# Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers

## An Analysis of IFRS in Practice

## A Securities and Exchange Commission Staff Paper
## November 16, 2011

DIVISION OF CORPORATION FINANCE
OFFICE OF THE CHIEF ACCOUNTANT
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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## Executive Summary

In the *Commission Statement in Support of Convergence and Global Accounting Standards,*[1] the U.S. Securities and Exchange Commission ("SEC" or "Commission") directed the staff of the Office of the Chief Accountant of the SEC, with appropriate consultation with other Divisions and Offices of the Commission ("Staff"), to develop and execute a work plan ("Work Plan").[2] The purpose of the Work Plan is to consider specific areas and factors relevant to a Commission determination as to whether, when, and how the current financial reporting system for U.S. issuers should be transitioned to a system incorporating International Financial Reporting Standards ("IFRS").

This Staff paper ("Staff Paper") contributes to the execution of the Work Plan by presenting the Staff's observations regarding the application of IFRS in practice, in order to provide the Commission with information to assist it in its future determination. This Staff Paper is not intended to, and does not, compare the application of IFRS to the application of U.S. generally accepted accounting principles ("U.S. GAAP"). Accordingly, similar observations may be present among companies reporting under U.S. GAAP.

In addition, the observations in this Staff Paper are not intended to be determinative as to whether or not IFRS is positioned for incorporation into the financial reporting system for U.S. issuers. This Staff Paper is one component of extensive efforts, forming part of the Work Plan, to facilitate the Commission's consideration of the incorporation of IFRS.

The Staff of the Division of Corporation Finance and the Office of the Chief Accountant analyzed the most recent[3] annual consolidated financial statements of 183 companies, including both SEC registrants and companies that are not SEC registrants, which prepare financial statements in accordance with IFRS.[4]

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[1] See SEC Release No. 33-9109 (February 24, 2010), Commission Statement in Support of Convergence and Global Accounting Standards ("2010 Statement").
[2] The Work Plan is included as an appendix to the 2010 Statement.
[3] Generally, the most recent annual consolidated financial statements available at the time of the analysis were the fiscal 2009 financial statements for each of the companies. In light of the anticipated time frame for issuance of the Staff Paper and given the number of companies to be analyzed, the availability of financial statements, and the time needed to complete the analysis and synthesize the results, the Staff determined that fiscal 2009 financial statements would be used for purposes of the analysis.
[4] The sample included financial statements prepared under IFRS (without qualifiers), IFRS as issued by the International Accounting Standards Board ("IASB"), IFRS as adopted by the European Union, and IFRS as adopted in Australia. Throughout this Staff Paper, the term "IFRS" refers to IFRS as issued by the IASB when describing the individual standards or the body of standards issued by the IASB. When used in the context of the basis of accounting applied in a company's financial statements, the term "IFRS" refers to IFRS as described in that company's financial statements, which may differ from IFRS as issued by the IASB.

Section I of the Staff Paper provides background on the Staff Paper, including the scope, process, and limitations of the Staff's analysis. Section II presents the Staff's observations of these companies in the following topical areas: accounting principles, presentation of financial statements, and accounting for assets, liabilities, shareholders' equity, revenue, expenses, broad transactions, and certain industry-specific matters. The Staff's observations address a number of data points in these areas, including transparency and clarity of disclosures, compliance with applicable accounting standards, and the comparability of financial statements.

The Staff found that company financial statements generally appeared to comply with IFRS requirements. This observation, however, should be considered in light of the following two themes that emerged from the Staff's analysis:

- First, across topical areas, the transparency and clarity of the financial statements in the sample could be enhanced. For example, some companies did not provide accounting policy disclosures in certain areas that appeared to be relevant to them. Also, many companies did not appear to provide sufficient detail or clarity in their accounting policy disclosures to support an investor's understanding of the financial statements, including in areas they determined as having the most significant impact on the amounts recognized in the financial statements. Some companies also used terms that were inconsistent with the terminology in the applicable IFRS. Further, some companies referred to local guidance, the specific requirements of which were often unclear. Consequently, certain disclosures presented challenges to understanding the nature of a company's transactions and how those transactions were reflected in the financial statements.

  In some cases, the disclosures (or lack thereof) also raised questions as to whether the company's accounting complied with IFRS. As the analysis conducted for the Staff Paper was not part of the Division of Corporation Finance's disclosure review program, the Staff was unable to obtain additional information from those companies that could have resolved many of these questions.[5]

- Second, diversity in the application of IFRS presented challenges to the comparability of financial statements across countries and industries. This diversity can be attributed to a variety of factors. In some cases, diversity appeared to be driven by the standards themselves, either due to explicit options permitted by IFRS or the absence of IFRS guidance in certain areas. In other cases, diversity resulted from what appeared to be noncompliance with IFRS.

  The diversity arising from the standards themselves was, at times, mitigated by guidance from local standard setters or regulatory bodies that narrowed the range of acceptable alternatives already permitted by IFRS or provided additional guidance or interpretations. This diversity also was mitigated by a tendency by some companies to carry over their

[5] If an issue regarding a company that also was an SEC registrant was identified, members of the Division of Corporation Finance Staff responsible for conducting the review of the company as part of the disclosure review program were informed, so those issues could be considered.

previous home country practices in their IFRS financial statements. While country guidance and carryover tendencies may promote comparability within a country, they may diminish comparability on a global level.

Section III presents a summary of frequent areas of comment from the Division of Corporation Finance's reviews, as part of its disclosure review program, of the most recent SEC filings of approximately 140 of the approximately 170 foreign private issuers that were registered with the Commission at the time of the analysis and disclosed that they prepared their financial statements in accordance with IFRS as issued by the IASB.[6]

[6] See Rule 4-01(a)(2) of Regulation S-X (providing that foreign private issuers may prepare their financial statements according to IFRS as issued by the IASB without also filing a reconciliation to U.S. GAAP); and Form 20-F Item 17(c) (requiring explicit statement of compliance with IFRS as issued by the IASB and auditor opinion of same).

# I. Background to the Analysis

## A. Objective

In the 2010 Statement, the Commission stated that it "has based its continued strong support for a single set of high-quality globally accepted accounting standards, including the consideration of incorporating IFRS into its financial reporting system, on the premise that U.S. investors ultimately will benefit from the comparability of financial information from issuers on a worldwide basis. Consistent and high-quality implementation is necessary for investors to benefit from a set of high-quality global accounting standards."[7] The Commission directed the staff of the Office of the Chief Accountant of the SEC, with appropriate consultation with other Divisions and Offices of the Commission, to study these issues as part of the Work Plan.

This Staff Paper contributes to the execution of the Work Plan by presenting the Staff's observations regarding the application of IFRS in practice, in order to provide the Commission with information to assist it in making a future determination regarding whether to incorporate IFRS into the financial reporting system for U.S. issuers.

## B. Scope and Process

The Staff of the Division of Corporation Finance and the Office of the Chief Accountant analyzed the most recent[8] annual consolidated financial statements of 183 companies, including both SEC registrants and companies that are not SEC registrants, which prepare financial statements in accordance with IFRS. The Staff based its selection of companies on the 2009 Fortune Global 500, which is an annual ranking of the top 500 corporations worldwide by revenue, as compiled and published by *Fortune* magazine ("FG500").[9] Specifically, the Staff selected all companies from this list that prepare their financial statements in accordance with IFRS and make their financial statements available to the public in English.[10] The Staff's observations of these companies are provided in Section II of this Staff Paper.

The 183 companies were domiciled in 22 countries. Approximately 80% of the companies were domiciled in the European Union, with companies from Germany, France, and the United Kingdom representing slightly more than half of the companies.

The companies in the analysis were from the following countries:

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[7] See 2010 Statement.
[8] Generally, the most recent annual consolidated financial statements available at the time of the analysis were the fiscal 2009 financial statements for each of the companies.
[9] Available at: http://money.cnn.com/magazines/fortune/global500/2009/full_list/
[10] Of the 500 companies in the FG500, the Staff excluded 286 companies that did not use IFRS to prepare their financial statements, 27 companies that did not provide financial statements to the public, 3 companies that did not make their financial statements available to the public in English, and 1 company whose financial statements were no longer available because it was acquired.

| Country | Number of Companies |
|---|---|
| Germany | 35 |
| France | 34 |
| United Kingdom | 26 |
| China | 14 |
| Spain | 11 |
| Netherlands | 10 |
| Australia | 9 |
| Switzerland | 9 |
| Italy | 8 |
| Sweden | 6 |
| Belgium | 5 |
| Other (represents 11 countries)[11] | 16 |
| **Total** | **183** |

The companies in the analysis represented the following 36 industries (as categorized by the FG500):

| Industry | Number of Companies |
|---|---|
| Banking | 38 |
| Petroleum Refining | 14 |
| Telecommunications | 12 |
| Food and Drug Stores | 11 |
| Utilities | 11 |
| Engineering and Construction | 10 |
| Motor Vehicles and Parts | 10 |
| Insurance | 9 |
| Mining and Crude Oil Production | 6 |
| Building Material and Glass | 5 |
| Chemicals | 5 |
| Energy | 5 |
| Pharmaceuticals | 5 |
| Other (represents 23 industries)[12] | 42 |
| **Total** | **183** |

[11] "Other" consisted of the following countries, each of which was represented by fewer than three companies: Austria, Brazil, Denmark, Finland, Hungary, Ireland, Luxembourg, Norway, Poland, Portugal, and Russia.
[12] "Other" comprised industries represented by fewer than five companies each: Aerospace and Defense; Airlines; Apparel; Beverages; Diversified Financials; Electronics and Electrical Equipment; Entertainment; Food Services; Food and Consumer Products; General Merchandisers; Household and Personal Products; Industrial Machinery; Mail, Package, and Freight Delivery; Metals; Miscellaneous; Networks and Other Communications Equipment; Shipping; Specialty Retailers; Temporary Help; Tobacco; Trading; Wholesalers: Electronics and Office Equipment; and Wholesalers: Health Care.

At the time of the analysis, 47 companies were SEC registrants, while another 29 companies had previously been SEC registrants.

The Staff's work undertaken as part of this analysis differs from the Division of Corporation Finance's disclosure review program.[13] As part of this analysis, the Staff read each company's financial statements and collected observations regarding a number of data points, including transparency and clarity of disclosures, compliance with applicable accounting standards, and the comparability of financial statements. The Staff focused on how the recognition and measurement requirements of IFRS were applied in practice. The Staff obtained data for its evaluation from information disclosed in company financial statements, without the benefit of a staff comment and response letter process, which could have elicited clarifying or additional information. The Staff then compared these observations for all companies in the analysis to identify trends on an overall basis as well as by country and industry.

Section III of the Staff Paper provides a summary of frequent areas of comment from the Division of Corporation Finance's reviews, as part of the disclosure review program, of the most recent SEC filings of approximately 140 of the approximately 170 foreign private issuers that were registered with the Commission at the time of the analysis and disclosed that they prepared financial statements in accordance with IFRS as issued by the IASB.[14] All of the registrants selected to be part of this analysis also have been reviewed as part of the Division of Corporation Finance's disclosure review program.

## C. Limitations and Clarifications

The Staff's analysis was affected by several factors described below.

### 1. Companies Selected

The companies analyzed for the Staff Paper were selected from the FG500, which is a listing of the world's largest companies by revenue. As a result, some countries and industries had a higher or lower representation than others, which may have resulted in the Staff providing more or fewer observations about certain countries or industries solely as a result of the representation of such countries or industries. For countries or industries that were not as well represented, the Staff's ability to determine the existence of country or industry trends was limited.

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[13] As part of the Division of Corporation Finance's disclosure review program, the Staff may request that a registrant: (1) provide additional supplemental information so the Staff can better understand a registrant's accounting and disclosure, (2) revise the accounting and/or disclosure in a document on file with the SEC, or (3) revise the accounting and/or disclosure in a future filing with the SEC.

[14] See Rule 4-01(a)(2) of Regulation S-X (providing that foreign private issuers may prepare their financial statements according to IFRS as issued by the IASB without also filing a reconciliation to U.S. GAAP); and Form 20-F Item 17(c) (requiring explicit statement of compliance with IFRS as issued by the IASB and auditor opinion of same).

This Staff Paper focuses on a limited number of companies as compared to the number of companies that prepare financial statements in accordance with IFRS. Due to the limited number of companies analyzed, the observations in the Staff Paper may not be representative of the full population of companies that report under IFRS.

Further, since the Staff Paper analyzes large companies, which generally have access to a higher level of staff, technology, funding, and other resources with which to prepare their financial statements, the number and nature of the Staff's observations may have differed if the analysis had included smaller companies.

As previously noted, 47 of the subject companies were SEC registrants at the time of the analysis, and 29 of the companies had previously been SEC registrants. Accordingly, these companies are or had been subject to the Staff's disclosure review program. The Staff Paper indicates that the Staff had fewer observations regarding companies that are currently or previously had been SEC registrants about the transparency of their financial statements, their compliance with IFRS, and the clarity of their disclosures. This may result from these companies currently being or previously having been subject to the Staff's disclosure review program. The financial statements of companies subject to the disclosure review program may reflect comments provided by, or anticipated from, the Staff.

### 2. Inability to Obtain Clarifying Information

The purpose of this analysis was to evaluate the manner in which IFRS is applied in practice, with a focus on the recognition and measurement of transactions in a company's financial statements. IFRS, like U.S. GAAP, consists of standards relating both to how transactions are to be reflected in a company's financial statements and to disclosures provided in the notes to the financial statements. Similarly IFRS, like U.S. GAAP, generally does not have explicit requirements for a company to explain how it satisfied a particular accounting standard. Rather, the accounting standards generally require a company to explain the accounting policies selected. However, as a regulator, the Staff also seeks to promote compliance with the accounting standards and, as such, the Staff's comments to a company can at times focus on how a company complied with a relevant accounting standard.

The Staff's observations in this regard were limited to that which was apparent from a company's presentation and disclosures. As part of this analysis, the Staff did not have the opportunity to provide comments on the financial statements or inquire of company officials as to how companies reflected transactions in their financial statements or why companies made certain determinations in the application of IFRS.[15] As a result, in many circumstances, the Staff was unable to determine the manner in which companies reflected transactions in their financial statements or confirm that the accounting complied with IFRS.

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[15] If an issue regarding a company that also was an SEC registrant was identified, members of the Division of Corporation Finance Staff responsible for conducting the review of the company as part of the disclosure review program were informed, so those issues could be considered.

In some cases, the Staff was unable to determine the manner in which companies applied IFRS because disclosures did not discuss certain aspects of the guidance. For example, in some cases, the Staff was unable to determine the basis for a company's classification of financial instruments as debt or equity, the basis for the recognition of deferred tax assets, and whether intercompany transactions were eliminated in consolidation. In addition, the Staff was unable to determine the basis for materiality assessments and whether the use of practical expedients was materially consistent with IFRS.

The Staff does not intend to suggest that disclosures in these instances were necessarily deficient or that the disclosures should have been prepared with the purpose of communicating to a regulator the manner in which a company complies with a set of accounting standards. The Staff recognizes that financial statements are intended to facilitate investor decision-making, and additional information that would have benefited the Staff in this analysis may be of less incremental value to an investor. In many cases, investors assume that the financial statements comply with IFRS. The investors are relying on management, board, auditor, and regulatory oversight to ensure compliance with the applicable accounting standards. However, due to limitations in obtaining information, the Staff cannot be certain of these assumptions. The Staff Paper does not identify every instance in which the Staff was unable to verify company accounting. Accordingly, the absence of an observation should not be construed to imply that there are no deficiencies in the accounting on a broad basis, nor do all observations imply deficiencies in the accounting treatment.

In other cases, the Staff was unable to obtain clarification regarding the disclosures that were provided. For example:

- Some companies referred to home country GAAP for particular types of transactions, but the specifics of the home country requirements and their consistency with IFRS were unclear. In addition, the reasons for reference to home country GAAP were unclear. For example, the references to local guidance may have been due to the manner in which a particular country incorporated IFRS into its financial reporting system or a company's determination that IFRS does not contain guidance specifically applicable to a transaction. In the latter case, it also was unclear whether companies had appropriately applied the accounting policy selection and application criteria in IFRS, as further discussed in Section II.B.1.

- Some companies used terms that were inconsistent with the terminology in the applicable IFRS. The Staff recognizes that varying terminology is a natural consequence of a cross-border environment which operates in multiple languages.[16] Nonetheless, because the Staff did not obtain further information, the Staff was unable to determine whether the differing terminology resulted from translation differences or noncompliant accounting.

[16] In conducting the analysis, the Staff used the English-language translated financial statements published by the companies on their websites or filed with the SEC.

- The Staff noted several instances in which companies highlighted only certain recognition or measurement criteria related to a standard, without an explanation of their significance, when multiple criteria must be satisfied. In the Staff's experience with U.S. GAAP, similar partial policy disclosures have sometimes been indicative of noncompliant accounting. However, due to the limitations of this analysis, the Staff was unable to determine whether this was also the case with companies in the analysis.

The Staff also has noted certain observations specific to a small number of companies. The Staff cannot be certain as to whether these items truly related to a small number of companies or, instead, applied to a broader population of companies that had not disclosed similar matters in as much detail.

### 3. Staff Judgment

A number of Staff members conducted the analysis of company financial statements. Although control procedures were implemented to standardize the collection of data points across companies, evaluations regarding the application of IFRS can be subjective and, thus, may vary based on an individual Staff member's judgment.

### 4. Implications

Readers should not interpret the Staff's observations of any country, industry, or individual company included in this Staff Paper as an indication of the Staff's views regarding the overall quality of a particular country, industry, or individual company's accounting and disclosure practices. While some observations speak to the clarity of disclosures and the possibility of noncompliance, other observations are intended to describe the manner in which companies comply with IFRS and the nature of company elections under IFRS.

An observation is not intended to be a criticism of a company's financial statements or to suggest that, had the company been an SEC registrant, the observation would have given rise to a Staff comment. The Staff's understanding of an SEC registrant's financial statement disclosure can be affected by the Division of Corporation Finance's disclosure review program as previously described. This analysis was not intended to provide a perspective on whether the Staff would have provided a greater or fewer number of comments on an SEC registrant. The Staff's comments on an SEC registrant are based on its disclosure and other public information, as well as the Staff's understanding of that registrant's facts and circumstances.

This Staff Paper provides the Staff's observations on the application of IFRS in practice. It is not intended to, and does not, compare the application of IFRS to the application of U.S. GAAP. Accordingly, similar observations may be present among companies reporting under U.S. GAAP.

Finally, the observations in this Staff Paper are not intended to be determinative as to whether or not IFRS is positioned for incorporation into the financial reporting system for U.S. issuers.

This Staff Paper is one component of extensive efforts, forming part of the Work Plan, to facilitate the Commission's consideration of incorporation of IFRS.

# II. Application of IFRS

## A. Introduction

This Section summarizes the Staff's observations regarding the transparency and clarity of disclosures, compliance with applicable accounting standards, and the comparability of financial statements within and across countries and industries for each sample company's financial statements. These observations are presented in the following topical areas:

- Accounting principles
- Financial statement presentation
- Accounting for assets
- Accounting for liabilities
- Accounting for shareholders' equity
- Accounting for revenue
- Accounting for expenses
- Accounting for broad transactions
- Accounting for certain industry-specific matters.

In each area, the Staff provides general observations, and, where relevant and possible, the Staff has highlighted trends by country or industry, or both.

## B. Accounting Principles

### 1. Selection of Accounting Policies

IFRS provides guidance regarding the selection of accounting policies by requiring companies to apply IFRS to transactions to which an IFRS standard specifically applies.[17] In the absence of a specific applicable standard, management is required first to consider guidance in an IFRS standard that relates to similar issues and then to consider the IFRS Framework.[18] Management also may consider recent pronouncements of other standard-setting bodies that use a similar conceptual framework, other accounting literature, and industry practices, if they do not conflict with IFRS.[19] The Staff noted that approximately 20% of companies in the analysis referred to local guidance for a specific transaction as part of their accounting policy disclosures. The Staff

[17] See IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* ("IAS 8"), paragraph 7. Throughout the remainder of this Staff Paper, where the Staff cites IFRS, the Staff is referring to IFRS as effective for the year ended December 31, 2009. In some cases, IFRS included standards that were not mandatory, but for which early adoption was permitted during 2009. In these cases, the Staff has cited the standard that was required to be in effect as of December 31, 2009. This convention is solely to facilitate understandability of this Staff Paper. For purposes of the analysis, the Staff took into account circumstances when multiple versions of a standard may appropriately be applied due to a new or revised standard's transition provisions.

[18] See IAS 8, paragraph 11. The IFRS Framework sets forth "concepts that underlie the preparation and presentation of financial statements for external users." (IFRS Framework, paragraph 1)

[19] See IAS 8, paragraph 12.

noted that companies in two countries more frequently disclosed use of local guidance than companies in other countries.

The Staff also noted one case in which a company elected to rely on the pronouncements of another standard setter to develop a specific aspect of the company's revenue recognition accounting policy. After the company's application of this guidance, the other standard setter changed its guidance applicable to such transactions. IFRS does not clearly address whether a company's accounting policy is required to reflect subsequent changes that other standard setters make to their pronouncements. In this case, the company did not incorporate the changes that the other accounting standard setter made.

IFRS requires compliance with Interpretations of the IFRS Interpretations Committee and predecessor bodies ("Interpretations").[20] However, like new IFRS standards, Interpretations are not mandatory in all cases on a jurisdictional basis. For example, in the European Union, such interpretations are not required until after they are adopted by the European Commission. The Staff noted that some companies in the European Union adopted Interpretations at dates later than specified by the Interpretations because the latest date that the European Commission required application of the Interpretations was after the effective dates required by the IASB.[21] This practice may delay the reductions in diverse accounting practices that the Interpretations are issued to address.

IFRS permits a departure from specific requirements of IFRS if an entity determines that the application of that requirement would result in the financial statements being so misleading that they no longer meet the objectives of the IASB's Framework.[22] This is often referred to as a "true and fair override." The Staff did not observe any examples of the true and fair override in the analysis, but is aware that it is invoked from time to time.

### 2. Disclosure of Accounting Policies

IFRS requires an entity "to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance."[23] The footnotes are required to:

[20] See IAS 1, *Presentation of Financial Statements* ("IAS 1"), paragraph 7.

[21] These Interpretations include: IFRIC 12, *Service Concession Arrangements* (see European Commission Regulation (EC) No 254/2009 (March 25, 2009)); IFRIC 14, *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (see European Commission Regulation (EC) No 633/2010 (July 19, 2010)); IFRIC 15, *Agreements for the Construction of Real Estate* (see Commission Regulation (EC) No 636/2009 (July 22, 2009)); IFRIC 17, *Distributions of Non-Cash Assets to Owners* (see European Commission Regulation (EC) No 1142/2009 (November 26, 2009)); and IFRIC 18, *Transfers of Assets from Customers* (see European Commission Regulation (EC) No 1164/2009 (November 27, 2009)).

[22] See IAS 1, paragraph 19.

[23] IAS 1, paragraph 17(c).

(a) present information about the basis of preparation of the financial statements and the specific accounting policies used …;
(b) disclose the information required by IFRSs that is not presented elsewhere in the financial statements; and
(c) provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them.[24]

Specifically with respect to disclosure of accounting policies, IFRS requires disclosure of both "the measurement basis (or bases) used in preparing the financial statements, and the other accounting policies used that are relevant to an understanding of the financial statements."[25] In particular, IFRS states:

> In deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in reported financial performance and financial position. Disclosure of particular accounting policies is especially useful to users when those policies are selected from alternatives allowed in IFRSs.[26]

The Staff found that the accounting policy disclosures of the companies in the analysis generally were consistent with the guidance above. However, IFRS relies on management judgment to determine the extent of disclosure regarding a company's accounting policies in order for the financial statements to achieve a fair presentation. The Staff noted considerable diversity in the level of detail management provided to describe the accounting policies applied and the extent to which other guidance was applied when IFRS does not provide explicit guidance. For example, the Staff observed several circumstances in which accounting policy disclosures were not provided for transactions which, in light of the size and nature of the company and other company disclosures, the Staff expected to be relevant to an understanding of the company's financial statements. In addition, the Staff noted several companies did not discuss the manner in which they applied a standard or a policy to their specific transactions.[27] Because accounting standards may often be appropriately applied in a variety of ways, disclosures regarding application of such standards could be helpful in facilitating comparability of financial statements.

Further, the Staff noted many instances in which the accounting policy disclosures were unclear. For example, the Staff observed many cases in which companies highlighted only certain recognition or measurement criteria related to a standard when multiple criteria must be met.

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[24] IAS 1, paragraph 112.
[25] IAS 1, paragraph 117.
[26] IAS 1, paragraph 119.
[27] Common examples of topical areas with unclear accounting policy disclosures include share-based payments, business combinations, discontinued operations, operating segments, inventory, construction contracts, income taxes, property, plant, and equipment, leases, revenue, borrowing costs, consolidation, investment in associates, impairment of assets, provisions and contingent liabilities, capitalization of internally generated intangible assets, and impairment of investment property.

In many cases, these observations related to accounting policies that the companies disclosed per IAS 1 as having the "most significant impact"[28] on the amounts recognized in the financial statements. Specifically, IAS 1 requires management to disclose the judgments it has made that have the most significant effect on the amounts recognized in the financial statements, assumptions made about the future, and certain other major sources of estimation uncertainty.[29] Five percent of companies did not provide these disclosures.

Companies that provided these disclosures identified between two and twelve accounting policies to which the most significant impact disclosures applied, with a mean of six. The following policies to which these disclosures applied were cited by more than 50% of companies in the analysis:

- Financial instruments
- Impairment of tangible and intangible assets
- Provisions (liability recognition)
- Employee benefits
- Income taxes.

In a number of areas, the percentage of companies with unclear accounting policy disclosures was higher for companies that were not SEC registrants than for companies that were SEC registrants. The Staff's observations regarding specific accounting policies are addressed below by applicable topical area.

### 3. Changes to the Financial Statements

IFRS provides guidance regarding changes to the financial statements as a result of a change in accounting policy, a change in an accounting estimate, or a correction of an error. When a company changes an accounting policy, changes an estimate, or corrects an error, IFRS requires the company to disclose clearly the nature of the change and other information.[30] The objective of this disclosure is to "enhance the comparability of those financial statements over time and with the financial statements of other entities."[31] Five percent of companies in the analysis reported a change in policy and/or a retrospective change in classification that appeared to be more akin to an error correction.

IFRS requires a company to present "a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements."[32] Of the companies that reported such changes, 10% did not

[28] IAS 1, paragraphs 122 to 133.
[29] See IAS 1, paragraphs 122 to 133.
[30] See IAS 8, paragraphs 28-31, 39-40, and 49.
[31] IAS 8, paragraphs 1.
[32] IAS 1, paragraph 10(f).

present an additional statement of financial position, although some of these companies provided this information as a footnote rather than as a separate statement of financial position.

IFRS permits a change in accounting policy when the new policy "results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows."[33] The Staff noted changes to accounting policies that appeared to result from a country's ongoing incorporation of IFRS. In these cases, the manner in which the change satisfied the requirements for a change in accounting policy was unclear. For example, several companies in one country reported that they changed or planned to change from the revaluation model to the cost model for property, plant, and equipment to conform their IFRS financial statements to their local GAAP financial statements.[34]

## C. Financial Statement Presentation

IFRS does not specify precise financial statement formats. Instead, IFRS provides general guidelines regarding the form and content of financial statements. The objective of these guidelines is to "ensure comparability both with the entity's financial statements over time and with the financial statements of other entities."[35] The Staff observed that companies interpreted and applied the guidelines differently, resulting in differences in form, content, and presentation across industries and countries. The Staff also found that, in many cases, the financial statements were presented based on a country's regulations. For example, companies in the banking industry in one country presented their financial statements in accordance with home country regulations and companies in another country reported related party transaction amounts on the face of the financial statements to comply with local requirements. While the local guidance promoted comparability at the country level, they contributed to diversity in practice on a global basis. However, the presentations did not appear to conflict with IFRS in any of the cases.

### 1. Statement of Financial Position

#### a. Statement of Financial Position Classification

Most companies in the sample reported totals for assets and for liabilities and equity combined. Companies from two countries, however, more frequently reported totals for net assets and for equity, consistent with practice under predecessor local GAAP.

[33] IAS 8, paragraph 14(b).
[34] The IASB amended IFRS 1, *First Time Adoption of International Financial Reporting* ("IFRS 1"), to permit companies that were required to report property, plant, or equipment at fair value as a result of a privatization or an initial public offering to use that fair value as deemed cost and to subsequently account for those assets under the cost model. Entities that adopted IFRS prior to the effective date of IFRS 1 or applied IFRS 1 in a previous period are permitted to retrospectively apply this amendment in the first annual period beginning on or after January 1, 2011. See IFRS 1, paragraph 39E.
[35] IAS 1, paragraph 1.

The Staff noted a fair degree of comparability associated with asset and liability classification on the face of the statement of financial position. The majority of companies classified assets and liabilities using a current/non-current distinction and ordered line items from the top of the statement of financial position based on increasing liquidity, with cash presented as the final asset. Companies in the banking and insurance industries presented unclassified statements of financial position. Companies in the banking industry typically ordered the statement of financial position line items based on decreasing liquidity while most companies in the insurance industry classified items based on increasing liquidity.

The classification of financial assets on the statement of financial position varied. For example, some companies in the banking industry disclosed a single line item such as "financial assets" or "investments" and then included supporting detail in the footnotes. Others provided captions for each different class of financial asset[36] (e.g., available for sale, trading, and loans) directly on the face of the statement of financial position.

#### b. Offsetting of Income Tax Assets and Liabilities

IFRS permits an entity to offset deferred tax assets and deferred tax liabilities in limited defined circumstances.[37] Of those companies that disclosed an accounting policy in this regard, most indicated that the criteria for offset of deferred tax assets and liabilities related to income taxes levied by the same taxation authority. The other criteria required for offsetting were typically not addressed.

#### c. Additional Disclosures on the Face of the Statement of Financial Position

Some companies, generally in three countries, presented additional metrics, such as "net debt," on the face of the statement of financial position. This practice appears to be carried over from requirements under certain local GAAPs.

### 2. Statement of Comprehensive Income

#### a. Income Statement Presentation

IFRS provides companies an option to "present all items of income and expense recogni[z]ed in a period in either a single statement of comprehensive income, or in two statements: a separate income statement and a separate statement of comprehensive income."[38] The overwhelming

[36] See IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"), paragraph 9.
[37] Offsetting of deferred tax assets and liabilities is permitted "if, and only if the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either: the same taxable entity; or different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realize the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered." See IAS 12, *Income Taxes* ("IAS 12"), paragraph 74.
[38] IAS 1, paragraph 81.

majority of companies reported a separate income statement with a separate statement of other comprehensive income immediately following it, thereby contributing to comparability on a global basis.

#### b. Presentation of Expenses

IFRS also provides companies an option to report expenses "using a classification based on either their nature or their function within the entity, whichever provides information that is reliable and most relevant."[39] Approximately half of the companies reported expenses by nature (e.g., salary) and the other half reported them by function (e.g., cost of sales). The majority of companies in the banking and energy industries presented expenses by nature, while most companies in the chemicals, motor vehicles, and mining and crude-oil production industries presented expenses by function, resulting in comparability on an industry basis, although not a global basis.

About one-third of companies that presented expenses by function did not disclose the nature of the amounts classified by function, as required by IFRS.[40] For example, many companies did not disclose the nature of the costs included in cost of goods sold. Others disclosed the nature of some, but not all, costs included in cost of goods sold. The Staff also noted inconsistencies in the types of costs mentioned.

#### c. Presentation of Subtotals and Line Items

IFRS specifies certain line items that should be presented in the income statement,[41] and states that entities should "present additional line items, headings, and subtotals … when such presentation is relevant to an understanding of the entity's financial performance."[42] IFRS also allows entities to amend "the descriptions used and the ordering of items when this is necessary to explain the elements of financial performance."[43]

The nature of subtotals reported on the face of the income statement varied greatly by company. The Staff noted 18 different types of subtotals used.[44] Most companies reported profit and loss

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[39] IAS 1, paragraph 99.
[40] See IAS 1, paragraph 104.
[41] See IAS 1, paragraph 82.
[42] IAS 1, paragraph 85.
[43] IAS 1, paragraph 86.
[44] The following types of subtotals were noted on the face of the income statement: *Adjusted Revenue* – IAS 18, *Revenue* ("IAS 18"), revenue adjusted to include income from associates or pass through receipts (e.g., excise taxes); *Total Revenue Less Partial Cost of Sales* – Included all categories of IAS 18 revenue net of the cost of sales of only a portion of those revenue items; *Gross Margin* – Included certain categories of IAS 18 revenue net of the cost of sales of those revenue items; *Operating Profit* – Net profit before passive activities; *Ordinary Operating Profit* – Net profit before passive activities and certain other items; *EBITDA* – Earnings before interest, taxes, depreciation and amortization; *EBIT* – Earnings before interest, and taxes; *Adjusted EBITDA/EBIT* – EBITDA and EBIT adjusted for other items; *Profit Before Tax* – Net income before income tax; *Operating Profit Before Non-operating Items* – Items determined to be exceptional and non-operating segregated; *Operating Profit Before Certain Operating Items* – Payroll, employee benefits and/or share-based payments costs excluded; *Finance*

subtotals that excluded certain income and expense items. Many also presented a measure of net profit or loss that excluded costs necessary to generate revenue, such as depreciation of equipment or labor costs. Some companies presented subtotals that they explicitly characterized as non-GAAP measures[45] on the face of the income statement. Most companies did not disclose an accounting policy that explained the basis they used to determine which income and expense items to exclude.

Companies in three countries most frequently presented income statement subtotals or formats (e.g., multiple columns) that excluded certain items. Some companies in one country presented boxes within the income statement that included subtotals of line items reported on the face of the statement or excluded certain items reported on the income statement. This practice appeared to be a carryover of financial statement presentation from previously applied home country GAAP. The Staff also noted companies in one country that presented additional income statement subtotals based on guidance from the local securities regulator and national standards setter. In addition, some companies in two countries presented additional information, such as reconciliations to company-determined measures, alongside or below the income statement.

The presentation of income statement subtotals, alternative income statement formats that excluded certain items, and additional information alongside the income statement was more prevalent among companies that were not SEC registrants than for SEC registrants.

While IFRS requires the investor's share of the profit or loss of associates to be disclosed separately,[46] it does not specify where to report this amount on the face of the income statement. The Staff noted six different classifications[47] that companies used to report the share of profit or loss from associates on the face of the income statement.

The Staff also noted inconsistencies in the presentation of operating results among companies in the insurance industry. For example, some companies presented premiums ceded to reinsurers as a deduction from revenue while others classified such amounts as part of underwriting expense. Much like the other companies in the sample, there also was diverse classification of both interest income and expense and asset impairment charges across companies in the insurance industry.[48]

IFRS does not specify how accrued interest income or expense should be presented on the income statement for instruments that are measured at fair value through profit or loss.

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*Income (Expense) Net*; *Profit Before Credit Impairments and Income Tax*; and other unique company-specific calculations. The terms used above to describe each type of subtotal were developed for this analysis. The actual terms companies used to caption these subtotals varied significantly.

[45] Some companies referred to these measures as non-IFRS measures.

[46] See IAS 28, *Investments in Associates* ("IAS 28"), paragraph 38.

[47] These classifications were: before profit before income tax; component of finance income (expense); component of operating profit; after operating income; before net income; and component of revenue and other income.

[48] IFRS does not have a comprehensive standard that addresses the accounting for insurance contracts.

Approximately half of the companies in the banking industry recognized accrued interest in a separate line item on the income statement and the other half included accrued interest in the change in fair value line item. The Staff noted that companies in the banking industry in two countries typically included accrued interest in the change in fair value line item.

About half of the companies in the sample separately reported finance income and expense and a subtotal of net finance cost. Companies in the banking industry typically presented net interest revenue less net interest expense to arrive at net interest income. Some companies in the banking industry also deducted a provision for credit losses to arrive at net interest income after credit expense. A few companies in the banking industry included items, such as income from associates, income from joint ventures, and income from investment properties in net interest income.

### 3. Statement of Cash Flows

#### a. Format

The Staff noted significant differences in the presentation of the statement of cash flows across the sample population. IAS 7, *Statement of Cash Flows* ("IAS 7"), requires classification of cash flows in "operating, investing, and financing activities,"[49] and provides examples of items within each category. Nonetheless, the Staff noted some instances in which companies did not apply this format.

#### b. Operating Cash Flows

Within the operating section, IFRS permits the use of the direct or indirect method of presentation.[50] The Staff noted that the vast majority of companies used the indirect method of presentation, thereby contributing to greater comparability on a global basis. Companies in two countries primarily used the direct method. In at least one country, this trend is likely due to a prohibition on the use of the indirect method that existed at the time of initial adoption of IFRS in that country. Under the indirect method, IFRS requires net cash flow from operating activities to be determined by adjusting "profit or loss" [51] for the effects of various items. However, the Staff observed 10 variations to the profit or loss measure used as the starting point to determine operating cash flows.[52] Companies in one country exhibited the most variations, using 7 of the 10 measures. The use of variations in the starting point was more pronounced for companies that were not SEC registrants than for SEC registrants. The Staff also noted that just over half of the companies reported one or more subtotals within operating cash flows. The

[49] IAS 7, paragraph 10.
[50] See IAS 7, paragraph 18.
[51] IAS 7, paragraph 18.
[52] The measures used included: net profit; profit before tax; net profit to shareholders; profit before tax and financial items; operating profit; cash flows from operating activities; beginning cash and cash equivalents; net profit from continuing operations; earnings before interest, taxes, depreciation, and amortization; and company determined subtotals.

Staff noted 13 different subtotals reported within operating cash flows,[53] with four countries showing the most variation in the subtotals used.

### c. Classification of Items within the Operating, Investing, and Financing Categories

The Staff also observed differences in the classification of items within the operating, investing, and financing categories. For example, most companies in the insurance industry classified their investment activities within cash flows from investing activities. However, a few companies presented investing activities within cash flows from operating activities, either on a gross basis or net of payments of related benefits and claims. In the banking industry, the Staff noted diversity in the classification of cash flows from loans and securities as operating or investing activities.

### d. Presentation of Discontinued Operations

IFRS permits net cash flows attributable to operating, investing, and financing activities of discontinued operations to be presented in the financial statements or in the footnotes.[54] For companies electing to present this information in the statement of cash flows, IFRS does not prescribe the manner of presentation. As a consequence, the Staff noted differences in the presentation of discontinued operations on the face of the statement of cash flows.[55]

### e. Cash Equivalents

IFRS defines cash equivalents as "short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value."[56] The Staff noted diversity in the items classified as cash equivalents. The following items, in differing combinations, were included in companies' definitions of cash and cash equivalents: balances at central banks or balances to/from central banks, repurchase agreements, loans/advances to banks of one month or less, treasury bills less than three months, accounts receivable, short-term deposits, bills receivable and remittances in transit, marketable securities, investments with a maturity exceeding three months, bank overdrafts, and restricted cash.

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[53] The subtotals presented within operating cash flows included the following: group operating profit; cash flows from operating activities before changes in working capital and provisions; cash flows from operating activities before changes in working capital; cash generated from operations; cash generated from operations before tax items; cash from continuing operations; cash generated from operations before finance items; cash generated from operations before finance and tax items; cash flows from operating activities before changes in working capital, tax, dividends and interest; adjusted EBITDA; and other, as defined by the company.

[54] See IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* ("IFRS 5"), paragraph 33(c).

[55] The following presentations were noted: gross presentation with discontinued operation cash flows disclosed in the footnotes (no segregation on the face of the statement); net presentation with discontinued operations cash flows disclosed in the footnotes (no segregation on the face of the statement); and gross presentation with subtotals for continuing and discontinued operations (segregation on the face of the statement).

[56] IAS 7, paragraph 6.

The Staff also noted that some companies in one country classified certain mutual fund shares held by the company as cash equivalents based on guidance issued by its home country financial regulator.

IFRS also requires disclosure of a reconciliation of the cash equivalent amounts in the statement of cash flows with the equivalent items reported in the statement of financial position.[57] However, the Staff found that several companies did not provide this reconciliation.

### 4. Footnotes

#### a. Presentation of Footnotes

Companies are required to "as far as practicable, present notes to their financial statements in a systematic manner."[58] Many companies ordered their footnote disclosure according to the ordering of the statement of financial position and income statement captions, consistent with an approach mentioned by IFRS.[59] However, the Staff also noted that many companies discussed different aspects of the same accounting area in multiple locations throughout the footnotes. Although the location of these footnotes was logical, this approach could make a company's complete situation for complex areas, such as income tax, more difficult to understand and efficiently compare to other companies' footnotes.

#### b. Footnote Disclosure Located Outside of the Financial Statements

The Staff observed that several companies presented required disclosures outside the financial statements. For example, the majority of companies in the sample provided their disclosures about financial instruments within the audited footnotes. However, about half of the companies in the banking industry provided some or all of the disclosures about financial instruments outside of the footnotes, in other sections of the annual report. Additionally, some companies in the banking industry combined the disclosures about financial instruments with disclosures required by prudential regulators and presented that combined information outside the financial statements. In some cases, disclosures about related party transactions and litigation contingencies also were located outside of the financial statements. It was often unclear whether such disclosures presented outside of the footnotes were audited.

### 5. Per Share Measures

IFRS requires the disclosure of earnings per share by public companies for each period presented.[60] The Staff noted a few companies, mostly companies in the banking industry in one country, which did not disclose earnings per share.

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[57] See IAS 7, paragraph 45.
[58] IAS 1, paragraph 113.
[59] See IAS 1, paragraph 114(c).
[60] See IAS 33, *Earnings per Share* ("IAS 33"), paragraph 2.

IFRS also permits, in addition to earnings per share, the disclosure of earnings per share based on a reported component of comprehensive income.[61] The Staff noted some companies, mostly in one country, disclosed earnings per share for alternative earnings measures.[62]

IFRS does not provide guidance on the calculation of per share measures that are not based on a measure of earnings. The Staff noted that some companies in the insurance and banking industries disclosed net asset value per share. In most cases, it was not clear how the measure was calculated or, if the measure was defined, it was not easily recalculated from the information provided.

## D. Accounting for Assets

### 1. Inventories

#### a. Inventory Measurement Basis

All companies are required to disclose "the accounting policies adopted in measuring inventories, including the cost formula used."[63] IAS 2 also requires inventories within its scope be measured at the lower of cost and net realizable value.[64] The Staff noted two companies that measured inventory on a basis other than that described in IAS 2.

#### b. Inventory Cost Capitalization

IFRS requires that "the cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition."[65] Most companies did not specify the nature of the costs that were capitalized as inventory. Such disclosures could help facilitate investor comparisons of financial statements, as specific capitalized costs may vary across companies.

IFRS also requires "a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods"[66] to be included in inventory. In one case, a company disclosed that it did not include production overhead in the cost of inventory. The Staff also noted that some companies included the amortization of product-related intangible assets in the cost of inventories while others did not, even in cases when the nature of the product and the intangible asset appeared to be similar. Most companies in the sample did not include borrowing costs in inventory; however, one company included borrowing costs on

[61] See IAS 33, paragraph 73.
[62] Alternative measures of earnings per share included: operating profit per share; normalized earnings per share; earnings per share before exceptional items; and earnings per share before restructuring, disposals, and other one-off items.
[63] IAS 2, *Inventories* ("IAS 2"), paragraph 36(a).
[64] See IAS 2, paragraph 9.
[65] IAS 2, paragraph 10.
[66] IAS 2, paragraph 12.

inventory that appeared to be "manufactured, or otherwise produced, in large quantities on a repetitive basis," [67] which is prohibited by IAS 23.

### c. Inventory Quantities

IFRS does not provide guidance regarding appropriate methods by which to estimate inventory quantities. The Staff observed that most of the companies that identified inventory as a source of estimation uncertainty[68] did not address how inventory quantities were determined in cases where they must estimate inventory quantities to determine the cost of inventory units that have been sold or transferred out of inventory,[69] such as in the chemicals or extractive industries. The companies that included this information provided limited information about the methods used and the extent to which the estimates were uncertain.

### d. Statement of Financial Position Classification

IFRS states that "current assets include assets (such as inventories…) that are sold, consumed or reali[z]ed as part of the normal operating cycle even when they are not expected to be reali[z]ed within twelve months after the reporting period."[70] The Staff observed diversity in the classification of inventory. While most companies classified all inventory as a current asset, some used non-current classification. However, it appeared that non-current classification may have been appropriate for some assets classified as current. For example, mining inventories were typically not classified as non-current even though mining companies routinely extract materials and set them aside for processing at a later time, usually for a period of time well in excess of their normal operating cycle. In addition, certain companies indicated that they were required by law to maintain minimum quantities of oil and gas. Most of these companies did not classify these amounts as non-current, even though they would not be realized as part of the normal operating cycle.

The Staff also noted other instances in which companies did not appear to comply with IAS 2. For example, one company credited the cost of recycling raw materials to the allowance for inventory obsolescence rather than recognizing a provision.

### e. Disclosures

Some companies did not disclose the amount of reversals of write downs during the period and the circumstances that led to the reversal, as required by IFRS.[71]

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[67] IAS 23, *Borrowing Costs* ("IAS 23"), paragraph 4.
[68] IAS 1, paragraph.125.
[69] See IAS 2, paragraph 34.
[70] IAS 1, paragraph 68.
[71] See IAS 2, paragraph 36.

### 2. Intangible Assets

IFRS defines an intangible asset as "an identifiable, non-monetary asset without physical substance."[72] IFRS requires internally-developed intangible assets to be recognized as assets if certain criteria are met.[73] For many companies, it was unclear what costs were being capitalized; thus, comparability was difficult to assess.

IFRS requires each entity to "assess whether the useful life of an intangible asset is finite or indefinite."[74] The Staff observed that some companies determined that certain types of intangible assets had a finite life, while other companies determined that the same type of intangible assets had an indefinite life. The Staff was not able to determine a reason for the difference in the useful life determination. For example, two companies in one country disclosed that certain brand names had a finite life. The brand names included some of the world's most recognized brands. In contrast, other companies classified similarly recognized brands as indefinite-lived intangible assets. The Staff also noted that some companies in two countries disclosed useful lives that appeared to be capped at a maximum length, such as 20 or 40 years. It was not clear whether these useful lives represented a carryover of previous home country practices.

Companies can select either the cost model[75] or the revaluation model[76] as their accounting policy and must apply that policy to an entire class of intangible assets. All of the companies elected to use the cost model to account for intangible assets other than emissions rights, thereby promoting comparability on a global basis.

IFRS does not explicitly address accounting for emission rights. Most companies did not address emissions rights in their accounting policy, which, in light of the size and industry of many companies in the Staff's sample, the Staff expected to be relevant to several companies. Of those companies that disclosed an accounting policy for emissions rights, most accounted for these rights at cost, while some accounted for them at fair value. The Staff also found that most companies classified emissions rights as non-current intangible assets and a few classified them as current inventory.

### 3. Property, Plant, and Equipment

#### a. Initial Recognition

IFRS requires property, plant, and equipment to be measured at its cost upon initial recognition.[77] The elements of cost are identified in IAS 16.[78] The cost of an item of property,

[72] IAS 38, *Intangible Assets* ("IAS 38"), paragraph 8.
[73] See IAS 38, paragraph 51.
[74] IAS 38, paragraph 88.
[75] See IAS 38, paragraph 74.
[76] See IAS 38, paragraph 75.
[77] See IAS 16, *Property, Plant and Equipment* ("IAS 16")," paragraph 15.

plant, and equipment includes "any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management."[79] Some companies indicated that costs incurred during a start-up period were capitalized but did not describe the nature of costs capitalized or the time span of the start-up period. Such disclosures could help facilitate investor comparisons of financial statements, as the details of cost capitalization may vary across companies.

#### b. Subsequent to Initial Recognition

IFRS permits companies to elect either the cost model[80] or the revaluation model[81] to account for property, plant, and equipment after initial recognition but requires application of that policy to an entire class of property, plant, and equipment.[82] The vast majority of companies in the sample elected to use the cost method, thereby promoting comparability on a global basis.

#### c. Depreciation

IFRS requires that the depreciable amount of an asset be allocated on a systematic basis over its useful life and reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.[83] The vast majority of companies used the straight-line method of depreciation, thereby promoting comparability on a global basis. Assets used to extract natural resources were typically depreciated using a units-of-production method. Refer to Section II.K.2.d.

### 4. Impairment of Assets

IFRS requires assets within the scope of IAS 36, *Impairment of Assets* ("IAS 36"),[84] to be carried at no more than the amount to be recovered from the higher of the use or sale of the asset. If an asset's carrying value exceeds its recoverable amount, the difference between the two amounts is expensed as an impairment loss. In future periods, if the conditions that resulted in the reduction of the carrying amount are no longer present, other than in the case of goodwill impairments, a portion[85] of the impairment loss is reversed.

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[78] See IAS 16, paragraphs 16-22.
[79] IAS 16, paragraph 16(b).
[80] See IAS 16, paragraph 30.
[81] See IAS 16, paragraph 31.
[82] See IAS 16, paragraph 29.
[83] See IAS 16, paragraphs 50 and 60.
[84] IAS 36 does not apply to: inventories; assets arising from construction contracts; deferred tax assets; assets arising from employee benefits; financial assets within the scope of IAS 39; investment property that is measured at fair value; biological assets related to agricultural activity measured at fair value less cost to sell; deferred acquisition costs, and intangible assets arising from an insurer's contractual rights under insurance contracts within the scope of IFRS 4, *Insurance Contracts* ("IFRS 4"); and non-current assets classified as held for sale. See IAS 36, paragraph 2.
[85] The amount of the asset, after reversal of the impairment loss, "shall not exceed the carrying amount that would have been determined (net of amorti[z]ation or depreciation) had no impairment loss been recogni[z]ed for the asset in prior years." See IAS 36, paragraph 117.

### a. Cash-Generating Unit Determination

IFRS requires assets to be evaluated for impairment individually, or, if the recoverable amount of an individual asset cannot be determined, by cash-generating unit.[86] A cash-generating unit is "the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets."[87] Goodwill is required to be allocated to a cash-generating unit(s) from the acquisition date.[88] The cash-generating unit to which goodwill is allocated and then evaluated for impairment must represent the lowest level within the entity at which goodwill is monitored and cannot be larger than an operating segment before aggregation.[89] The Staff observed several levels defined as cash-generating units, including the following: the operating segment, below the operating segment but not defined, one level below the operating segment, two levels below the operating segment, and the individual store or outlet. In certain other cases, the level at which goodwill was allocated was unclear.

### b. Determination of Value in Use

The recoverable amount of an asset or a cash-generating unit is "the highest of its fair value less costs to sell and its value in use," and the value in use is "the present value of the future cash flows expected to be derived from an asset or cash[-]generating unit."[90] The Staff observed value in use is most commonly calculated based on discounted cash flow projections. Income tax receipts or payments are not permitted to be included in estimates of future cash flows, and the discount rate is required to be determined on a pre-tax basis.[91] However, many companies disclosed the use of a post-tax discount rate. It was not always clear if those companies also used post-tax cash flow estimates.

### c. Disclosure

IFRS requires extensive disclosure of the assumptions used to estimate a cash-generating unit's value in use and the fair value less costs to sell, such as growth rates of cash flows, the period over which cash flows are projected, and discount rates.[92] The majority of companies identified this area as one of the policies having "the most significant effect on the amounts recogni[z]ed in the financial statements."[93] However, some of the key assumptions and judgments used in computing the value in use and fair value less costs to sell were not disclosed. The Staff also noted several instances of companies recognizing goodwill impairments but not providing any

[86] See IAS 36, paragraph 66.
[87] IAS 36, paragraph 6.
[88] See IAS 36, paragraph 80.
[89] Id.
[90] IAS 36, paragraph 6.
[91] See IAS 36, paragraphs 50 and 51.
[92] See IAS 36, paragraph 134.
[93] IAS 1, paragraph 122.

narrative discussion of the "events and circumstances that led to the recognition or reversal of the impairment loss."[94]

### 5. Financial Instruments

Unless otherwise noted, the Staff's observations with respect to financial instruments are primarily related to companies in the banking industry.

#### a. Recognition and Measurement

Unrealized gains and losses on financial instruments in the fair value through profit or loss category are immediately recognized in profit or loss, whereas unrealized gains and losses on financial instruments classified as available-for-sale securities are not recognized in profit or loss.[95] In October 2008, the IASB amended IAS 39 and IFRS 7, *Financial Instruments: Disclosures* ("IFRS 7"), to permit an entity to reclassify a financial asset out of the fair value through profit or loss category.[96] Twelve companies in the banking industry disclosed that they reclassified financial assets in accordance with the amendment. Most of these companies were in three countries. One company reclassified securities from the fair value through profit or loss category to the available-for-sale category, and subsequently sold a portion of the reclassified securities in the same fiscal year. This reclassification followed by a sale raises a question as to the purpose of the reclassification.

The Staff noted that some companies relied on home country guidance to account for financial instruments. For example, some companies in the banking industry within the European Union applied the European Union "carve out" in their application of IAS 39's hedging requirements.[97] All of the companies in the banking industry in one country disclosed the use of the carve-out while none of the companies in a different country disclosed use of the carve-out. The practice in other countries was mixed.

The Staff also noted that one company disclosed that it relied on a home country accounting standard to measure the fair value of an embedded derivative in a financial liability.
IFRS requires capitalization and deferral of loan origination costs.[98] One company disclosed that direct costs incurred in a loan origination were immediately recognized in earnings, which does not comply with IFRS.

[94] IAS 36, paragraph 130(a).
[95] See IAS 39, paragraph 55.
[96] See IAS 39, paragraph IN8A
[97] The European Union "carve out" refers to the provisions in IAS 39 that the European Union did not adopt. The "carve out" permits the application of fair value hedge accounting for hedges of interest rate risk for a portfolio of demand or core deposits and provides accommodations to IAS 39's hedge effectiveness requirements for certain hedges.
[98] See IAS 18, paragraph IE14.

Most non-financial companies' accounting policy disclosures mirrored the accounting requirements for financial instruments prescribed by IFRS, without providing additional insight regarding how those requirements applied to the companies' transactions. Some companies provided only limited disclosure about their accounting policy to determine whether available-for-sale investments were impaired.

#### b. Fair Value Option

IFRS provides companies with an option to measure financial assets and liabilities at fair value through profit or loss, if certain criteria are met.[99] This option was primarily relevant to companies in the banking and insurance industry, which held material amounts of the financial assets and liabilities to which this option applied. Within these two industries, most companies elected to apply fair value for a portion of their financial assets and liabilities.

#### c. Measurement of Regular-Way Purchase or Sale of a Financial Asset

Companies can elect to use either settlement date or trade date accounting to recognize regular-way purchases or sales of financial assets.[100] Most companies recognized financial instruments on the trade date. However, most companies in one country recognized financial instruments on the settlement date.

#### d. Available-for-Sale Investments

IFRS contemplates the use of impairment indicators[101] as a basis for recognition of impairment. The Staff noted that many companies in the banking and insurance industries, as well as some non-financial companies, used numerical thresholds (magnitude of share price decline and time span of decline) as bright-line indicators of when to record impairment of available-for-sale investments. The numerical thresholds varied from company to company with respect to both the magnitude of the price decline and the length of the decline. The Staff noted that the majority of companies in the sample that disclosed numerical thresholds were in two countries. The Staff also noted that one non-financial company used numerical indicators (time span of non-payment) to determine when to record impairment of accounts receivable.

Some companies indicated that investments in equity instruments not traded on an active market were measured at cost because fair value could not be reliably measured. None of the companies provided additional disclosure to explain why the market was not considered active. Such disclosures could help facilitate investor comparisons of financial statements, as the reasons for inactive market determinations may vary across companies.

[99] See IAS 39, paragraph 9.
[100] See IAS 39, paragraph 38.
[101] See IAS 39, paragraph 59.

The Staff also found that a few companies used an allowance account to record impairment on securities classified as available for sale and securities held to maturity, rather than directly writing down the value of the security, as required by IFRS.[102]

### e. Hedge Accounting

Of the companies that applied hedge accounting, the Staff observed that many did not disclose their method to assess effectiveness. Such disclosures could help facilitate investor comparisons of financial statements, as a variety of approaches may be appropriately applied under IFRS.

In addition, several companies did not disclose the "ineffectiveness recogni[z]ed in profit or loss arising from cash flow hedges," as required by IFRS.[103]

### f. Allowance for Loan Losses and Loan Impairment

IFRS requires:

> An entity [to] assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the entity shall apply paragraph 63 (for financial assets carried at amorti[z]ed cost) … to determine the amount of any impairment loss.[104]

The Staff noted diversity in the accounting policies for recognizing loan impairment, the factors considered when evaluating loans for potential impairment, the methods for assigning internal ratings, and the time periods considered. For example, some companies in the banking industry disclosed numerical rules (time span that the loan was past due) for identifying impairments of loans.

IFRS requires that interest income be recognized on all impaired loans at the loan's effective interest rate.[105] The majority of, but not all, companies in the banking industry recognized interest income on impaired loans.

The Staff found that some companies relied on home country guidance or rules to account for loan losses. One company disclosed that the loss rates used to estimate its allowance for loan losses were obtained from the home country regulations for collective assessments. Similarly, another company disclosed that the allowance percentages for its general allowance were mandated by the home country central bank. That company also disclosed different allowance percentages based on whether the receivable was secured or unsecured and also based on the time past due. Another company disclosed that it excluded unsecured consumer loans that were

[102] See IAS 39, paragraph 46 and 67.
[103] IFRS 7, paragraph 24(b).
[104] IAS 39, paragraph 58.
[105] See IAS 39, paragraph 46(a). IFRS does not have the concept of a nonaccrual loan.

less than a certain number of days past due from impairment consideration in accordance with guidance provided by the home country prudential regulator.

Companies are permitted but not required to use an allowance method.[106] Almost all companies used an allowance method. Even though IFRS does not require the allowance to be separately disclosed on the face of the statement of financial position, about 20% of companies, mostly companies in the banking industry in one country, did so.[107] While all companies that used an allowance account presented a roll forward of the balance in the footnotes, there was variety in the disclosure of the components to the roll forward.

As an alternative to the allowance method, companies can impair financial assets measured at amortized cost and reverse impairment of financial assets measured at amortized cost directly. Two companies in the banking industry in one country did not use an allowance account to record impairment in loans but rather recorded impairment as a direct charge off.[108]

The Staff observed differences in the use of the terms "provision" and "allowance." It was often unclear whether the terms "provision" and "allowance" were referring to the income statement or statement of financial position or vice-versa. Additionally, various companies used the following terms to indicate "provision" and/or "allowance:" cost of risk, depreciation, risk provisions, impairment, accumulated balance of impairment losses, valuation adjustment, and reserves. The description of the components comprising the allowance for loan losses also varied by company.[109]

#### g. Loan Charge Offs

IFRS requires disclosure of "the summary of significant accounting policies, the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements,"[110] which may include "the criteria for writing off amounts charged to the allowance account against the carrying amount of impaired financial assets."[111] While most companies in the banking industry disclosed an accounting policy for loan charge offs, the disclosures generally comprised a generic statement that loans were charged off when they were deemed uncollectible or when there was no realistic possibility of recovery. Additional detail in this regard may facilitate an investor's comparison of financial statements.

[106] See IAS 39, paragraphs 63-65.
[107] See IFRS 7, paragraph 16.
[108] IFRS permits this type of presentation; however, the IASB expected that virtually all entities would use an allowance account. See IAS 39, paragraph 63 and IFRS 7, paragraph BC27.
[109] Some of the components that companies disclosed included the following: specific, general, incurred but not reported, portfolio, collective, and country risk.
[110] IFRS 7, paragraph 21.
[111] IFRS 7, paragraph B5(d)(ii).

The Staff also noted that most companies in the banking industry in two countries did not disclose an accounting policy for when loans were charged off.

### h. Renegotiated Loans

Because credit impairment under IFRS is measured based on the net present value of future cash flows compared to the receivable's carrying amount,[112] one would expect an impairment loss on a renegotiated loan where an interest rate concession was granted. While most companies in the banking industry disclosed an accounting policy for renegotiated loans, it was unclear how they considered a renegotiation in determining whether a receivable was impaired. Generally, it also was unclear whether a lender recognized an impairment loss upon the renegotiation of a loan.

Most companies in the banking industry in one country did not disclose an accounting policy for renegotiated loans. In addition, some companies did not disclose the "carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated."[113]

### i. Disclosure

The Staff noted differences in the extent of and information provided in disclosures about credit quality. Some companies provided great detail into their allowance methodology, assessment of impaired loans, charge-off policies, and credit risks including mapping to equivalent external credit ratings. Some companies also provided quantitative information on loss expectations. However, many companies did not provide the amount of the allowance on impaired loans, the amount of nonperforming loans, an aging analysis of loans that are past due but not considered impaired, the amount of interest income recognized on impaired loans, and the balance of restructured loans. Although IFRS does not specifically require these disclosures, many companies voluntarily provided them, and such disclosures may facilitate better investor understanding of a company's financial position.

The Staff also observed variations in the level of disclosure of the balances of impaired, nonperforming, and past due loans. The majority of companies disclosed an impaired loan balance. A few companies disclosed impaired loans with no allowance. Half of the companies disclosed the balance of nonperforming loans. The majority of companies disclosed the balance of all past due loans; however, some companies only disclosed past due loans that were impaired, and a few companies did not disclose the balance of past due loans.

Most companies in the sample disclosed credit concentrations as one indicator of credit quality. However, it was not always easy to discern whether the information was limited to loans or if it also included securities. Examples of other disclosures about credit quality included:

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[112] See IAS 39, paragraph 63.
[113] IFRS 7, paragraph 36(d).

- Credit exposure by credit rating (e.g., the percentage of credit exposure that was AAA rated).

- A roll forward of impaired loans as well as a past due analysis of impaired loans by geography.

- A narrative description of the internal credit rating system and how it is applied to each of the different loan grades.

- Allowance ratios, such as allowance as a percentage of total loans and charge offs as a percentage of total loans.

The Staff noted differences in disclosures about fair value measurements. Some disclosures included detailed discussion of measurement methodologies and assumptions at a disaggregated level. In contrast, the Staff noted many disclosures that provided minimal information and appeared to be noncompliant with disclosure requirements. For example, the amount of hedging ineffectiveness (among other hedging disclosures) was frequently omitted.[114]

In addition, IFRS requires disclosure of the methods and assumptions used to estimate the fair value of each class of financial assets and financial liabilities.[115] Most companies did not disclose the assumptions used in measuring fair value. It usually was not clear whether the fair value measurement of loans included credit risk. Some companies disclosed generic assumptions, such as the fact that credit losses and discount rates were used in determining the value, but did not disclose the quantitative measure of these assumptions. One company did not disclose the methods used in developing its fair value disclosures and did not address loans in the disclosure.

IFRS suggests disclosure of how the entity has satisfied the criteria for being eligible to apply fair value accounting when the fair value option is elected for an instrument.[116] The Staff noted many instances in which entities did not disclose how the criteria for designation were met. Several companies measured certain financial liabilities at fair value through earnings; however, they did not disclose the change in the fair value attributable to changes in their own credit risk, as required by IFRS.[117]

The Staff also noted inconsistencies in the disclosure regarding Level 3 instruments.[118] One company did not disclose the amount of the gain/loss attributable to Level 3 instruments still

[114] See IFRS 7, paragraphs 10 and 22-24
[115] See IFRS 7, paragraph 27.
[116] See IFRS 7, paragraph B5.
[117] See IFRS 7, paragraph 10.
[118] IFRS requires entities to classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. (IFRS 7, paragraph 27A) Level 3 refers to fair value measurement that is not based on observable market data (unobservable inputs). (IFRS 7, paragraph 27A(c))

held at period end as required.[119] Several companies in one country did not provide all of the disclosures required for Level 3 instruments including the amount of the gain/loss attributable to Level 3 instruments still held and the amount of gain/loss recognized in other comprehensive income.

The Staff noted some instances in which companies did not appear to determine fair value in a manner that complies with IFRS. For example, one company disclosed that it measured the fair value of certain assets held based on redemption prices, which may differ from the current bid price, as contemplated by IFRS in determining the fair value for assets held.[120] In another example, a company disclosed that the carrying value of variable rate loans as well as lease receivables was assumed to be fair value. It is unclear how the carrying value considered future expected credit losses in order to appropriately reflect fair value. The Staff also noted that a few companies disclosed that they used the carrying value of certain assets to approximate the fair value for disclosure purposes (e.g., equity securities that do not trade), which is permitted by IFRS.[121]

IFRS requires disclosure of market risk through "a sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period."[122] All companies in the banking industry except one disclosed the results from their value-at-risk ("VaR") analysis to comply with this disclosure requirement. The company that did not use VaR instead disclosed the impact to equity from a defined basis point change and a defined percent change in the value of the functional currency. IFRS also requires the disclosure of the main parameters and assumptions underlying the data in the sensitivity analysis.[123] The Staff noted considerable diversity in the parameters used to perform the VaR analysis, including: the confidence level, the holding period, the types of securities included in the analysis, and the inclusion of equity risk. The Staff also noted diversity in the number of periods disclosed and limited disclosure about VaR back-testing exceptions.

IFRS requires disclosure of a "maturity analysis for non-derivative financial liabilities that shows the remaining contractual maturities."[124] The Staff noted that nearly half of the companies in the banking industry did not segregate financial liabilities classified as trading by their contractual maturity. Similarly, many did not disclose the on-demand amount in the contractual maturity analysis.

### 6. Investment Property

One-third of companies disclosed that they entered into transactions within the scope of IAS 40, *Investment Property* ("IAS 40"). IAS 40 permits companies, in certain circumstances, to elect

[119] See IFRS 7, paragraph 27B(d).
[120] See IAS 39, paragraph IG.E.2.1.
[121] See IFRS 7, paragraph 29.
[122] IFRS 7, paragraph 40(c).
[123] See IFRS 7, paragraph 41.
[124] IFRS 7, paragraph 39.

either the fair value model or the cost model in measuring investment property.[125] Most companies applied the cost method. Half of the companies with transactions in the scope of IAS 40 were in the banking industry and represented the largest portion of companies that applied the fair value method.

Several companies did not disclose the methods and significant assumptions used to determine the fair value of the investment properties, as required by IFRS.[126] The Staff also noted variations by country in the determination of fair value for investment properties. The Staff noted that one company indicated that the determination of fair value of investment property was regulated in one country, and another disclosed that investment property was measured for fair value in accordance with guidance published by a home country organization.

#### 7. Agriculture

Less than five percent of companies in the sample disclosed that they entered into transactions within the scope of IAS 41, *Agriculture* ("IAS 41"). A few of the companies with transactions within the scope of IAS 41 did not disclose "the methods and significant assumptions applied in determining the fair value of each group of agricultural produce at the point of harvest and each group of biological assets,"[127] as required.

### E. Accounting for Liabilities

#### 1. Recognition and Measurement

IFRS requires a provision to be recognized:

> when an entity has a present obligation (legal or constructive) as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle that obligation, and a reliable estimate can be made of the amount of obligation.[128]

Most companies stated these recognition criteria in their accounting policy, but did not provide any additional explanation as to how the criteria were applied. Some companies disclosed criteria that did not appear to comply with IFRS. For example, one company disclosed that one of the criteria applied to recognize a provision would be that no inflow of resources of an equivalent amount was expected. IFRS does not permit offsetting in the statement of financial position of amounts recoverable from third parties.[129] In addition, a few companies did not discuss the recognition criteria in IAS 37; rather, they indicated that they looked to legal experts to determine whether a provision should be recorded.

[125] See IAS 40, paragraph 30.
[126] See IAS 40, paragraph 75(d).
[127] IAS 41, paragraph 47.
[128] IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* ("IAS 37"), paragraph 14.
[129] See IAS 37, paragraph 53.

One company disclosed that it looks to home country accounting interpretations regarding the determination of the amount of environmental provisions.

The Staff noted that some companies did not record provisions because of estimation uncertainty even though IFRS indicates that these circumstances should be "extremely rare."[130]

The discount rate used to discount a liability is required to be a "pre-tax rate (or rates) that reflect(s) the current market assessments of the time value of money and the risks specific to the liability."[131] Certain companies did not use a discount rate that took into account the risks specific to the liability. For example, the Staff observed that one company used the real interest rate based on common practice in one country, even though the real interest rate typically does not take into account the risks specific to the liability.

### 2. Disclosure

Most companies either did not disclose all of the required disclosures, or provided limited disclosure of, provisions, contingent liabilities, and contingent assets. For example, many companies omitted disclosure or provided limited disclosure of the financial exposure and the underlying uncertainties surrounding provisions and contingent liabilities.[132] In addition, IFRS requires disclosure of provisions and contingent liabilities by class but does not define a class.[133] Many companies grouped classes of provisions at a high level and in some cases did not disclose the required roll forward for each class of provision.[134]

It was unclear whether the level of disclosures in this area was due to noncompliance, immateriality, or reliance upon IFRS's accommodation for disclosure of seriously prejudicial information. In extremely rare cases, IFRS allows a company to omit certain disclosures about provisions and contingent liabilities when the disclosure is expected to seriously prejudice the position of the company.[135] In these cases, the company is required to disclose the general nature of the dispute, that information was omitted, and why.[136] Only one company disclosed reliance on this accommodation. Further, this company disclosed that it omitted certain disclosure, but simply referred to the matters not disclosed as continuing litigation. It did not provide any additional information about the general nature of the matters.

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[130] IAS 37, paragraph 26.
[131] IAS 37, paragraph 47.
[132] See IAS 37, paragraphs 84 and 86.
[133] Id.
[134] See IAS 37, paragraph 84.
[135] See IAS 37, paragraph 92.
[136] Id.

## F. Accounting for Shareholders' Equity

### 1. Separate Accounts within Shareholders' Equity

The Staff observed several instances in which local laws or accounting regulations required the use of a separate account within shareholders' equity to provide for specifically mandated reserves. IFRS provides no guidance regarding the presentation of these separate accounts. Some companies in one country disclosed that 10% of profit was transferred to a non-distributable statutory surplus reserve in shareholders' equity in accordance with home country accounting standards. One company in that same country disclosed that home country law required it to maintain a general reserve within shareholders' equity for the risk of impairments (in addition to impairment allowances) equal to one percent of risk assets, which are defined by law. A company in another country referred to a specific statement issued by a home country organization as its accounting policy for determining the amount of equity to classify as mandated reserves as a separate account within equity. Some companies in one country disclosed that home country law required them to maintain a legal reserve within shareholders' equity.

### 2. Classification of a Financial Instrument as a Liability or Equity

IFRS was amended in 2009 to clarify that rights issues, options, and warrants denominated in a currency other than the issuer's functional currency and offered on a pro-rata basis to all owners of the same class of equity must be classified as equity.[137] The change relates only to instruments that, when exercised, would result in the issuance of a fixed number of shares at a fixed foreign-currency exercise price. The amendment is to be applied for annual periods beginning on or after February 1, 2010, with earlier application permitted. A few companies early adopted the amendment, which resulted in those companies accounting for cross-currency rights offerings as equity rather than as derivative assets/liabilities in 2009.

### 3. Offsetting a Financial Asset and a Financial Liability

IFRS states:

> A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity: (a) currently has a legally enforceable right to set off the recogni[z]ed amounts; and (b) intends either to settle on a net basis, or to reali[z]e the asset and settle the liability simultaneously. In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability...[138]

[137] See IAS 32, *Financial Instruments: Presentation* ("IAS 32"), paragraph 97E.
[138] IAS 32, paragraph 42.

Most companies in the banking industry that disclosed the use of a master netting arrangement presented derivatives on a net basis. However, some companies disclosed the use of a master netting arrangement with their counterparties, but indicated that they still presented derivatives on a gross basis. It was unclear whether these companies' netting determinations differed from the others due to different intent or potentially noncompliant presentation.

## G. Accounting for Revenue

### 1. General

IFRS provides limited guidance for revenue recognition but does require several general conditions to be satisfied for a company to recognize revenue.[139] IFRS also requires disclosure of "the accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services."[140]

Just over one-third of companies in the sample disclosed an accounting policy for revenue that did not fully explain how the revenue recognition guidance was applied to its transactions. Unclear revenue recognition policies disclosures were most prevalent among companies in two countries. The majority of companies with unclear revenue recognition policy disclosures were in the telecommunications, motor vehicles and parts, utilities, and food and drug stores industries.

### 2. Sales Transactions with Multiple Elements

Many companies that disclosed an accounting policy for sales transactions with multiple elements did not explain how the value of each of the elements of revenue was determined. They also did not disclose how they determined when to recognize revenue in future periods or the amount to be recognized in each period. The telecommunications industry, in particular, exhibited significant diversity in the accounting for the different elements in a revenue transaction. These variations included the following:

- Some companies disclosed that they used a fair value method to compute the amount allocated to a particular element.
- Some companies did not disclose how they allocated revenues if the fair value of an element was not determinable, while others disclosed that they used a residual method.
- Some companies did not disclose the policy used to allocate revenues to the multiple elements.

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[139] See IAS 18, paragraphs 14 and 20.

[140] IAS 18, paragraph 35.

### 3. Revenue Recognition Specific to Certain Industries

The Staff observed the following trends related to revenue recognition in certain industries:

- Most companies in the motor vehicles industry that entered into sales with buy-back arrangements did not address whether significant risks and rewards were transferred to the buyer or explain the factors considered when making this determination. The Staff noted that most companies accounted for these transactions as sales subject to an operating lease. Most companies did not explain how they determined the amount of residual value guarantees or buy-backs.

- Most companies in the retail industry did not disclose an accounting policy for the redemption of gift cards and provided only limited disclosure about customer loyalty programs.

- The Staff noted a number of differences in the accounting for the sale of handsets in the telecommunications industry.[141]

### 4. Presentation

IFRS states that "[a]mounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the entity and do not result in increases in equity."[142] It also requires revenue to be measured "at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity."[143] The Staff noted differences in the nature of items netted against revenue for companies both within and across industries.[144] The Staff also noted limited disclosure to explain how the amounts netted against revenue were measured.

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[141] The following accounting practices were identified:

- The loss on the handset was recognized immediately through cost of sales because the sale of the handset at a loss was considered to be a revenue transaction.
- The loss on the handset was considered a subscriber acquisition cost, similar to a commission paid, that met the definition of an intangible asset. Under this view, the intangible asset was amortized over its useful life.
- The handset and the service contract were two separate deliverables. However, the handset consisted of two components: revenue was recognized to the extent of the proceeds from the sale of the handset and the loss was considered an asset (subscriber acquisition cost) that was amortized over its useful life.
- The loss on the handset was recognized immediately and classified as part of selling and marketing expenses in the income statement.

[142] IAS 18, paragraph 8.

[143] IAS 18, paragraph 10.

[144] Examples include: charge backs, customer incentives, customs fees, discounts, excise taxes, fees and taxes collected on behalf of local authorities when the company does not bear the risk of payment default by third parties, price declines, rebates (e.g., Medicaid), refining and treatment costs, sales incentives (including below market interest rates), sales returns, sales tax, value added tax, volume rebates, and costs associated with rental and licensing income.

### 5. Construction Contracts

Just over one-third of companies disclosed that they entered into transactions within the scope of IAS 11, *Construction Contracts* ("IAS 11"). In some cases, the companies referred to IAS 11 rather than disclosing the manner in which they applied IAS 11 to their transactions. For example, most companies did not address the combining and segmenting of contracts, the components of contract revenue and contract costs, and the criteria applied to recognize changes in estimates. While most companies disclosed the approach used to determine the stage of completion of a contract in applying the percentage of completion method, some companies disclosed use of more than one approach but did not specify when each approach was applied. Although IFRS does not explicitly require these disclosures, additional detail in this regard may facilitate an investor's comparison of financial statements.

## H. Accounting for Government Grants and Disclosure of Government Assistance

Half of the companies in the sample disclosed transactions that appeared to be within the scope of IAS 20, *Accounting for Government Grants and Government Assistance* ("IAS 20"). IFRS permits entities to present government grants related to assets, including non-monetary grants at fair value, as either deferred income or as a deduction in arriving at the carrying amount of the related asset.[145] Of the companies that disclosed the classification of government grants, two-thirds reported these grants as deferred income and the remainder reported the grants net against the related asset. All of the companies in two countries reported government grants as deferred income.

IAS 20 also provides guidance regarding disclosures related to government assistance, which differs from government grants.[146] A few companies in the banking industry provided limited disclosure about government assistance, but did not describe the accounting for the assistance or provide other required disclosures.[147] One company disclosed that it received subsidies from a public fund in conjunction with loans that it originated with a reduced interest rate. The accounting for the subsidies appeared to be based on home country accounting standards.

## I. Accounting for Expenses

### 1. Share-Based Payments

IFRS requires goods or services received or acquired in share-based payment transactions to be recognized as either an asset or an expense when the goods are obtained or as the services are received. An award is accounted for either as equity or as a liability depending on whether it is

[145] See IAS 20, paragraph 24.
[146] See IAS 20, paragraph 3.
[147] See IAS 20, paragraph 39.

expected to be settled in equity or cash. Two-thirds of companies disclosed that they entered into transactions within the scope of IFRS 2, *Share-based Payment* ("IFRS 2").

### a. Recognition and Measurement

Just less than half of the companies that had transactions within the scope of IFRS 2 disclosed an accounting policy for equity-settled and/or cash-settled share-based payments that was unclear. For example, a number of companies addressed some, but not all of the recognition and measurement criteria in IFRS 2. The majority of companies that disclosed an unclear accounting policy for share-based payments were in five countries. The majority of companies that disclosed an unclear accounting policy for share-based payments were in the motor vehicles, petroleum refining, banking, telecommunications, and utilities industries.

In addition, one company disclosed that it estimated the value of stock options once every three years and used that calculation as the basis to calculate share-based payments made during intervening years. How these policies complied with IFRS was unclear.

The Staff also noted that many companies' disclosures suggested that the amount expensed relating to employee share purchase plans was based on a price calculated using a formula, rather than fair value, as required by IFRS.[148]

The Staff also noted several instances in which companies referred to national standard-setter guidance to account for certain aspects of share-based payments. It was not clear whether their accounting policies complied with IFRS (i.e., the reference to the home country accounting standard was due to the manner in which that country incorporated IFRS into its financial reporting system) or whether the companies appropriately determined to use local GAAP in the absence of an IFRS that specifically applies to their transactions, in accordance with IAS 8. The Staff observed the following:

- Some companies in the sample indicated that they calculated the amount of the adjustment to the fair value of certain share awards for a non-transferability restriction using guidance received from the local standard setter.

- Some companies disclosed that they sold equity to certain groups of people at a discount to comply with local laws and determined that these transactions were in the scope of IFRS 2 based on IFRIC 8, *Scope of IFRS 2*, and home country GAAP from where the local law originated.

- A few companies disclosed that they applied home country GAAP to account for social costs associated with the issuance of equity-settled share based payments. These companies disclosed that they applied guidance issued by the local standard setter.

[148] See IFRS 2, paragraph 10.

#### b. Assumptions to Measure the Fair Value of Awards

IFRS provides factors to consider in estimating expected volatility in determining the fair value of share-based payments, including factors indicating that expected future volatility might differ from past volatility. For example, IFRS states:

> [I]f an entity's share price was extraordinarily volatile for some identifiable period of time because of a failed takeover or a major restructuring, that period of time could be disregarded in computing historical average annual volatility.[149]

Certain companies in one country disclosed that expected volatility was either capped or smoothed to exclude periods of high/extreme volatility. One company stated that volatility was partially smoothed to eliminate extreme deviations and to better reflect long-term trends. Several companies used historical volatility rather than estimated volatility to measure share-based payments.

The Staff also noted that some companies used estimated volatility calculated over a period of time that was different than the expected term of the related stock options. IFRS states that "the historical volatility of the share price over the most recent period that is generally commensurate with the expected term of the option…" be considered in estimating expected volatility.[150]

#### c. Disclosure

For companies that provided share-based payment disclosures, the level of disclosure varied greatly. Some companies disclosed very little information while others disclosed the detailed assumptions used to measure the value of awards and detailed tabular information on award activity and balances. Some companies disclosed that outside experts were used to determine the fair value of share-based payments.

### 2. Income Taxes

One-third of companies disclosed an accounting policy for income taxes that either did not address all of the recognition and measurement criteria of IAS 12, or was otherwise unclear, as further discussed below.

#### a. Scope of Taxes Accounted for under IAS 12

IFRS states that "income taxes include all domestic and foreign taxes which are based on taxable profits."[151] The determination of whether a tax or required payment to a government

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[149] IFRS 2, paragraph B25(d).
[150] IFRS 2, paragraph B25(b).
[151] IAS 12, paragraph 2.

represents an operating expense or an income tax is highly dependent on the specific terms of the assessed tax as well as country-specific laws and regulations. The Staff noted differences in the determination of whether certain taxes were income taxes, rather than operating expenses. For example, some companies determined that a business tax in one country was an income tax while other companies determined that it was an operating expense. One company disclosed that income taxes included special taxes relating to extraction and production of certain natural resources.

### b. Recognition of Deferred Tax Assets and Liabilities

IFRS prohibits the recognition of deferred tax assets and liabilities that arise from the initial recognition of goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination, and, at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).[152]

Two companies provided additional disclosure regarding the application of the initial recognition requirements of IAS 12 to finance leases and the provision for asset closure and restoration costs. One company determined that the exemption did apply to these types of transactions and did not record deferred taxes, while the other company determined that the exemption did not apply and recorded deferred taxes. While most companies in the analysis had these types of transactions, these two companies were the only ones that provided additional disclosure regarding their application of the initial recognition requirements of IAS 12 to finance leases and the provision for asset closure and restoration costs.

### c. Recognition of Deferred Tax Assets and Liabilities Related to Subsidiaries, Branches, Associates, and Joint Ventures

IFRS requires an entity to recognize deferred tax liabilities for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, unless the entity is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.[153] IFRS requires an entity to recognize deferred tax assets for all deductible temporary differences associated with such investments to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.[154] One company disclosed that deferred taxes on temporary differences on participations in subsidiaries and associated companies were only reported when it was probable that the difference would be recovered in the near future.

In addition, some companies did not disclose the amount of unrecorded aggregate temporary differences, as required by IFRS.[155]

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[152] See IAS 12, paragraphs 15 and 24.
[153] See IAS 12, paragraph 39.
[154] See IAS 12, paragraph 44.
[155] See IAS 12, paragraph 81(f).

### d. Tax Rate Used for Current and Deferred Tax Assets and Liabilities

IFRS requires the use of tax rates (and tax laws) that have been enacted or substantively enacted to determine current and deferred tax liabilities and assets.[156] Some companies disclosed that the tax rates used to determine current and deferred assets and tax liabilities and assets were based on terms other than "enacted" or "substantively enacted."[157]

### e. Recognition of Deferred Tax Assets

IFRS limits the recognition of deferred tax assets to the extent that it is probable that taxable profit will be available against which a deductible temporary difference can be utilized.[158] Some companies in the sample used a criterion other than probable to recognize deferred tax assets.[159] The Staff also noted several companies in one country that reported a deferred tax asset valuation allowance and reported deferred tax assets before taking into account the valuation allowance. IFRS does not contemplate the use of a valuation allowance.[160] Although these companies' total assets complied with IFRS, it would appear that these deferred tax assets and the related valuation allowances should not have been recognized under IFRS.

### f. Income Tax Related Contingencies

The determination of current and deferred tax assets and liabilities requires significant management judgment and estimation. IFRS does not address the recognition of provisions arising from positions taken by an entity that may be challenged by income tax authorities. Just over 10% of companies provided additional disclosure regarding their accounting policy for income tax uncertainties. The Staff observed significant differences in the nature of and the detail of the disclosure provided for uncertain tax positions. The majority of companies that provided additional disclosure regarding their accounting policy for income tax uncertainties were in four countries.

## 3. Employee Benefits

IFRS provides guidance regarding short-term employee benefits and longer term post-employment benefits.

[156] See IAS 12, paragraphs 46 and 47.
[157] They referred to tax rates used as "expected to apply," "applicable and announced," or "applicable and essentially adopted."
[158] See IAS 12, paragraphs 24(a), 34-36, and 44.
[159] The criteria disclosed to recognize a deferred tax asset included "recoverable," "likely," "expected to be realizable in the foreseeable future," "probability of future recovery," and similar terms.
[160] See IAS 12, paragraph 24.

### a. Defined Benefit Plans

The Staff noted several instances of companies accounting for defined benefit pension plans either based on or adjusted by local guidance. For example:

- Several companies in one country disclosed that their pension accounting complied with local regulatory requirements. For example, a company disclosed that home country law dictated the discount rate that was to be used to measure pension liabilities. Another company disclosed that the home country central bank required actuarial gains/losses to be amortized over a maximum of five years. IFRS requires recognition over the average remaining work lives of the employees in the plan, or any systematic method that results in faster recognition.[161]

- A company in one country disclosed that certain aspects of its pension disclosures were determined under a home country GAAP standard, which differed from IFRS requirements.

- Some companies in one country disclosed that they applied home country GAAP as a supplement to IFRS. For example, a company in that country disclosed that it relied on home country GAAP to determine whether or not a defined benefit plan was a multi-employer plan.

- Some companies in one country did not recognize a provision related to vested statutory training rights for employees of entities in that country. Instead, these companies followed home country GAAP.

IFRS allows companies to elect how and when, within prescribed limits, to recognize actuarial gains and losses.[162] Actuarial gains and losses can be recognized as income/expense or as part of other comprehensive income.[163] The majority of companies that had defined benefit plans charged all amounts directly to other comprehensive income. Some companies applied a corridor amortization approach, and one charged amounts directly to profit and loss. The Staff noted that companies in four countries predominantly charged all amounts directly to other comprehensive income, while in three other countries the use of the corridor method was more prevalent. One company disclosed that it recorded actuarial gains and losses directly to retained earnings, which is not consistent with IFRS requirements.

IFRS requires that past service costs be expensed on a straight-line basis over the average period until the benefits become vested.[164] One company disclosed that it expensed past service costs

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[161] See IAS 19, *Employee Benefits* ("IAS 19"), paragraph 93.
[162] See IAS 19, paragraphs 92 and 93B. The available choices include the corridor method, charging all amounts directly to other comprehensive income during the period incurred, or a systematic method that results in faster recognition of actuarial gains and losses than the corridor method.
[163] See IAS 19, paragraphs 92 and 93A.
[164] See IAS 19, paragraph 96.

immediately. The company's policy may have been appropriate if benefits vested immediately but the vesting period was not specified.

Seven companies, primarily located in one country, disclosed that they did not have defined benefit plans. One company accounted for a multi-employer defined benefit plan as a defined contribution plan because certain information was not available, as permitted by IFRS, but did not provide the required disclosures as to why sufficient information was not available.[165]

#### b. Discount Rate

IFRS requires the rate used to discount post-employment benefit obligations (both funded and unfunded) to be determined by reference to market yields at the end of the reporting period on high-quality corporate bonds in a currency and with a term consistent with the currency and estimated term of the post-employment benefit obligations.[166] In countries where there is no deep market in such bonds, the market yields of government bonds should be used.[167] Some companies determined that there was not a deep market in high-quality corporate bonds in certain countries due to turmoil in the markets and instead used the market yields of government bonds. In contrast, other companies used the market yields of high-quality corporate bonds in those countries for the same periods. Still other companies did not disclose the source of their discount rates. In light of the differing applications of IFRS in this area, additional disclosure may help facilitate investor comparisons of financial statements.

#### c. Disclosure

A few companies grouped certain pension plans together and provided the assumptions on an aggregated basis. However, it was unclear if the assumptions were on a weighted-average basis, as required.[168] Another company reported pension assumptions on an aggregated basis and disclosed a range of the assumptions, as permitted by IFRS. However, the ranges used may have been wider than provided by IFRS.[169]

Some companies disclosed the specific mortality tables used, usually from the country where the pensioners were located. Although this disclosure is not specifically required by IFRS, it may provide investors with additional information regarding the assumptions used in these estimates and facilitate comparability among entities.

### 4. Borrowing Costs

IFRS states: "Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are

[165] See IAS 19, paragraph 30.
[166] See IAS 19, paragraph 78.
[167] Id.
[168] See IAS 19, paragraph 122.
[169] Id.

recogni[z]ed as an expense."[170] The Staff noted that many companies disclosed an accounting policy for borrowing costs that was unclear.

IFRS also requires that the amount of borrowing costs eligible for capitalization be determined by:

- Use of the actual borrowing rate where funds are borrowed specifically for the purpose of obtaining a qualifying asset.[171]

- Use of the weighted average borrowing rate where funds are borrowed generally for purposes of obtaining a qualifying asset.[172]

In one case, the Staff noted disclosure that a company used the bank overdraft rate incurred before taxation to determine the amount of costs eligible for capitalization. However, it was unclear whether this company used funds from the bank overdraft specifically for the purpose of obtaining a qualifying asset.

## J. Accounting for Broad Transactions

### 1. Business Combinations

IFRS specifies "an entity shall account for each business combination by applying the acquisition method," which requires identification of the acquirer; determination of the acquisition date; recognition and measurement of identifiable assets acquired, the liabilities assumed and any non-controlling interests in the acquiree; and recognition and measurement of goodwill or a gain from a bargain purchase.[173]

#### a. Recognition and Measurement

Almost 10% of companies did not disclose an accounting policy for business combinations. Most of those companies were in the banking industry. Of the companies that disclosed a policy, most provided a very brief description of the purchase method and the majority did not address many of the aspects of that accounting method.[174]

IFRS 3, *Business Combinations* ("IFRS 3"), does not address how to account for the acquisition of a non-controlling interest that does not result in a change in control. Of the companies that engaged in these transactions, the Staff noted two accounting methods that were commonly

[170] IAS 23, paragraph 1.
[171] See IAS 23, paragraph 12.
[172] See IAS 23, paragraph 14.
[173] IFRS 3, paragraphs 4 and 5.
[174] These include: identification of the acquirer, determination of the cost of a business combination, adjustments to the cost of a business combination contingent on future events, business combinations achieved in stages, initial accounting determined provisionally, and transaction costs.

used, which are referred to here as the "parent entity extension method" and the "entity concept method." The parent entity extension method records the difference between the purchase price and the carrying amount of the non-controlling interest in goodwill, while under the entity concept method the difference is recorded as an adjustment to equity.[175] Of the companies that disclosed their accounting policy for the acquisition of a non-controlling interest, two-thirds applied the parent entity extension method. The Staff observed that most companies in one country applied the parent entity extension method, likely due to a carryover of accounting under home country accounting standards, while there was mixed practice in the rest of the world. While this carryover of home country accounting standards appears to have promoted comparability in one country, it does not do so on a global basis.

### 2. Common Control Transactions

IFRS does not provide guidance on how to account for transactions among entities under common control. The Staff noted that most companies did not appear to have common control transactions. Of those that did, several different methods were applied[176] and most companies did not disclose why they selected a particular method or how the selection of the accounting policy affected their financial statements. While these disclosures may not be specifically required, they may provide investors with an understanding as to the reasons a company's selection differs from its peers and the impact of the policy to facilitate comparability.

### 3. Non-Current Assets Held for Sale and Discontinued Operations

#### a. Definition

IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations* ("IFRS 5"), requires:

> (a) assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and *fair value* less *costs to sell*, and depreciation on such assets to cease; and
>
> (b) assets that meet the criteria to be classified as held for sale to be presented separately in the statement of financial position and the results of discontinued operations to be presented separately in the statement of comprehensive income.[177]

Most companies in the sample reported either assets held for sale or discontinued operations. Approximately one-third of the companies that disclosed an accounting policy for discontinued operations and a majority of companies that reported assets held for sale disclosed accounting

[175] IFRS addressed this in later amendments which coincide with the effective date of IFRS 3(2008). See IAS 27, *Consolidated and Separate Financial Statements* ("IAS 27"), paragraph 30.
[176] The Staff noted the following accounting policies used to account for common control transactions: the purchase method, the excess of the cost of acquisition over the initial carrying values of the company's share of the net assets acquired recorded as part of a common control reserve, book value, and modified book value.
[177] IFRS 5, paragraph 1.

policies that were unclear. For example, several companies addressed some, but not all of the criteria required for classification as discontinued or held for sale. Most companies in the banking industry did not disclose how they accounted for repossessed assets such as other real estate owned ("OREO"), including policies surrounding the use of appraisals.

The Staff also noted that several companies described accounting practices that did not appear to comply with IFRS. For example, one company indicated that one of its criteria to classify an asset as held for sale was that a sale would be completed within one year from the statement of financial position date, rather than one year from the date of classification. Another company classified assets as held for sale that were not available for sale in their present condition. This is not consistent with IFRS, which requires that the asset "must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets..."[178]

In addition, the Staff noted that some companies used definitions of a discontinued operation that did not correspond exactly with IFRS 5, such as: (1) operations that may clearly be separated operationally and for accounting purposes from the remainder of the company and have been sold or classified as held for sale, and (2) a line of business that the company has decided to abandon and/or sell whose assets, liabilities, and net profit or loss can be distinguished physically, operationally, and for financial reporting purposes.

**b. Presentation**

IFRS does not specify whether discontinued operations should be presented in a single- or multiple-column format. The majority of companies presented discontinued operations in a single column format while a few companies presented a multiple-column income statement that reported results inclusive and exclusive of the discontinued operations.

The Staff noted some cases in which companies did not comply with the presentation requirements of IFRS 5. Several companies included assets and liabilities held for sale in "other assets" and "other liabilities." IFRS requires separate presentation on the statement of financial position of assets and liabilities held for sale.[179] A few companies reported the loss on classification to discontinued operations as a component of other operating expense rather than as discontinued operations.[180]

The Staff noted diversity in the presentation of OREOs in the banking industry. Some companies in the banking industry disclosed that they included OREOs in assets held for sale. Other companies in the banking industry disclosed that OREOs were included in other assets.

[178] IFRS 5, paragraph 7.
[179] See IFRS 5, paragraph 38.
[180] See IFRS 5, paragraph 33(a).

### c. Disclosure

Some companies in the sample did not comply with the narrative disclosure requirements of IFRS to describe the disposal group, the facts and circumstances leading to the sale, and the operating segment in which the disposal group was presented.[181]

## 4. Operating Segments

IFRS requires that an entity disclose "information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates."[182]

### a. Determination of Operating Segments

IFRS states that:

> An operating segment is a component of an entity: (a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity), (b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and (c) for which discrete financial information is available."[183]

Two companies in one country stated that they had no operating segments. It was unclear whether this disclosure intended to communicate that the companies had the minimum one segment that would be expected of any company or whether these companies truly had no segments. If the latter possibility were the case, it was also unclear how these companies determined the level at which to test for goodwill. A few companies used a definition of an operating segment that did not align with IFRS, such as: (1) a group of assets and operations that engage in providing products or services that are subject to risks and returns that are different from those of other business segments, and (2) a distinguishable component of the group that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and rewards that are different from those of other business segments.

### b. Aggregation of Operating Segments

IFRS 8 states that operating segments can be aggregated if they have similar economic and operating characteristics.[184] The Staff noted that most companies in the sample did not disclose whether operating segments were aggregated, as required by IFRS.[185]

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[181] See IFRS 5, paragraph 41.
[182] IFRS 8, *Operating Segments* ("IFRS 8"), paragraph 1.
[183] IFRS 8, paragraph 5.
[184] See IFRS 8, paragraph 12, which states, in part:

#### c. Entity-Wide Disclosures

IFRS requires companies to provide additional disclosure about geographical areas, major customers, and product and service revenue.[186] One company disclosed that it had a significant customer but did not provide the required disclosures of the amount of revenue from that customer. Most companies did not provide entity-wide disclosures regarding product and service revenue to external customers. If information about product and service revenue is not disclosed because it is not available and the cost to develop it would be excessive, companies are required to disclose that this is the case.[187] Only one company explained why it had not presented this information.

### 5. Leases

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. If it does not, it is classified as an operating lease.[188] Some companies with material leases did not disclose an accounting policy for the classification of leases as either finance or operating. In addition, the Staff noted that some companies referred to some but not all of the lease recognition and measurement criteria in the lease accounting policy disclosure. For example, some companies did not address how they accounted for the interest element in a finance lease, and others did not disclose how they accounted for contingent rents or incentives.

IFRS requires lessors to present assets subject to operating leases in their statements of financial position according to the nature of the asset.[189] The Staff observed variations in classification in which some lessors classified assets subject to operating leases as inventory while others classified them as equipment. One company indicated that a finance lease was classified as land and buildings when lease payments cannot be allocated reliably between the land and buildings elements. IFRS requires the land and building elements to be accounted for separately.[190]

A few companies disclosed that disclosures of lease commitments in prior year financial statements were either omitted or incorrect. These disclosures were corrected in the current year financial statements.

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Segments have similar economic characteristics, and the segments are similar in each of the following respects: (a) the nature of the products and services; (b) the nature of the production processes; (c) the type or class of customer for their products and services; (d) the methods used to distribute their products or provide their services; and (e) if applicable, the nature of the regulatory environment, for example, banking, insurance or public utilities.

[185] See IFRS 8, paragraph 22.
[186] See IFRS 8, paragraphs 32-34.
[187] See IFRS 8, paragraph 32.
[188] See IAS 17, *Leases* ("IAS 17"), paragraph 8.
[189] See IAS 17, paragraph 49.
[190] See IAS 17, paragraph 15.

### 6. The Effects of Changes in Foreign Currency Exchange Rates and Reporting in Hyperinflationary Economies

IFRS provides guidance on how to recognize "foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency,"[191] and defines functional currency as the "currency of the primary economic environment in which the entity operates."[192] Some companies indicated that certain subsidiaries used a functional currency other than the local currency. A few companies in the banking industry disclosed the U.S. dollar as their functional currency for all global operations, even though they had significant operations outside of the United States.

### 7. Related Party Transaction Disclosures

One company disclosed the existence of related party relationships but did not provide the required disclosures regarding these relationships.[193] One company disclosed that transactions with related parties were normally entered into on terms equivalent to those that prevail on an arm's length basis in the ordinary course of business but did not further explain the assertion.

IAS 24 was amended[194] in 2009 to change the definition of a related party, which simplified the disclosure requirements about transactions with government-related entities. This amendment is effective for annual periods beginning on or after January 1, 2011 with early adoption permitted. The Staff noted that some companies in one country disclosed that they early adopted this amendment.

### 8. Consolidation of Subsidiaries

Twenty percent of companies disclosed a consolidation accounting policy that either did not address all of the recognition and measurement criteria of IAS 27 or was otherwise unclear. The majority of these companies were in one country.

IFRS requires consolidated financial statements to include all subsidiaries of the parent.[195] The Staff noted that about 20% of companies disclosed that IAS 27 was not applied to subsidiaries that were considered immaterial. The majority of these companies were in one country. The Staff noted similar disclosure by some companies in two other countries. Several companies in one country disclosed numerical materiality thresholds for the policy. Companies

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[191] IAS 21, *The Effects of Changes in Foreign Exchange Rates* ("IAS 21"), paragraph 1.
[192] IAS 21, paragraph 8.
[193] See IAS 24, *Related Party Disclosures* ("IAS 24"), paragraphs 17-22.
[194] November 4, 2009, International Accounting Standards Board press release, *IASB simplifies requirements for disclosure of related party transactions*. See http://www.ifrs.org/News/Press+Releases/IASB+simplifies+requirements+for+disclosure+of+related+party+transactions.htm.
[195] See IAS 27, paragraph 12.

in the other countries did not disclose a numerical threshold. These subsidiaries were typically accounted for as investments measured at fair value or at cost.

A subsidiary is an entity that is controlled by its parent.[196] Under IFRS, control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control.[197] Several companies disclosed entities in which they had less than a 50% ownership interest but had consolidated, or more than 50% ownership interest but did not consolidate, as a result of other arrangements or other forms of control, but did not explain the nature of the arrangements or what these other forms of control represented.[198]

The vast majority of companies in the banking industry disclosed the use of special purpose entities ("SPEs"). Most of these companies provided limited disclosure about their relationships with the SPEs, whether the SPEs were consolidated, and the nature and amount of the assets within the SPEs. Additionally, most of these companies disclosed a generic accounting policy for how they determined whether to consolidate SPEs. The Staff noted a number of cases in which companies did not consolidate SPEs despite the presence of indicators of control.

IFRS requires the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements to be prepared as of the same reporting date,[199] unless it is impracticable to do so. Of the companies that referred to using a subsidiary's financial statements as of a different reporting date, several did not disclose the reason for doing so.[200]

### 9. Investments in Associates

An investment in an associate is required to be accounted for using the equity method, except under certain circumstances.[201] An associate is defined as "an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture."[202] A few companies did not disclose an accounting policy for associates even when they appeared to have significant investments in associates.

The Staff also noted several circumstances in which a company applied the equity method to account for an investment with a voting ownership interest that was either lower or higher than the threshold (i.e., 20 to 50%) at which significant influence is presumed; however, these

[196] See IAS 27, paragraph 4.
[197] See IAS 27, paragraph 13.
[198] See IAS 27, paragraph 41(b).
[199] See IAS 27, paragraph 22.
[200] See IAS 27, paragraph 41(c).
[201] See IAS 28, paragraph 13.
[202] IAS 28, paragraph 2.

companies did not provide the required disclosures regarding the basis for the use of the equity method.[203]

The Staff noted that 10% of companies in the sample disclosed that IAS 28 was not applied to associates that were considered immaterial. The majority of these companies were in one country. The Staff noted similar disclosure by some companies in another country.

IFRS requires the financial statements of the associate to be as of the same date as the company's financial statements unless this is impracticable.[204] The difference in financial statement dates cannot be more than three months, and adjustments are required to be made for significant transactions that occur during any lag period.[205] Of the companies that disclosed that there were differences in the financial periods used, a few used lag times in excess of three months.

IFRS requires the investor's financial statements to be "prepared using uniform accounting policies for like transactions and events in similar circumstances."[206] The Staff observed several instances in which associates prepared their financial statements using accounting principles other than IFRS. It was not always clear whether the financial information of the associate was converted to IFRS prior to the application of the equity method.

IFRS requires disclosure of summarized financial information for associates accounted for under the equity method.[207] IFRS does not specify whether the information is to be based on the portion owned by the company or the amounts reported in total by the associate. It also does not specify whether the financial information is to be prepared in accordance with IFRS. Most companies did not disclose the basis used to present summarized financial information. A few companies disclosed that the summarized financial information was prepared on a basis of accounting other than IFRS.

### 10. Interests in Joint Ventures

IFRS provides an option to use either the proportionate consolidation method or the equity method to account for jointly controlled entities.[208] The Staff noted that about half of the companies that had joint ventures accounted for them using the proportionate consolidation and the other half applied the equity method. The majority of companies in three countries applied the proportionate consolidation method. The majority of companies in five other countries applied the equity method. The majority of companies in the energy, mining and crude oil production, and utilities industries applied the proportionate consolidation method. The majority of companies in the telecommunications, petroleum refining, motor vehicles, and

[203] See IAS 28, paragraphs 37(c) and (d).
[204] See IAS 28, paragraph 24.
[205] See IAS 28, paragraph 25.
[206] IAS 28, paragraph 26.
[207] See IAS 28, paragraph 37(i)
[208] See IAS 31, *Interests in Joint Ventures* ("IAS 31"), paragraphs 30 and 38.

banking industries applied the equity method. These trends indicate comparability on a country- or industry-wide basis but not on a global basis.

Many companies in one country disclosed that certain joint ventures were not accounted for under IAS 31 because they were not considered material.

One company used the equity method to account for all of its joint venture entities except for one entity where it used the proportionate consolidation method. It was unclear why the same accounting method was not used to account for all joint venture arrangements.

## K. Accounting for Industry-Specific Areas

### 1. Insurance Contracts

Currently, IFRS does not address comprehensively the accounting for insurance contracts. Except for certain specific matters, IFRS 4 permits companies to continue their pre-existing accounting policies for insurance contracts, including related acquisition costs and other intangible assets. As a result, the Staff observed substantial differences in the accounting policies used by different companies to account for these contracts, as discussed below.

#### a. Comprehensive Basis of Accounting Applied for Insurance Operations

Of the nine companies in the insurance industry in the analysis, the Staff noted seven different accounting bases used to account for insurance operations. In some cases, companies used a single accounting basis for their consolidated operations, whereas in others, companies used a mixture of accounting bases depending on the subsidiary and type of contract.

#### b. Statement of Financial Position Classification

The Staff noted differences in the way in which companies in the insurance industry presented liabilities related to insurance contracts and investment contracts, both in how the contracts were characterized in the financial statement line items and in the level of granularity of line items that were presented.

#### c. Insurance Liability Recognition

IFRS 4 extends the circumstances in which an entity may elect to apply the fair value option by permitting an insurer to reclassify its financial assets to "at fair value through profit or loss" in certain circumstances when an insurer changes its accounting policies for insurance liabilities[209] to avoid artificial mismatches in the accounting for insurance liabilities and financial assets.[210]

[209] IFRS 4, paragraph 45.
[210] See IFRS 4, paragraph BC145.

Some companies in the insurance industry disclosed their accounting under IFRS 4 and/or IAS 39 with the stated intention of mitigating an accounting mismatch between insurance contract liabilities and related investment assets. In some cases, however, company disclosures did not clearly describe the reason for their accounting elections. While these disclosures are not required, they may provide investors with an understanding as to the reasons a company's selection differs from its peers and the impact of the policy to facilitate comparability. Examples of company policies included the following:

- Some companies in the insurance industry remeasured designated insurance liabilities under IFRS 4 to reflect current market interest rates and other current estimates and assumptions.

- Some companies in the insurance industry applied the fair value option under IAS 39 to financial liabilities for unit-linked contracts and/or to their underlying financial assets.

- Some companies described the fair value option in terms of their investment assets, some in terms of their liabilities, and some in terms of both. However, for those companies describing the valuation of liabilities, they did not explain how their measurement of contract liabilities at "fair value" was in accordance with the guidance in IAS 39, other than by stating that the liability was based on the fair value of the underlying financial assets. While IFRS does not require further clarifications, these disclosures raised questions for the Staff as to whether the fair value measurements of these liabilities complied with IFRS.

The Staff noted differences in the basis used to measure liabilities associated with unit-linked insurance contracts, unit-linked investment contracts, and investment products by companies in the insurance industry. All of the companies in the insurance industry discounted their life liabilities.

Just over half of the companies in the sample in the insurance industry disclosed that life liability assumptions remained locked unless a premium deficiency occurred. One company disclosed that they were not locked, and it was unclear whether the assumptions remained locked for the remaining companies.

Half of the companies in the insurance industry disclosed that they did not separate and measure at fair value policyholder options to surrender an insurance contract for a fixed amount even if the exercise price differed from the carrying amount of the host insurance liability. The disclosure presented by the other half of the companies was unclear. Half of the companies disclosed that they unbundled the deposit component of insurance contracts and recognized all obligations and rights arising from the deposit component. The other half did not clarify whether deposit components existed or how they accounted for the deposit component.

The Staff also noted differences in whether non-life insurance liabilities were discounted by companies in the insurance industry.

While all companies in the insurance industry included estimated claims handling costs in measuring non-life liabilities, the nature of those costs appeared to vary.

#### d. Policy Acquisition Costs

The Staff noted differences in the nature of costs considered to be "acquisition costs" that were subject to deferral and amortization. A few companies expensed acquisition costs as incurred.

#### e. Claims Development Table

Just over half of the companies in the insurance industry presented the claims development table based on the accident year. Some presented the claims development table on a calendar year basis, and one company did not disclose a claims development table. The Staff noted differences in the number of years of payment activity that companies captured in the claims development table. The period captured ranged from five to eleven years with a mean of eight years.

### 2. Extractive Industries

Currently, IFRS does not comprehensively address the accounting for extractive industry activities. IFRS permits companies to continue their pre-existing accounting policies for exploration and evaluation expenditures.[211] As a result, the Staff observed substantial differences in the accounting policies used by different companies to account for exploration and evaluation expenditures.

#### a. Capitalization and Classification of Exploration and Evaluation Costs

The Staff noted differences in the accounting policy selected for the capitalization and classification of exploration and evaluation costs by companies engaged in extractive activities. The majority of companies engaged in oil and gas extractive activities expensed all exploration and evaluation costs as incurred, except for exploratory drilling costs. In contrast, a few capitalized all costs, and one capitalized exploration costs if they related to properties acquired in a business combination or if the existence of commercially viable material had been established. The majority of companies engaged in mining activities capitalized all exploration and evaluation costs, based on criteria that appeared to be specific to each company. Companies in three countries typically classified exploration and evaluation assets as tangible assets. Companies in two countries typically classified exploration and evaluation assets as intangible assets. Most companies with significant oil and gas operations classified exploration and evaluation assets as intangible assets, while companies in the energy industry typically classified these assets as tangible assets.

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[211] See IFRS 6, *Exploration for and Evaluation of Mineral Resources*, paragraphs 6 and 7.

### b. Guidelines Used to Determine Natural Resource Reserve Estimates

For both oil and gas and mining, most companies did not disclose the guidelines used to determine natural resource reserve estimates. Of those companies that did, the Staff noted use of guidelines from a variety of country regulators.

### c. Accounting Method Used to Account for Oil and Gas Activities

Many companies disclosed that a successful efforts method was used to account for oil and gas operations. However, it was not clear if the companies followed home country GAAP or another variation of a successful efforts method. Some oil and gas companies did not use an accounting policy that was consistent with a successful efforts method. Each of these companies applied a different accounting policy.

### d. Depreciation and Depletion

Most companies in the sample with extractive operations depreciated the related assets using the units-of-production method. Entities in the mining industry were more likely to include mineral resources incremental to proven and probable reserves in their calculation of units-of-production depreciation.

# III. Review of SEC Registrants

## A. Introduction

This section summarizes observations from comments that the Division of Corporation Finance issued in its reviews, as part of the disclosure review program, of the most recent SEC filings of approximately 140 foreign private issuers that were registered with the Commission at the time of the analysis and disclosed that they prepared their financial statements in accordance with IFRS as issued by the IASB. Some of the registrants reviewed as part of the Division of Corporation Finance's disclosure review program were also included as part of the analysis conducted in conjunction with the Work Plan and discussed in Section II.[212]

Overall, approximately 170 foreign private issuers with a class of securities registered with the Commission at the time of the analysis prepared financial statements in accordance with IFRS. These registrants are from more than 30 countries with approximately half domiciled in the United Kingdom, Israel, China, Australia, Chile, or Brazil. The majority of these registrants are in the banking, telecommunications, energy, natural resources, pharmaceutical, and transportation industries.[213] Most have large market capitalizations and about one-fourth of these registrants are in the 2009 FG500.

As part of the Division of Corporation Finance's disclosure review program, the Staff may request that a registrant: (1) provide additional supplemental information so the Staff can better understand a registrant's accounting and disclosure, (2) revise the accounting and/or disclosure in a document on file with the SEC, or (3) revise the accounting and/or disclosure in a future filing with the SEC.

## B. Frequent Areas of Staff Comment

The following table depicts, by accounting topic, the Staff's most frequent areas of comment on the approximately 140 IFRS registrants' most recent annual filings and the percentage of these IFRS registrants that received comments in these areas.

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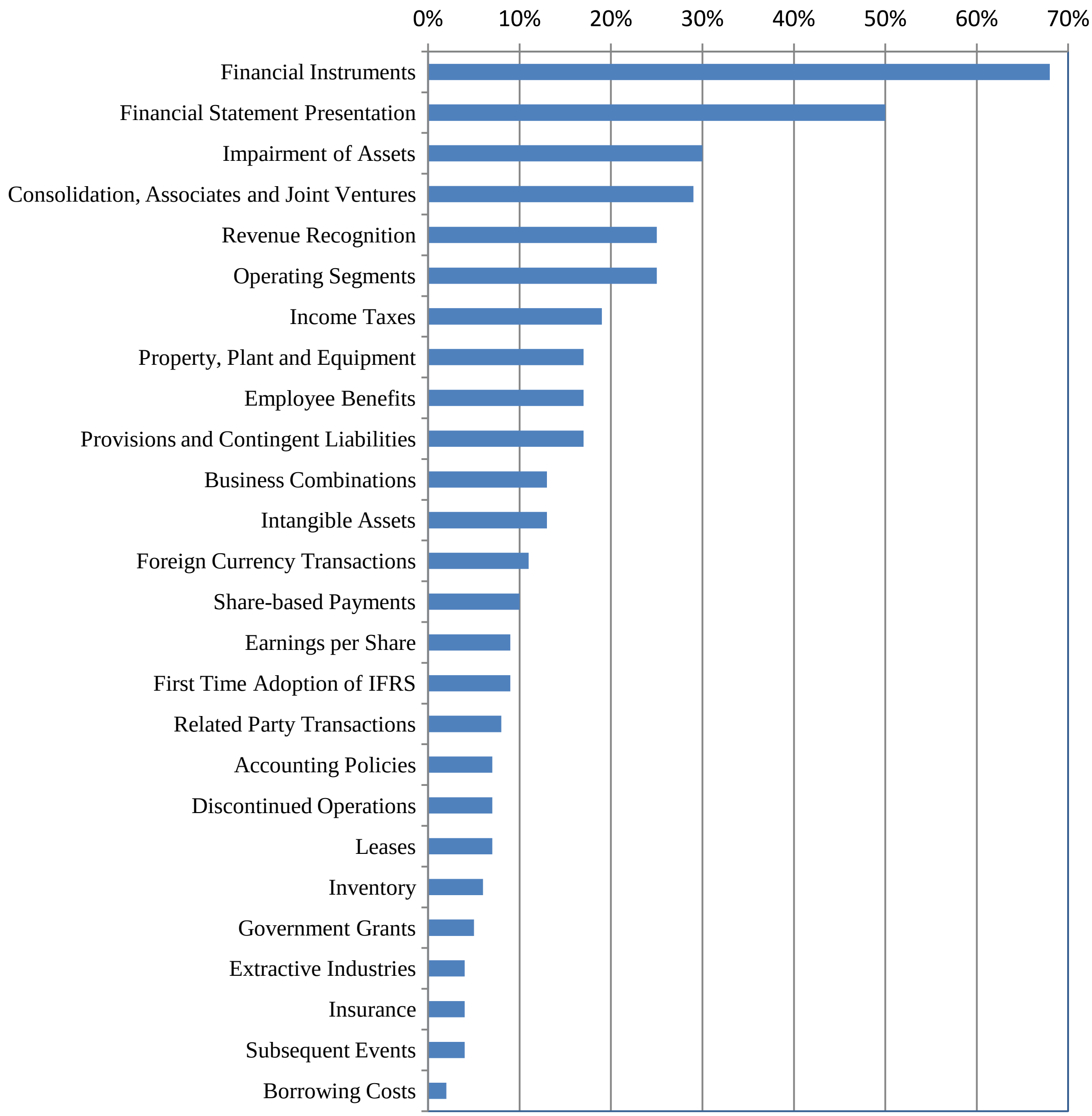
[212] These registrants were included in the analysis if they met the selection criteria discussed in Section I.
[213] The disclosure review program uses industry classifications based on registrant Standard Industrial Classification (SIC) codes.

*Percentage of IFRS Registrants Issued Comments by Accounting Standard*




A discussion of the most significant frequent areas of comment follows.

### 1. Financial Instruments (IAS 39, IAS 32, IFRS 7)

Most of the Staff comments regarding financial instruments requested clarification and expanded disclosure about the methods and market data used to determine fair value, the criteria applied to determine whether financial instruments were impaired, the methods and assumptions used in preparing the sensitivity analyses, and the criteria applied when financial instruments were derecognized.  The Staff also issued comments regarding classification of financial instruments, and components therein, as a liability or equity. In addition, the Staff commented on determinations to account for certain investments at cost when fair value would have been expected. Further, the Staff commented on asymmetrical financial instrument transactions between two counterparties when symmetrical accounting would have been expected.

### 2. Financial Statement Presentation (IAS 1, IAS 7)

The Staff asked registrants to expand their disclosure to explain the reasons why certain income or expense items had been excluded from measures of profit or loss reported on the face of the income statement. The Staff also asked registrants to disclose the nature of expenses classified in each income statement line item when they reported expenses by function.

Additionally, the Staff often requested clarification about the classification of items in the statement of cash flows as operating, investing, or financing, as well as the nature of financial assets classified as cash equivalents.

Further, the Staff commented when registrants did not present an opening statement of financial position in conjunction with a retrospective change in accounting policy or reclassification. The Staff also commented when first-time IFRS adopters did not present an opening statement of financial position.

### 3. Impairment of Assets (IAS 36)

The Staff requested clarification regarding how cash-generating units were determined and how management determined the level to which goodwill should be allocated.

In addition, IAS 36 requires the use of pre-tax assumptions to calculate value in use. The Staff noted that some registrants calculated value in use with post-tax assumptions. The Staff requested registrants to disclose whether value in use was calculated using pre-tax assumptions. If not, registrants were expected to disclose that the use of post-tax assumptions did not result in a value in use that was materially different than if pre-tax assumptions had been used and to disclose both the post-tax discount rate and the pre-tax discount rate.

The Staff often reminded registrants to provide disclosure about the events and circumstances that led to the recognition of impairment losses, as well as circumstances in which a cash-generating unit's recoverable amount was close to its book value.

### 4. Consolidation, Investments in Associates and Joint Ventures (IAS 27, IAS 28, IAS 31)

The Staff asked registrants to add or expand footnote disclosure to explain why their determinations regarding control or significant influence were not consistent with the voting power held (e.g., circumstances in which a registrant held more than 50% voting power but asserted that it did not control the entity). The Staff also requested registrants to disclose the nature and extent of restrictions on the ability of subsidiaries or associates to transfer funds to the parent or investor.

The Staff also questioned registrants' application of SIC 12, *Consolidation – Special Purpose Entities*.

### 5. Revenue Recognition (IAS 18, IAS 11)

The Staff requested expanded revenue recognition accounting policy disclosures when registrants cited the standard's revenue recognition criteria but did not explain how the criteria were applied to the registrant's sales transactions. The requested disclosure included clarification regarding the nature of the sales transactions and explanations of how the standard was applied to each type of revenue. The Staff also requested clarification and expanded disclosures of how and when related expenses, such as warranties, were recognized and measured.

### 6. Operating Segments (IFRS 8)

The Staff solicited clarification and expanded disclosures about the factors registrants used to identify their operating segments. The Staff also requested clarification regarding whether operating segments were aggregated and reminded registrants to provide the required entity-wide disclosures for products and services, geographic areas, and major customers.

### 7. Income Taxes (IAS 12)

The Staff requested disclosure of the amount of deferred tax assets that were not recognized and whether these unrecognized deferred tax assets were re-evaluated at the end of each year. The Staff also requested disclosure of when tax loss carry forwards will expire. In some cases, the Staff asked registrants to clarify the source of the tax rate and to more clearly depict the nature of the line item components used in the rate reconciliation.

### 8. Property, Plant, and Equipment (IAS 16)

The Staff requested registrants to disclose the depreciation methods used and useful lives of each class of property and equipment. The Staff also asked registrants whether a review of the residual value, the useful lives, and the depreciation method of property, plant, and equipment was performed at least annually.

### 9. Employee Benefits (IAS 19)

Staff comments in this area requested clarification of how frequently actuarial reviews of defined benefit plans were performed and the source of the discount rate. The Staff also requested clarification or disclosure of the accounting policy applied for curtailments and settlements.

### 10. Provisions and Contingent Liabilities (IAS 37)

The Staff frequently requested expanded and more granular disclosure of each class of provision, clarified disclosure of the nature of the underlying matter, disclosure of the uncertainties surrounding the amount or the timing of related payments, disclosure of how the provisions were estimated, and disclosure of the assumptions used. The Staff often requested registrants to disclose this information for provisions, as well as contingent liabilities, to the extent applicable. In addition, the Staff often reminded registrants to disclose the amount of provisions that were reversed, as well as the impact of discounting.

### 11. Business Combinations (IFRS 3)

The Staff requested registrants to expand accounting policy disclosures to more fully address the recognition and measurement criteria of IFRS 3. The Staff also requested registrants to address the accounting for acquisitions in which control was obtained initially, step-acquisitions in which control was obtained after initial investment, and acquisitions of non-controlling interests. In addition, the Staff requested registrants to clarify the nature of adjustments to the measurement of the consideration transferred in a business combination and to add disclosures required by the standard. Further, the Staff commented on policies for accounting for common control transactions and the consistency of those policies with the requirement in IAS 8 that, in the absence of an IFRS that specifically applies to a transaction, management shall apply an accounting policy that results in relevant and reliable information.