisation are disclosed on the face of the income statement after operating profit but before interest and are analysed between continuing and discontinued operations.

REFERENCES: **IAS:** IAS 8. **US GAAP:** APB 30. **UK GAAP:** FRS 3.

Segment Reporting

Segment disclosures are required for listed companies under all three frameworks and also for very large private companies under UK GAAP. The disclosures differ between each framework.

IAS The primary segment format (i.e. business or geographical) is determined based on the entity's predominant source of business risks and returns and identified by reference to the entity's management and internal financial reporting structure. A segment must be separately reported where most of its sales are to external customers and its sales, profit or assets are 10% or more of the consolidated totals. The principal disclosure requirements for the primary segment format are as follows:

- revenue and result;
- total assets and liabilities;
- capital expenditure;
- depreciation/amortisation and other significant non-cash expenses; and
- share of result and net assets of investments accounted for under the equity method.

For the secondary segment analysis (i.e. business or geographical, whichever is not the primary format), disclosures are limited to revenue, total assets and capital expenditure; segment result does not have to be disclosed.

US GAAP Segment information presented is based on the financial information about an entity's operating segments as reported in its internal financial reports; importantly this would not necessarily be on a consolidated GAAP basis, which is the basis required by **IAS** and **UK GAAP**. Operating segments are those business activities for which discrete information is available, and whose operating results are regularly reviewed by the entity's chief operating decision maker in determining resource allocation and assessing performance. The same 10% threshold as in IAS applies in determining the segments to be reported. If any of the following items are disclosed in the internal financial reports, they must also be disclosed in the segment information in the financial statements:

- revenue and result;
- total assets;
- interest revenue/expense;
- depreciation/amortisation and other significant non-cash items;
- unusual (i.e. exceptional) items/extraordinary items;
- share of net income/net assets of equity method investees; and
- tax charge/credit.

US GAAP also requires certain enterprise-wide disclosures, for example revenues and long-lived assets by geographic area, revenues by product group and revenues from single customers or countries that represent 10% or more of consolidated revenues. These enterprise-wide disclosures must be prepared on a consolidated GAAP basis (i.e. not the internal financial reporting basis used for the operating segment disclosures).

UK GAAP For both business and geographical segments whose third party turnover, result or net assets are equal to 10% or more of the corresponding entity totals, disclose the following:

- revenue and result;
- net assets; and
- share of results and net assets of significant associated undertakings.

Alone amongst the three frameworks, UK GAAP permits exemption from segment disclosures if the directors consider these would be seriously prejudicial to the interests of the reporting entity, but if this exemption is used it must be disclosed.

REFERENCES: **IAS:** IAS 14 (Revised). **US GAAP:** FAS 131. **UK GAAP:** Companies Act 1985, SSAP 25.

Cash Flow Statements

Cash flow statements must be presented under all three frameworks. Some exemptions are available under UK GAAP, for example in the financial statements of (at least) 90% owned subsidiaries, provided that the parent's consolidated financial statements that include those subsidiaries are publicly available. Limited exemptions are also available under US GAAP and UK GAAP for certain investment enterprises.

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. Significant non-cash transactions are disclosed separately in narrative or numerical form to show clearly the cash and non-cash elements.

The main differences between the three frameworks are the formats adopted and the definition of cash and cash equivalents, particularly with regard to overdrafts and short term marketable securities.

Format

IAS There are three main headings: operating, investing and financing activities. Whereas US and UK GAAP prescribe the treatment of interest and dividends paid and received, under IAS an entity should classify these items in a consistent manner from period to period, as either operating or financing cash flows (interest or dividends paid) or operating or investing cash flows (interest or dividends received).

US GAAP The headings under which cash flows must be categorised are the same as those under IAS but US GAAP prescribes which items must be included in each heading. Interest paid and received and dividends received are operating activities cash flows, whilst dividends paid are financing cash flows.

UK GAAP The standard format for cash flow statements includes the following headings:

- operating activities;
- dividends received from associates;
- returns on investments and servicing of finance (including interest paid, interest received and other dividends received);
- taxation;
- capital expenditure and financial investment;
- acquisitions and disposals;
- equity dividends paid;
- management of liquid resources; and
- financing.

Definition of cash and cash equivalents

IAS Cash includes overdrafts repayable on demand but not short-term bank borrowings, which are considered to be financing. Cash equivalents are defined as short term, highly liquid investments that are readily convertible to known amounts of cash and which 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 IAS, but under US GAAP 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 but are dealt with in liquid resources and financing.

REFERENCES: **IAS:** IAS 7. **US GAAP:** FAS 95. **UK GAAP:** FRS 1 (Revised).

Statement of Recognised Gains and Losses

Each framework requires prominent presentation of a primary statement showing total recognised gains and losses (total comprehensive income). The total of gains and losses recognised in the period attributable to shareholders comprises net income plus gains and losses recognised directly in equity, such as movements in revaluation reserves, foreign exchange translation differences and the effects of changes in accounting policies. Under IAS and US GAAP changes in fair values on certain financial instruments and movements on hedging reserves are also included.

IAS The statement of recognised gains and losses can be presented either as a separate primary statement or separately highlighted within the primary statement of movements in equity.

US GAAP One of three possible formats of presentation exist:

- a single primary statement of income and comprehensive income containing both net income and other comprehensive income;
- a two-statement approach (as under IAS and UK GAAP); or
- a separate category highlighted within the primary statement of changes in equity (as under IAS).

In addition, an entity must show the cumulative amounts for each item of comprehensive income.

UK GAAP A separate primary statement of total recognised gains and losses (STRGL) is required.

REFERENCES: **IAS**: IAS 1 (Revised). **US GAAP**: FAS 130. **UK GAAP**: FRS 3.

Operating and Financial Review

IAS and **UK GAAP** encourage but do not mandate the inclusion of an operating and financial review (OFR) outside the financial statements of public and large private companies. Both frameworks give some guidance as to the contents of such a review. By contrast, an enterprise filing with the SEC in the **US** is required to include a management discussion and analysis (MD&A) section in addition to the financial statements.

IAS
UK GAAP There is much common ground in the information which both the IASC and ASB guidance suggests should be included in the OFR:

- main features of operating performance for the current period of review;
- "dynamics of the business" – changes in the business environment, the reaction of the business to them and their effect on performance;
- policy for investment in the current period to maintain and enhance performance in future periods; and
- sources of funding, gearing policy and strategies for managing risks.

US GAAP The MD&A focuses on liquidity, capital resources and results of operations addressing the three year period covered by the financial statements and includes:

- explanation of material changes in financial statement balances, focusing on each relevant reportable segment if the revenues, profits and cash needs of these are disproportionate;
- general economic and industry conditions, including known prospective information;
- infrequent events or transactions; and
- the likely impact in future periods of recently issued accounting standards not yet implemented by the company.

Foreign companies listed in the USA should also discuss pertinent governmental, fiscal, monetary or political policies that may affect them or their US investors. They should also provide an explanation of the main differences between local accounting and US GAAP.

REFERENCES: **IAS**: IAS 1 (Revised). **US GAAP**: SEC Regulation S-K, SEC FRR 36. **UK GAAP**: ASB's Statement on Operating and Financial Reviews.

Interim Financial Reporting

Stock Exchange requirements

IAS The IASC is unable to mandate that public enterprises produce interim statements, but does encourage interim reporting – see additional guidance below.

US GAAP As well as following APB 28, domestic US SEC registrants must also comply with the specific financial reporting requirements in Regulation S-X applicable to quarterly reporting, including publication within 45 days 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 London Stock Exchange Listing Rules require only income statement information in respect of the first six months of each financial year, use of accounting policies consistent with the latest published annual financial statements and an explanatory statement to shareholders. In practice, many listed companies in the UK go further than the minimum requirements and already comply with the ASB's Statement on Interim Reports.

Additional guidance

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

- consistent and comparable 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 which 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. Hence incomplete transactions should be treated in the same way as at the year end, although 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 all three 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.

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

REFERENCES: **IAS**: IAS 34. **US GAAP**: APB 28, FAS 130, FAS 131. **UK GAAP**: London Stock Exchange Listing Rules (Chapter 12), ASB's Statement on Interim Reports, ASB's Statement on Preliminary Announcements.

Index

Subject	Page
Accounting assumptions	11
Accounting convention	11
Accounting estimates, changes in	11
Accounting policies, changes in	11
Acquisitions	14
Associates	12
Balance sheet	11
Borrowing costs, capitalisation of	21
Business combinations	14
Capital instruments	33
Cash equivalents	41
Cash flow statement	41
Comparatives	11
Comprehensive income	42
Computer software	19
Consolidation of subsidiaries	12
Construction contracts	25
Contingencies	27
Contingent consideration	15
Contributions	31
Convertible debt	33
Debt securities	24
Deferred income taxes	32
Depreciation	20
Derecognition of financial assets/liabilities	26
Derivatives	34
Discontinuing/discontinued operations	38
Earnings per share	39
Employee benefits	28
Employee stock compensation	30
Employee share option plans (ESOPs)	31
Equity method of accounting	12
Exceptional items	39
Extraordinary items	39
Financial instruments	34
Financial statements:	
– contents and presentation	11
Foreign currency transactions	13
Fundamental errors	11
Going concern	11
Goodwill	16
Government grants	31
Hedge accounting	34
Historical cost	11
Hyperinflation	13

Subject	Page
Impairment of assets	21
Income statement	11
Intangible assets	18
Interim financial reporting	43
Inventories	25
Investments	24
Investment properties	21
Joint ventures	12
Leases - classification	22
Leases - lessee accounting	22
Leases - lessor accounting	23
Long-term contracts	25
Management's discussion and analysis	42
Mergers	17
Minority interests	15
Negative goodwill	16
Operating and financial review	42
Pension costs	28
Pooling of interests method	17
Post balance sheet events	37
Post-employment benefits	29
Post-retirement benefits	28
Preference shares	33
Presentation of financial statements	11
Property, plant and equipment	20
Proportional consolidation	12
Provisions	27
Purchase method	14
Purchase of own shares	33
Related party transactions	37
Research and development costs	19
Restructuring provisions	27
Revaluations	18, 20,24
Revenue recognition	25
Sale and leaseback transactions	23
Segment reporting	40
Statement of recognised gains and losses	42
Subsidiaries	12
Termination benefits	29
Treasury shares	33
True and fair override	11
Uniting of interests	17

Glossary

APB	Accounting Principles Board Opinion (US)
ARB	Committee on Accounting Procedure Accounting Research Bulletins (US)
ASR	SEC Accounting Series Release (US)
AU	Auditing Standards (US)
CON	Financial Accounting Standards Board Concept (US)
E/ED	Exposure Draft (IAS/US)
EITF	Emerging Issues Task Force (US)
FAS	Financial Accounting Standard (US)
FASB TB	Financial Accounting Standards Board Technical Bulletin (US)
FIN	Financial Accounting Standards Board Interpretation (US)
FRED	Financial Reporting Exposure Draft (UK)
FRS	Financial Reporting Standard (UK)
IAS	International Accounting Standard (IAS)
SAB	SEC Staff Accounting Bulletin (US)
SEC FRR	SEC Financial Reporting Release (US)
SIC	Standing Interpretations Committee (IAS)
SOP	AICPA Statement of Position (US)
SSAP	Statement of Standard Accounting Practice (UK)
UITF	Urgent Issues Task Force (UK)

The following companion publications are available from your nearest PricewaterhouseCoopers office:

Understanding IAS - Analysis and Interpretation of International Accounting Standards

International Accounting Standards – A Pocket Guide

International Accounting Standards - Illustrative Corporate Financial Statements

International Accounting Standards - Illustrative Bank Financial Statements

International Accounting Standards – Disclosure Checklist

International Accounting Standards – Applying IAS 12: Income Taxes in practice

International Accounting Standards – Applying IAS 34: Interim Financial Reporting in practice

International Accounting Standards – Financial Instruments – Understanding IAS 39

Notes

Notes

International Accounting Standards - Similarities and Differences - IAS, US GAAP and UK GAAP is designed for the information of readers. While every effort has been made to ensure accuracy, information contained in this publication may not be comprehensive or may have been omitted which may be relevant to a particular reader. In particular, this publication is not intended as a study of all aspects of accounting practice under IAS, US GAAP and UK GAAP, nor as a substitute for reading the local accounting standards and other official pronouncements dealing with specific issues. PricewaterhouseCoopers can accept no responsibility for loss to any person acting or refraining from acting as a result of any material in this publication. Recipients should not act on the basis of this publication without seeking professional advice.

© PricewaterhouseCoopers 2000

Copyright © 2000 PricewaterhouseCoopers. All rights reserved. PricewaterhouseCoopers is authorised by the Institute of Chartered Accountants in England and Wales to carry on investment business. Designed by the studio 10783.