

FSA Faculty Consortium Comments on Footnote Extracts

Aixtron – Inventories Footnote

Identifiable Differences:

- Inventories are stated at lower of cost or NRV. NRV is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. That is a different measure than what we use under U.S. GAAP, where we use LCM. Where market is defined as replacement cost, provided that it does not exceed NRV and provided it is not less than NRV reduced by a normal profit margin. This can result in differences in write-downs under the two standards.
- IFRS permits reversals of inventory write-downs. Write-downs create a new cost basis under U.S. GAAP and the inventory cannot be subsequently written up.

Other Potential Differences:

- While not relevant to Aixtron, IFRS does not permit use of LIFO.
- Also, IFRS requires that an entity shall use the same cost formula for all inventories having similar nature and use. Different cost formulas can be used under U.S. GAAP.

Arcelormittal – Provisions and Accruals

Identifiable Differences:

- Terminology issues – IFRS distinguishes between provisions and contingent liabilities. A contingent liability is not probable or estimable and hence is not recorded. On the other hand, a provision is a liability (with uncertain timing) but is probable and estimable and hence, must be recorded. Under U.S. GAAP we usually think of a provision as a charge to the income statement. When think about contingencies we think in terms of assessing whether a loss contingency should be recorded based on the probable and estimable criteria. If it meets the criteria, it is recorded and if it doesn't, it isn't recorded. There is also terminology difference with respect to the term – probable. Under IFRS probable means more likely than not whereas we normally think of a higher threshold (maybe 70-75%).
- IFRS requires discounting if the time value of money is significant. We normally would not discount unless there are fixed and determinable payment streams for example in conjunction with some sort of structured settlement.
- Under **IFRS** A present obligation exists for a restructuring when the entity is 'demonstrably committed' to the restructuring. An entity is usually demonstrably committed when there is legal obligation or when the entity has a detailed formal plan for the restructuring. The entity must be unable to withdraw because it has started to implement the plan or announced its main features to those affected (constructive obligation). Thus, there must be a formal plan and they must have

created a valid expectation that it will be carried out by having commenced the restructuring plan or announced the key provisions of the plan to those that will be affected. Although the treatment of restructurings are similar to what we have under U.S. GAAP, there may be situations where a restructuring might be recognized earlier than under U.S. GAAP because you can begin implementing a plan without communicating all of its terms to those that will be affected. U.S. GAAP requires that there be communication to those that would be affected by the plan as a prerequisite to recording a restructuring reserve for termination benefits. The IASB is currently working on an exposure draft that would align with U.S. GAAP and may eliminate this difference in the future.

Potential Differences:

- Under circumstances where there is a probable loss but the loss is only estimable within a range and no amount within the range is more likely than any other amount, IFRS requires that you record a provision at the midpoint of the range. Under U.S. GAAP we would record the lower end of the range.

Arcelormittal – Income Taxes

Identifiable Differences:

- Terminology difference – IFRS term probable – means “more likely than not”. U.S. GAAP uses the “more likely than not terminology”.
- IFRS provides taxes based on the enacted or substantively enacted tax rates. U.S. GAAP would use only enacted tax rates.
- Under IFRS deferred tax assets are recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Under U.S. GAAP we would recognize all deferred tax assets and if it is “more likely than not” that some of those deferred tax assets will not be realized, we would record a valuation reserve. In contrast, IFRS only recognizes a deferred tax asset if it meets the “more likely than not” criteria in the first place.
- There is an exemption under IFRS which states that an entity is prohibited from recognizing a deferred tax liability or asset for taxable temporary differences that arise from the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting income nor taxable income. U.S. GAAP has no similar exemption.
- Subtle differences may exist with respect to deferred tax liabilities relating to taxable temporary differences with respect to investments in subsidiaries, associates and joint ventures. Under IFRS, such deferred tax liabilities are recognized except where the company can control the reversal of the temporary differences and it is probable that the temporary differences will not reverse in the foreseeable future. Under U.S. GAAP, the rules differ depending on whether it is a subsidiary, equity method investment or joint venture and whether it is a foreign or domestic subsidiary. Without trying to sort through all of the permutations and combinations, there could be

differences with respect to deferred taxes recorded relating to undistributed profits and other outside basis differences.

- While not apparent from your reading of the footnote, a very notable difference exists with respect to classification of deferred taxes under IFRS – they are all classified as non-current. We classify deferred taxes as current or long-term under U.S. GAAP.

Other Potential Differences:

- Any change in a deferred tax asset or liability originally recorded in equity due to a change in the tax rate would also be recorded in equity. U.S. GAAP would record the impact of such change in the income statement.
- Deferred taxes on share-based payments are recognized based on the estimated future tax benefit and allocated between equity and the income statement. Under U.S. GAAP deferred tax is recognized based on cumulative compensation in the income statement and any excess benefit is reflected in equity when final tax benefit is determined.
- Under IFRS deferred taxes on unrealized profit in inventory is reflected in the consolidation entry at the buyer's rate whereas U.S. GAAP would use the sellers rate.

China Telecom – Property Plant and Equipment

- IFRS permits use of a revaluation model or a cost model. China Telecom uses the revaluation model and hence they revalue property and they follow the practice of resizing the depreciation reserve such that the net plant amount equals the revalued amount. Increases in revaluations increase the plant values and a revaluation reserve (in equity) unless there was previously a downward revision in the revaluation that was charged to the income statement. Decreases in revaluations are charged to the income statement unless there is existing surplus in the revaluation reserve. We only use a cost model under U.S. GAAP.
- China Telecom notes that they capitalize assets that are subject to lease if there has effectively been a transfer of risks and rewards of ownership. Unlike U.S. GAAP, there are no bright-line tests in determining lease classification (eg: no 90% or 75% tests).
- They also disclose that the present value of minimum lease payments is calculated using the discount rate of interest implicit in the lease. Under U.S. GAAP we would use the incremental borrowing rate or, if known and lower, the rate implicit in the lease.
- China Telecom discloses that when different parts of an item of property plant and equipment have different useful lives, such parts are depreciated separately. This is referred to as componentization and is different than what we typically do under U. S. GAAP.
- They also disclose that useful lives and residual values of assets are reviewed annually. There is no explicit requirement to do so under U.S. GAAP.
- They also state that they capitalize borrowed funds used during construction. There can be some subtle differences here as the definition of borrowing costs

under IFRS is a bit broader and the definition of a qualifying asset is slightly different. Also, IFRS permits for capitalization of net borrowing costs when financing is specific to a project. U.S. GAAP only permits such treatment with respect to tax-exempt financings.

China Telecom – Impairment

- IFRS uses a one-step impairment test where the carrying amount of an asset or cash generating unit is compared to its recoverable amount (higher of net selling price or value in use – value in use is essentially discounted cash flows) and would record an impairment for the difference if the carrying amount is higher. Under U.S. GAAP we have a two-step test where we first compare the carrying amount to undiscounted cash flows and if the carrying amount is greater we would then go on to step two and record an impairment based on the extent to which the carrying amount exceeds fair value. This could result in impairments being recorded under IFRS that may not be recorded under U.S. GAAP because there is no undiscounted cash flow test. Even if both GAAPs require an impairment, the amounts may be different since recoverable amount is not necessarily the same as fair value.
- The test for impairment of goodwill is also different. Under IFRS impairment of goodwill is done at the lowest level CGU or an aggregation of CGUs to which management allocates and monitors goodwill (can't be larger than an operating segment). The carrying amount of the CGU is then compared to the recoverable amount of the CGU and if it is greater, you would first write-off any goodwill and then any remaining amount would be written off against other assets of the CGU on a pro-rata basis. Under U.S. GAAP, goodwill is allocated to reporting units (which may or may not be at the same level as the level used under IFRS). Also, the U.S. GAAP test is different. We determine the fair value of the reporting unit and if it less than the carrying amount of the reporting unit we essentially do a hypothetical purchase price allocation based on the fair value of the reporting unit to determine "implied goodwill". Implied goodwill would then be compared to the carrying amount of goodwill to determine if there is any goodwill impairment. This is strictly a goodwill impairment test and you would not write down or write off any more than just the goodwill.
- They also disclose that they reverse impairment charges if there is a subsequent increase in the recoverable amount, although they would not reverse a goodwill impairment. Under U.S. GAAP, no impairments are reversed.

Sanofi-Aventis – Research and Development Costs

- Under IFRS internally generated development costs can be capitalized provided that all six of the criteria set forth in IAS 38 are met. Research costs and all development costs up to the date at which you meet the capitalization criteria must be charged to expense. Since this is a pharmaceutical company, they have concluded that obtaining regulatory approval for marketing is essential to meeting the capitalization criteria. Under U.S. GAAP we would not capitalize internally

generated development costs. All R&D costs would be expensed, with the exception of in-process R&D capitalized in conjunction with a business combination.

Helical Bar plc – Investment Property

- Investment property is unique to IFRS. There is not an equivalent in U.S. GAAP such property would simply be included in and accounted for in the same manner as other property, plant and equipment (cost basis). Under IFRS a company may elect to use a fair value method rather than the cost method. Since Helical uses the fair value method the property is revalued at the balance sheet date and gains and losses are reflected in the income statement. Since the property is accounted for at fair value, it is not depreciated.