KPMG

Implementing IFRS

Extract from:

IFRS compared with US GAAP and German GAAP

Assurance

Copies of the publication IFRS (International Financial Reporting Standards) compared with US GAAP and German GAAP can be purchased for euro 50 each. Please contact any KPMG office, or contact Ina Heinz at +49 (0)30 2068 4642 or e-mail iheinz@kpmg.com.

www.kpmg.com

About this document

Content

This document is an extract from KPMG's March 2003 publication *IFRS compared with US GAAP and German GAAP*, focusing on recognition, measurement and presentation, rather than disclosure. This document focuses on the preparation of consolidated financial statements by listed enterprises on a going concern basis. Requirements that are specific to stand-alone financial statements are not discussed; neither are specialised industry accounting practices.

For each major financial statement line item or accounting area, a brief summary of the key points under IFRS for identifying GAAP differences is provided on the left; on the right is a commentary identifying where German GAAP has significant differences from IFRS. However, this document does not describe fully the significant differences; for more information you should refer to the full publication.

The requirements of IFRS are summarised assuming that the enterprise has adopted IFRS already. The special transitional rules that will apply in the period that an enterprise changes to IFRS are not discussed. The IASB currently is debating these transitional rules and a new standard is expected during 2003.

Cut-off date

Final pronouncements issued to 31 December 2001 are reflected in this document even if those pronouncements are not effective immediately. Both IFRS and German GAAP are in a process of continual development and change. As a result, a number of the differences highlighted in this document may disappear, and new differences may arise.

Future developments

In May and June 2002 the IASB published a series of exposure drafts as part of its "Improvements Project"; comments on the exposure drafts were due in September and October 2002, and the final standards are expected to be published during 2003. As a result, a number of the significant differences highlighted in this document may disappear, and further differences may arise. Where the document summarises a requirement that is expected to be amended as part of the Improvements Project, it is highlighted with the symbol * to indicate a possible change. In such cases please take particular care to watch for future developments.

Contents

Contents (continued)

Regulatory background

Generally accepted accounting practice

IFRS is the term used to indicate the whole body of IASB authoritative literature. At present the sources of such accounting requirements are International Accounting Standards (IAS) and interpretations thereof (such pronouncements are known as "SICs"). In addition, an Implementation Guidance Committee (IGC) provided interpretive guidance in applying IAS 39.

Legal and listing requirements

IFRS are not limited to a particular legal framework.

The requirements of IFRS are the same for all enterprises regardless of their structure or size.

A true and fair override applies when the application of IFRS would be misleading.

General issues

Form and elements of financial statements

The following must be presented:

- balance sheet;
- income statement;
- a statement of recognised gains and losses or a statement of changes in equity, which incorporates recognised gains and losses;
- statement of cash flows; and
- notes to the financial statements, including accounting policies.

In certain limited circumstances consolidated financial statements need not be prepared.

Generally accepted accounting practice

The overall rule, which affects the accounting for all legal forms of business organisations, is that the financial statements must be prepared in accordance with the principles of proper bookkeeping (Grundsätze ordnungsmäßiger Buchführung, GoB). The true and fair view is required only for enterprises with limited liability.

The principles of proper bookkeeping comprise: completeness, materiality, accuracy, continuity, clarity, valuation based on corresponding payments, economic focus, substance over legal form, prudence, realisation, individual valuation and measurement at the balance sheet date.

Legal and listing framework

German accounting rules are based on legal regulations.

Applicable financial reporting, auditing and disclosure rules depend on the legal form, size, industry sector and stock exchange listing of an enterprise.

A true and fair view override generally does not exist in German accounting.

Form and elements of financial statements

A statement of cash flows and a statement of changes in equity (from 2003) are required only for listed companies.

The exemptions from preparing consolidated financial statements are more extensive than under IFRS.

Statement of recognised gains and losses

The statement of recognised gains and losses cannot be combined with the income statement.

Statement of cash flows

IFRS requires a number of disclosures, but does not prescribe the exact line items in the statement.

Interest and dividends may be classified as operating or as investing (if received) or financing (if paid). Taxes usually are classified as operating.

Cash flows from extraordinary items are classified as operating, investing or financing as appropriate.

Basis of accounting

Many items in the financial statements are revalued, on either an optional or compulsory basis.

If an enterprise's measurement currency is hyperinflationary, it must make current purchasing power adjustments.

Consolidation

Consolidation is based on the *power* to control.

SPEs are consolidated in many cases where benefits flow back to the sponsor.

A subsidiary is not consolidated if it is acquired and held exclusively for disposal in the near future, or if severe long-term restrictions significantly impair the transfer of funds to the parent.*

IFRS

Statement of recognised gains and losses

There is no requirement to present a statement of recognised gains and losses.

Statement of cash flows

A specific format of the statement of cash flows is required.

Cash flows from interest received and paid, dividends received and income taxes generally are classified as cash flows from operating activities.

Cash flows from extraordinary items are classified as operating.

Basis of accounting

Financial statements are prepared on a historical cost basis.

There are no rules on accounting for the effects of changing prices or hyperinflationary currencies.

Consolidation

Consolidation can be based on actual control in practice.

There are no special rules for the consolidation of SPEs.

A subsidiary *may* be excluded if there are severe long-term restrictions that substantially hinder the exercise of the rights of the parent.

A subsidiary *may* be excluded if held exclusively for resale, regardless of the expected date of sale.

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Consolidation (continued)

Subsidiaries cannot be excluded on the basis of disproportionate expense or undue delay.

Subsidiaries cannot be excluded on the basis of dissimilar activities.

Subsidiaries excluded from consolidation are treated as financial assets.

The difference in reporting dates between the parent and a subsidiary cannot be more than three months either way.

Minority interests are presented separately from parent shareholders' equity and liabilities.*

A debit balance on minority interests is recognised only if the minority has an obligation to fund the losses.

Business combinations

Uniting of interests accounting is allowed in limited circumstances.

A subsidiary is consolidated from the date of acquisition.

All acquired identifiable intangibles and goodwill are capitalised and amortised.

Generally deferred tax is recognised on fair value adjustments.

Acquired assets and liabilities are measured at fair value, either in full or to the extent of the acquirer's interest.

Consolidation (continued)

A subsidiary *may* be excluded if the information necessary for consolidation cannot be obtained without disproportionate expense or undue delay.

A subsidiary is excluded if its operations are so different from those of the rest of the group that consolidation would impair fair presentation.

Subsidiaries excluded from consolidation may be treated as associates rather than financial assets.

A subsidiary's reporting date cannot be after that of the consolidated financial statements.

Minority interests are presented as part of equity.

Minority interests in losses are recognised except to the extent that the group has an obligation to provide finance.

Business combinations

The requirements for a uniting of interests are easier to satisfy than under IFRS, but such accounting is applied optionally.

A subsidiary may be consolidated from any date from the date of acquisition that is within the reporting period in which it is acquired.

Goodwill may be written off against equity.

There is no requirement to provide for deferred tax on fair value adjustments.

If full fair values are recognised, fair value adjustments are limited to an amount that does not create negative goodwill.

Business combinations (continued)

Negative goodwill is recognised in the income statement, first to match any identified expected costs, and then over the lives of the acquired depreciable assets.

Shares issued as purchase consideration are measured at fair value, determined at the date control is obtained.

Contingent consideration is recognised when it is probable and reliably measurable.

Costs of restructuring the acquiree are capitalised if the main features of the plan are announced by the date of acquisition and a detailed plan is finalised by the earlier of three months or when the financial statements are authorised.

Subject to limited exceptions, adjustments to goodwill must be made by the end of the first full financial year following the acquisition.

"Push down" accounting is not used, although fair value adjustments may be recorded in the acquiree's financial statements if such revaluations are in accordance with IFRS.

There is no guidance on accounting for transactions between enterprises under common control, and practice varies.

Foreign currency translation

The financial statements are prepared in an appropriate measurement currency, but may be presented in a different presentation currency.

Unrealised gains resulting from the translation of foreign currency transactions are permitted.

There are detailed rules for the translation of the financial statements of foreign subsidiaries.

Business combinations (continued)

Negative goodwill is recognised in the income statement either to match any identified expected costs or losses, or if it is certain that the negative difference corresponds to a realised profit.

There is no legal requirement to measure shares issued as purchase consideration at fair value.

Contingent consideration is recognised when the contingency is resolved and the consideration becomes payable/issuable.

The rules for recognising restructuring provisions are different from IFRS; in particular, a public announcement is not necessary.

Adjustments to goodwill can be made after the period of the first-time consolidation only in exceptional cases.

"Push down" accounting is not allowed.

Transactions between enterprises under common control are accounted for in the same way as other business combinations.

Foreign currency translation

The financial statements must be presented in euro and generally are prepared in euro.

Foreign currency monetary items, and foreign currency non-monetary items carried at fair value following a write-down, are not retranslated if this would lead to the recognition of unrealised gains.

There are no legal requirements for translating the financial statements of foreign subsidiaries for consolidation purposes. A variety of methods is used.

Foreign currency translation (continued)

If the measurement currency of a foreign entity is hyperinflationary, current purchasing power adjustments are made to its financial statements prior to translation.

Prior period adjustments and other accounting changes

Errors that are not "fundamental" are adjusted in the current year.*

Most accounting policy changes and all corrections of fundamental errors may be effected by either restating comparatives or making an adjustment in the current year.*

Events after the balance sheet date

Generally the balance sheet is adjusted for events occurring after the balance sheet date only if they provide evidence of conditions that existed at the balance sheet date.

Specific balance sheet items

General

No specific balance sheet format is required.

Minority interests are presented separately from parent shareholders' equity and liabilities.*

Property, plant and equipment

The cost of acquisition includes appropriate dismantling, removal and restoration costs.

Property, plant and equipment may be revalued to fair value.

Component accounting is used for the separate components of an asset.

IFRS

Foreign currency translation (continued)

There are no legal requirements for hyperinflation accounting, and practice varies.

Prior period adjustments and other accounting changes

Normally prior period errors are adjusted in the current period.

Changes in accounting policy are accounted for prospectively.

Events after the balance sheet date

There are no significant differences from IFRS.

General

A specific balance sheet format is required, based on order of liquidity.

Minority interests are presented as part of equity.

Property, plant and equipment

Dismantling, removal and restoration costs cannot be capitalised.

Revaluations are not permitted.

Component accounting is not allowed.

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Property, plant and equipment (continued)

Depreciation is based on the useful life of an asset.

Compensation for loss or impairment is recognised in the income statement, but only when its receipt is virtually certain.

Intangible assets

Many internally developed intangibles, including development costs, must be capitalised once certain criteria are met.

The amortisation period of intangible assets may exceed 20 years if justified.

Revaluation of some intangibles is permitted in limited circumstances.

Investment property

Investment property may be stated at fair value.

Investments in associates and joint ventures

An associate is characterised by the power to exercise significant influence.

The cost of an associate includes acquisition-accounted goodwill.

Inter-company eliminations in respect of an associate are made to the extent of the investor's interest.

The accounting policies of an associate should be consistent with those of the group unless impractical.

IFRS

Property, plant and equipment (continued)

Depreciation is tax driven and not necessarily based on the useful life of an asset.

Compensation received for a lost asset is deducted from the carrying amount of the replacement asset.

Intangible assets

Internally generated intangible assets, including development costs, cannot be capitalised.

Amortisation is tax driven and not necessarily based on the useful life of an asset.

Revaluations are not permitted.

Investment property

There is no fair value accounting for investment property.

Investments in associates and joint ventures

An associate is characterised by the actual exercise of significant influence in practice.

In equity accounting, goodwill on acquisition may be presented with intangible assets.

Inter-company eliminations in respect of an associate may be made in full.

The accounting policies of an associate need not be consistent with those of the group.

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Financial instruments, including hedging

Financial instruments initially are stated at cost.

Many financial instruments are carried at fair value.

All derivatives are recognised on-balance sheet at fair value.

Split accounting of compound instruments is required where there are both liability and equity characteristics.

Impairment losses are recognised even if not considered permanent.

There are detailed rules governing the use of hedge accounting.

Inventories

Payments received on account of orders are recognised as liabilities.

The determination of net realisable value is based on the estimated selling price.

Biological assets

Biological assets are stated at fair value for periods beginning on or after 1 January 2003.

Impairment

An impairment exists if an asset's (cash generating unit's) carrying amount exceeds the greater of its net selling price and value in use (net present value of future cash flows); this excess is the amount of the impairment loss.

Financial instruments, including hedging

Financial liabilities generally are stated at redemption amount initially.

Fair value accounting for financial instruments is not allowed.

There are no legal accounting rules for derivatives, which often are off-balance sheet.

The recognition of financial assets and liabilities is influenced significantly by the legal structure of the transaction, and more instruments are classified as equity than under IFRS.

Long-term investments are not written down unless an impairment is considered permanent.

The use of hedge accounting is widely debated, but generally is accepted in limited circumstances.

Inventories

Payments received on account of orders may be deducted from inventories.

Purchase market prices generally are considered to be more relevant than sales market prices in assessing the current market price (net realisable value) of inventory.

Biological assets

There are no rules concerning biological assets.

Impairment of fixed assets

A compulsory impairment exists only if the carrying amount of a fixed asset permanently exceeds its current value.

Impairment (continued)

In many cases impairment losses are measured on the basis of cash generating units.

Equity

There are no capital maintenance rules.

Some shares must be classified as liabilities.

Equity issue costs are recognised directly in equity.

Treasury shares are deducted from equity and no gain or loss is recognised in the income statement from trading in own shares.

Provisions

A provision is recognised on the basis of a legal *or* constructive obligation.

A provision is recorded at its best estimate.

All provisions must be discounted if the effect thereof is material.

Restructuring costs are not provided for until the plan has been communicated to those affected by it.

Provisions for decommissioning generally are capitalised.

Repairs and maintenance provisions are prohibited.

Impairment of fixed assets (continued)

Repurchase prices, costs, estimated selling prices or discounted cash flows can be the basis of measuring impairment losses.

Impairment losses are measured on an item-by-item basis, instead of using cash generating units.

Equity

There are specific capital maintenance rules for stock corporations and other enterprises with limited liability.

There are certain forms of financing that are regarded as equity although repayment is expected after a long period of time.

Equity issue costs are recognised in the income statement as incurred.

Treasury stock held for reissue is presented as a current asset; any gain/loss on reissue is recognised in profit and loss.

Provisions

The recognition of provisions is influenced by the prudence principle to a greater extent than under IFRS.

Provisions often are measured at an amount higher than the most probable estimate.

Only provisions that clearly contain an interest rate component are discounted.

Normally restructuring provisions, including voluntary employee severance, would be recognised earlier than under IFRS.

Provisions for decommissioning cannot be capitalised and are built up over the period until decommissioning.

Provisions are recognised for certain repairs and maintenance expenses.

Deferred tax

Deferred tax is provided based on temporary differences, which are focused on the balance sheet.

Deferred tax assets are recognised when recovery is *probabl*e.

Where assets are sold intragroup the deferred tax is computed at the tax rate applicable to the buying enterprise.

Deferred tax is based on enacted or substantively enacted statutory tax rates.

Deferred tax is recognised directly in equity if it relates to an item recognised directly in equity.

Contingent assets and liabilities

A contingent liability includes a present obligation where it is not "more likely than not" that an outflow of resources will be required to settle the obligation.

Specific income statement items

General

Flexibility is allowed in presenting the income statement.

There is no restriction on the recognition of unrealised gains in the income statement.

Items of income and expense are offset in certain cases.

IFRS

Deferred tax

Deferred tax is provided in respect of timing differences, which are focused on the income statement.

In practice deferred tax assets, except those that arise from consolidation procedures, seldom are recognised.

Where assets are sold intragroup the deferred tax could be computed at the tax rate applicable to the selling enterprise.

In practice deferred tax often is provided using an enterprise's average effective tax rate rather than the statutory rate.

Deferred tax cannot be recognised directly in equity.

Contingent assets and liabilities

Due to the prudence principle, it is likely that a provision is recognised for amounts that are contingent liabilities under IFRS.

General

The income statement is presented in one of two prescribed formats.

Generally only realised gains may be recognised in the income statement.

Items of income and expense cannot be offset.

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Revenue

Revenue recognition generally is based on the substance of an arrangement.

Construction and service contracts are recognised using the percentage-of-completion method.

There is detailed guidance on the recognition of revenue from advertising barter transactions.

Government grants

Government grants relating to biological assets are recognised as revenue when receivable and unconditional.

Other government grants are recognised as revenue so as to match the expenses that they are intended to compensate.

Employee benefits

The frequency of actuarial valuations for defined benefit plans is not mandated. Valuations are performed using the projected unit credit method.

The rate used to discount plan liabilities is based on rates applicable to corporate or government bonds.

Plan assets are recognised at fair value.

Actuarial gains and losses are spread using the "corridor method".

Revenue

The legal structure of a transaction is more important than under IFRS.

Revenue from construction and fixed price service contracts generally are recognised using the completed contract method.

There is no specific guidance on advertising barter transactions.

Government grants

Grants in respect of biological assets generally are recognised as revenue over the useful life of the asset.

Employee benefits

Valuations for defined benefit plans should be done annually and must be based on conditions at the balance sheet date. Consideration of future developments such as future salaries is not permitted.

The interest rate used for discounting by most enterprises is six per cent due to tax rules.

There is no guidance in respect of plan assets.

Actuarial gains and losses are recognised immediately as expense or income.

There is no requirement to accrue an obligation that arose before 1 January 1987.

Share-based payments

There is no guidance on share-based payments.

Interest expense

Imputed interest is recognised using the effective interest method.

Interest, including general borrowing costs, may be expensed as incurred or capitalised if certain conditions are met.

Income tax

Current tax expense is based on enacted or substantively enacted tax rates.

Current tax is recognised directly in equity if it relates to an item recognised directly in equity.

The income tax consequences of dividends are recognised at the same time as the related dividend.

Extraordinary and exceptional items

Extraordinary items are rare.*

"Exceptional" items may be disclosed separately on the face of the income statement.

IFRS

Share-based payments

When shares are issued to employees, the acquisition cost thereof, less payment from employees, is recognised in the income statement.

There is no other guidance on share-based payments.

Interest expense

Certain imputed interest may be recognised in the income statement immediately or on a straight-line basis over the term of the liability.

General borrowing costs may not be capitalised.

Income tax

Current tax expense is based on enacted tax rates.

No part of income tax expense is recognised in equity.

The income tax consequences of dividends generally are recognised in the year to which the dividend relates.

Extraordinary and exceptional items

Extraordinary items occur more frequently than under IFRS.

The presentation of exceptional items is more restrictive than under IFRS.

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Special topics

IFRS

Leases

A lease is classified as finance or operating based on its substance.

Gains on sale and leaseback transactions are deferred in some cases.

Segment reporting

Segmentation is based on the dominant source and nature of an enterprise's risks and returns as well as the internal reporting structure.

Earnings per share

Basic and diluted EPS must be disclosed on the face of the income statement.

Discontinuing operations

An operation is discontinuing when either there is a binding sale agreement or there is an announced plan for the discontinuance, whichever is earlier.

The results of a discontinuing operation are not presented as a single figure in the income statement, and cannot be presented as extraordinary.

Related party disclosures

Related party transactions need not be disclosed by some enterprises.

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Leases

In practice the classification of leases generally is driven by tax guidelines. In many cases lease contracts are classified as operating leases, but would be finance leases under IFRS.

Gains on sale and leaseback transactions often are recognised in the period of sale.

Segment reporting

The segmentation is based wholly on the internal reporting structure.

Earnings per share

EPS is not required to be disclosed.

Discontinuing operations

There is no concept of discontinuing operations.

A gain/loss on the sale or abandonment of a major part of an enterprise sometimes is presented as an extraordinary item.

Related party disclosures

Except in respect of directors' remuneration, the disclosures are less extensive than under IFRS.

Financial instruments disclosure

The level of detailed disclosures may vary depending on the quantitative information necessary to understand the financial risks of those instruments.

Non-monetary transactions

Generally, exchanges of similar assets do not result in revenue recognition.

Accompanying financial and other information

A financial review by management is encouraged.

Interim financial reporting

There is no requirement to disclose the results of any independent audit or review carried out.

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Financial instruments disclosure

Disclosures of certain risks are part of the management report. There are no specific rules that are comparable to IFRS.

Non-monetary transactions

A gain or loss on a non-monetary transaction may be recognised even if the assets exchanged are similar.

Accompanying financial and other information

A management report is required for most limited liability enterprises.

Interim financial reporting

The results of any review by an independent auditor are disclosed.

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Look out for the following publications:
IFRS compared
with US GAAP
and …
… Austrian GAAP
… Belgian GAAP
… Danish GAAP
… Dutch GAAP
… Finnish GAAP
… French GAAP
… Greek GAAP
… Italian GAAP
… Luxembourg GAAP
… Norwegian GAAP
… Portuguese GAAP
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