GlaxoSmithKline plc: Identifying and analyzing IFRS vs. U.S. GAAP differences

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ABSTRACT

GlaxoSmithKline plc (GSK), headquartered in the United Kingdom, is a global leader in the pharmaceutical industry. Like much of the rest of the world outside the U.S., GSK uses International Financial Reporting Standards (IFRS) to prepare its financial statements. Despite more than two decades of convergence progress, IFRS and U.S. Generally Accepted Accounting Principles (U.S. GAAP) continue to differ in a number of areas. This case helps students develop a better understanding of specific differences with U.S. GAAP that GSK exhibits in its reporting. The case focuses on the core financial accounting processes of recognition, measurement, and classification of information.

GSK's IFRS basis reporting reflects more than 25 differences with U.S. GAAP. This case asks students to identify a total of 11 differences and determine how each one affects four key financial statement line items. For six of the differences identified, students must determine the direction and magnitude of effect on each financial statement metric. For five more differences where the magnitude of effect might not be evident from GSK's reporting, students must determine the direction of effect on each metric. To successfully complete this case, students must document each difference from the IFRS and U.S. GAAP standards, and they must carefully analyze each one to determine the effect(s) on the financial statement metrics.

Keywords: IFRS, IFRS vs. U.S. GAAP differences, direction of effect, magnitude of effect, foreign registrant

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INTRODUCTION

This case gives students opportunity to achieve insights into a listed company's use of International Financial Reporting Standards (IFRS) and how the company's financial statements would appear differently if prepared according to U.S. Generally Accepted Accounting Principles (U.S. GAAP). Students must identify differences with U.S. GAAP arising from the core accounting processes of recognition, measurement, and classification. Such differences have the potential to change the amounts a company reports for some of the most important financial statement items.

IFRS is the dominant financial accounting and reporting system outside the U.S., with now 156 jurisdictions around the world either requiring or permitting domestic listed companies to use these standards (IFRS Foundation 2018). Of the 156 jurisdictions, nearly all (144) require that domestic listed companies use IFRS. With much of these companies' operating, investing, and financing activities being executed on a cross-border basis, developing an understanding of IFRS remains as important as ever. At least one of the Big Four public accounting firms has promoted the importance of accounting professionals in the U.S. being financially bilingual, meaning conversant in both U.S. GAAP and IFRS (PwC 2022). This case aims to help students achieve a deeper understanding of the differences between IFRS and U.S. GAAP.

This instructional case takes students significantly beyond the very useful comparisons of U.S. GAAP and IFRS treatments prepared by many of the larger public accounting firms. The case requires students to determine the directional effect on each of four measures (total stockholders' equity, income before income taxes, other comprehensive income before income taxes, and net operating cash flows) spread across three financial statements: the balance sheet, the income statement, and the statement of cash flows. In addition, for a subset of the differences identified, students must evaluate the magnitude of effect on the four financial statement measures. Evaluating the magnitude of effect may involve estimation, and the case includes guidance to assist students with the task of formulating estimates. The magnitude analysis requires students to investigate certain of the differences they identify to determine precisely for the case company how the IFRS and U.S. GAAP accounting and reporting treatments differ.

The case includes a research aspect as well. Students must consult the IFRS and U.S. GAAP standards and provide specific citations from them to document the differing treatments. This case is appropriate for senior level and master's level financial accounting courses where students are expected to develop some understanding of IFRS.

CASE COMPANY

GlaxoSmithKline plc (GSK) is a global pharmaceutical company headquartered in Brentford, United Kingdom (UK). Officially, GSK is in the Pharmaceutical Preparations industry (SIC = 2834) (SEC.report 2022). Based upon revenues for 2020, GSK is the 6th largest company in this industry (Sagonowsky 2021). GSK's top selling prescription drugs in 2018 included Tivicay, Juluca, Advair, and Triumeq (Belk 2020). According to its *Annual Report 2020*, GSK has 94,000 employees working in 96 countries. GSK is one of the largest companies in Europe (#20) and in the world (#97) (based upon a set of measures including market value, as of April 16, 2021) (Murphy et al. 2021). GSK's financial statements highlight the scale of its operations. For the year 2020, GSK reported revenues of £34,099 million and total assets at year-end of £80,431 million (at year-end 2020, £1 = $0.73).

As detailed in its 2020 annual report, GSK has three main product lines: Pharmaceuticals, Vaccines, and Consumer Healthcare. The Pharmaceuticals segment accounts for the largest share of consolidated revenue (50.0%), followed by Consumer Healthcare (29.4%). GSK's pharmaceuticals assist people in managing such conditions as HIV, asthma, cancer, and diabetes. Its vaccines offer protection against such diseases as shingles, meningitis, hepatitis, and measles. No surprise, GSK invests heavily in research and development (R&D). In 2020, the company spent 15.0% of its revenue on R&D. The R&D efforts are directed to such areas as gene editing, cell therapy, and mRNA technology.

As a UK-based company, GSK adheres to IFRS for financial reporting purposes. GSK's common shares are listed on both the London Stock Exchange and the New York Stock Exchange (as American Depository Receipts). With the listing on the New York Stock Exchange, GSK must satisfy the reporting requirements for foreign registrants set by the U.S. Securities and Exchange Commission (SEC). GSK qualifies as a foreign private issuer (SEC 2020, ¶6110.2). As such, GSK has an option to submit just IFRS-basis financial statements to the SEC, as long as it fully complies with IFRS as issued by the International Accounting Standards Board (IASB) (SEC 2020, ¶6310.1). GSK states in its notes that it does apply IFRS as issued by the IASB, so it is relieved of the need to provide any U.S. GAAP information.

According to the most recent data available from the SEC, as of December 31, 2015, there were 923 foreign registrants in the U.S. market (SEC 2016). The IFRS Foundation website states that more than 500 of the foreign registrants in the U.S. market submit IFRS-basis financial statements to the SEC (IFRS Foundation 2017). GSK is a good example of one of these companies.

GSK was selected as the basis for this case for several reasons. GSK is a large foreign registrant, and the company is well known to both U.S. investors and consumers. In its notes, GSK cites just one foreign (non-UK) country as being material for purposes of reporting revenues by individual country under IFRS – the U.S. GSK earned revenue of £14,556 million in the U.S. for 2020, 42.7% of the consolidated total. The company deploys 34.5% of its noncurrent assets and 16.0% of its workforce in the U.S. market (GSK US 2021). GSK's sizable footprint in the U.S. includes two corporate hubs (Philadelphia and Research Triangle Park (NC)), a vaccine R&D center (MD), a pharmaceutical R&D hub (PA), and nine manufacturing facilities (GSK US 2021). Additionally, the company exhibits a number of noteworthy differences with U.S. GAAP in its reporting.

CASE REQUIREMENTS

Review GSK's *Annual Report 2020*, giving particular attention to the consolidated financial statements and accompanying note disclosures. GSK presents its IFRS-basis financial statements on pages 154 to 157 and the 47 accompanying notes on pages 158 to 237. Use the information GSK reports for 2020 to complete the following two tasks:

Tasks

(1) Identify and briefly discuss six (6) differences between GSK's reporting under IFRS and requirements under U.S. GAAP, considering the specific effect(s) of each difference.

Evaluate the effect(s) of each IFRS vs. U.S. GAAP difference on the following four financial statement measures:

- Total Stockholders' Equity (SE)
- Income before Income Taxes (IBT)
- Other Comprehensive Income before Income Taxes (OCI)
- Net Operating Cash Flows (NOCF)

Limit the search to differences in recognition, measurement, and classification (e.g., net income versus other comprehensive income; operating cash flow versus investing or financing cash flow) and those where GSK's treatment under IFRS would not be permitted under U.S. GAAP. For each of the six differences addressed, cite the applicable IFRS guidance and the applicable U.S. GAAP guidance, and clearly indicate the type of difference (i.e., recognition issue, measurement issue, or classification issue).

Also, indicate the direction and magnitude of effect for each IFRS vs. U.S. GAAP difference on the four financial statement measures. View the "effect" as the change(s) in the financial statement measures that would result from GSK converting from their treatment under IFRS to the treatment required by U.S. GAAP. For each of the differences addressed in this task, present a template like the one below to clearly show both the direction of effect (i.e., ↑, ↓ or –) and the magnitude of effect (i.e., amount in millions of British pounds) on each of the financial statement measures.

(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
↑ or ↓ in £	↑ or ↓ in £	↑ or ↓ in £	↑ or ↓ in £	↑ or ↓ in £	↑ or ↓ in £

For some IFRS vs. U.S. GAAP differences, the amount of effect will be evident, or at least determinable, from GSK's reporting. For other differences (see the Resources section below), it is possible to estimate the amount of effect.

(2) Identify and briefly discuss an additional five (5) differences where only the direction of effect on the financial statement measures of interest can be determined.

Focus on a different set of the IFRS vs. U.S. GAAP differences GSK exhibits in its reporting – those for which the direction (but not magnitude) of effect on at least one of the four financial statement measures can be determined. Observe all of the other instructions given in Task (1). Use a template like the one below to clearly show the direction (i.e., ↑, ↓ or –) of effect on the four financial statement measures.

(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
↑ or ↓	↑ or ↓	↑ or ↓	↑ or ↓	↑ or ↓	↑ or ↓

Resources

In addition to the IFRS standards and the FASB Accounting Standards Codification (ASC), it might be helpful to consult one or more of the guides on IFRS vs. U.S. GAAP differences prepared by the larger public accounting firms. A partial list of the guides that might be found useful follows:

- Deloitte's *Comparing IFRS Standards and U.S. GAAP: Bridging the Differences* (most recent – October 2021)
- EY's *US GAAP/IFRS Accounting Differences Identifier Tool* (most recent – December 2021)
- Grant Thornton's *Comparison of U.S. GAAP and International Financial Reporting Standards* (most recent – December 31, 2018)
- KPMG's *IFRS Compared to US GAAP* (most recent – December 2021)
- PwC's *IFRS and US GAAP: Similarities and Differences* (most recent – February 2022)
- RSM's *U.S. GAAP versus IFRS Comparisons* series (most recent – 2020)

GSK's 2020 financial statements exhibit more than 25 differences when compared to U.S. GAAP guidance. To make the task of identifying IFRS vs. U.S. GAAP differences a little more manageable, concentrate the search efforts on the following accounting topics:

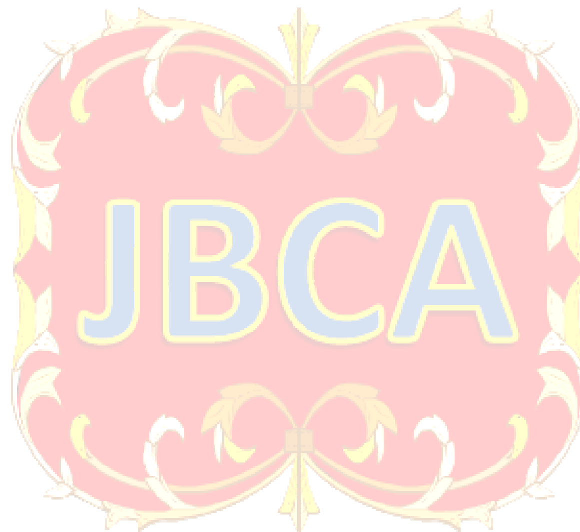
- Inventory
- Investments
- Fixed Assets
- Intangible Assets
- Pensions
- Uncertain Assets/Liabilities
- Income Taxes/Deferred Income Taxes
- Stockholders' Equity Items
- Cash Flows
- Business Combinations

For approximately half of the identified IFRS vs. U.S. GAAP differences, it is not possible to determine the amount of the directional effect(s) of converting to U.S. GAAP from the information GSK reports. For certain of these differences, though, it is possible to form an estimate of the amount(s). Use the information that follows to approximate the amount(s) for these differences:

- Noncontrolling interest:
  It is not possible to determine the full amount of difference in the noncontrolling interest under IFRS and U.S. GAAP. Note that GSK does provide information on a noncontrolling interest arising in one of the acquisitions it made in 2019. Use the information GSK provides for this acquisition to serve as a stand-in estimate for the full amount.
- Pensions (past/prior service cost):
  Applying IFRS, GSK does not report a balance for unamortized past/prior service cost. It is possible to estimate the balance, as of January 1, 2020, using GSK's reported annual past service cost for several previous years (e.g., seven years: 2013 to 2019). Estimating this balance requires consideration of the plans' average remaining service period. Note that while GSK does not give the average remaining service period, a U.S. competitor does – Pfizer Inc. In Note 11 accompanying its 2016 financial statements, Pfizer discloses the average remaining service period as 8.2 years (Pfizer 2017). For simplicity, assume GSK's average remaining service period is 8.0 years. Proceed with the amount determined by this process, £175 million, as the unamortized balance at the start of 2020.
- Pensions (expected return on plan assets):
  Applying IFRS, GSK does not report an expected return on plan assets. The amount for the year 2020 can be estimated, though, by applying the 2020 expected rate of return used by the same U.S. competitor – Pfizer Inc. In Note 11 accompanying its 2020 financial statements, Pfizer provides sufficient information to determine the weighted-average expected rate of return for its U.S. and international plans combined, 5.71% (Pfizer

2021). For estimation purposes, assume for GSK an expected rate of return on plan assets for the year 2020 of 5.71%.

- Pensions (cumulative pension gain/loss):
  Applying IFRS, GSK does not report a balance for cumulative pension gain/loss. This balance can be approximated using the assumed expected rate of return of 5.71% plus information GSK reports in its "Pensions and Other Post-Employment Benefits" notes over the last several years. Accumulating over the last seven years (2013 to 2019) produces a net pension asset gain, as of January 1, 2020, of £669 million and a net pension liability loss as of the same date of £5,250 million. Using these amounts, it is possible to formulate an estimate of the directional effect(s) of converting GSK's accounting for pension remeasurement gains/losses on the four measures of interest. Further assume that, in applying U.S. GAAP, GSK would not make the elective option to report such remeasurement gains/losses immediately through net income.



TEACHING NOTE

Implementation

One of the authors administered two slightly different variations of this case in a professional accounting research course in a master of science in accountancy (MSA) program at a public university in the southeastern U.S., in spring 2020 and in spring 2021. Students also had exposure to U.S. GAAP guidance and IFRS guidance related to a variety of topics earlier in the course, as part of the course lecture and in completing more minor research practice activities as well as other case analyses.

Work on this case was completed mostly toward the end of each of the referenced terms and was completed in small randomly assigned groups (three to five students). Students were asked to identify and briefly describe either eight (8) or six (6) recognition or measurement differences (depending on the term administered) that applied to GSK, including references to both the relevant IFRS guidance and U.S. GAAP guidance. They were also asked to identify either six (6) or eight (8) presentation or classification differences that applied to GSK, with reference to the relevant IFRS guidance. Using the 2018 and 2019 financial statements for GSK, respectively, the authors and students identified and documented a total of 16 and 29 recognition and measurement differences and a total of 28 and 33 presentation and classification differences. Some of the differences were deemed more substantial whereas others were deemed more subtle. In the coming pages, a total of 22 differences GSK exhibits for the year 2020 are addressed, with an emphasis on recognition, measurement, and classification differences.

Certain differences were more commonly included in student submittals, perhaps due to influence from the guides published by the large public accounting firms. Student submittals were evaluated based on the legitimacy of the identified difference and the documentation of the relevant guidance. In a course not so focused on research, the documentation requirements, including direct quotes of applicable guidance, could be reduced.

Students did occasionally express frustration with the case, stating that they were not quite sure where to begin. The following two options are worthwhile to present as approaches to getting started:

(1) Carefully review the GSK financial statements and accompanying notes and identify any recognition, measurement, or classification aspects that seem unusual, based on familiarity with U.S. GAAP. Then, research the IFRS guidance and/or U.S. GAAP guidance to determine the basis for the difference.

(2) Carefully review one or more of the guides of IFRS vs. U.S. GAAP differences published by the large public accounting firms. Then, for any particular difference, determine if it applies to GSK. If it does apply, research the IFRS guidance and/or U.S. GAAP guidance to document the basis for the difference.

While either of these strategies likely provides a good start, the authors acknowledge that the GSK financial statements and accompanying notes comprise nearly 100 pages, and the firm guides on IFRS vs. U.S. GAAP differences can be similarly lengthy. Thus, the case might seem overwhelming for students at first. Instructors using this case could, at their discretion, assign just Task (1), and for that task, consider asking students to provide just the directional effects on the four financial statement metrics.

Final Form 20-F income and equity reconciliations

Prior to 2007, companies like GSK, that applied IFRS and reported to the SEC to support a listing in U.S. markets, were required to prepare detailed reconciliations of their net income and stockholders' equity stated on an IFRS basis to the amounts stated on a U.S. GAAP basis. Foreign registrants were required to disclose these reconciliations in their annual Form 20-F filings with the SEC. Based upon progress the IASB and FASB made in converging their standards, in 2007, the SEC eliminated the "reconciliation" requirement for foreign registrants who apply IFRS as issued by the IASB. GSK reported its final set of reconciliations for 2006 (GSK 2007).

To provide a reference point derived from GSK's actual reporting of IFRS vs. U.S. GAAP differences, this section briefly overviews the largest adjustments in the company's stockholders' equity reconciliation for 2006. It is important to note that both IFRS and U.S. GAAP have changed since 2006, and the company's business activities may have changed as well. GSK's equity reconciliation as of 2006 year-end shows a total of 12 adjustments. As indicated in Table 1 (Appendix), six of these equity adjustments exceeded £100 million, and the six ranged in size from 2% of GSK's IFRS basis equity to more than 100% of it.

When GSK adopted IFRS, effective January 1, 2003, it elected to not restate the prior accounting it did under UK GAAP for certain activities, including its prior acquisitions. Many of the largest adjustments stem from a historical difference between UK GAAP and U.S. GAAP in the accounting for business combinations. The largest two adjustments, for goodwill and product rights (intangible asset), are good examples. The adjustment for deferred taxes arises mainly from the adjustment to product rights, adding to the existing taxable temporary difference for this item under IFRS. Certain adjustments, such as the one for capitalized interest, relate to legacy differences between IFRS and U.S. GAAP that have been reduced or eliminated through convergence efforts.

This case does not aim to construct the Form 20-F reconciliations for the year 2020. Rather, it uses the information GSK reports for 2020 as a tool to help students better understand IFRS vs. U.S. GAAP differences and how these differences impact a company's financial statements. The case focuses upon the individual differences, and helping students to understand each one. No attempt is made to aggregate the effects of the individual differences. Doing so would not be worthwhile given the SEC's official action on the matter and the significant data limitations that exist in trying to create U.S. GAAP information from IFRS-basis financial statements.

IFRS vs. U.S. GAAP differences: Direction and magnitude (amounts in millions)

Task (1)

Identify and briefly discuss six (6) differences between GSK's reporting under IFRS and requirements under U.S. GAAP, considering the specific effect(s) of each difference.

1-1. Reversal of inventory write-downs [recognition]

IFRS requires that inventory be reported at the lower of cost or net realizable value (IAS 2 ¶ 9,28). Reductions in net realizable value generally occur when goods held in inventory become obsolete or otherwise less marketable. Adjusting inventory for declines in value or marketability is also prescribed under U.S. GAAP (ASC 330-10-35-1B). The two sets of standards differ, though, with regard to reversing any prior write-downs of inventory. If a company continues to hold the inventory in a subsequent period and the selling price or net realizable value has increased, then IFRS calls for reversal of the previously recorded loss (IAS 2 ¶ 33). Under U.S. GAAP, if inventory has been written down to market value / net realizable value, then that amount becomes the new cost basis (ASC 330-10-35-14). Further interpretation is provided for SEC registrants, where it is indicated specifically that the cost basis for the inventory cannot be subsequently marked up due to changes in underlying facts and circumstances (ASC 330-10-S99-2).

GSK indicates in Note 8 (page 170) that £274 of inventory write-downs were reversed during 2020. If GSK were following U.S. GAAP, then it would not be allowed to reverse the inventory write-downs. That would result in lower net income, in the amount of £274 during 2020. (However, not reversing the write-downs might have caused cost of goods sold to be lower, indirectly also affecting net income; and not reversing write-downs in a prior year might have reduced the likelihood of write-downs in the current year.) The table below shows the expected effect on the financial statement metrics of following U.S. GAAP related to inventory write-down reversals rather than IFRS:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
↓ £274	–	↓ £274	↓ £274	–	–

1-2. Development costs [recognition]

IFRS and U.S. GAAP differ in their guidance on accounting for development costs. IFRS requires companies to capitalize the qualifying development costs associated with creating a new asset (e.g., new product, process, intangible asset) (IAS 38 ¶ 57). Once a company satisfies a set of six criteria for a particular development project, the company must capitalize any further development costs incurred to complete the project (¶ 65). The standards view the capitalized development costs as an intangible asset. If a company believes the benefits of the project (in the form of net cash inflows) will be of limited duration, the company must classify the development costs asset as finite-life (¶ 88). For a finite-life intangible, the company must then amortize the asset over the period of expected benefit. The amortization should begin once the new product, process or intangible asset is ready for its intended use. The amortization procedure should reflect the expected pattern of benefit, if determinable, or otherwise a straight-line basis (¶ 97).

U.S. GAAP generally requires the expensing of development costs (ASC 730-10-25-1). The U.S. standards provide exceptions for certain software development costs (ASC 985-20-25-3) and the costs of resources such as inventory, fixed assets, and intangible assets that may have an alternative future use in another development project or in non-development activities (ASC 730-10-25-2(a),(c)).

In Note 2 (page 160), GSK states its policy of capitalizing qualifying development costs in accordance with the IAS 38 guidance. The company adds that it generally capitalizes development costs once "… a regulatory filing has been made in a major market and approval is considered highly probable." GSK does not disclose the amount of capitalized development costs included in its assets as of December 31, 2020. The company, though, does show, in Note 20 (page 182), the new amounts it capitalized in 2019 and 2020. The reporting shows that, in 2020, GSK capitalized an additional £313 of development costs in relation to licenses, patents, amortized brands, etc. In that same note (page 183), the company reports that it recognized £191 of amortization and £219 of impairment losses in 2020 through the income item research and development. These charges appear to indicate at least a portion of the capitalized development costs that GSK expensed through net income in 2020. It is possible the company expensed additional amounts through other income items.

If GSK were reporting on a U.S. GAAP basis, it would not be permitted to capitalize the development costs that it did in applying the guidance of IAS 38 ¶ 57. Thus, it is very likely the company's assets and stockholders' equity would appear lower on a U.S. GAAP basis, though the amount of the decreases cannot be determined from the information GSK provides. In contrast, it is possible to estimate the effect of a conversion to U.S. GAAP on the company's income before taxes for 2020. The amortization and impairment amounts for 2020 noted above, totaling £410, would not be reflected in the U.S. GAAP income before taxes for 2020. Rather, on a U.S. GAAP basis, GSK would show an expense for the new development costs incurred in 2020 of £313. Netting the two effects, the company's income before taxes for 2020 would be higher by an estimated £97. The table below summarizes the estimated effects of converting GSK's accounting for this issue to a U.S. GAAP basis:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
↓	–	↓	↑ ~£97	–	–

If a different year, with a different set of facts, the direction of the effect on income before taxes could have been different. For example, in 2019, GSK reported capitalization of development costs of £239 and a total for amortization and impairment through the income item research and development of £208 (£159 of amortization + £49 of impairment). For the year 2019, converting GSK's accounting for development costs to a U.S. GAAP basis would have decreased the income before taxes by £31.

1-3. Reversal of impairment losses [recognition]

IFRS allows companies to reverse impairment losses related to non-current assets, if the recoverable amount for the impaired asset increases in a subsequent period (IAS 36 ¶¶110,114). Under U.S. GAAP, reversals of impairment losses are prohibited, whether related to property, plant and equipment (PP&E) assets or intangible assets. Specifically, related to intangible assets subject to amortization, U.S. GAAP indicates that the adjusted carrying amount of the asset after recognition of the impairment loss becomes the new basis for the asset (ASC 350-30-35-14). The U.S. standards give similar guidance for intangible assets (other than goodwill) that are not subject to amortization (ASC 350-30-35-20) and also for PP&E assets (ASC 360-10-35-20).

GSK indicates in Note 2 that impairment losses on non-current assets other than goodwill are sometimes reversed, but only if "there has been a change in estimates used to determine recoverable amounts and only to the extent that the revised recoverable amounts do not exceed the carrying values that would have existed, net of depreciation or amortisation, had no impairments been recognised" (page 162). Note 17 of GSK's annual report (page 179) indicates that, for PP&E assets, £477 of impairment losses were recognized and £34 of impairments were reversed during 2020. And Note 20 (page 182) indicates that, for other intangible assets, £295 of impairment losses were recognized and £38 of impairments were reversed during 2020. If GSK were following U.S. GAAP instead, then net income would be lower by £72 (i.e., no impairment loss reversals allowed). This expected effect of applying the U.S. GAAP treatment rather than IFRS is reflected in the table below:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
↓ £72	–	↓ £72	↓ £72	–	–

1-4. Deferred taxes for elimination of profits on intra-entity inventory transfers [recognition]

When one entity acquires a controlling interest in another, the acquirer must prepare consolidated financial statements that include the acquiree from the acquisition date forward. The business combination creates a new economic entity, and the acquirer's consolidated financial statements must report on this entity. The two parties often continue as separate legal entities, perhaps based in different countries and income tax jurisdictions. The legal entities usually continue to file their separate income tax returns. In contrast, the consolidated entity must report the income tax effects for the full set of legal entities from a group perspective. If the parties engage in intra-entity transactions, the effects of these transactions may be reported by one of the legal entities in one year, and by the other in a different year. For an intra-entity transaction such as a sale of inventory from one party (i.e., parent or subsidiary) to the other party (i.e., subsidiary or parent), the gross profit on the transfer from a consolidated perspective should not be recognized until the transferee resells the inventory to an external customer.

In such situations, the internal transferor would report the gross profit in their income tax return and pay the tax due on it, while the gross profit from a consolidated perspective might be deferred for a year or more. In effect, the transferee's tax basis for the inventory exceeds the carrying amount for it in the consolidated accounts. This situation creates a book-tax difference, with the tax basis in this case larger than the book value. A potential deductible temporary difference arises.

IFRS calls for the recognition of a deferred income tax asset for such intra-entity inventory transfers (IFRS 10 ¶ B86(c)). The consolidated entity essentially has prepaid the income tax, a tax effect not yet expensed in the consolidated income statement. In contrast, U.S. GAAP prohibits the consolidated entity from recognizing a deferred income tax asset for this situation (ASC 740-10-25-3(e)). The FASB issued ASU 2016-16, *Intra-Entity Transfers of Assets Other Than Inventory*, calling for the recognition of deferred taxes on intra-entity transfers, but it exempted inventory transfers from the treatment. The FASB exempted inventory transfers due to concerns some stakeholders expressed about the cost and complexity of implementing the requirement for these transactions. The stakeholders pointed to the high volume of such transactions and relatively short deferral period (ASC 740-10-25-BC7). Thus,

under U.S. GAAP, the consolidated entity does not recognize a deferred tax asset and associated decrease to income tax expense.

Applying IFRS, GSK recognizes a deferred tax asset for the elimination of unrealized gross profit on intra-entity transfers of inventory. In Note 14 (page 177), GSK reports the total amount of deferred tax assets arising from elimination of intra-entity inventory profits. The total amount as of December 31, 2020 is £1,024. During 2020, this particular source of deferred tax assets decreased by £96 (–£29 + –£67). If GSK were following U.S. GAAP, the deferred tax asset would be reduced and retained earnings would be reduced. Also, for the current year, earnings would increase. The table below summarizes the effects on the four financial statement measures of moving from GSK's treatment under IFRS to the U.S. GAAP treatment:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
↓ £1,024	–	↓ £1,024	↑ £96	–	–

1-5. Dividends to stockholders [recognition]

U.S. GAAP and IFRS can differ in the timing for recognizing dividends. IFRS requires that companies report the dividends to stockholders during the period and gives two options for doing so: present in the statement of changes in equity or disclose in the notes (IAS 1 ¶ 107). The IFRS standards view the distribution (payment) of the dividends as the critical event, not the declaration of them. Any dividend amounts declared but not yet distributed are merely disclosed in the notes under IFRS (¶ 137). U.S. GAAP, however, generally requires that dividends be recognized when declared. This is addressed in guidance specific to the insurance industry (ASC 944-805-25-11). This recognition timing difference can have an impact on the financial statements if a company declares dividends late in one fiscal year, but does not actually make the distribution until the subsequent fiscal year.

Consistent with IFRS guidance, GSK indicates in Note 16 (page 178) that dividends are only recognized when paid and not when declared. If GSK were following U.S. GAAP, then it would presumably have to record dividends earlier, when declared rather than when paid. Based on the information provided by GSK in Note 16 (page 178), two of the dividend declarations (for the third and fourth "interims" of 2020) were not paid until 2021. Those two declarations, totaling £2,092, would have to be deducted from retained earnings and reflected as a liability under U.S. GAAP, as reflected in the following table:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
–	↑ £2,092	↓ £2,092	–	–	–

1-6. Noncontrolling interests [measurement]

In a business combination, the acquiring company might not secure 100% of the acquiree's voting shares. Both IFRS and U.S. GAAP call for the acquirer to include 100% of the acquiree's assets, liabilities, and income (from the acquisition date forward) in the consolidated financial statements. At the same time, the consolidated balance sheet must clearly show the equity interests of the outside ownership in the consolidated entity. The amount of the

noncontrolling interests (NCI) must be presented in the equity section of the balance sheet. IFRS and U.S. GAAP differ on the initial measurement of this item.

The difference is rooted in how the goodwill asset is viewed. IFRS grants companies a choice of two measurements (IFRS 3 ¶¶ 18-19). One option is to recognize goodwill arising from the acquisition, but just to the extent of the controlling interest acquired. In this case, the acquirer would measure the NCI based upon the NCI's share of the acquiree's identifiable assets and liabilities, but none of the goodwill. The acquirer recognizes goodwill, but only to the extent of the controlling interest acquired. The other option is to project goodwill to 100% of the acquiree, even the portion not acquired. The acquirer would measure the NCI based upon the NCI's share of the acquiree, including goodwill. In contrast, U.S. GAAP requires the second option, sometimes referred to as the full goodwill approach (ASC 805-30-30-1).

In Note 40 (page 208), GSK states that it used the proportionate goodwill approach to measure goodwill and NCI for a small acquisition the company made in 2020. GSK acquired a 55% controlling interest in Pfizer Biotech Corporation Taiwan, leaving a 45% NCI. While GSK does not report the amount of the IFRS vs. U.S. GAAP difference, it can be estimated. GSK does report the recognized goodwill arising from this acquisition, £124. The goodwill pertains to the 55% controlling interest GSK acquired. From this information, it is possible to project the full amount of goodwill that would have been recognized under U.S. GAAP. Assuming there was no control premium, the full goodwill would have been £225 (£124 ÷ 0.55). Applying IFRS, GSK recognized less goodwill and NCI than it would have under U.S. GAAP. The table below summarizes the estimated effects of moving from GSK's election under IFRS to the required treatment under U.S. GAAP:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
↑ ~£101	–	↑ ~£101	–	–	–

The amount of £101 is an estimate, and it comes from just one acquisition the company reported during 2020. In Note 2 (page 159), GSK states that it chooses between the two options on a case-by-case basis. So, it is quite possible the effect of this difference exceeds the estimated amount in the table above.

1-7. Net unrealized gain/loss on equity investments [classification]

Both IFRS and U.S. GAAP use multiple accounting categories for investments. IFRS, as a general rule, requires that equity investments be reported at fair value, with the change in fair value each period included in net income. The standards provide an exception, though, whereby the change in fair value each period could be reported through OCI (IFRS 9 ¶ 4.1.4). The alternative treatment is restricted to exclude equity securities held for trading and those held as contingent consideration in a business combination (¶ 5.7.5). Furthermore, it must be elected at the point of initial recognition, and the election is irrevocable. If an investor company elects this treatment, the investor would report the change in fair value each period through OCI.

Following the FASB's issuance of ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, U.S. GAAP generally requires that equity investments be reported at fair value, and the change in fair value each period be included in net income (ASC 321-10-35-1). With the elimination of investments in equity securities from the

available-for-sale classification, U.S. GAAP no longer permits the changes in fair value for these securities to be reported through OCI.

GSK appears to have elected the alternative treatment for the majority of its equity investments. For the year 2020, the company reports a net gain on these investments of £1,348. GSK reports the amount through OCI and adds it to the equity component of "other reserves" (Note 37, page 204). The other reserves item is similar to accumulated OCI under U.S. GAAP. The table that follows summarizes the effects of moving from GSK's treatment under IFRS to the U.S. GAAP treatment:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
–	–	–	↑ £1,348	↓ £1,348	–

Similar effects in prior years likely would produce different amounts under IFRS and U.S. GAAP for retained earnings and accumulated OCI. While these equity components likely would differ between IFRS and U.S. GAAP, the total equity should be the same under the two sets of standards.

1-8. Past/prior service cost [classification]

Past service cost (prior service cost in U.S. standards) can arise in the context of a defined-benefit pension plan. Specifically, it refers to credit granted to employees at the time of a plan amendment for services provided in previous periods. IFRS and U.S. GAAP differ in their treatment of this cost. IFRS generally requires that past service cost be expensed in the period of plan amendment (as incurred) (IAS 19 ¶ 103). The past service cost is expensed through net income. In contrast, U.S. GAAP requires that prior service cost be expensed in the period of plan amendment, but through OCI rather than net income. The amount recognized through OCI must be reclassified to net income by means of a straight-line amortization process. The accumulated OCI must be amortized over the estimated remaining service period of the employees affected by the plan amendment (ASC 715-30-35-11). In effect, U.S. GAAP views the awarding of credit for prior service as a motivation for the employees to remain loyal and productive in future periods (ASC 715-30-35-10).

In Note 30 (page 193), GSK discloses that it recognized £43 total for past service cost arising from plan amendments completed in 2020. GSK states that it included this amount in its 2020 operating profit. Applying U.S. GAAP, GSK would recognize this cost of £43 immediately in OCI and reclassify the amount to net income beginning in 2021 using the straight-line amortization process. Adding to that, the company would need to continue amortizing any amounts of prior service cost that would have been recognized under U.S. GAAP through OCI in previous years.

For illustration purposes, assume the estimates given in the case of £175 for the unamortized prior service cost as of January 1, 2020 and 8.0 years for the average remaining service period. The amount of £175 is derived from the actual past service cost GSK expensed each year, 2013 to 2019, less the amount of the accumulating balance they would have amortized each year using Pfizer's reported average remaining service period of 8.2 years (rounded to 8.0 years). As indicated in Table 2 (Appendix), GSK's estimated unamortized prior service cost as of January 1, 2020, for U.S. GAAP reporting purposes, is £175.37.

Applying U.S. GAAP using these estimates, GSK would have reclassified £22 of expense from accumulated OCI to net income in 2020 (£175 ÷ 8.0 years = £21.9, rounded to £22). The table that follows summarizes the estimated effects of GSK moving from the IFRS treatment to the U.S. GAAP treatment:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	L =	SE)	IBT	OCI	NOCF
–	–	–	↑ ~£21	↓ ~£21	–

For this illustration, GSK would show approximately £21 more of income before taxes. The amount comes from comparing the pre-tax income effect GSK reported under IFRS (–£43) with the estimated pre-tax income effect the company would have reported under U.S. GAAP (–£22).

1-9. Return on pension plan assets [classification]

IFRS and U.S. GAAP differ in their income classification of the return on pension plan assets. The two sets of standards differ as to the amount of income counted in net income versus OCI. IFRS requires companies to decompose the actual return on plan assets into two components: interest income and non-interest return (IAS 19 ¶ 57(c-d)). The interest income is computed on a company's beginning of period plan assets (¶ 125). The amount computed is included as a negative element in the company's net pension interest cost and thus counts in the company's net income for the period (¶¶ 57(c), 124). The non-interest return on plan assets is viewed as a remeasurement gain/loss and counted in the period's OCI (¶ 125).

U.S. GAAP calls for companies to decompose the actual return on plan assets into components as well, but into two different components: expected return and asset gain/loss (ASC 715-30-35-22). U.S. GAAP uses the more stable expected return on plan assets construct as a mechanism to smooth a company's periodic income. The U.S. guidance treats the expected return as an element of net pension expense and, thus, a positive component of net income. The asset gain/loss captures the difference between the actual and expected returns each period, and the standards permit companies to treat the asset gain/loss as a component of OCI (ASC 715-30-35-23).

In Note 30 (page 194), GSK reports for 2020 an actual return on plan assets of £1,428. GSK's reporting shows a net interest cost of £36. The net interest cost reflects the difference between a computed interest charge on the beginning pension liability (£408) and a computed interest income on the beginning pension assets (£372). Applying IFRS, GSK effectively counts the interest income of £372 in its 2020 net income. In addition, GSK reports a non-interest return (asset remeasurement gain) of £1,056, and the company counts this amount in its 2020 OCI.

Applying U.S. GAAP, GSK would need to determine the expected return on plan assets for the year. For illustration purposes, assume the estimated expected return on plan assets given in the case of 5.71%. The expected return of 5.71% comes from Pfizer, a competitor who applies U.S. GAAP. As indicated in Table 3 (Appendix), Pfizer's weighted-average expected pension return for 2020, considering both its U.S. plans and international plans, is 5.71%.

Using Pfizer's expected rate of return, GSK's expected return on plan assets for 2020 can be estimated as £1,052 (beginning plan assets of £18,432 × 0.0571). Applying U.S. GAAP, GSK would have counted the estimated expected return of £1,052 in its net income, and it would have

counted an asset gain of £376 in its OCI (£1,428 actual return – £1,052 estimated expected return). The table below summarizes the estimated effects of GSK moving from the IFRS treatment to the U.S. GAAP treatment:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
-	-	-	↑ ~£680	↓ ~£680	-

GSK would have counted the estimated expected return of £1,052 in net income rather than the IFRS interest income of £372. It should be noted that U.S. GAAP gives companies a policy option to count the asset gain/loss each period directly in the period's net income (ASC 715-30-35-20). With this policy option, a company effectively counts the actual return on plan assets each period in its net income. If GSK elected this option for U.S. GAAP reporting, the effects shown in the table above would change to £1,056 (£1,428 actual return – £372 IFRS interest income).

1-10. Reclassification of cumulative pension gain/loss [classification]

The two sets of standards differ fundamentally on the matter of reclassifying amounts recognized in OCI to a company's net income. IFRS prohibits such reclassification adjustments (IAS 19 ¶ 122), while U.S. GAAP requires them (ASC 715-30-35-24). Both IFRS and U.S. GAAP count the remeasurement gains/losses arising each period on pension assets and liabilities in OCI, though the amounts of these gains/losses could differ. (See, for example, the discussion of the asset gains/losses counted in OCI in 1-9 above.) In subsequent periods, U.S. GAAP sets a different course in that it requires a portion of the cumulative pension gain/loss recognized over time be reclassified from OCI to net income, once the cumulative gain/loss amount is assessed to be material.

IFRS does not require any tracking of a cumulative pension gain/loss for purposes of income reclassification. In order to show GSK on a U.S. GAAP basis, the amount of the cumulative pension gain/loss would need to be determined. For illustration purposes, assume the estimated beginning cumulative gain/loss amounts provided in the case: a cumulative asset gain of £669 and a cumulative liability loss of £5,250. As indicated in Table 4 (Appendix), rough estimates of cumulative asset and liability gain and loss amounts, needed for U.S. GAAP reporting purposes, can be derived from GSK's reporting on an IFRS basis for the years 2013 to 2019.

U.S. GAAP directs companies to reclassify a portion of a material cumulative pension gain/loss through an amortization procedure known as the "corridor method" (ASC 715-30-35-24). The corridor method requires a company to identify the larger of the beginning of period (1) plan assets and (2) benefit obligation, and then multiply the larger by 10%. The amount thus determined defines a corridor, positive and negative, for the purpose of assessing the materiality of the beginning of period cumulative pension gain/loss. If the beginning of period cumulative gain/loss falls outside of the corridor, the company must amortize the excess into the current period's net income. The amortization period is the average remaining service period of the covered employees.

From GSK's reporting in Note 30 (pages 196-197), the larger of the company's beginning of 2020 plan assets (£18,432) and benefit obligation (£20,353) is the benefit obligation

of £20,353. The estimated corridor for U.S. GAAP reporting purposes for the year 2020 would be –£2,035 to +£2,035. A portion of GSK's estimated cumulative pension loss as of the beginning of 2020 falls outside of this estimated corridor. Applying U.S. GAAP, GSK would need to amortize the excess of £2,546 (= £4,581 cumulative loss – £2,035 corridor amount) over the estimated average remaining service period of the company's employees (stated in the case as 8.0 years). As a result, GSK would need to increase its reported pension expense for 2020 under U.S. GAAP by £318 and increase OCI by the same amount. The table below summarizes the estimated effects of converting GSK's accounting for this issue from IFRS to U.S GAAP:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
-	-	-	↓ ~£318	↑ ~£318	-

1-11. Interest received [classification]

IFRS indicates that interest and dividends received can be classified as operating, investing, or financing activities in the statement of cash flows (IAS 7 ¶ 31), but need to be classified consistently from period to period. Under U.S. GAAP, by rule, interest received is deemed to be a cash flow from operating activities (ASC 230-10-45-16). Specifically, U.S. GAAP includes in cash flows from operating activities "cash receipts from returns on loans, other debt instruments of other entities, and equity securities – interest and dividends". Also, U.S. GAAP does not require that interest received be reported separately on the face of the statement of cash flows (ASC 230-10-50-2).

GSK reports interest received of £39 for 2020 as a cash inflow from investing activities on the cash flow statement (page 157). This is allowable under IFRS. However, if GSK were following U.S. GAAP, the interest collections would need be reported instead as an increase to operating cash flows. This effect is indicated in the following table:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
–	–	–	–	–	↑ £39

1-12. Dividends received [classification]

Again, guidance provided in IAS 7 indicates that interest and dividends received can be classified as operating, investing, or financing activities, consistently from one period to the next (¶ 31). Under U.S. GAAP, by rule, dividends received are deemed to be a cash flow from operating activities (ASC 230-10-45-16). U.S. GAAP specifically includes in cash flows from operating activities "cash receipts from returns on loans, other debt instruments of other entities, and equity securities – interest and dividends".

GSK reports dividends received (from associates, joint ventures, and equity investments) of £31 for 2020 as a cash inflow from investing activities on the cash flow statement (page 157), consistent with the options provided under IFRS. If GSK were following U.S. GAAP, the dividends received would have to be reported as an increase to operating cash flows. This difference is reflected in the table below:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	L =	SE)	IBT	OCI	NOCF
–	–	–	–	–	↑ £31

1-13. Interest paid [classification]

IFRS guidance also indicates that interest and dividends paid can be classified as operating, investing, or financing activities on a consistent basis from period to period (IAS 7 ¶ 31). Under U.S. GAAP, by rule, interest paid is also deemed to be a cash flow from operating activities (ASC 230-10-45-17). The guidelines specifically call for any payments to creditors for interest charges be classified as operating outflows. Also, U.S. GAAP does not require that interest paid be reported separately on the face of the statement of cash flows (ASC 230-10-50-2).

GSK reports interest paid of £864 for 2020 as a cash outflow for financing activities on the cash flow statement (page 157), which is allowable based on the IFRS guidance. If GSK were following U.S. GAAP, then the interest payments would have to be reported as a reduction (outflow) in operating cash flows; that effect is indicated in the table below:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	L =	SE)	IBT	OCI	NOCF
–	–	–	–	–	↓ £864

IFRS vs. U.S. GAAP differences: Direction only (amounts in millions)

Task (2)

Identify and briefly discuss an additional five (5) differences where only the direction of effect on the financial statement measures of interest can be determined.

The answer options for Task (2) include the differences discussed in the suggested solutions above for Task (1) that the student / group did not address in their response to Task (1) (seven differences). In the suggested solutions for Task (2) that follow, the direction of effect on at least one of the financial statement measures is determinable for differences 2-1 through 2-9.

2-1. Direct transaction costs for purchase of equity investments [measurement]

This difference relates to the same investments discussed in suggested solution 1-7 above: investments in equity securities reported at fair value through OCI. In the recording of the purchase of these securities, there is a difference between IFRS and U.S. GAAP in terms of the initial measurement of the asset. The two sets of standards agree in concept that the securities should be measured initially at their acquisition date fair value. IFRS goes beyond that, though, by requiring that the direct transaction costs be reflected in the asset account, even if that means showing a balance that exceeds the fair value of the securities (IFRS 9 ¶ 5.1.1). In contrast, U.S. GAAP calls for all investments in equity securities to be recorded at their fair value, excluding any transaction costs (ASC 820-10-35-9B). The direct transaction costs presumably should be expensed in the period of purchase under U.S. GAAP.

The IFRS guidance applies to many financial assets and financial liabilities. This difference, though, focuses on investments in equity securities reported at fair value through OCI. The reason is, in Note 2 (page 162), GSK addresses the initial measurement of these particular securities. Consistent with the IFRS guidance, GSK states that it capitalizes direct transaction costs as part of the initial measurement of the asset. Applying U.S. GAAP, GSK would not be permitted to capitalize these costs.

GSK does not state the amount of direct transaction costs it has capitalized. In Note 22 (page 185), the company disclosed that it added £409 of these equity investments during 2020. GSK likely incurred some direct transaction costs on the new investments, which it would have had to expense under U.S. GAAP. Hence, the company's pre-tax income likely would have been lower under U.S. GAAP. The table below shows the likely directional effects of GSK moving from its treatment under IFRS to the U.S. GAAP treatment:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
↓	–	↓	↓	–	–

2-2. Credit losses on financial assets reported at amortized cost or at fair value through OCI [measurement]

This difference arises from relatively recent additions to IFRS and U.S. GAAP. The sources are IFRS 9 (*Financial Instruments*), revised in 2014; and ASU 2016-13 (*Measurement of Credit Losses on Financial Instruments*). Both sets of standards now incorporate guidance on the accounting for expected credit losses (essentially, bad debts) on financial assets. The standards differ somewhat in their guidance, including this particular difference.

IFRS and U.S. GAAP agree in concept that companies must anticipate future credit losses and establish an allowance for them at the point of initial recognition of the asset. The standards differ, though, as to how far into the future companies should anticipate. IFRS requires companies to examine 12 months into the future, and recognize the credit losses expected to arise over that period (IFRS 9 ¶ 5.5.5). In contrast, U.S. GAAP requires companies to extend their analysis over the full term of the financial asset, which could be more than 12 months (ASC 326-20-30-1; 30-4). Note that IFRS requires something similar if, in a subsequent period, the company judges that the credit risk has increased significantly (IFRS 9 ¶ 5.5.3).

In Note 2 (page 162), GSK states that for certain financial assets subject to credit risk, it establishes a provision for the credit losses expected to arise during the first 12 months. GSK describes the financial assets as all except trade receivables, equity investments, and others measured at fair value through net income. The exclusions leave the debt investments measured at amortized cost or at fair value through OCI. In Note 25 (page 186), GSK reports that it had £402 of debt investments subject to the credit loss guidance. The company has established an allowance for expected credit losses of £6 relating to these assets. GSK disclosed that there was no further charge for credit losses against net income in 2020.

If GSK were applying U.S. GAAP and having to consider credit losses over the full term of these assets, it seems reasonable to believe the company would have established a larger allowance for credit losses. The table below shows the likely directional effects of GSK moving from the IFRS treatment to the U.S. GAAP treatment:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	L =	SE)	IBT	OCI	NOCF
↓	–	↓	↓	–	–

2-3. Restructuring provisions [recognition]

The conditions for a provision as set forth in IFRS include either legal or constructive obligations (IAS 37 ¶ 14). A constructive obligation arises when recognition criteria are met, including the company preparing a detailed plan for a restructuring and raising an expectation among those affected that it will execute the restructuring (IAS 37 ¶ 72). But U.S. GAAP does not allow for the recognition of restructuring charges unless there is an unavoidable legal obligation (ASC 420-10-25-2). The guidelines note that the company incurs an obligation only when an event leaves the company with little or no discretion to avoid the future asset transfer. And an exit plan, by itself, is not sufficient.

In Note 10 (pages 172-173), GSK describes £1,532 of major restructuring costs incurred during 2020 (and related amounts in prior years). It is not clear from the information provided by GSK how much of the major restructuring costs recognized were based on legal obligations or constructive obligations. GSK does indicate in the Strategic Report (page 70) that provisions are recorded when a legal or constructive obligation exists. Information in Note 31 (page 200) provides further indication of GSK recognizing a liability based even on just a constructive obligation, with the description of expected staff severance payments being recognized as a provision when management has made such a decision and has communicated that decision to the affected employees.

It is quite possible that at least a portion of the restructuring costs GSK recognized under IFRS for 2020 was based upon a constructive obligation. In that case, the company would recognize a restructuring charge and liability in 2020 according to IFRS that it would not be permitted to recognize until 2021, or later, according to U.S. GAAP. The potential directional effects of GSK converting to U.S. GAAP for this item follow:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	L =	SE)	IBT	OCI	NOCF
–	↓	↑	?	–	–

The effect on the 2020 income before taxes would depend upon whether the new restructuring costs in 2020 based upon constructive obligations are larger than any amounts delayed under U.S. GAAP reporting from 2019, or prior, to the current year's income. GSK's reporting does not provide the information needed to determine which of the two effects is larger.

2-4. Recoveries of reimbursements of environmental costs [recognition]

In Note 2 (page 160), GSK refers to recognizing a liability for environmental clean-up costs it has incurred from current and prior activities. The company must estimate the amount as it will depend upon how litigation and regulatory actions might resolve over time. For some locations, GSK may share a legal exposure with one or more other parties. In those cases, GSK will accrue a charge if it perceives the likelihood of the other parties not paying their shares as

being probable. The difference with U.S. GAAP arises when, at a later point, one of these parties acknowledges responsibility and reimburses GSK for the previous payment it made of the other company's portion.

Both IFRS and U.S. GAAP view these reimbursements as gain contingencies. Both sets of standards require a high degree of verification for recognizing the uncertain asset. They use slightly different thresholds, though. IFRS permits a company to recognize the uncertain asset once realization of it is virtually certain (IAS 37 ¶ 33). Realization means receiving cash or a claim to cash. In contrast, U.S. GAAP does not permit a company to recognize an uncertain asset until the asset is realized (ASC 450-30-25-1). The realization must be certain. The recognition threshold IFRS uses, virtually certain, creates the possibility for recognizing the uncertain asset before the realization is certain.

GSK does not provide any information on reimbursements it may have recognized. It is possible that the company did not have any reimbursements recorded in 2020. With the possibility that IFRS could permit a slightly earlier recognition of these reimbursements, the table below shows the potential directional effects of GSK moving from the IFRS treatment for this item to the U.S. GAAP treatment:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
↓	–	↓	?	–	–

The effect on pre-tax income depends upon what has happened during the current period. If applying IFRS leads to an earlier recognition of the uncertain asset and related gain in the current period, IFRS would show a higher income. On the other hand, if applying U.S. GAAP produces a delayed recognition of the uncertain asset and related gain in the current period, then U.S. GAAP could show higher pre-tax income for 2020.

2-5. Liability arising from uncertain tax positions [measurement]

With the IASB's issuance of IFRIC 23 (*Uncertainty over Income Tax Treatments*) in 2017, both sets of standards now provide specialized guidance to companies on the accounting for uncertainty in the tax positions taken in their income tax filings. While conceptually similar, the two standards differ in certain of their detailed requirements. GSK illustrates one of these differences in their reporting.

According to IFRS, if a company believes it is less than probable that a taxing authority will accept a tax treatment upon examination, the company must recognize a liability for the additional taxes likely to be due. As used in IFRS, the term "probable" generally means more likely than not (i.e., more than 50% likely) (see IAS 37 ¶ 23). The company recognizes the additional taxes by decreasing tax assets, increasing tax liabilities, or a combination of the two. The difference of interest here lies in the measurement of the liability for additional taxes. IFRS requires companies to measure the liability at the more predictive of the most likely amount to be paid or the probability-weighted expected value of the future payment (IFRIC 23 ¶ 11). In contrast, U.S. GAAP requires companies to establish the liability for additional taxes at the full amount that would be due (ASC 740-10-25-8; 25-16).

In Note 14 (page 176), GSK discloses a provision for uncertain tax positions as of December 31, 2020 of £856. According to the IFRS guidance, this amount should reflect a

realistic assessment of the additional taxes that will need to be paid in a future period. This amount could be less than what U.S. GAAP requires, the full amount of additional taxes that could be due. Based upon this difference in measurement guidance, the table below shows the potential directional effects of GSK moving to the U.S. GAAP treatment:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
–	↑	↓	?	–	–

It is not possible to know for sure the direction of the effect on GSK's pre-tax income. The direction would depend upon what happened during the current period. If 2020 is an originating period, and GSK recognized a smaller provision under IFRS, the pre-tax income would be higher under IFRS (lower under U.S. GAAP). Alternatively, if 2020 is a reversing period, and applying U.S. GAAP, GSK might possibly settle for less than the full liability amount established in a previous period, the pre-tax income in that case would be higher under U.S. GAAP.

2-6. Deferred taxes for control or influence investments with permanently reinvested earnings [recognition]

In situations where an investor uses the equity method or consolidation for an investment in another company, the investor may accrue income before receiving the cash. In some cases, the investee's or subsidiary's income may be reinvested on a long-term or even permanent basis. In such situations, the carrying amount of the investment may exceed the income tax basis. This is particularly true if the investee or subsidiary is located in a different tax jurisdiction, and the legal entity owes little or no current tax in that jurisdiction. IFRS and U.S. GAAP both provide an exception to recognizing a deferred tax liability in these situations. The standards differ, though, in terms of the scope and qualifications for using this exception.

IFRS exempts companies from recognizing a deferred tax liability, but only when (1) the investor can control the timing of reversal (that is, when the investor will receive the income) and (2) the reversal is not expected to occur in the foreseeable future (IAS 12 ¶ 39). The IFRS exception applies to all subsidiaries, associates, and joint ventures, foreign and domestic. The exception in U.S. GAAP requires that the earnings of the related entity be reinvested on a permanent basis (ASC 740-30-25-18). The U.S. GAAP exception is more limited in scope, applying to just foreign subsidiaries and corporate-form joint ventures.

There are two differences here, though both are rather subtle. The IFRS exception applies to a larger set of investments, and it is slightly easier to qualify to use. The condition in IFRS allows for the possibility that the reinvested earnings could be received at some point in the future.

In Note 2 (page 163), GSK describes a policy that is consistent with the IFRS guidance. In Note 14 (page 176), GSK discloses that it has not recognized a deferred tax liability for £974 of temporary differences arising from the reinvested earnings of certain foreign subsidiaries. Applying U.S. GAAP, with its more restrictive condition, GSK might have had to recognize a deferred tax liability for some or all of these temporary differences. Considering the difference in recognition guidance, the table below shows the potential directional effects of GSK converting from the IFRS treatment to the U.S. GAAP treatment:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
–	↑	↓	?	–	–

As with a number of the previous differences, the effect on pre-tax income can be difficult to discern. If a deferred tax liability is originating in 2020, GSK might show less expense (and liability) under IFRS; hence, a higher pre-tax income (lower under U.S. GAAP). Otherwise, the pre-tax income probably would be the same under IFRS and U.S. GAAP.

2-7. Discounting of uncertain liabilities / provisions [measurement]

IFRS requires that provisions (the IFRS equivalent of an uncertain liability that is booked) be discounted to present value (IAS 37 ¶ 45). U.S. GAAP does not address possible discounting of uncertain liabilities. Instead, U.S. GAAP only addresses what amount to accrue if a range of uncertain loss amounts are possible (ASC 450-20-30-1). More generally, though, U.S. GAAP tends to require discounting of future amounts only when the timing of the future cash flows is fixed (Grant Thornton, *Comparison between U.S. GAAP and IFRS Standards*, 2019, page 77). With uncertain liabilities, the timing is usually not known much in advance.

In Note 31 (page 200), GSK indicates that various of its provisions are discounted based on risk-adjusted projected cash flows and risk-free rates of return. If GSK were to follow U.S. GAAP, then its provisions would likely be reported at the full amount rather than the discounted amount. It is not clear from Note 31 how much total discounting has been reflected in the GSK provisions, but it seems quite likely that converting to U.S. GAAP would increase the liabilities and decrease the retained earnings. As for the effect on 2020 pre-tax income, GSK recognizes new provisions of £1,146 in 2020. The new round of discounting very likely exceeded the unwinding of the discounts recognized in prior years, reported as £3. Thus, converting to U.S. GAAP would produce a larger net charge for provisions in 2020 and a smaller pre-tax income. The table that follows shows the likely directional effects of moving GSK's reporting to a U.S. GAAP basis:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
–	↑	↓	↓	–	–

2-8. Definition of control for consolidation purposes [recognition & measurement]

IFRS and U.S. GAAP differ in their definitions of control for purposes of identifying a business combination and the acquirer. For an acquisition of a voting-interest entity, U.S. GAAP uses a "bright-line" criterion of the investor acquiring a majority (> 50%) of the voting shares of the investee (ASC 810-10-25-1). IFRS uses a broader, more concept-based definition that could lead to more transactions being reported as business combinations. Under IFRS, an investor gains effective control of an investee when it satisfies a set of three conditions: (1) the power to direct the investee's activities, (2) exposure to returns that vary with the investee's performance and (3) the ability to shape the amount of those returns (IFRS 10 ¶¶ 6-7). The investor obtains control when it has the ability to make the critical decisions that determine the returns it receives

from the investee. The IFRS definition includes those situations where the investor can direct the activities of the investee for its own benefit, even though it does not own a majority of the investee's voting shares. IFRS 10 gives an example of achieving the power to direct an investee's activities by other means, such as by contract (¶ 11).

In Note 40 (page 208), GSK discusses the significant acquisitions it made during the last two years. In 2019, GSK acquired 68% of the equity shares of a new joint venture with Pfizer (Consumer Healthcare Joint Venture) and 100% of the equity shares of Tesaro Inc. In 2020, GSK acquired 55% of the equity shares of Pfizer Biotech Corporation Taiwan. Clearly, GSK acquired a majority of the equity shares of each of these controlled entities, so it very likely would have accounted for them as acquisitions under U.S. GAAP as well. It is possible, though, that in prior years GSK completed an acquisition under IFRS that would not have been accounted for that way under U.S. GAAP (i.e., a controlling interest at < 50%).

In another section of GSK's annual report (Group Companies), the company lists its subsidiaries and identifies the percentage of equity shares it owns in each one (pages 287-298). In a part of this list labeled "Subsidiaries where the effective interest is less than 100%," GSK identifies the subsidiaries for which it holds an equity interest of less than 100% (pages 293-297). This part of the list includes 177 subsidiaries. A review of this part of the list reveals six subsidiaries for which GSK owns less than a majority of the equity shares:

- British Pharma Group Limited (50%)
- GlaxoSmithKline Consumer Nigeria plc (46.4%)
- GSK Gebro Consumer Healthcare GmbH (40.8%)
- Pfizer Biotech Corporation (37.4%)
- Sino-American Tianjin Smith Kline & French Laboratories Ltd (37.4%)
- Winster Pharmaceuticals Limited (46.4%)

Applying U.S. GAAP, GSK would not have been able to consolidate these investees, unless the investees qualified as variable-interest entities. GSK does not address variable-interest entities as IFRS uses the same definition of control for all entities. If the six entities listed above qualified as voting-interest entities under U.S. GAAP, GSK probably would have viewed them as significant influence investments and applied the equity method to account for them. The table below shows the potential directional effects of GSK moving from the IFRS treatment for this item to the U.S. GAAP treatment:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
↓	↓	↓	?	–	–

The consolidation process adds 100% of the subsidiaries' assets and liabilities. The amount of assets added tends to be larger than the amount of liabilities added. For example, for the acquisitions GSK made in 2019 and 2020, the assets added (including goodwill) exceeded the liabilities added for all three of them. Thus, the stockholders' equity likely would appear larger under IFRS (smaller under U.S. GAAP). The direction of the effect on pre-tax income would depend upon the net amount of income, or loss, the six subsidiaries contributed in 2020, which is not reported.

2-9. Measurement of impairment for finite-life assets [measurement]

IFRS guidance indicates that, when recognizing an impairment for a finite-life asset (PP&E or intangible asset), the asset carrying amount is reduced to the estimated recoverable amount (IAS 36 ¶ 59). And the specific definition of the recoverable amount for a finite-lived asset is provided as “the higher of its fair value less costs of disposal and its value in use” (¶ 6). Under U.S. GAAP, when an impairment is recognized, the asset amount is reduced to fair value, which is often less than the recoverable amount. This is true both for PP&E assets (ASC 360-10-35-17; 35-20) and finite-lived intangible assets (ASC 350-30-35-19).

In Note 2 (page 160), GSK describes the conditions under which an impairment would be reversed for finite-lived assets, indicating that the impairment is reversed “to the extent that the revised recoverable amounts do not exceed the carrying values.” This suggests that, when recording an impairment, GSK reduces the recorded amount for the asset down to the recoverable amount, as specified by IFRS. GSK reports in Note 17 total impairment losses for PP&E in 2020 of £477 (page 179). They report an additional £3 of impairment losses related to right-of-use assets (Note 18, page 180) and £295 of impairment losses related to other intangible assets (Note 20, page 182) for 2020. While it can be presumed that these impairment losses resulted in the associated assets being written down to their respective recoverable amounts, there is no information given regarding the fair values for the associated assets. Thus, it is not possible to determine what exact effect GSK would experience if following U.S. GAAP.

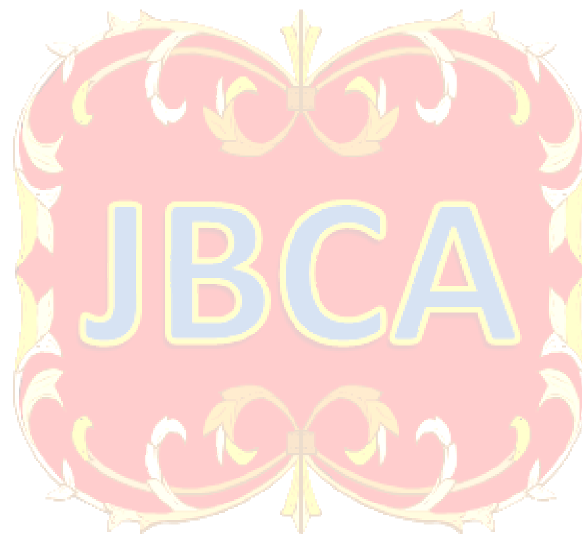
That said, if an asset subject to impairment had a current fair value that was higher than the recoverable amount (undiscounted future cash flows), then the company likely should sell the asset immediately. As such, logically, fair value related to an impaired asset will likely most always be less than the recoverable amount. As such, GSK changing to U.S. GAAP would most likely result in a reduction to the carrying amount of assets and more impairment loss being recognized. The additional loss would reduce income before taxes, as reflected in the below table:

Effect(s) of Converting to U.S. GAAP Treatment					
(A –	**L =**	**SE)**	**IBT**	**OCI**	**NOCF**
↓	–	↓	↓	–	–

Summary

The purpose of this case is to encourage students to explore in greater depth some of the current differences between accounting under IFRS and accounting under U.S. GAAP, and specifically in the context of a large, well-known company that utilizes IFRS: GlaxoSmithKline plc (GSK). Students focus their review on four important financial statement metrics: total stockholders’ equity, income before income taxes, other comprehensive income before income taxes, and net operating cash flows. Based on a review GSK’s *Annual Report 2020*, the accompanying Teaching Note identifies and describes a total of 22 differences of interest. Each such difference is classified as pertaining to recognition, measurement, or classification. For 13 of the 22 differences, the direction of the effect (of hypothetically switching from IFRS treatment to U.S. GAAP treatment) is noted and the magnitude of the effect is determinable or estimable. For the other nine differences, only the direction of the effect can be determined, but not the magnitude.

The most notable differences discussed, as they pertain to GSK, were dividends to stockholders (suggested solution 1-5; recognition difference), net unrealized gain/loss on equity investments (suggested solution 1-7; classification difference), and deferred taxes for elimination of profits on intra-entity inventory transfers (suggested solution 1-4; recognition difference). Converting to U.S. GAAP for each of those differences would be expected to have an effect of over £1 billion on one or more of the financial statement metrics. Not considering magnitude of effect, the most significant other differences discussed are likely restructuring provisions (suggested solution 2-3; recognition difference) and liability arising from uncertain tax positions (suggested solution 2-5; measurement difference).



APPENDIX

Table 1

Largest GSK Form 20-F Stockholders' Equity Adjustments (2006)		
Source of Difference	**Amount (in millions)**	**Relative to IFRS Equity Balance**
Goodwill	£17,949	186.0%
Product Rights	10,634	110.2%
Deferred Taxation	(3,262)	33.8%
Dividends	(676)	7.0%
Investments	500	5.2%
Capitalized Interest	183	1.9%

Table 2

Estimate of Accumulated Unamortized Prior Service Cost			
Year	**Past Service Cost Expensed**	**Fraction Remaining as of January 1, 2020**	**Estimate of Unamortized Prior Service Cost**
2013	(£27)	$\times {}^{2}/_{8}$	(£6.75)
2014	(3)	$\times {}^{3}/_{8}$	(1.13)
2015	17	$\times {}^{4}/_{8}$	8.50
2016	54	$\times {}^{5}/_{8}$	33.75
2017	37	$\times {}^{6}/_{8}$	27.75
2018	94	$\times {}^{7}/_{8}$	82.25
2019	31	$\times {}^{8}/_{8}$	31.00
			£175.37

Table 3

Computation of Pfizer Weighted-Average Expected Pension Return			
Pension Plan	**Pension Plan Assets January 1, 2020**	**Expected Return**	**Weighted-Average Expected Return**
U.S.	\$14,586	7.0%	7.0% × (14,586 ÷ 23,542) = 4.34%
International	8,956	3.6%	3.6% × (8,956 ÷ 23,542) = 1.37%
Total (sum)	\$23,542		5.71%

Table 4

Components of Net Remeasurement (Actuarial) Gain/Loss

Year	Actual Return [a]	Expected Return [b]	Asset Gain (Loss) [c]	Liability Gain (Loss) [d]	Total Pension Gain (Loss) [e]
2013	£1,699	£1,028	£ 671	(£ 493)	£ 178
2014	1,257	1,134	123	(1,693)	(1,570)
2015	(6)	1,155	(1,161)	725	(436)
2016	2,725	997	1,728	(2,611)	(883)
2017	1,369	1,186	183	(414)	(231)
2018	(156)	1,153	(1,309)	1,193	(116)
2019	1,488	1,054	434	(1,957)	(1,523)
Total Accumulated			**£ 669**	**(£5,250)**	**(£4,581)** [f]

[a] Actual Return is GSK's interest income netted into interest cost plus asset remeasurement gain (loss).
[b] Expected Return is based on the Pfizer's annual expected rate of return of 5.71% × GSK's pension plan assets balance on January 1 of each year.
[c] Asset Gain (Loss) is computed as Actual Return – Expected Return (i.e., the difference between the actual return and the expected return).
[d] Liability Gain (Loss) is GSK's liability remeasurement gain (loss).
[e] Total Pension Gain (Loss) is Asset Gain (Loss) + Liability Gain (Loss).
[f] Amount of £4,581 is GSK's estimated accumulated pension gain (loss) as of January 1, 2020, applying U.S. GAAP. This accumulated balance ignores years prior to 2013, and any excess accumulated balance would have needed to be amortized starting in 2014.

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