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IFRS digest : what U.S. practitioners and entities need to know now

Donna L. Street

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IFRS Digest: What U.S. Practitioners and Entities Need to Know Now

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS



IFRS Digest:

What U.S. Practitioners and Entities Need to Know Now

AICPA[®]

Editors

Donna L. Street, Ph.D.
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AICPA[®]



IFRS Digest:

What U.S. Practitioners and Entities Need to Know Now



Editors

Donna L. Street, Ph.D.
Belverd E. Needles Jr., Ph.D., CPA

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Professor Street has published several papers in journals including *Behavioral Research in Accounting*; *Accounting and Business Research*; *Accounting Horizons*; *International Journal of Accounting*; *Journal of International Financial Management and Accounting*; *Journal of International Accounting Research*; *Journal of International Accounting, Auditing, and Taxation*; *Journal of Accountancy*; *CPA Journal*, and *Accountancy International*. She is co-editor of the Institutional Perspectives section of the *Journal of International Financial Management* and serves on the editorial body of the *Journal of International Accounting Research* and the *Journal of International Accounting, Auditing, and Taxation*. Her research endeavors focus on international accounting standards and financial reporting in general.

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Active in many academic and professional organizations, he is currently Vice-President-Education-Elect of the American Accounting Association. He is the past Chair of the Board of Directors of the Illinois CPA Society and past-president of the International Association for Accounting Education and Research (IAAER). He served as the elected U.S. representative to the European Accounting Association, chair of the International Accounting Section of the American Accounting Association, director of continuing education for the American Accounting Association, and president of the Federation of Schools of Accountancy. He served as chair of the Academic and Career Development Executive Committee and on the Information Technology Executive Committee of the American Institute of CPAs. He served as the United States representative on the Education Committee of the International Federation of Accountants (IFAC) and on the Consultative Group of the International Accounting Standards Committee (IASC). He serves on the Board of Directors and Chair of the Audit Committee of Ziegler Companies, Inc., a boutique capital markets and financial services company.

He has received the Distinguished Alumni Award from Texas Tech University, the Illinois CPA Society Outstanding Educator Award and its Life-Time Achievement Award, the Joseph A. Silviso Faculty Award of Merit from the Federation of Schools of Accountancy, the Ledger & Quill Award of Merit, and the Ledger & Quill Teaching Excellence Award. He was named Educator of the Year by the American Institute of CPAs, Accountant of the Year for Education by the national honorary society Beta Alpha Psi, and Outstanding International Accounting Educator by the American Accounting Association. He has received the Excellence in Teaching Award from DePaul University.

Foreword

It is difficult to envision a more perfect storm of events converging to invite inquiry, encourage debate and necessitate change than the one that confronts US accounting and financial reporting today. Global and domestic economic factors, changes in the standards setting process at home and abroad, and a host of other forces are at play, making this an unpredictable and fascinating time to be in this profession.

CPAs have a longstanding reputation for bringing current and important issues to the attention of the business community. The challenges and change management associated with IFRS will require the CPA profession to take a leading role in deliberation, discussion and decision-making in a critical emerging area.

Some in our profession may find it hard to resist the temptation to turn our backs on the new developments in an effort to stick with the principles and rules we already know. The unavoidable truth is that major change will soon arrive on our collective doorsteps, whether we are opposed or in favor of the changes, prudent professionals will confront the changes early, engage in the process of defining them, understand them thoroughly, and then take action. As the largest membership organization for the accounting profession in the world, the AICPA has taken an active role in that process on an organizational level. We feel that now is the time to begin the process in earnest at the level of our individual member firms and organizations. In that regard, with respect to IFRS, we hope this book will be a useful and important tool.

The AICPA supports one set of high-quality global accounting standards for public companies. We believe the capital markets ultimately will insist on this, and that IFRS, which is already in broad use across the globe, will be the standard selected. The United States Securities and Exchange Commission's publication of a proposed Roadmap to IFRS adoption was a logical and inevitable step in a robust and thoughtful convergence process which has been underway for some time. AICPA supports SEC's efforts via the following initiatives:

- Ongoing collaboration among the Financial Accounting Standards Board, the International Accounting Standards Board and the International Accounting Standards Committee Foundation to bring the convergence milestones set forth in the Roadmap to fruition and achieve convergence on terms that are in the best interests of US and global accounting.
- Making certain the voice of U.S. CPAs is heard internationally.
- Preparing for the shift to IFRS-based reporting using eXtensible Business Reporting Language (XBRL).
- Ensuring accounting educators, textbook authors and educational institutions have the resources needed to prepare future professionals to use IFRS.
- Taking steps toward incorporation of questions about IFRS into the Uniform CPA Examination at the appropriate time.

A critical initial step is the development and implementation of a project plan that directs all components of the financial reporting system toward achieving the milestones laid out by the SEC. We are actively working with our various constituencies to develop and implement such a plan.

The very first step in any change process, of course, is awareness. For that reason, and with the gratefully acknowledged assistance of our outside editors, we have assembled this collection of articles and readings on the baseline issues key to a practical and applied understanding of IFRS for US practitioners and corporate entities. Because many of the largest firms and companies have already developed their own tools for understanding IFRS, our selections are geared toward the needs of practitioners and entities in the small to mid-size market segments. Many of the readings included in this volume were created and published by large accounting firms for use in their own practices. We deeply appreciate their gracious contribution of those materials for this volume.

Herein you'll find discussion of what IFRS means for the small to mid size firm or entity, as well as critical IFRS to US GAAP similarities and differences, tax implications, systems considerations, and more. Think of this as your "toe in the water" exercise for gaining practical understanding of IFRS. We hope that it serves you well as a point of entry to the topic, and leaves you better prepared when it's time to take a deep breath and jump in.

A handwritten signature in black ink, appearing to read "Barry C. Melancon". The signature is fluid and cursive, with a long horizontal stroke at the end.

Barry C. Melancon, CPA
President and CEO
The American Institute of Certified Public Accountants

Preface

In the autumn 2007, we were approached by the AICPA to assist in the project that ultimately resulted in this book. Our task was to select a group of articles we believed represented the best and most pertinent discussions of highly relevant issues for U.S. practitioners and entities to understand, at this moment in time, about International Financial Reporting Standards (IFRS). Our goal was to focus on issues a public or private, small-to-medium business entity or accounting firm would need to comprehend first and foremost in preparing for the day when the IFRS affect its practice, clients, or organization (assuming, of course, such a day has not already occurred). We did not seek to prepare a comprehensive treatise. Rather, we placed ourselves in the shoes of our proposed reader, to scan the vast and ever growing sea of articles, white papers, and briefs on the IFRS. From these, we plucked a few we thought best delivered the essential information our reader needs to know to understand the IFRS, as this body of global accounting standards affects U.S. markets now, and to prepare for where we seem to be going.

We understood from the outset that this would be no small task. However, we could not have perceived how much the landscape of this information would change through the short duration of this project or how critically important the information would be at the time the book came to press.

Increasingly, the IFRS represent the global norm. Over 15,000 non-U.S.-listed-companies use the IFRS, and another 12,000 are scheduled to adopt the IFRS by 2011. Many foreign-based subsidiaries of U.S. multinationals prepare IFRS financial statements. With most of the world using the IFRS to communicate to investors and other financial statement users, expectations have existed for some time that the United States would ultimately follow. Consider the following recent events:

November 2007. The U.S. Securities and Exchange Commission (SEC) commissioners vote unanimously to permit foreign registrants to report under the IFRS as promulgated by the International Accounting Standards Board (IASB). This decision eliminated a long-standing rule requiring foreign registrants not filing U.S. generally accepted accounting principles (GAAP) financial statements to provide a reconciliation in Form 20-F from non-U.S. to U.S. GAAP. The SEC indicated that the new rule represents an important step toward crafting a “common set” of high quality global accounting standards. More importantly, the SEC issued a 2007 concept release posing questions aimed at determining whether U.S. registrants should also be given the option to report under the IFRS, thereby creating a level playing field.

May 2008. The governing council of the AICPA votes unanimously to recognize standards issued by the IASB as “high quality standards” under Rule 203, Accounting Principles, of the Code of Professional Conduct (AICPA, Professional Standards, vol. 2, ET sec. 203 par. .01). This change makes it possible for CPAs to render an unqualified opinion on statements for U.S. companies following the IFRS.

August 27, 2008. The SEC commissioners unanimously agree to propose for comment a roadmap establishing a timetable for allowing some large U.S. registrants to begin voluntarily using the IFRS beginning with 2010 filings and eventually requiring all U.S. registrants to use the IFRS by 2016.

November 14, 2008. The SEC publishes the roadmap. The roadmap appears in the U.S. Federal Register one week later, thereby officially commencing the regulatory process of converting the SEC proposal into a federal rule. A longer than usual 90 day comment period is set, which expired February 19, 2009

* * *

Thus, in one short year, we progressed from a discussion of *whether* the United States would or should adopt the IFRS to a regulatory process designed to determine *when* this step will occur. Of course, many open questions remain to be answered in determining the exact timing of U.S. adoption of the IFRS. The roadmap is, in large part, designed to serve as a framework for moving the process forward at a measured pace while gathering information to answer open questions and reserving the option to modify course, based on the answers.

Under the roadmap, larger accelerated, smaller accelerated, and nonaccelerated filers would be scheduled to adopt the IFRS in 2014, 2015, and 2016, respectively. The roadmap indicates that in 2011 the SEC plans to consider if key milestones have been met and then determine whether to proceed with the proposed IFRS adoption schedule. The milestones include the following:

- Improvements in accounting standards
- Accountability and funding of the International Accounting Standards Committee Foundation—the parent body of the IASB
- Improvements in the ability to use interactive data (for example, eXtensible Business Reporting Language [XBRL]) for IFRS reporting
- Creation of U.S. based IFRS education and training
- Analysis of limited early use of the IFRS
- Anticipated timing of future rulemaking by the SEC
- Potential implementation of the mandatory use of the IFRS, including considerations relating to whether any mandatory use of the IFRS should be staged or sequenced among groups based on their market capitalization

Work on many, if not most, of these milestones has been underway for some time. For example, the U.S. Financial Accounting Standards Board (FASB) has been working with the IASB since the IASB's inception to achieve convergence between U.S. GAAP and the IFRS. Most notably the two boards entered a formal memorandum of understanding (MOU) in 2002 and updated the MOU in 2006. Further amendments were announced in September 2008. A joint IASB and FASB press release announcing the amendments, which is included in this book, highlights the boards' process toward convergence and presents an updated work program aimed at achieving additional convergence before 2011.

Short-term uncertainty about exactly when domestic U.S. listed companies will be required to use the IFRS does not change the long-term outlook. The IFRS—not U.S. GAAP—are the clearly established global norm and the benefits to capital markets of adopting the IFRS are paramount. The period before the IFRS becomes mandatory in the United States offers substantial opportunities for companies—and the finance professionals that serve them—to leverage the transition period to adequately prepare for a smooth conversion to the IFRS.

Conversion to the IFRS requires vigorous change management to be initiated and championed by a company's leadership. Several pieces included in this volume highlight the necessity of early action in preparing for IFRS conversion. Careful planning and early action will enable U.S. entities to control costs, understand and manage the scope of implementation, and ensure a smooth transition to the IFRS.

Conversion from U.S. GAAP to the IFRS will require numerous technical accounting changes. We selected the readings in this collection to, among other things, provide readers with a broad understanding of the major differences between the two sets of accounting standards and encourage a thoughtful consideration of how changes in accounting policies associated with the move to the IFRS will flow through general business practices into important areas for company leadership. Although the

impact of IFRS adoption will vary based on industry and other factors, the readings should facilitate an understanding of the likely impact the IFRS will have on key performance metrics and highlight the importance of preparing communication plans with boards of directors, investors, and other key stakeholders.

U.S. practitioners and entities need to understand where and how reporting changes under the IFRS are likely to occur. Companies should advise investors, analysts, and other stakeholders of these changes *well in advance* of conversion. Early communication of the impact of IFRS conversion on key performance metrics, such as earnings per share, will enable U.S. entities to appropriately frame reported IFRS results in a manner where they will not be misinterpreted. Engaging the analyst community can help ensure that companies' interests are not overlooked. For example, choices made between different options allowed under the IFRS should be meaningful and helpful to analysts. Choice of policies should enhance transparency and comparability. Companies also need to consider how the IFRS policies selected compare with their competitors.

The primary objective of this collection is to increase the prospects of experiencing a smooth, economical, and effective move to the IFRS. Some readings address the impact the IFRS will have on a company's infrastructure, including underlying processes, systems, controls, tax and human resource strategies, and customer contracts and interactions. We cannot overemphasize the importance of awareness and preparedness. Practitioners and entities that identify these key issues early will be in a better position to recommend or take appropriate action in a timely manner. Prepared companies will understand their options, determine which options are most appealing, and know the best way forward to pursue their selections.

The collection also contains a section that highlights the importance of CPAs staying informed and being actively engaged in the debate as the United States moves to the IFRS. We conclude the book with a section summarizing recent actions of the IASB, many in collaboration with FASB, to respond to the credit crisis and play a key role in restoring confidence in financial markets.

We greatly appreciate the opportunity provided to us by the AICPA to select the readings included in this collection and thereby assist CPAs in preparing for an orderly transition to the IFRS in the United States. The experience significantly enhanced our knowledge of the IFRS, especially in placing the international standards in a U.S. context. We hope you will find the collection equally informative.

Donna L. Street, Ph.D.
Belverd E. Needles, Jr., Ph.D. CPA, CMA

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What Practitioners and Entities Need to Know About International Federal Reporting Standards

EDITOR'S COMMENTARY

The articles included in this section provide basic background information for the adoption of IFRS and address implementation considerations for adoption in the areas of financial reporting, tax accounting, information systems, and corporate governance (that is, audit committees and executive compensation).

Since signing their original memorandum of understanding (MOU) in 2002, the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) have worked formally to converge and improve their two sets of accounting standards. However, major differences remain. Ernst and Young's "US GAAP vs. IFRS: The Basics" provides a top-level look at current similarities and differences between the IFRS and U.S. generally accepted accounting principles (GAAP) in a number of key areas including consolidation, impairment testing, and revenue recognition. "US GAAP vs. IFRS" also summarizes the convergence efforts of the two boards to minimize existing differences. In evaluating convergence efforts we also recommend referring to Chapter 5 of this volume, addressing IFRS in the context of the ongoing credit crisis. At the end of that chapter you will find a table charting the response of the IASB to the G20 report. This material is a useful follow-on to the US GAAP vs. IFRS article in that it covers convergence activities subsequent to those addressed in the article, specifically in the area of accounting for financial instruments.

Adoption of the IFRS in Europe and Australia, where IFRS adoption was required in 2005 for listed companies, reveals that conversion often consumes substantially more time and resources than expected. A troubling number of companies had to rush and risk mistakes or outsource more work than necessary. Companies in the United States, however, enjoy a unique position and have the luxury of time to learn from the experiences of other countries and better prepare for IFRS adoption. Planning now for the inevitable move to the IFRS will enable U.S. companies to take advantage of a one-time opportunity to comprehensively reconsider financial reporting and begin with a clean slate approach to financial policies and processes.

PricewaterhouseCoopers' "Preparing Your First IFRS Financial Statements: Adopting IFRS" is designed to help U.S. companies understand the process of selecting new IFRS accounting policies and in applying the guidance in IFRS 1, *First-time Adoption of International Financial Reporting Standards*, as they start preparing for their first IFRS financial statements. We believe readers will find the coverage of specific "key U.S. considerations" to be especially informative. We encourage readers to follow the Securities and Exchanges Commission's (SEC's) decision on IFRS adoption by U.S. companies. Although the roadmap lays out alternatives, including IFRS 1 for U.S. adoption of the IFRS, other alternatives requiring disclosure of additional comparative years of IFRS data are also under consideration.

Joan Rood and Laura Kinney's "IFRS Implications for Income Taxes" projects the possible implications of a transition to the IFRS on U.S. tax rules and regulations. Rood and Kinney stress that a U.S. transition to the IFRS will not only affect financial statements but will also have a substantial impact on tax issues given the intertwined relationship of tax rules and regulations with U.S. GAAP. Topics covered by Rood and Kinney include tax treatment of last in, first out inventories, advance payments, and research and development.

PricewaterhouseCoopers' "IFRS: The Right Move Toward Convergence: What IFRS Will Mean to US Tax Executives" stresses the importance of tax executives being part of the IFRS conversion process at a very early stage. Topics covered include how the move to the IFRS will potentially affect a company's effective tax rate and other aspects of tax accounting and reporting; and explanations of the implications the IFRS will have for U.S. taxes, international tax planning, state and local taxes, and transfer pricing determinations.

In line with several of the readings in this section, "IFRS: The Right Move Toward Convergence" highlights the systems implications of IFRS adoption. Specifically, the PricewaterhouseCoopers' report explains how processes, controls, and systems for tax reporting and compliance will need to be modified as underlying accounting systems change to the IFRS. This chain of thought is further developed in KPMG's "The Effects of IFRS on Information Systems." The KPMG article stresses that although many companies around the world have found that IFRS conversion initially appeared to be only an accounting change, it soon developed into a "multifaceted business initiative involving systems and processes, people and change management, and other business considerations." Implementation experience around the world suggests that the cost of IFRS conversion will be substantial for many U.S. companies. For example, experience from postadoption nations indicates that IT costs normally account for more than 50 percent of the cost of converting to the IFRS. "The Effects of IFRS on Information Systems" provides guidance on assessing the IFRS impact on information systems; developing a conversion work plan; and building, implementing, and rolling out the plan.

The AICPA's "IFRS Primer for Audit Committees" is included in this section to help audit committees identify issues related to the filing of IFRS financial statements, questions the committee should consider in its own deliberations, and questions the committee should review with management regarding IFRS conversion.

The section concludes with "IFRS May Prompt Revamp of Pay Plans." In this article, Deloitte and PricewaterhouseCoopers caution companies that the move to the IFRS may necessitate a reconsideration of compensation and employee benefit plans including share-based payment plans.

As you review the readings in this section, we encourage you to consider them not only in the context of implementation challenges and reporting changes, but also in terms of shareholder perception. Also consider the vital question of what needs to be communicated to investors about the IFRS conversion and when that communication should take place. In a perfect world, the move to the IFRS would not affect stock prices or shareholder value—underlying fundamentals would not change. However, conversion to the IFRS will affect key performance measures for many U.S. companies. Thus, it is important that U.S. companies understand how the IFRS will affect their financial position and results of operations in order that they inform investors, analysts, and other key stakeholders in a timely manner about the changes associated with IFRS conversion. U.S. companies should also be prepared to explain changes in IFRS driven performance metrics in the context of corresponding changes among competitors. Companies failing to communicate effectively the impact on IFRS conversion risk the possibility of having their financial performance misinterpreted and, more importantly, penalized by markets and other financial statement users.

US GAAP vs. IFRS: The Basics

By Ernst & Young LLP

January, 2009

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INTRODUCTION

It is not surprising that many people who follow the development of worldwide accounting standards today might be confused. Convergence is a high priority on the agendas of both the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB)—and “convergence” is a term that suggests an elimination or coming together of differences. Yet much is still made of the many differences that exist between US GAAP as promulgated by the FASB and International Financial Reporting Standards (IFRS) as promulgated by the IASB, suggesting that the two GAAPs continue to speak languages that are worlds apart. This apparent contradiction has prompted many to ask just how different are the two sets of standards? And where differences exist, why do they exist, and when, if ever, will they be eliminated?

In this guide, “US GAAP v. IFRS: The basics,” we take a top level look into these questions and provide an overview, by accounting area, both of where the standards are similar and also where they diverge. While the US and international standards do contain differences, the general principles, conceptual framework, and accounting results between them are often the same or similar, even though the areas of divergence seem to have disproportionately overshadowed these similarities. We believe that any discussion of this topic should not lose sight of the fact that the two sets of standards are generally more alike than different for most commonly encountered transactions, with IFRS being largely, but not entirely, grounded in the same basic principles as US GAAP.

No publication that compares two broad sets of accounting standards can include all differences that could arise in accounting for the myriad of business transactions that could possibly occur. The existence of any differences—and their materiality to an entity’s financial statements—depends on a variety of specific factors including: the nature of the entity, the detailed transactions it enters into, its interpreta-

tion of the more general IFRS principles, its industry practices, and its accounting policy elections where US GAAP and IFRS offer a choice. This guide focuses on those differences most commonly found in present practice and, where applicable, provides an overview of how and when those differences are expected to converge.

Why do differences exist?

As the international standards were developed, the IASB and its predecessor, the International Accounting Standards Committee (IASC), had the advantage of being able to draw on the latest thinking of standard setters from around the world. As a result, the international standards contain elements of accounting standards from a variety of countries. And even where an international standard looked to an existing US standard as a starting point, the IASB was able to take a fresh approach to that standard. In doing so, the IASB could avoid some of the perceived problems in the FASB standard—for example, exceptions to the standard’s underlying principles that had resulted from external pressure during the exposure process, or practice difficulties that had emerged subsequent to the standard’s issuance—and attempt to improve them. Further, as part of its annual “Improvements Project,” the IASB reviews its existing standards to enhance their clarity and consistency, again taking advantage of more current thinking and practice.

For these reasons, some of the differences between US GAAP and IFRS are embodied in the standards themselves—that is, they are intentional deviations from US requirements.

Still other differences have emerged through interpretation. As a general rule, IFRS standards are more broad than their US counterparts, with limited interpretive guidance. The IASB has generally avoided issuing interpretations of its own standards, preferring to instead leave implementation of the principles embodied in its standards to preparers and auditors, and its official interpretive body, the International

US GAAP vs. IFRS: The Basics

Financial Reporting Interpretations Committee (IFRIC). While US standards contain underlying principles as well, the strong regulatory and legal environment in the US market has resulted in a more prescriptive approach—with far more “bright lines,” comprehensive implementation guidance and industry interpretations.

Therefore, while some might read the broader IFRS standard to require an approach similar to that contained in its more detailed US counterpart, others might not. Differences also result from this divergence in interpretation.

Will the differences ever be eliminated?

Both the FASB and IASB (the Boards) publicly declared their commitment to the convergence of IFRS and US GAAP in the “Norwalk Agreement” in 2002, and since that time have made significant strides toward that goal, including formally updating their agreement in 2008. Additionally, the United States Securities and Exchange Commission (SEC) has been very active in this area. For example, within the past two years, the SEC eliminated the requirement for foreign private issuers to reconcile their IFRS results to US GAAP and proposed an updated “Roadmap” addressing the future use of IFRS in the United States. The Roadmap includes the potential for voluntary adoption of IFRS by certain large companies as early as 2009 and contemplates mandatory adoption for all companies by 2014, 2015 or 2016. The SEC has stated that continued progress towards convergence is an important milestone that it will assess when ultimately deciding on the use of IFRS in the United States.

Convergence efforts alone will not totally eliminate all differences between US GAAP and IFRS. In fact, differences continue to exist in standards for which convergence efforts already have been completed, and for which no additional convergence work is planned. And for those standards currently on the Boards’ convergence agenda, unless the words of the standards are totally conformed, interpretational differences will almost certainly continue to arise.

The success of a uniform set of global accounting standards also will depend on the willingness of

national regulators and industry groups to cooperate and to avoid issuing local interpretations of IFRS and guidance that provides exceptions to IFRS principles. Some examples of this have already begun to emerge and could threaten the achievement of international harmonization.

In planning a possible move to IFRS, it is important that US companies monitor progress on the Boards’ convergence agenda to avoid spending time now analyzing differences that most likely will be eliminated in the near future. At present, it is not possible to know the exact extent of convergence that will exist at the time US public companies may be required to adopt the international standards. However, that should not stop preparers, users and auditors from gaining a general understanding of the similarities and key differences between IFRS and US GAAP, as well as the areas presently expected to converge. We hope you find this guide a useful tool for that purpose.

{Place E-sig of Ernst & Young LLP here}

January 2009

FINANCIAL STATEMENT PRESENTATION

Similarities

There are many similarities between US GAAP and IFRS relating to financial statement presentation. For example, under both frameworks, the components of a complete set of financial statements include: balance sheet, income statement, other comprehensive income for US GAAP or statement of recognized income and expense (SORIE) for IFRS, statement of cash flows, and accompanying notes to the financial statements. Further, both frameworks require that the financial statements be prepared on the accrual basis of accounting (with the exception of the cash flows statement) except for rare circumstances. Both GAAPs have similar concepts regarding materiality and consistency that entities have to consider in preparing their financial statements. Differences between the two tend to arise in the level of specific guidance.

Significant differences

	US GAAP	IFRS
Financial periods required	Generally, comparative financial statements are presented; however, a single year may be presented in certain circumstances. Public companies must follow SEC rules, which typically require balance sheets for the two most recent years, while all other statements must cover the three-year period ended on the balance sheet date.	Comparative information must be disclosed in respect of the previous period for all amounts reported in the financial statements.
Layout of balance sheet and income statement	No general requirement within US GAAP to prepare the balance sheet and income statement in accordance with a specific layout; however, public companies must follow the detailed requirements in Regulation S-X.	IAS 1 <i>Presentation of Financial Statements</i> does not prescribe a standard layout, but includes a list of minimum items. These minimum items are less prescriptive than the requirements in Regulation S-X.
Presentation of debt as current versus non-current in the balance sheet	Debt for which there has been a covenant violation may be presented as non-current if a lender agreement to waive the right to demand repayment for more than one year exists prior to the issuance of the financial statements. Deferred taxes are presented as current or non-current based on the nature of the related asset or liability.	Debt associated with a covenant violation must be presented as current unless the lender agreement was reached prior to the balance sheet date. Deferred taxes are presented as non-current. (Note: In the joint convergence project on income taxes, IFRS is expected to converge with US GAAP.)
Income statement—classification of expenses	SEC registrants are required to present expenses based on function (for example, cost of sales, administrative).	Entities may present expenses based on either function or nature (for example, salaries, depreciation). However, if function is selected, certain disclosures about the nature of expenses must be included in the notes.
Income statement—extraordinary items	Restricted to items that are both unusual and infrequent.	Prohibited.
Income statement—discontinued operations presentation	Discontinued operations classification is for components held for sale or to be disposed of, provided that there will not be significant continuing cash flows or involvement with the disposed component.	Discontinued operations classification is for components held for sale or to be disposed of that are either a separate major line of business or geographical area or a subsidiary acquired exclusively with an intention to resale.
Changes in equity	Present all changes in each caption of stockholders' equity in either a footnote or a separate statement.	At a minimum, present components related to "recognized income and expense" as part of a separate statement (referred to as the SORIE if it contains no other components). Other changes in equity either disclosed in the notes, or presented as part of a single, combined statement of all changes in equity (in lieu of the SORIE).

(continued)

US GAAP vs. IFRS: The Basics

	US GAAP	IFRS
Disclosure of performance measures	SEC regulations define certain key measures and require the presentation of certain headings and subtotals. Additionally, public companies are prohibited from disclosing non-GAAP measures in the financial statements and accompanying notes.	Certain traditional concepts such as “operating profit” are not defined; therefore, diversity in practice exists regarding line items, headings and subtotals presented on the income statement when such presentation is relevant to an understanding of the entity’s financial performance.

Convergence

In April 2004, the FASB and the IASB (the Boards) agreed to undertake a joint project on financial statement presentation. As part of “Phase A” of the project, the IASB issued a revised IAS 1 in September 2007 (with an effective date for annual reporting periods ending after January 1, 2009) modifying the requirements of the SORIE within IAS 1 and bringing it largely in line with the FASB’s statement of other comprehensive income. As part of “Phase B,” the Boards each issued an initial discussion document in October 2008, with comments due by April 2009. This phase of the project addresses the more fundamental issues for presentation of information on the face of the financial statements, and may ultimately result in significant changes in the current presentation format of the financial statements under both GAAPs.

In September 2008, the Boards issued proposed amendments to FAS 144 and IFRS 5 to converge the definition of discontinued operations. Under the proposals, a discontinued operation would be a component of an entity that is either (1) an operating segment (as defined in FAS 131 and IFRS 8, respectively) held for sale or that has been disposed of, or (2) a business (as defined in FAS 141(R)) that meets the criteria to be classified as held for sale on acquisition.

CONSOLIDATIONS, JOINT VENTURE ACCOUNTING AND EQUITY METHOD INVESTEEES

Similarities

The principle guidance for consolidation of financial statements under US GAAP is ARB 51 Consolidated Financial Statements (as amended by FAS 160

Noncontrolling Interests in Consolidated Financial Statements) and FAS 94 Consolidation of All Majority-Owned Subsidiaries; while IAS 27 (Amended) Consolidated and Separate Financial Statements provides the guidance under IFRS. Special purpose entities are addressed in FIN 46 (Revised) Consolidation of Variable Interest Entities and SIC 12 Consolidation—Special Purpose Entities in US GAAP and IFRS respectively. Under both US GAAP and IFRS, the determination of whether or not entities are consolidated by a reporting enterprise is based on control, although differences exist in the definition of control. Generally, under both GAAPs all entities subject to the control of the reporting enterprise must be consolidated (note that there are limited exceptions in US GAAP in certain specialized industries). Further, uniform accounting policies are used for all of the entities within a consolidated group, with certain exceptions under US GAAP (for example, a subsidiary within a specialized industry may retain the specialized accounting policies in consolidation). Under both GAAPs, the consolidated financial statements of the parent and its subsidiaries may be based on different reporting dates as long as the difference is not greater than three months. However, under IFRS a subsidiary’s financial statements should be as of the same date as the financial statements of the parent’s unless it is impracticable to do so.

An equity investment that gives an investor significant influence over an investee (referred to as “an associate” in IFRS) is considered an equity-method investment under both US GAAP (APB 18 The Equity Method of Accounting for Investments in Common Stock) and IFRS (IAS 28 Investments in Associates), if the investee is not consolidated. Further, the equity method of accounting for such investments, if applicable, generally is consistent under both GAAPs.

Significant differences

	US GAAP	IFRS
Consolidation model	Focus is on controlling financial interests. All entities are first evaluated as potential variable interest entities (VIEs). If a VIE, FIN 46 (Revised) guidance is followed (below). Entities controlled by voting rights are consolidated as subsidiaries, but potential voting rights are not included in this consideration. The concept of “effective control” exists, but is rarely employed in practice.	Focus is on the concept of the power to control, with control being the parent’s ability to govern the financial and operating policies of an entity to obtain benefits. Control presumed to exist if parent owns greater than 50% of the votes, and potential voting rights must be considered. Notion of “de facto control” must also be considered.
Special purpose entities (SPE)	FIN 46 (Revised) requires the primary beneficiary (determined based on the consideration of economic risks and rewards) to consolidate the VIE.	Under SIC 12, SPEs (entities created to accomplish a narrow and well-defined objective) are consolidated when the substance of the relationship indicates that an entity controls the SPE.
Preparation of consolidated financial statements—general	Required, although certain industry-specific exceptions exist (for example, investment companies).	Generally required, but there is a limited exemption from preparing consolidated financial statements for a parent company that is itself a wholly-owned subsidiary, or is a partially-owned subsidiary if certain conditions are met.
Preparation of consolidated financial statements—different reporting dates of parent and subsidiary(ies)	The effects of significant events occurring between the reporting dates when different dates are used are disclosed in the financial statements.	The effects of significant events occurring between the reporting dates when different dates are used are adjusted for in the financial statements.
Presentation of noncontrolling or “minority” interest	Presented outside of equity on the balance sheet (prior to the adoption of FAS 160).	Presented as a separate component in equity on the balance sheet.
Equity-method investments	FAS 159 <i>The Fair Value Option for Financial Assets and Financial Liabilities</i> gives entities the option to account for their equity-method investments at fair value. For those equity-method investments for which management does not elect to use the fair value option, the equity method of accounting is required. Uniform accounting policies between investor and investee are not required.	IAS 28 requires investors (other than venture capital organizations, mutual funds, unit trusts, and similar entities) to use the equity-method of accounting for such investments in consolidated financial statements. If separate financial statements are presented (that is, those presented by a parent or investor), subsidiaries and associates can be accounted for at either cost or fair value. Uniform accounting policies between investor and investee are required.

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US GAAP vs. IFRS: The Basics

	US GAAP	IFRS
Joint ventures	Generally accounted for using the equity-method of accounting, with the limited exception of unincorporated entities operating in certain industries which may follow proportionate consolidation.	IAS 31 <i>Investments in Joint Ventures</i> permits either the proportionate consolidation method or the equity method of accounting.

Convergence

As part of their joint project on business combinations, the FASB issued FAS 160 (effective for fiscal years beginning on or after December 15, 2008) and the IASB amended IAS 27 (effective for fiscal years beginning on or after July 1, 2009, with early adoption permitted), thereby eliminating substantially all of the differences between US GAAP and IFRS pertaining to noncontrolling interests, outside of the initial accounting for the noncontrolling interest in a business combination (see the Business Combinations section). In addition, the IASB recently issued an exposure draft that proposes the elimination of proportionate consolidation for joint ventures.

At the time of this publication, the FASB is proposing amendments to FIN 46 (Revised). Additionally, the IASB is working on a consolidation project that would replace IAS 27 (amended) and SIC 12 and is expected to provide for a single consolidation model within IFRS. It is currently unclear whether these projects will result in additional convergence, and future developments should be monitored.

Significant differences

	US GAAP	IFRS
Measurement of noncontrolling interest	Noncontrolling interest is measured at fair value, which includes the noncontrolling interest's share of goodwill.	Noncontrolling interest is measured either at fair value including goodwill or its proportionate share of the fair value of the acquiree's identifiable net assets, exclusive of goodwill.
Assets and liabilities arising from contingencies	<p><i>Initial Recognition</i></p> <p>Distinguishes between contractual and noncontractual contingencies. Contractual contingencies are measured at fair value at the acquisition date, while noncontractual contingencies are recognized at fair value at the acquisition date only if it is more likely than not that the contingency meets the definition of an asset or liability.</p>	<p><i>Initial Recognition</i></p> <p>Contingent liabilities are recognized as of the acquisition date if there is a present obligation that arises from past events and its fair value can be measured reliably. Contingent assets are not recognized.</p>

BUSINESS COMBINATIONS

Similarities

The issuance of FAS 141(R) and IFRS 3(R) (both entitled Business Combinations), represent the culmination of the first major collaborative convergence project between the IASB and the FASB. Pursuant to FAS 141(R) and IFRS 3(R), all business combinations are accounted for using the acquisition method. Under the acquisition method, upon obtaining control of another entity, the underlying transaction should be measured at fair value, and this should be the basis on which the assets, liabilities and noncontrolling interests of the acquired entity are measured (as described in the table below, IFRS 3(R) provides an alternative to measuring noncontrolling interest at fair value), with limited exceptions. Even though the new standards are substantially converged, certain differences will exist once the new standards become effective. The new standards will be effective for annual periods beginning on or after December 15, 2008, and July 1, 2009, for companies following US GAAP and IFRS, respectively.

	US GAAP	IFRS
	<p><i>Subsequent Measurement</i></p> <p>Contingently liabilities are subsequently measured at the higher of its acquisition-date fair value, or the amount that would be recognized if applying FAS 5, <i>Accounting for Contingencies</i>. (See “Provisions and contingencies” for differences between FAS 5 and IAS 37.)</p>	<p><i>Subsequent Measurement</i></p> <p>Contingent liabilities are subsequently measured at the higher of its acquisition-date fair value less, if appropriate, cumulative amortization recognized in accordance with IAS 18, Revenue, or the amount that would be recognized if applying IAS 37, <i>Provisions, Contingent Liabilities and Contingent Assets</i>.</p>
Acquiree operating leases	If the terms of an acquiree operating lease are favorable or unfavorable relative to market terms, the acquirer recognizes an intangible asset or liability, respectively, regardless of whether the acquiree is the lessor or the lessee.	Separate recognition of an intangible asset or liability is required only if the acquiree is a lessee. If the acquiree is the lessor, the terms of the lease are taken into account in estimating the fair value of the asset subject to the lease—separate recognition of an intangible asset or liability is not required.
Combination of entities under common control	Accounted for in a manner similar to a pooling of interests (historical cost).	Outside the scope of IFRS 3R. In practice, either follow an approach similar to US GAAP or apply the purchase method if there is substance to the transaction.

Other differences may arise due to different accounting requirements of other existing US GAAP-IFRS literature (for example, identifying the acquirer, definition of control, definition of fair value, replacement of share-based payment awards, initial classification and subsequent measurement of contingent consideration, initial recognition and measurement of income taxes, and initial recognition and measurement of employee benefits).

Convergence

No further convergence is planned at this time. Note, however, that as of the date of this publication, the FASB has issued a proposed FSP that would change the accounting for preacquisition contingencies under FAS 141(R). The proposed FSP proposes a model that is very similar to the existing requirements of FAS 141 for purposes of initial recognition. Assets and liabilities measured at fair value would continue to be subject to subsequent measurement guidance similar to that currently described in FAS 141(R).

INVENTORY

Similarities

ARB 43 Chapter 4 Inventory Pricing and IAS 2 Inventories are both based on the principle that the primary basis of accounting for inventory is cost. Both define inventory as assets held for sale in the ordinary course of business, in the process of production for such sale, or to be consumed in the production of goods or services. The permitted techniques for cost measurement, such as standard cost method or retail method, are similar under both US GAAP and IFRS. Further, under both GAAPs the cost of inventory includes all direct expenditures to ready inventory for sale, including allocable overhead, while selling costs are excluded from the cost of inventories, as are most storage costs and general administrative costs.

US GAAP vs. IFRS: The Basics

Significant differences

	US GAAP	IFRS
Costing methods	LIFO is an acceptable method. Consistent cost formula for all inventories similar in nature is not explicitly required.	LIFO is prohibited. Same cost formula must be applied to all inventories similar in nature or use to the entity.
Measurement	Inventory is carried at the lower of cost or market. Market is defined as current replacement cost as long as market is not greater than net realizable value (estimated selling price less reasonable costs of completion and sale) and is not less than net realizable value reduced by a normal sales margin.	Inventory is carried at the lower of cost or net realizable value (best estimate of the net amounts inventories are expected to realize. This amount may or may not equal fair value).
Reversal of inventory write-downs	Any write-downs of inventory to the lower of cost or market create a new cost basis that subsequently cannot be reversed.	Previously recognized impairment losses are reversed, up to the amount of the original impairment loss when the reasons for the impairment no longer exist.
Permanent inventory markdowns under the retail inventory method (RIM)	Permanent markdowns do not affect the gross margins used in applying the RIM. Rather, such markdowns reduce the carrying cost of inventory to net realizable value, less an allowance for an approximately normal profit margin, which may be less than both original cost and net realizable value.	Permanent markdowns affect the average gross margin used in applying RIM. Reduction of the carrying cost of inventory to below the lower of cost or net realizable value is not allowed.

Convergence

In November 2004, the FASB issued FAS 151 Inventory Costs to address a narrow difference between US GAAP and IFRS related to the accounting for inventory costs, in particular, abnormal amounts of idle facility expense, freight, handling costs and spoilage. At present, there are no other ongoing convergence efforts with respect to inventory.

LONG-LIVED ASSETS

Similarities

Although US GAAP does not have a comprehensive standard that addresses long-lived assets, its definition of property, plant and equipment is similar to IAS 16 Property, Plant and Equipment, which addresses tangible assets held for use that are expect-

ed to be used for more than one reporting period. Other concepts that are similar include the following:

Cost

Both accounting models have similar recognition criteria, requiring that costs be included in the cost of the asset if future economic benefits are probable and can be reliably measured. The costs to be capitalized under both models are similar. Neither model allows the capitalization of start-up costs, general administrative and overhead costs or regular maintenance. However, both US GAAP and IFRS require that the costs of dismantling an asset and restoring its site (that is, the costs of asset retirement under FAS 143 Accounting for Asset Retirement Obligations or IAS 37 Provisions, Contingent Liabilities and Contingent Assets) be included in the cost of the asset. Both models require a provision for asset retirement costs

to be recorded when there is a legal obligation, although IFRS requires provision in other circumstances as well.

Capitalized interest

FAS 34 Capitalization of Interest and IAS 23 Borrowing Costs address the capitalization of borrowing costs (for example, interest costs) directly attributable to the acquisition, construction or production of a qualifying asset. Qualifying assets are generally defined similarly under both accounting models. However, there are significant differences between US GAAP and IFRS in the specific costs and assets that are included within these categories as well as the requirement to capitalize these costs.

Depreciation

Depreciation of long-lived assets is required on a systematic basis under both accounting models. FAS 154 Accounting Changes and Error Corrections and IAS 8 Accounting Policies, Changes in Accounting

Estimates and Error Corrections both treat changes in depreciation method, residual value and useful economic life as a change in accounting estimate requiring prospective treatment.

Assets held for sale

Assets held for sale are discussed in FAS 144 and IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations, with both standards having similar held for sale criteria. Under both standards, the asset is measured at the lower of its carrying amount or fair value less costs to sell; the assets are not depreciated and are presented separately on the face of the balance sheet. Exchanges of nonmonetary similar productive assets are also treated similarly under APB 29 Accounting for Nonmonetary Exchanges as amended by FAS 153 Accounting for Nonmonetary Transactions and IAS 16, both of which allow gain/loss recognition if the exchange has commercial substance and the fair value of the exchange can be reliably measured.

Significant differences

	US GAAP	IFRS
Revaluation of assets	Revaluation not permitted.	Revaluation is a permitted accounting policy election for an entire class of assets, requiring revaluation to fair value on a regular basis.
Depreciation of asset components	Component depreciation permitted but not common.	Component depreciation required if components of an asset have differing patterns of benefit.
Capitalization of borrowing costs	Requires interest costs to be capitalized as part of the cost of a qualifying asset. Qualifying assets include certain equity-method investments but do not include inventories that are routinely manufactured repetitively in large quantities.	Policy choice to capitalize or expense must be applied consistently to all qualifying assets. (Note: this policy choice will be eliminated in 2009 with the adoption of IAS 23 (Revised) and amounts will have to be capitalized.) Qualifying assets do not include equity-method investments but include inventories that require a substantial period of time to get ready for sale, including routinely manufactured repetitively in large quantities. (Note: with the adoption of IAS 23 (Revised) such inventories are not required to be included as qualifying assets.)

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US GAAP vs. IFRS: The Basics

	US GAAP	IFRS
Measurement of borrowing costs	<p>Eligible borrowing costs do not include exchange rate differences. Interest earned on the investment of borrowed funds generally cannot offset interest costs incurred during the period.</p> <p>For borrowings associated with a specific qualifying asset, borrowing costs equal to the weighted average accumulated expenditures times the borrowing rate are capitalized.</p>	<p>Eligible borrowing costs include exchange rate differences from foreign currency borrowings. Borrowing costs are offset by investment income earned on those borrowings.</p> <p>For borrowings associated with a specific qualifying asset, actual borrowing costs are capitalized.</p>
Costs of a major overhaul	Multiple accounting models have evolved in practice, including: expense costs as incurred, capitalize costs and amortize through the date of the next overhaul, or follow the IFRS approach.	Costs that represent a replacement of a previously identified component of an asset are capitalized if future economic benefits are probable and the costs can be reliably measured.
Investment property	Investment property is not separately defined and, therefore, is accounted for as held for use or held for sale.	Investment property is separately defined in IAS 40 as an asset held to earn rent or for capital appreciation (or both) and may include property held by lessees under a finance/operating lease. Investment property may be accounted for on a historical cost basis or on a fair value basis as an accounting policy election. Capitalized operating lease classified as investment property must be accounted for using the fair value model.

Other differences include: (i) hedging gains and losses related to the purchase of assets, (ii) constructive obligations to retire assets, (iii) the discount rate used to calculate asset retirement costs, and (iv) the accounting for changes in the residual value.

Convergence

No further convergence is planned at this time.

INTANGIBLE ASSETS

Similarities

The definition of intangible assets as non-monetary assets without physical substance is the same under both US GAAP's FAS 141(R) and FAS 142 Goodwill and Other Intangible Assets and the IASB's IFRS 3(R) and IAS 38 Intangible Assets. The recognition crite-

ria for both accounting models require that there be probable future economic benefits and costs that can be reliably measured. However, some costs are never capitalized as intangible assets under both models, such as start-up costs. Goodwill is recognized only in a business combination in accordance with FAS 141(R) and IFRS 3(R). In general, intangible assets that are acquired outside of a business combination are recognized at fair value. With the exception of development costs (addressed in the following table), internally developed intangibles are not recognized as an asset under either FAS 142 or IAS 38. Moreover, internal costs related to the research phase of research and development are expensed as incurred under both accounting models.

Amortization of intangible assets over their estimated useful lives is required under both US GAAP and IFRS, with one minor exception in FAS 86

Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed related to the amortization of computer software assets. In both, if there is no foreseeable limit to the period over which

an intangible asset is expected to generate net cash inflows to the entity, the useful life is considered to be indefinite and the asset is not amortized. Goodwill is never amortized.

Significant differences

	US GAAP	IFRS
Development costs	Development costs are expensed as incurred unless addressed by a separate standard. Development costs related to computer software developed for external use are capitalized once technological feasibility is established in accordance with specific criteria (FAS 86). In the case of software developed for internal use, only those costs incurred during the application development stage (as defined in SOP 98-1 <i>Accounting for the Costs of Computer Software Developed or Obtained for Internal Use</i>) may be capitalized.	Development costs are capitalized when technical and economic feasibility of a project can be demonstrated in accordance with specific criteria. Some of the stated criteria include: demonstrating technical feasibility, intent to complete the asset, and ability to sell the asset in the future, as well as others. Although application of these principals may be largely consistent with FAS 86 and SOP 98-1, there is no separate guidance addressing computer software development costs.
Advertising costs	Advertising and promotional costs are either expensed as incurred or expensed when the advertising takes place for the first time (policy choice). Direct response advertising may be capitalized if the specific criteria in SOP 93-07 <i>Reporting on Advertising Costs</i> are met.	Advertising and promotional costs are expensed as incurred. A prepayment may be recognized as an asset only when payment for the goods or services is made in advance of the entity's having access to the goods or receiving the services.
Revaluation	Revaluation is not permitted	Revaluation to fair value of intangible assets other than goodwill is a permitted accounting policy election for a class of intangible assets. Because revaluation requires reference to an active market for the specific type of intangible, this is relatively uncommon in practice.

Convergence

While the convergence of standards on intangible assets was part of the 2006 "Memorandum of Understanding" (MOU) between the FASB and the IASB, both boards agreed in 2007 not to add this project to their agenda. However, in the 2008 MOU, the FASB indicated that it will consider in the future whether to undertake a project to eliminate differences in the accounting for research and development costs by fully adopting IAS 38 at some point in the future.

IMPAIRMENT OF LONG-LIVED ASSETS, GOODWILL AND INTANGIBLE ASSETS

Similarities

Both US GAAP and IFRS contain similarly defined impairment indicators for assessing the impairment of long-lived assets. Both standards require goodwill and intangible assets with indefinite lives to be reviewed at least annually for impairment and more frequently if impairment indicators are present.

US GAAP vs. IFRS: The Basics

Long-lived assets are not tested annually, but rather when there are indicators of impairment. The impairment indicators in US GAAP and IFRS are similar. Additionally, both GAAPs require that an asset found to be impaired be written down and an impairment loss recognized. FAS 142, FAS 144 Accounting for the Impairment or Disposal of Long-Lived Assets, and

IAS 36 Impairment of Assets apply to most long-lived and intangible assets, although some of the scope exceptions listed in the standards differ. Despite the similarity in overall objectives, differences exist in the way in which impairment is reviewed, recognized and measured.

Significant differences

	US GAAP	IFRS
Method of determining impairment—long-lived assets	Two-step approach requires a recoverability test be performed first (carrying amount of the asset is compared to the sum of future undiscounted cash flows generated through use and eventual disposition). If it is determined that the asset is not recoverable, impairment testing must be performed.	One-step approach requires that impairment testing be performed if impairment indicators exist.
Impairment loss calculation—long-lived assets	The amount by which the carrying amount of the asset exceeds its fair value, as calculated in accordance with FAS 157.	The amount by which the carrying amount of the asset exceeds its recoverable amount; recoverable amount is the higher of: (1) fair value less costs to sell, and (2) value in use (the present value of future cash flows in use including disposal value). (Note that the definition of fair value in IFRS has certain differences from the definition in FAS 157.)
Allocation of goodwill	Goodwill is allocated to a reporting unit, which is an operating segment or one level below an operating segment (component).	Goodwill is allocated to a cash-generating unit (CGU) or group of CGUs which represents the lowest level within the entity at which the goodwill is monitored for internal management purposes and cannot be larger than an operating segment as defined in IFRS 8, <i>Operating Segments</i> .
Method of determining impairment—goodwill	Two-step approach requires a recoverability test to be performed first at the reporting unit level (carrying amount of the reporting unit is compared to the reporting unit fair value). If the carrying amount of the reporting unit exceeds its fair value, then impairment testing must be performed.	One-step approach requires that an impairment test be done at the cash generating unit (CGU) level by comparing the CGU's carrying amount, including goodwill, with its recoverable amount.

	US GAAP	IFRS
Impairment loss calculation—goodwill	The amount by which the carrying amount of goodwill exceeds the implied fair value of the goodwill within its reporting unit.	Impairment loss on the CGU (amount by which the CGU's carrying amount, including goodwill, exceeds its recoverable amount) is allocated first to reduce goodwill to zero, then, subject to certain limitations, the carrying amount of other assets in the CGU are reduced pro rata, based on the carrying amount of each asset.
Impairment loss calculation—indefinite life intangible assets	The amount by which the carrying value of the asset exceeds its fair value.	The amount by which the carrying value of the asset exceeds its recoverable amount.
Reversal of loss	Prohibited for all assets to be held and used.	Prohibited for goodwill. Other long-lived assets must be reviewed annually for reversal indicators. If appropriate, loss may be reversed up to the newly estimated recoverable amount, not to exceed the initial carrying amount adjusted for depreciation.

Convergence

Impairment is one of the short-term convergence projects agreed to by the FASB and IASB in their 2006 MOU. However, as part of their 2008 MOU, the boards agreed to defer work on completing this project until their other convergence projects are complete.

FINANCIAL INSTRUMENTS

Similarities

The US GAAP guidance for financial instruments is contained in several standards. Those standards include, among others, FAS 65 Accounting for Certain Mortgage Banking Activities, FAS 107 Disclosures about Fair Value of Financial Instruments, FAS 114 Accounting by Creditors for Impairment of a Loan, FAS 115 Accounting for Certain Investments in Debt and Equity Securities, FAS 133 Accounting for Derivative Instruments and Hedging Activities, FAS 140 Accounting for Transfers

and Servicing of Financial Assets and Extinguishments of Liabilities, FAS 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, FAS 155 Accounting for Certain Hybrid Financial Instruments, FAS 157 Fair Value Measurements, and FAS 159 The Fair Value Option for Financial Assets and Financial Liabilities. IFRS guidance for financial instruments, on the other hand, is limited to three standards (IAS 32 Financial Instruments: Presentation, IAS 39 Financial Instruments: Recognition and Measurement, and IFRS 7 Financial Instruments: Disclosures). Both GAAPs require financial instruments to be classified into specific categories to determine the measurement of those instruments, clarify when financial instruments should be recognized or derecognized in financial statements, and require the recognition of all derivatives on the balance sheet. Hedge accounting and use of a fair value option is permitted under both. Each GAAP also requires detailed disclosures in the notes to financial statements for the financial instruments reported in the balance sheet.

US GAAP vs. IFRS: The Basics

Significant differences

	US GAAP	IFRS
Fair value measurement	<p>One measurement model whenever fair value is used (with limited exceptions). Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.</p> <p>Fair value is an exit price, which may differ from the transaction (entry) price.</p>	<p>Various IFRS standards use slightly varying wording to define fair value. Generally fair value represents the amount that an asset could be exchanged for, or a liability settled between knowledgeable, willing parties in an arm's length transaction.</p> <p>At inception, transaction (entry) price generally is considered fair value.</p>
Use of fair value option	<p>Financial instruments can be measured at fair value with changes in fair value reported through net income, except for specific ineligible financial assets and liabilities.</p>	<p>Financial instruments can be measured at fair value with changes in fair value reported through net income provided that certain criteria, which are more restrictive than under US GAAP, are met.</p>
Day one gains and losses	<p>Entities are not precluded from recognizing day one gains and losses on financial instruments reported at fair value even when all inputs to the measurement model are not observable. For example, a day one gain or loss may occur when the transaction occurs in a market that differs from the reporting entity's exit market.</p>	<p>Day one gains and losses are recognized only when all inputs to the measurement model are observable.</p>
Debt vs. equity classification	<p>US GAAP specifically identifies certain instruments with characteristics of both debt and equity that must be classified as liabilities.</p> <p>Certain other contracts that are indexed to, and potentially settled in, a company's own stock may be classified as equity if they: (1) require physical settlement or net-share settlement, or (2) give the issuer a choice of net-cash settlement or settlement in its own shares.</p>	<p>Classification of certain instruments with characteristics of both debt and equity focuses on the contractual obligation to deliver cash, assets or an entity's own shares. Economic compulsion does not constitute a contractual obligation.</p> <p>Contracts that are indexed to, and potentially settled in, a company's own stock are classified as equity when settled by delivering a fixed number of shares for a fixed amount of cash.</p>
Compound (hybrid) financial instruments	<p>Compound (hybrid) financial instruments (for example, convertible bonds) are not split into debt and equity components unless certain specific conditions are met, but they may be bifurcated into debt and derivative components, with the derivative component subjected to fair value accounting.</p>	<p>Compound (hybrid) financial instruments are required to be split into a debt and equity component and, if applicable, a derivative component. The derivative component may be subjected to fair value accounting.</p>

	US GAAP	IFRS
Impairment recognition— Available for Sale (AFS) financial instruments	<p>Declines in fair value below cost may result in an impairment loss being recognized in the income statement on an AFS debt security due solely to a change in interest rates (risk-free or otherwise) if the entity does not have the positive ability and intent to hold the asset for a period of time sufficient to allow for any anticipated recovery in fair value.</p> <p>When an impairment is recognized through the income statement, a new cost basis in the investment is established. Such losses can not be reversed for any future recoveries.</p>	<p>Generally, only evidence of credit default results in an impairment being recognized in the income statement of an AFS debt instrument.</p> <p>Impairment losses recognized through the income statement for available-for-sale equity securities cannot be reversed through the income statement for future recoveries. However, impairment losses for debt instruments classified as available-for-sale may be reversed through the income statement if the fair value of the asset increases in a subsequent period and the increase can be objectively related to an event occurring after the impairment loss was recognized.</p>
Hedge effectiveness— shortcut method for interest rate swaps	Permitted.	Not permitted.
Hedging a component of a risk in a financial instrument	The risk components that may be hedged are specifically defined by the literature, with no additional flexibility.	Allows entities to hedge components (portions) of risk that give rise to changes in fair value.
Measurement—effective interest method	Requires catch-up approach, retrospective method or prospective method of calculating the interest for amortized cost-based assets, depending on the type of instrument.	Requires the original effective interest rate to be used throughout the life of the instrument for all financial assets and liabilities, except for certain reclassified financial assets, in which case the effect of increases in cash flows are recognized as prospective adjustments to the effective interest rate.
Derecognition of financial assets	<p>Derecognition of financial assets (sales treatment) occurs when effective control has been surrendered over the financial assets. Control has been surrendered only if certain specific criteria have been met, including evidence of legal isolation.</p> <p>Special rules apply for transfers involving “qualifying” special-purpose entities.</p>	<p>Derecognition is based on a mixed model that considers both transfer of risks and rewards and control. If the transferor has neither retained nor transferred substantially all of the risks and rewards, there is then an evaluation of the transfer of control. Control is considered to be surrendered if the transferee has the practical ability to unilaterally sell the transferred asset to a third party, without restrictions. There is no legal isolation test</p> <p>The concept of a qualifying special-purpose entity does not exist.</p>

(continued)

US GAAP vs. IFRS: The Basics

	US GAAP	IFRS
Measurement—loans and receivables	Unless the fair value option is elected, loans and receivables are classified as either (1) held for investment, which are measured at amortized cost, or (2) held for sale, which are measured at the lower of cost or fair value.	Loans and receivables are carried at amortized cost unless classified into the “fair value through profit or loss” category or the “available for sale” category, both of which are carried at fair value on the balance sheet.

Other differences include: (i) application of fair value measurement principles, including use of prices obtained in ‘principal’ versus ‘most advantageous’ markets, (ii) definitions of a derivative and embedded derivative, (iii) cash flow hedge—basis adjustment and effectiveness testing, (iv) normal purchase and sale exception, (v) foreign exchange gain and/or losses on AFS investments, (vi) recognition of basis adjustments when hedging future transactions, (vii) macro hedging, (viii) hedging net investments, (ix) impairment criteria for equity investments, (x) puttable minority interest and (xi) netting and offsetting arrangements.

Convergence

The IASB is currently working on a project to establish a single source of guidance for all fair value measurements required or permitted by existing IFRSs to reduce complexity and improve consistency in their application (similar to FAS 157). The IASB intends to issue an exposure draft of its fair value measurement guidance in Q2 of 2009.

In September 2008, FASB issued a proposed amendment to FAS 140. The proposed statement would remove (1) the concept of a qualifying SPE from FAS 140, and (2) the exceptions from applying FASB Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities to qualifying SPEs.

The FASB and the IASB have separate, but related, projects on reducing complexity in this area, with both Boards issuing documents in 2008. The FASB issued an exposure draft directed at simplifying hedge accounting, and the IASB issued a discussion paper on reducing complexity in reporting financial instruments. Additionally, the FASB and the IASB have a joint project to address the accounting for financial instruments with characteristics of equity, with a goal of issuing a converged standard by 2011.

The IASB has a project on its agenda to develop a new standard on derecognition that is more consistent with the IASB conceptual framework of financial reporting. Ultimately, the two Boards will seek to issue a converged derecognition standard.

FOREIGN CURRENCY MATTERS

Similarities

FAS 52 Foreign Currency Translation and IAS 21 The Effects of Changes in Foreign Exchange Rates are quite similar in their approach to foreign currency translation. While the guidance provided by each for evaluating the functional currency of an entity is different, it generally results in the same determination (that is, the currency of the entity’s primary economic environment). Both GAAPs generally consider the same economies to be hyperinflationary, although the accounting for an entity operating in such an environment can be very different.

Both GAAPs require foreign currency transactions of an entity to be remeasured into its functional currency with amounts resulting from changes in exchange rates being reported in income. Once a subsidiary’s financial statements are remeasured into its functional currency, both standards require translation into its parent’s functional currency with assets and liabilities being translated at the period-end rate, and income statement amounts generally at the average rate, with the exchange differences reported in equity. Both standards also permit the hedging of that net investment with exchange differences from the hedging instrument offsetting the translation amounts reported in equity. The cumulative translation amounts reported in equity are reflected in income when there is a sale, or complete liquidation or abandonment of the foreign operation, but there are differences between the two standards when the investment in the foreign operation is reduced through dividends or repayment of long-term advances as indicated below.

Significant differences

	US GAAP	IFRS
Translation/functional currency of foreign operations in a hyperinflationary economy	Local functional currency financial statements are remeasured as if the functional currency was the reporting currency (US dollar in the case of a US parent) with resulting exchange differences recognized in income.	Local functional currency financial statements (current and prior period) are indexed using a general price index, and then translated to the reporting currency at the current rate.
Treatment of translation difference in equity when a partial return of a foreign investment is made to the parent	Translation difference in equity is recognized in income only upon sale (full or partial), or complete liquidation or abandonment of the foreign subsidiary. No recognition is made when there is a partial return of investment to the parent.	A return of investment (for example, dividend) is treated as a partial disposal of the foreign investment and a proportionate share of the translation difference is recognized in income.
Consolidation of foreign operations	The “step-by-step” method is used whereby each entity is consolidated into its immediate parent until the ultimate parent has consolidated the financial statements of all the entities below it.	The method of consolidation is not specified and, as a result, either the “direct” or the “step-by-step” method is used. Under the “direct” method, each entity within the consolidated group is directly consolidated into the ultimate parent without regard to any intermediate parent. The choice of method could affect the cumulative translation adjustments deferred within equity at intermediate levels, and therefore the recycling of such exchange rate differences upon disposal of an intermediate foreign operation.

Convergence

No convergence activities are underway or planned for foreign currency matters.

LEASES

Similarities

The overall accounting for leases under US GAAP and IFRS (FAS 13 Accounting for Leases and IAS 17 Leases, respectively) is similar, although US GAAP has more specific application guidance than IFRS. Both focus on classifying leases as either capital (IAS 17 uses the term “finance”) or operating, and both separately discuss lessee and lessor accounting.

Lessee accounting (excluding real estate)

Both standards require the party that bears substantially all the risks and rewards of ownership of the leased property to recognize a lease asset and corresponding obligation, and specify criteria (FAS 13) or indicators (IAS 17) to make this determination (that is, whether a lease is capital or operating). The criteria or indicators of a capital lease are similar in that both standards include the transfer of ownership to the lessee at the end of the lease term and a purchase option that, at inception, is reasonably expected to be exercised. Further, FAS 13 requires capital lease treatment if the lease term is equal to or greater than 75% of the asset’s economic life, while IAS 17

US GAAP vs. IFRS: The Basics

requires such treatment when the lease term is a “major part” of the asset’s economic life. FAS 13 specifies capital lease treatment if the present value of the minimum lease payments exceeds 90% of the asset’s fair value, while IAS 17 uses the term “substantially all” of the fair value. In practice, while FAS 13 specifies bright lines in certain instances (for example, 75% of economic life), IAS 17’s general principles are interpreted similarly to the bright line tests. As a result, lease classification is often the same under FAS 13 and IAS 17.

Under both GAAPs, a lessee would record a capital (finance) lease by recognizing an asset and a liability, measured at the lower of the present value of the minimum lease payments or fair value of the asset. A lessee would record an operating lease by recognizing expense on a straight-line basis over the lease term. Any incentives under an operating lease are amortized on a straight line basis over the term of the lease.

Lessor accounting (excluding real estate)

Lessor accounting under FAS 13 and IAS 17 is similar and uses the above tests to determine whether a lease is a sales-type/direct financing lease or an operating lease. FAS 13 specifies two additional criteria (that is, collection of lease payments is reasonably expected and no important uncertainties surround the amount of unreimbursable costs to be incurred by the lessor) for a lessor to qualify for sales-type/direct financing lease accounting that IAS 17 does not have. Although not specified in IAS 17, it is reasonable to expect that if these conditions exist, the same conclusion may be reached under both standards. If a lease is a sales-type/direct financing lease, the leased asset is replaced with a lease receivable. If a lease is classified as operating, rental income is recognized on a straight-line basis over the lease term and the leased asset is depreciated by the lessor over its useful life.

Significant differences

	US GAAP	IFRS
Lease of land and building	<p>A lease for land and buildings that transfers ownership to the lessee or contains a bargain purchase option would be classified as a capital lease by the lessee, regardless of the relative value of the land.</p> <p>If the fair value of the land at inception represents 25% or more of the total fair value of the lease, the lessee must consider the land and building components separately for purposes of evaluating other lease classification criteria. (Note: Only the building is subject to the 75% and 90% tests in this case.)</p>	<p>The land and building elements of the lease are considered separately when evaluating all indicators unless the amount that would initially be recognized for the land element is immaterial, in which case they would be treated as a single unit for purposes of lease classification. There is no 25% test to determine whether to consider the land and building separately when evaluating certain indicators.</p>
Recognition of a gain or loss on a sale and leaseback when the leaseback is an operating leaseback	<p>If the seller does not relinquish more than a minor part of the right to use the asset, gain or loss is generally deferred and amortized over the lease term. If the seller relinquishes more than a minor part of the use of the asset, then part or all of a gain may be recognized depending on the amount relinquished. (Note: Does not apply if real estate is involved as the specialized rules are very restrictive with respect to the seller’s continuing involvement and they may not allow for recognition of the sale.)</p>	<p>Gain or loss is recognized immediately, subject to adjustment if the sales price differs from fair value.</p>

	US GAAP	IFRS
Recognition of gain or loss on a sale leaseback when the leaseback is a capital leaseback	Generally, same as above for operating leaseback where the seller does not relinquish more than a minor part of the right to use the asset.	Gain or loss deferred and amortized over the lease term.

Other differences include: (i) the treatment of a leveraged lease by a lessor under FAS 13 (IAS 17 does not have such classification), (ii) real estate sale-leasebacks, (iii) real estate sales-type leases, and (iv) the rate used to discount minimum lease payments to the present value for purposes of determining lease classification and subsequent recognition of a capital lease, including in the event of a renewal.

Convergence

The Boards are jointly working on a long-term convergence project on lease accounting with an overall objective of comprehensively reconsidering the existing guidance issued by both standard setters. The Boards have tentatively decided to defer the development of a new accounting model for lessors and to adopt an approach that would apply the existing capital lease model, adapted as necessary, to all leases. A joint discussion paper is planned to be issued in the first quarter of 2009, with the Boards then moving towards publication of an exposure draft.

INCOME TAXES

Similarities

FAS 109 Accounting for Income Taxes and IAS 12 Income Taxes provide the guidance for income tax accounting under US GAAP and IFRS, respectively. Both pronouncements require entities to account for

both current tax effects and expected future tax consequences of events that have been recognized (that is, deferred taxes) using an asset and liability approach. Further, deferred taxes for temporary differences arising from non-deductible goodwill are not recorded under either approach, and tax effects of items accounted for directly in equity during the current year also are allocated directly to equity. Finally, neither GAAP permits the discounting of deferred taxes.

Significant differences and convergence

The IASB is expected to publish an exposure draft to replace IAS 12 in 2009 that will eliminate certain of the differences that currently exist between US GAAP and IFRS. The table below highlights the significant differences in the current literature, as well as the expected proposed accounting under the IASB's exposure draft. While initially participating in the deliberations on this proposed standard, the FASB decided to suspend deliberations on this project until the IASB issues its exposure document on the proposed replacement to IAS 12 for public comment. The FASB is expected to solicit input from US constituents regarding the IASB's proposed replacement to IAS 12 and then determine whether to undertake a project to fully eliminate the differences in the accounting for income taxes by adopting the revised IAS 12.

US GAAP vs. IFRS: The Basics

	US GAAP	IFRS	IASB exposure draft
Tax basis	<p>Tax basis is a question of fact under the tax law.</p> <p>For most assets and liabilities there is no dispute on this amount; however, when uncertainty exists it is determined in accordance with FIN 48 <i>Accounting for Uncertainty in Income Taxes</i>.</p>	<p>Tax basis is generally the amount deductible or taxable for tax purposes. The manner in which management intends to settle or recover the carrying amount affects the determination of tax basis.</p>	<p>IFRS is expected to propose a new definition for tax basis that will eliminate consideration of management's intent in determination of the tax basis.</p>
Uncertain tax positions	<p>FIN 48 requires a two-step process, separating recognition from measurement. A benefit is recognized when it is "more likely than not" to be sustained based on the technical merits of the position. The amount of benefit to be recognized is based on the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement. Detection risk is precluded from being considered in the analysis.</p>	<p>Does not include specific guidance. IAS 12 indicates tax assets and liabilities should be measured at the amount expected to be paid. In practice, the recognition principles in IAS 37 on provisions and contingencies are frequently applied. Practice varies regarding consideration of detection risk in the analysis.</p>	<p>IFRS is expected to address uncertain tax positions; however, the approach is expected to be different from FIN 48. The IFRS exposure draft is not expected to include separate recognition criteria; instead it is expected to require, based on the technical merits of the position, measurement of the benefit to be recognized based on the probability weighted average of the possible outcomes, including consideration of detection.</p>
Initial recognition exemption	<p>Does not include an exemption like that under IFRS for non-recognition of deferred tax effects for certain assets or liabilities.</p>	<p>Deferred tax effects arising from the initial recognition of an asset or liability are not recognized when (1) the amounts did not arise from a business combination and (2) upon occurrence the transaction affects neither accounting nor taxable profit (for example, acquisition of non-deductible assets).</p>	<p>IFRS is expected to converge with US GAAP requirements by eliminating the initial recognition exemption.</p>
Recognition of deferred tax assets	<p>Recognized in full (except for certain outside basis differences), but valuation allowance reduces asset to the amount that is more likely than not to be realized.</p>	<p>Amounts are recognized only to the extent it is probable (similar to "more likely than not" under US GAAP) that they will be realized.</p>	<p>IFRS is expected to converge with US GAAP requirements.</p>

	US GAAP	IFRS	IASB exposure draft
Calculation of deferred tax asset or liability	Enacted tax rates must be used.	Enacted or “substantively enacted” tax rates as of the balance sheet date must be used.	IFRS is expected to clarify the definition of “substantively enacted” to indicate that for US jurisdictions, it equates to when tax laws are enacted.
Classification of deferred tax assets and liabilities in balance sheet	Current or non-current classification, based on the nature of the related asset or liability, is required.	All amounts classified as non-current in the balance sheet.	IFRS is expected to converge with US GAAP requirements.
Recognition of deferred tax liabilities from investments in subsidiaries or joint ventures (JVs) (often referred to as outside basis differences)	Recognition not required for investment in foreign subsidiary or corporate JV that is essentially permanent in duration, unless it becomes apparent that the difference will reverse in the foreseeable future.	Recognition required unless the reporting entity has control over the timing of the reversal of the temporary difference and it is probable (“more likely than not”) that the difference will not reverse in the foreseeable future.	IFRS is expected to converge with US GAAP requirements.
Taxes on intercompany transfers of assets that remain within a consolidated group	Requires taxes paid on intercompany profits to be deferred and prohibits the recognition of deferred taxes on differences between the tax bases of assets transferred between entities/tax jurisdictions that remain within the consolidated group.	Requires taxes paid on intercompany profits to be recognized as incurred and permits the recognition of deferred taxes on differences between the tax bases of assets transferred between entities/tax jurisdictions that remain within the consolidated group.	IFRS is not expected to change.

Other differences include: (i) the allocation of subsequent changes to deferred taxes to components of income or equity, (ii) the calculation of deferred taxes on foreign nonmonetary assets and liabilities when the local currency of an entity is different than its functional currency and (iii) the tax rate applicability to distributed or undistributed profits.

PROVISIONS AND CONTINGENCIES

Similarities

While the sources of guidance under US GAAP and IFRS differ significantly, the general recognition criteria for provisions are similar. For example, IAS 37 Provisions, Contingent Liabilities and Contingent

Assets provides the overall guidance for recognition and measurement criteria of provisions and contingencies. While there is no equivalent single standard under US GAAP, FAS 5 Accounting for Contingencies and a number of other statements deal with specific types of provisions and contingencies (for example, FAS 143 for asset retirement obligations and FAS 146 for exit and disposal activities). Further, the guidance provided in two Concept Statements in US GAAP (CON 5 Recognition and Measurement in Financial Statements of Business Enterprises and CON 6 Elements of Financial Statements) is similar to the specific recognition criteria provided in IAS 37. Both GAAPs require recognition of a loss based on the probability of occurrence, although the definition of probability is different under US GAAP (where prob-

US GAAP vs. IFRS: The Basics

able is interpreted as “likely”) and IFRS (where probable is interpreted as “more likely than not”). Both US GAAP and IFRS prohibit the recognition of provisions for costs associated with future operating activ-

ities. Further, both GAAPs require information about a contingent liability, whose occurrence is more than remote but did not meet the recognition criteria, to be disclosed in the notes to the financial statements.

Significant differences

	US GAAP	IFRS
Discounting provisions	Provisions may be discounted only when the amount of the liability and the timing of the payments are fixed or reliably determinable, or when the obligation is a fair value obligation (for example, an asset retirement obligation under FAS 143). Discount rate to be used is dependent upon the nature of the provision, and may vary from that used under IFRS. However, when a provision is measured at fair value, the time value of money and the risks specific to the liability should be considered.	Provisions should be recorded at the estimated amount to settle or transfer the obligation taking into consideration the time value of money. Discount rate to be used should be “a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.”
Measurement of provisions—range of possible outcomes	Most likely outcome within range should be accrued. When no one outcome is more likely than the others, the minimum amount in the range of outcomes should be accrued.	Best estimate of obligation should be accrued. For a large population of items being measured, such as warranty costs, best estimate is typically expected value, although mid-point in the range may also be used when any point in a continuous range is as likely as another. Best estimate for a single obligation may be the most likely outcome, although other possible outcomes should still be considered.
Restructuring costs	Under FAS 146, once management has committed to a detailed exit plan, each type of cost is examined to determine when recognized. Involuntary employee termination costs are recognized over future service period, or immediately if there is none. Other exit costs are expensed when incurred.	Once management has “demonstrably committed” (that is a legal or constructive obligation has been incurred) to a detailed exit plan, the general provisions of IAS 37 apply. Costs typically are recognized earlier than under US GAAP because IAS 37 focuses on exit plan as a whole, rather than individual cost components of the plan.
Disclosure of contingent liability	No similar provision to that allowed under IFRS for reduced disclosure requirements.	Reduced disclosure permitted if it would be severely prejudicial to an entity’s position in a dispute with other party to a contingent liability.

Convergence

Both the FASB and the IASB have current agenda items dealing with this topic. An exposure draft proposing amendments to IAS 37 was issued in 2005, with a final standard expected no earlier than 2010. The IASB has indicated its intent to converge with US GAAP in the accounting for restructuring costs as part of this project. In June 2008, the FASB issued proposed amendments to the disclosure requirements in FAS 5. Many of the proposed changes are consistent with current disclosures under IAS 37. A final standard is expected in the second quarter of 2009.

REVENUE RECOGNITION

Similarities

Revenue recognition under both US GAAP and IFRS is tied to the completion of the earnings process and the realization of assets from such completion. Under IAS 18 Revenue, revenue is defined as “the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity other than increases relating to contributions from equity participants.” Under US GAAP, revenues represent actual or expected cash inflows that have occurred or will result from the entity’s ongoing major operations. Under both GAAPs, revenue is not recognized until it is both realized (or realizable) and earned.

Ultimately, both GAAPs base revenue recognition on the transfer of risks and both attempt to determine when the earnings process is complete. Both GAAPs contain revenue recognition criteria that, while not identical, are similar. For example, under IFRS, one recognition criteria is that the amount of revenue can be measured reliably, while US GAAP requires that the consideration to be received from the buyer is fixed or determinable.

Significant differences

Despite the similarities, differences in revenue recognition may exist as a result of differing levels of specificity between the two GAAPs. There is extensive guidance under US GAAP, which can be very prescriptive and often applies only to specific industries. For example, under US GAAP there are specific rules for the recognition of software revenue and sales of real estate, while comparable guidance does not exist under IFRS. In addition, the detailed US rules often contain exceptions for particular types of transactions. Further, public companies in the US must follow additional guidance provided by the SEC staff. Conversely, a single standard (IAS 18) exists under IFRS, which contains general principles and illustrative examples of specific transactions. Exclusive of the industry-specific differences between the two GAAPs, following are the major differences in revenue recognition.

	US GAAP	IFRS
Sale of goods	Public companies must follow SAB 104 <i>Revenue Recognition</i> , which requires that delivery has occurred (the risks and rewards of ownership have been transferred), there is persuasive evidence of the sale, the fee is fixed or determinable, and collectibility is reasonably assured.	Revenue is recognized only when risks and rewards of ownership have been transferred, the buyer has control of the goods, revenues can be measured reliably, and it is probable that the economic benefits will flow to the company.

(continued)

US GAAP vs. IFRS: The Basics

	US GAAP	IFRS
Rendering of services	Certain types of service revenue, primarily relating to services sold with software, have been addressed separately in US GAAP literature. All other service revenue should follow SAB 104. Application of long-term contract accounting (SOP 81-1 <i>Accounting for Performance of Construction-Type and Certain Production-Type Contracts</i>) is not permitted for non-construction services.	Revenue may be recognized in accordance with long-term contract accounting, including considering the stage of completion, whenever revenues and costs can be measured reliably, and it is probable that economic benefits will flow to the company.
Multiple elements	Specific criteria are required in order for each element to be a separate unit of accounting, including delivered elements that must have standalone value, and undelivered elements that must have reliable and objective evidence of fair value. If those criteria are met, revenue for each element of the transaction can be recognized when the element is complete.	IAS 18 requires recognition of revenue on an element of a transaction if that element has commercial substance on its own; otherwise the separate elements must be linked and accounted for as a single transaction. IAS 18 does not provide specific criteria for making that determination.
Deferred receipt of receivables	Discounting to present value is required only in limited situations.	Considered to be a financing agreement. Value of revenue to be recognized is determined by discounting all future receipts using an imputed rate of interest.
Construction contracts	<p>Construction contracts are accounted for using the percentage-of-completion method if certain criteria are met. Otherwise completed contract method is used.</p> <p>Construction contracts may be, but are not required to be, combined or segmented if certain criteria are met.</p>	<p>Construction contracts are accounted for using the percentage-of-completion method if certain criteria are met. Otherwise, revenue recognition is limited to recoverable costs incurred. The completed contract method is not permitted.</p> <p>Construction contracts are combined or segmented if certain criteria are met. Criteria under IFRS differ from those in US GAAP.</p>

Convergence

The FASB and the IASB are currently conducting a joint project to develop concepts for revenue recognition and a standard based on those concepts. The Boards issued a discussion paper in December 2008 that describes a contract-based revenue recognition approach using the customer consideration model. This model focuses on the asset or liability that arises from an enforceable arrangement with a customer. The customer consideration model allocates the customer consideration to the contractual performance

obligations on a pro rata basis, and revenue is not recognized until a performance obligation is satisfied.

SHARE-BASED PAYMENTS

Similarities

The guidance for share-based payments, FAS 123 (Revised) and IFRS 2 (both entitled Share-Based Payment), is largely convergent. Both GAAPs require a fair value-based approach in accounting for share-based payment arrangements whereby an entity (1)

acquires goods or services in exchange for issuing share options or other equity instruments (collectively referred to as “shares” in this guide) or (2) incurs liabilities that are based, at least in part, on the price of its shares or that may require settlement in its shares. Under both GAAPs, this guidance applies to transactions with both employees and non-employees, and is applicable to all companies. Both FAS 123 (Revised) and IFRS 2 define the fair value of the transaction to be the amount at which the asset or liability could be bought or sold in a current transaction between willing parties. Further, both GAAPs

require, if applicable, the fair value of the shares to be measured based on market price (if available) or estimated using an option-pricing model. In the rare cases where fair value cannot be determined, both standards allow the use of intrinsic value. Additionally, the treatment of modifications and settlement of share-based payments is similar in many respects under both GAAPs. Finally, both GAAPs require similar disclosures in the financial statements to provide investors sufficient information to understand the types and extent to which the entity is entering into share-based payment transactions.

Significant differences

	US GAAP	IFRS
Transactions with non-employees	<p>Either the fair value of (1) the goods or services received, or (2) the equity instruments is used to value the transaction, whichever is more reliable.</p> <p>If using the fair value of the equity instruments, EITF 96-18 <i>Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services</i> requires measurement at the earlier of (1) the date at which a “commitment for performance” by the counterparty is reached, or (2) the date at which the counterparty’s performance is complete.</p>	<p>Fair value of transaction should be based on the value of the goods or services received, and only on the fair value of the equity instruments if the fair value of the goods and services cannot be reliably determined.</p> <p>Measurement date is the date the entity obtains the goods or the counterparty renders the services. No performance commitment concept.</p>
Measurement and recognition of expense—awards with graded vesting features	<p>Entities make an accounting policy election to recognize compensation cost for awards containing only service conditions either on a straight-line basis or on an accelerated basis, regardless of whether the fair value of the award is measured based on the award as a whole or for each individual tranche.</p>	<p>Must recognize compensation cost on an accelerated basis—each individual tranche must be separately measured.</p>
Equity repurchase features at employee’s election	<p>Does not require liability classification if employee bears risks and rewards of equity ownership for at least six months from date equity is issued or vests.</p>	<p>Liability classification is required (no six-month consideration exists).</p>

(continued)

US GAAP vs. IFRS: The Basics

	US GAAP	IFRS
Deferred taxes	<p>Calculated based on the cumulative GAAP expense recognized and trued up or down upon realization of the tax benefit.</p> <p>If the tax benefit exceeds the deferred tax asset, the excess (“windfall benefit”) is credited directly to shareholder equity. Shortfall of tax benefit below deferred tax asset is charged to shareholder equity to extent of prior windfall benefits, and to tax expense thereafter.</p>	<p>Calculated based on the estimated tax deduction determined at each reporting date (for example, intrinsic value).</p> <p>If the tax deduction exceeds cumulative compensation expense, deferred tax based on the excess is credited to shareholder equity. If the tax deduction is less than or equal to cumulative compensation expense, deferred taxes are recorded in income.</p>
Modification of vesting terms that are improbable of achievement	<p>If an award is modified such that the service or performance condition, which was previously improbable of achievement, is probable of achievement as a result of the modification, the compensation expense is based on the fair value of the modified award at the modification date. Grant date fair value of the original award is not recognized.</p>	<p>Probability of achieving vesting terms before and after modification is not considered. Compensation expense is the grant-date fair value of the award, together with any incremental fair value at the modification date.</p>

Convergence

No significant convergence activities are underway or planned for share-based payments.

EMPLOYEE BENEFITS OTHER THAN SHARE-BASED PAYMENTS

Similarities

Multiple standards apply under US GAAP, including FAS 87 Employers’ Accounting for Pensions, FAS 88 Employers’ Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, FAS 106 Employers’ Accounting for Postretirement Benefits Other than Pensions, FAS 112 Employers’ Accounting for Postemployment Benefits, FAS 132 (Revised)

Employers’ Disclosures about Pensions and Other Postretirement Benefits, and FAS 158 Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans. Under IFRS, IAS 19 Employee Benefits is the principal source of guidance for employee benefits other than share-based payments. Under both GAAPs, the periodic postretirement benefit cost under defined contribution plans is based on the contribution due from the employer in each period. The accounting for defined benefit plans has many similarities as well. The defined benefit obligation is the present value of benefits that have accrued to employees through services rendered to that date, based on actuarial methods of calculation. Additionally, both US GAAP and IFRS provide for certain smoothing mechanisms in calculating the period pension cost.

Significant differences

	US GAAP	IFRS
Actuarial method used for defined benefit plans	Different methods are required dependent on the characteristics of the benefit calculation of the plan.	Projected unit credit method is required in all cases.
Valuation of defined benefit plan assets	Valued at “market-related” value (which is either fair value or a calculated value that smooths the effect of short-term market fluctuations over five years) within three months of the balance sheet date. (Note: for fiscal years ending after December 15, 2008, the valuation must be done as of the balance sheet date.)	Valued at fair value as of the balance sheet date.
Treatment of actuarial gains and losses for annual pension cost	May be recognized in income statement as they occur or deferred through either a corridor approach or other rational approach applied consistently from period to period.	May be recognized in the income statement as they occur or deferred through a corridor approach. If immediately recognized, can elect to present in either the income statement or other comprehensive income.
Amortization of deferred actuarial gains and losses	Over the average remaining service period of active employees or over the remaining life expectancy of inactive employees.	Over the average remaining service period (that is, immediately for inactive employees).
Amortization of prior service costs	Over the future service lives of employees or, for inactive employees, over the remaining life expectancy of those participants.	Over the average remaining service period; immediate recognition if already vested.
Recognition of plan asset or liability in the balance sheet	<p>Must recognize in balance sheet the over/under funded status as the difference between the fair value of plan assets and the benefit obligation. Benefit obligation is the PBO for pension plans, and APBO for any other postretirement plans.</p> <p>No portion of a plan asset can be classified as current; current portion of net postretirement liability is the amount expected to be paid in the next 12 months.</p>	<p>Must recognize a liability in the balance sheet equal to the present value of the defined benefit obligation plus or minus any actuarial gains and losses not yet recognized, minus unrecognized prior service costs, minus the fair value of any plan assets. (Note: If this amount is negative, the resulting asset is subject to a “ceiling test.”)</p> <p>Balance sheet classification not addressed in IAS 19.</p>
Settlements and curtailments	Settlement gain or loss recognized when obligation is settled. Curtailment losses recognized when curtailment is probable of occurring, while curtailment gains are recognized when the curtailment occurs.	Gain or loss from settlement or curtailment recognized when it occurs.

(continued)

US GAAP vs. IFRS: The Basics

	US GAAP	IFRS
Multi-employer pension plans	Accounted for similar to a defined contribution plan.	Plan is accounted for as either a defined contribution or defined benefit plan based on the terms (contractual and constructive) of the plan. If a defined benefit plan, must account for the proportionate share of the plan similar to any other defined benefit plan unless insufficient information is available.

Convergence

The FASB and the IASB have agreed to a long-term convergence project that will comprehensively challenge the accounting for postretirement benefits. This project is expected to address many of the common concerns with the current accounting model such as the smoothing and deferral mechanisms in the current model. The IASB issued a discussion paper in March 2008, as the first step of the IASB project, addressing a limited number of topics in this area, and is expecting to issue an exposure draft in 2009.

EARNINGS PER SHARE

Similarities

Entities whose ordinary shares are publicly traded, or that are in the process of issuing such shares in the public markets, must disclose earnings per share (EPS) information pursuant to FAS 128 and IAS 33 (both entitled Earnings Per Share, which are substantially the same). Both require presentation of basic and diluted EPS on the face of the income statement, and both use the treasury stock method for determining the effects of stock options and warrants on the diluted EPS calculation. Both GAAPs use similar methods of calculating EPS, although there are a few detailed application differences.

Significant differences

	US GAAP	IFRS
Contracts that may be settled in shares or cash	Presumption that such contracts will be settled in shares unless evidence is provided to the contrary.	Such contracts are <i>always</i> assumed to be settled in shares.
Calculation of year-to-date diluted EPS for options and warrants using the treasury stock method and for contingently issuable shares	The number of incremental shares is computed using a year-to-date weighted average of the number of incremental shares included in each quarterly calculation.	The number of incremental shares is computed as if the entire year-to-date period were “the period” (that is, do not average the current period with each of the prior periods).
Treatment of contingently convertible debt	Potentially issuable shares are included in diluted EPS using the “if-converted” method if one or more contingencies relate to the entity’s share price.	Potentially issuable shares are considered “contingently issuable” and are included in diluted EPS using the if-converted method only if the contingencies are satisfied at the end of the reporting period.

Convergence

Both Boards are jointly working on a short-term convergence project to resolve the differences in the standards, with both Boards issuing exposure drafts in August 2008 and planning to issue a final standard in the second half of 2009. The Boards have tentatively decided to adopt the approaches used by IFRS to eliminate the significant differences noted above, with the exception of the treatment of contingently convertible debt. Additionally, instruments that may be settled in cash or shares are classified as an asset or liability, and are measured at fair value with changes in fair value recognized in earnings, would no longer be included in diluted EPS. Other issues to be converged include the effect of options and warrants with a nominal exercise price on basic EPS (including the two-class method), and modifications of the treasury stock method to (1) require the use of the end-of-period share price in calculating the

shares hypothetically repurchased rather than the average share price for the period and (2) for liabilities that are not remeasured at fair value, including the carrying amount of the liability within the assumed proceeds used to hypothetically repurchase shares under the treasury stock method.

SEGMENT REPORTING

Similarities

The requirements for segment reporting under FAS 131 Disclosures about Segments of an Enterprise and Related Information and IFRS 8 Operating Segments, are applicable to entities with public reporting requirements and are based on a “management approach” in identifying the reportable segments. These two standards are largely converged, and only limited differences exist between the two GAAPs.

Significant differences

	US GAAP	IFRS
Determination of segments	Entities with a “matrix” form of organization (that is, business components are managed in more than one way and the CODM reviews all of the information provided) must determine segments based on products and services.	All entities determine segments based on the management approach, regardless of form of organization.
Disclosure requirements	Entities are not required to disclose segment liabilities even if reported to the CODM.	If regularly reported to the CODM, segment liabilities are a required disclosure.

Convergence

No further convergence is planned at this time.

INTERIM FINANCIAL REPORTING

Similarities

APB 28 and IAS 34 (both entitled Interim Financial Reporting) are substantially similar with the exception of the treatment of certain costs as described below. Both require an entity to use the same

accounting policies that were in effect in the prior year, subject to adoption of new policies that are disclosed. Both standards allow for condensed interim financial statements (which are similar but not identical) and provide for comparable disclosure requirements. Neither standard mandates which entities are required to present interim financial information, that being the purview of local securities regulators. For example, US public companies must follow the SEC’s Regulation S-X for the purpose of preparing interim financial information.

US GAAP vs. IFRS: The Basics

Significant differences

	US GAAP	IFRS
Treatment of certain costs in interim periods	Each interim period is viewed as an integral part of an annual period. As a result, certain costs that benefit more than one interim period may be allocated among those periods, resulting in deferral or accrual of certain costs. For example, certain inventory cost variances may be deferred on the basis that the interim statements are an integral part of an annual period.	Each interim period is viewed as a discrete reporting period. A cost that does not meet the definition of an asset at the end of an interim period is not deferred and a liability recognized at an interim reporting date must represent an existing obligation. For example, inventory cost variances that do not meet the definition of an asset cannot be deferred. However, income taxes are accounted for based on an annual effective tax rate (similar to US GAAP).

Convergence

As part of their joint Financial Statement Presentation project, the FASB will address presentation and display of interim financial information in US GAAP, and the IASB may reconsider the requirements of IAS 34. This phase of the Financial Statement Presentation project has not commenced.

SUBSEQUENT EVENTS

Similarities

Despite differences in terminology, the accounting for subsequent events under AU Section 560

Subsequent Events of the AICPA Codification of Statements on Auditing Standards and IAS 10 Events after the Balance Sheet Date is largely similar. An event that during the subsequent events period that provides additional evidence about conditions existing at the balance sheet date usually results in an adjustment to the financial statements. If the event occurring after the balance sheet date but before the financial statements are issued relates to conditions that arose subsequent to the balance sheet date, the financial statements are not adjusted, but disclosure may be necessary in order to keep the financial statements from being misleading.

Significant differences

	US GAAP	IFRS
Date through which subsequent events must be evaluated	Subsequent events are evaluated through the date that the financial statements are issued. For public entities, this is the date that the financial statements are filed with the SEC.	Subsequent events are evaluated through the date that the financial statements are "authorized for issue." Depending on an entity's corporate governance structure and statutory requirements, authorization may come from management or a board of directors. Most US entities do not have a similar requirement.
Stock dividends declared after balance sheet date	Financial statements are adjusted for a stock dividend declared after the balance sheet date.	Financial statements are not adjusted for a stock dividend declared after the balance sheet date.

	US GAAP	IFRS
Short-term loans refinanced with long-term loans after balance sheet date	Short-term loans are classified as long-term if the entity intends to refinance the loan on a long-term basis <i>and</i> , prior to issuing the financial statements, the entity can demonstrate an ability to refinance the loan.	Short-term loans refinanced after the balance sheet date may not be reclassified to long-term liabilities.

Convergence

No convergence activities are planned at this time, although the FASB recently issued an exposure draft with the objective of incorporating into FASB literature the current guidance included in AU 560, with certain modifications.

RELATED PARTIES

Similarities

Both FAS 57 and IAS 24 (both entitled Related Party Disclosures) have a similar reporting objective: to make financial statement users aware of the effect of related party transactions on the financial statements. The related party definitions are broadly

similar, and both standards require that the nature of the relationship, a description of the transaction, and the amounts involved (including outstanding balances) be disclosed for related party transactions. Neither standard contains any measurement or recognition requirements for related party transactions. FAS 57 does not require disclosure of compensation of key management personnel as IAS 24 does, but the financial statement disclosure requirements of IAS 24 are similar to those required by the SEC outside the financial statements.

Significant Differences and Convergence

There are no significant differences between the two standards, nor are there any convergence initiatives.

APPENDIX—THE EVOLUTION OF IFRS

This appendix provides a high level overview of key milestones in the evolution of international accounting standards.

Phase I—2001 and prior

- **1973: International Accounting Standards Committee (IASC) formed.** The IASC was founded to formulate and publish International Accounting Standards (IAS) that would improve financial reporting and that could be accepted worldwide. In keeping with the original view that the IASC's function was to prohibit undesirable accounting practices, the original IAS permitted several alternative accounting treatments.
- **1994: IOSCO (International Organization of Securities Commissions) completed its review of then current IASC standards and communicated its findings to the IASC.** The review identified areas that required improvement before IOSCO could consider recommending IAS for use in cross-border listings and offerings.
- **1994: Formation of IASC Advisory Council approved to provide oversight to the IASC and manage its finances.**
- **1995: IASC developed its Core Standards Work Program.** IOSCO's Technical Committee agreed that the Work Program would result, upon successful completion, in IAS comprising a comprehensive core set of standards. The European Commission (EC) supported this agreement between IASC and IOSCO and "associated itself" with the work of the IASC towards a broader international harmonization of accounting standards.
- **1997: Standing Interpretations Committee (SIC) established to provide interpretation of IAS.**
- **1999: IASC Board approved a restructuring that resulted in the current International Accounting Standards Board (IASB).** The newly constituted IASB structure comprises: (1) the IASC Foundation, an independent organization with 22 trustees who appoint the IASB members, exercise oversight, and raise the funds needed, (2) the IASB (Board) which has 12 full-time, independent board members and two part-time board members with sole responsibility for setting accounting standards, (3) the Standards Advisory Council, and (4) the International Financial Reporting Interpretations Committee (IFRIC) (replacing the SIC) and is mandated with

interpreting existing IAS and IFRS standards, and providing timely guidance on matters not addressed by current standards.

- **2000: IOSCO recommended that multinational issuers be allowed to use IAS in cross-border offerings and listings.**
- **April 2001: IASB assumed standard-setting responsibility from the IASC.** The IASB met with representatives from eight national standard-setting bodies to begin coordinating agendas and discussing convergence, and adopted the existing IAS standards and SIC Interpretations.
- **February 2002: IFRIC assumed responsibility for interpretation of IFRS.**

Phase II—2002 to 2005

- **July 2002: EC required EU-listed companies to prepare their consolidated financial statements in accordance with IFRS as endorsed by the EC, generally from 2005 onward.** This was a critically important milestone that acted as a primary driver behind the expanded use of IFRS.
- **September 2002: Norwalk Agreement executed between the FASB and the IASB.** A "best efforts" convergence approach was documented in a Memorandum of Understanding in which the Boards agreed to use best efforts to make their existing financial reporting standards fully compatible as soon as practicable and to coordinate future work programs.
- **December 2004: EC issued its Transparency Directive.** This directive would require non-EU companies with listings on an EU exchange to use IFRS unless the Committee of European Securities Regulators (CESR) determined that the national GAAP was "equivalent" to IFRS. Although CESR advised in 2005 that US GAAP was "equivalent" subject to certain additional disclosure requirements, the final decision as to US GAAP equivalency, and what additional disclosures, if any, will be required, has not been reached.
- **April 2005: SEC published the "Roadmap."** An article published by then SEC Chief Accountant discussed the possible elimination of the US GAAP reconciliation for foreign private issuers that use IFRS. The Roadmap laid out a series of milestones, which if achieved, would result in the elimination of the US GAAP reconciliation by 2009, if not sooner.

Phase III—2006 to present

- **February 2006: FASB and IASB published a Memorandum of Understanding (MOU).** The MOU reaffirmed the Boards' shared objective to develop high quality, common accounting standards for use in the world's capital markets, and further elaborated on the Norwalk Agreement. The Boards would proceed along two tracks for convergence: (1) a series of short-term standard setting projects designed to eliminate major differences in focused areas, and (2) the development of new common standards when accounting practices under both GAAPs are regarded as candidates for improvement.
- **August 2006: CESR/SEC published a joint work plan.** The regulators agreed that issuer-specific matters could be shared between the regulators, following set protocols, and that their regular reviews of issuer filings would be used to identify IFRS and US GAAP areas that raise questions in terms of high-quality and consistent application. The plan also provides for the exchange of technological information to promote the modernization of financial reporting and disclosure. Finally, the staff of both regulators agreed to dialogue on risk management practices.
- **November 2007: the SEC eliminates the US GAAP reconciliation for foreign private issuers.** After hosting a roundtable discussion in March 2007 to discuss the effects the acceptance of IFRS would have on

investors, issuers, and capital raising in the US capital markets and issuing a summary of its observations regarding foreign private issuers that adopted IFRS for the first time in 2005, the SEC determined that the milestones on its 2005 Roadmap had been sufficiently met to eliminate the reconciliation requirement.

- **Mid-2007, continuing into 2008: SEC explores the future use of IFRS by US companies.** Also in August 2007, the SEC issued a Concept Release asking the public to comment on the possible use of IFRS by US domestic registrants. In December 2007 and August 2008, the SEC held three additional roundtables on the topic of IFRS, with the roundtables focusing on the potential use of IFRS for US issuers. Further, in August 2008 the SEC approved for public issuance an updated Roadmap which anticipates mandatory reporting under IFRS beginning in 2014, 2015 or 2016, depending on the size of the company.
- **Looking ahead: The future remains uncertain, but momentum continues to build for a single set of high quality global standards.** The possible use of IFRS by US domestic registrants is a topic that remains active on the SEC's agenda. The updated proposed Roadmap identifies certain milestones to be considered in determining whether reporting under IFRS should be mandated for US companies, and calls for future SEC action in 2011 to make that assessment.

Preparing Your First IFRS Financial Statements: Adopting IFRS

By PricewaterhouseCoopers

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IFRS—A REALITY FOR US BUSINESS

Conversion is coming

Most of the world already talks to investors and stakeholders about corporate financial performance in the language of International Financial Reporting Standards (IFRS). All signs suggest the United States (US) will soon follow.

By acting now, well in advance of IFRS conversion deadlines, US companies have a rare opportunity to make time work for them. Early action will allow companies to control costs, understand and manage the challenging scope of implementation, and ensure a smooth transition plan.

Conversion experience in Europe, Asia, and Australia shows that conversion projects often take more time and resources than anticipated. Historically, that has led some companies to rush and risk mistakes or outsource more work than necessary, driving up costs and hindering the embedding of IFRS knowledge within the company.

At the same time, conversion brings a one-time opportunity to comprehensively reassess financial reporting and take “a clean sheet of paper” approach to financial policies and processes. Such an approach recognizes that major accounting and reporting changes may have a ripple effect impacting many aspects of a company’s organization.

Adopting IFRS will likely impact key performance metrics, requiring thoughtful communications plans for the Board of Directors, shareholders and other key stakeholders. Internally, IFRS could have a broad impact on a company’s infrastructure, including underlying processes, systems, controls, and even customer contracts and interactions.

Many of these business effects will require attention; others can be addressed at the discretion of the company. In both cases, companies that identify these impacts early will be in a better position to take appropriate action. No company will want to embrace every available change in connection with

adopting IFRS, but insightful companies will want to understand their options so that they know what the possible changes are, which options are most appealing, and how best to pursue them.

The process of conversion demands robust change management, initiated and championed by a company’s leadership. PricewaterhouseCoopers (PwC), drawing on its broad experience with conversion project in dozens of countries, has a full spectrum of publications aimed at providing insight for top executives as they confront IFRS conversion. Moving forward, PwC will continue to stand at the vanguard of IFRS conversion developments, providing guidance and assistance.

As US companies convert from US generally accepted accounting principles (US GAAP) to IFRS they will need to apply IFRS 1, *First-time Adoption of International Financial Reporting Standards*. The IASB issued IFRS 1 to assist companies with the process of converting from their current GAAP to IFRS. The overriding principle of IFRS 1 is full retrospective application of all IFRS standards. The IASB recognized how challenging retrospective application may be for many companies, particularly where data and information may not be readily available. Accordingly, IFRS 1 includes several optional exemptions and mandatory exceptions to retrospective application to ease the burden of first-time adoption. Even with these accommodations, the conversion process remains complex and time-consuming and presents management with some tough decisions.

The purpose of this volume is to help US companies address some of those decisions by understanding the process of selecting their new IFRS accounting policies and applying the guidance in IFRS 1 as they begin to prepare for their first IFRS financial statements. This publication provides specific considerations for US companies and is part of the firm’s ongoing commitment to help companies navigate the switch from US GAAP to IFRS.

Preparing Your First IFRS Financial Statements: Adopting IFRS

ADOPTING IFRS

This guide explains when and how International Financial Reporting Standard (IFRS) 1, *First-Time Adoption of International Financial Reporting Standards*, is applied in preparing a company's first IFRS financial statements. This overview of the requirements of IFRS 1 explains the selection of accounting policies as well as the implications of the optional exemptions and mandatory exceptions. It also provides key considerations for US companies that are or are considering adopting IFRS, guidance on interim reports during a company's first year of IFRS, and answers to some common questions that arise when applying IFRS 1. This guide includes amendments to IFRS 1 and other authoritative pronouncements through June 30, 2008.

What is IFRS 1?

The International Accounting Standards Board (IASB) created IFRS 1 to help companies transition to using IFRS as their basis of financial reporting. The key principle of IFRS 1 is full retrospective application of all IFRS standards in effect as of the closing balance sheet date ("reporting date") to a company's first IFRS financial statements. In other words, a company's first set of IFRS financial statements should present its financial position and performance as if the company had always reported using IFRS. IFRS 1 requires companies to:

- Identify the first IFRS financial statements.
- Prepare an opening balance sheet at the date of transition to IFRS.
- Select accounting policies that comply with IFRS, and apply those policies retrospectively to all periods presented in the first IFRS financial statements.
- Consider whether to apply any of the optional exemptions from retrospective application.
- Apply the mandatory exceptions from retrospective application.
- Make extensive disclosures to explain the transition to IFRS.

The IASB recognized how challenging retrospective application may be for many companies, particularly for certain standards where data and information may not be readily available. As a result, the IASB included several optional exemptions and mandatory exceptions to the general principles of

IFRS 1 that provide practical accommodations to help make first-time adoption less onerous. Additionally, guidance is provided to illustrate the application of difficult conversion topics, such as the use of hindsight and the application of successive versions of the same standards.

Despite the relief from retrospective application of some standards, companies will still need to make significant changes to existing accounting policies to comply with IFRS. Changes may come in key areas such as revenue recognition, financial instruments and hedging, employee benefit plans, impairment testing, provisions, and stock-based compensation. No significant exemptions exist for IFRS disclosure requirements, and companies will likely need to collect new information and data for some disclosures.

When to apply IFRS 1

IFRS 1 is applied when a company prepares its first IFRS financial statements. These are the first financial statements to contain an explicit and unreserved statement of compliance with IFRS. Most companies will apply IFRS 1 when they move from their previous Generally Accepted Accounting Standards (GAAP) to IFRS. For example, IFRS 1 must be applied even if a company's financial reporting:

- Included a reconciliation of some items from a previous GAAP to IFRS.
- Complied with some, but not all, IFRSs, in addition to a previous GAAP—for example, a jurisdictional version of IFRS.
- Complied with IFRS in all respects, in addition to a previous GAAP, but did not include an explicit and unreserved statement of compliance with IFRS.
- Was prepared in accordance with IFRS, but used them only for internal purposes (i.e., the IFRS financial statements were not distributed to the company's owners or external users).
- Was prepared as a group reporting package using IFRS principles.
- Did not prepare financial statements.

When is IFRS 1 not applied?

IFRS 1 cannot be applied if a company previously issued financial statements that contained an explicit and unreserved statement of compliance with IFRS. It also cannot be applied when a company pre-

pared financial statements that included an unreserved statement of compliance with IFRS and:

- Decided to stop presenting separate financial statements in accordance with a previous GAAP;
- Decided to delete an additional reference to compliance with a previous GAAP; or
- The auditors' report on the previous IFRS financial statements was qualified.

Overriding principles

The overriding principles of IFRS 1 require a company to apply all IFRS standards to its financial statements. In its opening IFRS balance sheet, a company should:

- Include all assets and liabilities that IFRS requires.
- Exclude any assets and liabilities that IFRS does not permit.
- Classify all assets, liabilities and equity in accordance with IFRS.
- Measure all items in accordance with IFRS.

Exceptions to these general principles exist where one of the optional exemptions or mandatory exceptions does not require or permit recognition, classification, and measurement in accordance with IFRS.

Adjustments as a result of applying IFRS for the first time are recorded in retained earnings or another equity category in the opening IFRS balance sheet. For example:

- A company with defined benefit plans may elect to recognize all cumulative actuarial gains and losses in retained earnings at the transition date, even if it adopts a policy of deferring actuarial gain and loss recognition using the corridor approach prospectively.
- A company must test goodwill for impairment at the transition date in accordance with IAS 36, *Impairment of Assets*, with any resulting impairment charges recorded in opening retained earnings.
- A company that decides to use the revaluation model allowed by IAS 16, *Property, Plant and Equipment*, would recognize the difference between the original cost and the revalued amount of a building in an equity account that captures revaluation reserves.

Consolidate all controlled entities

Companies may also be required to consolidate entities that were not consolidated under their previous GAAP (or vice versa). There are no IFRS 1 exemptions from the consolidation principles of IAS 27R, *Consolidated and Separate Financial Statements*, or Standing Interpretation Committee (SIC)-12, *Consolidation-Special Purpose Entities*. Companies will be required to consolidate any entity over which they are able to exercise control (as defined by IAS 27R). Subsidiaries that were previously excluded from the group financial statements are consolidated as if they were first-time adopters on the same date as the parent. If a company presents parent company stand-alone financial statements, the difference between the cost of the parent's investment in the subsidiary and the subsidiary's net assets under IFRS is treated as goodwill.

Consolidation under IFRS focuses on the definition of control in IAS 27R—"the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities." SIC 12 provides additional guidance to determine when an entity controls a special purpose entity (SPE). Unlike FIN 46R, IAS 27R does not make a distinction between variable interest and voting interest entities. Rather, the same control-based model applies to all entities for consolidation purposes. This difference may result in certain entities being consolidated or deconsolidated in a company's first IFRS financial statements.

KEY US CONSIDERATION

Some US companies may need to consolidate Qualified Special Purpose Entities (QSPEs) established to facilitate securitization transactions. SIC-12 does not have the same scope exception for QSPEs as FAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

Common US GAAP to IFRS adjustments

The chart below summarizes some implications of the necessary adjustments to the opening balance sheet using IFRS 1, although it is not all-inclusive. For more information on IFRS versus US GAAP differences, refer to the PwC publication *IFRS and US GAAP: similarities and differences*.

Preparing Your First IFRS Financial Statements: Adopting IFRS

Accounting requirement	Implications
Recognize assets and liabilities required under IFRS	<p>Companies may recognize additional assets and liabilities, for example:</p> <ul style="list-style-type: none"> • Financial assets and liabilities in securitization structures • Assets and liabilities under finance (i.e., capital) leases • Development costs that meet the IAS 38, <i>Intangible Assets</i>, capitalization criteria • Provisions meeting the IFRS recognition threshold of probable (defined as “more likely than not”) • Provisions for executory contracts that meet the definition of an onerous contract
Derecognize assets and liabilities that IFRS does not permit	<p>Some assets and liabilities recognized under US GAAP may have to be derecognized, for example:</p> <ul style="list-style-type: none"> • Insurance reimbursement assets that do not meet the virtually certain recognition criteria of IAS 37, <i>Provisions, Contingent Liabilities and Contingent Assets</i> • Certain types of regulatory assets and liabilities recognized under FAS 71, <i>Accounting for the Effects of Certain Types of Regulation</i> • Deferred costs that do not meet the definition of an asset
Classify all assets and liabilities in accordance with IFRS	<p>Assets and liabilities that might be reclassified at the transition date include:</p> <ul style="list-style-type: none"> • Investments in accordance with IAS 39, <i>Financial Instruments: Recognition and Measurement</i> (e.g., use of the fair value option is limited under IAS 39) • Certain financial instruments previously classified in mezzanine or equity under US GAAP that meet the IAS 32, <i>Financial Instruments: Presentation</i>, definition of a financial liability • Debt issuance costs (must be netted against the related financial liability) • Bifurcated debt and equity components of compound financial instruments • Hedging relationships that do not meet the IAS 39 criteria for hedge accounting
Measure all assets and liabilities in accordance with IFRS	<p>Assets and liabilities that might be measured differently include:</p> <ul style="list-style-type: none"> • Financial instruments, including accounts receivables • Long-term employee benefit obligations and pension assets • Inventory, if currently using LIFO (LIFO prohibited under IFRS) • Provisions • Deferred tax assets relating to stock options • Uncertain tax positions • Impairments of property, plant and equipment, and intangible assets • Deferred revenue related to customer loyalty programs • Noncontrolling interests (i.e., minority interests) • Deferred taxes related to intercompany asset transfers

Sequence of adjustments

Some adjustments included in the opening IFRS balance sheet will depend on other adjustments (such as deferred taxes and any noncontrolling interests). Therefore, some balances should be calculated after other adjustments have been processed.

In general, we would expect companies to make adjustments in the following sequence.

- Recognition of assets and liabilities whose recognition is required
- Derecognition of assets and liabilities whose recognition is not permitted
- Adjustments to values of recognized assets and liabilities
- Recognition and measurement of deferred tax
- Recognition and measurement of noncontrolling interest
- Adjustment to goodwill balances

IFRS 1 requires goodwill to be tested for impairment at the transition date. That test compares the carrying amount of cash generating units (CGU) to which goodwill has been allocated to the recoverable amount of the CGU. The carrying amount will depend on all other adjustments before it can be finalized. It is therefore important that companies test goodwill balances for impairment as a last step.

Selected definitions

The opening IFRS balance sheet

The opening IFRS balance sheet is the starting point for all subsequent accounting under IFRS.

IAS 1, *Presentation of Financial Statements*, requires a company to include a balance sheet as of the beginning of the earliest comparative period presented when a policy is applied retrospectively. Accordingly, IFRS 1 requires that the opening balance sheet be prepared and presented in the first IFRS financial statements.

The preparation of the opening IFRS balance sheet may require the capture of information that was not accumulated under a company's previous GAAP.

Companies need to identify the differences between IFRS and their previous GAAP early so that all of the information required can be produced.

For example: IAS 38 requires the capitalization of internally generated intangible assets (e.g., development costs) when certain criteria are met. Such intangibles are subsequently amortized over their useful lives. Companies would need to capture the appropriate cost data from periods prior to the transition date and apply the appropriate useful lives to properly present the net unamortized intangible asset balance in the opening IFRS balance sheet.

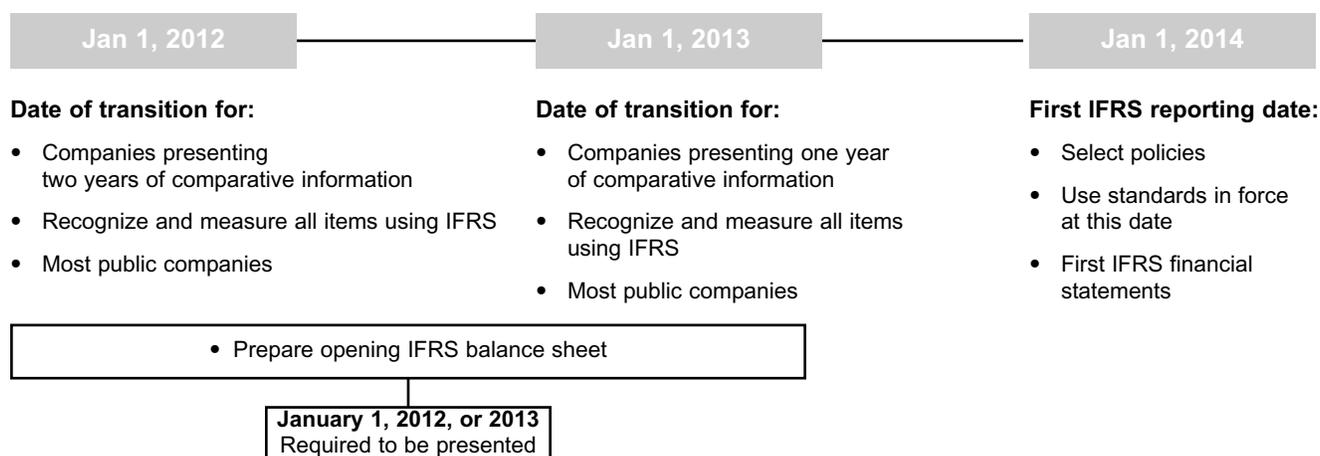
Transition date

Transition date is identified as the beginning of the earliest period for which full comparative information is presented in accordance with IFRS.

For example: If a company prepares its first IFRS financial statements for the year ending December 31, 2014, with one year of comparatives, the date of transition to IFRS will be January 1, 2013, and the opening IFRS balance sheet will be prepared at that date. A company required to present two years of comparative information will have a transition date of January 1, 2012, and should prepare an opening balance sheet at that date.

The transition date concept is illustrated in the following chart:

FIGURE 2-1



Preparing Your First IFRS Financial Statements: Adopting IFRS

KEY US CONSIDERATION

Generally, US domestic registrants with the Securities and Exchange Commission (SEC) are required to include in their Form 10-K filings audited balance sheets as of the end of each of the two most recent fiscal years and audited statements of income, cash flows and stockholders' equity for each of the three fiscal years preceding the date of the most recent audited balance sheet. The SEC may provide relief to registrants by allowing them to include only one year of comparative financial statements when filing their first set of IFRS financial statements. Companies should monitor the SEC's decisions in this area as these will impact their transition date and the timing of their conversion activities.

Date of adoption

Date of adoption, although not defined in IFRS 1, is commonly understood as the beginning of the fiscal year for which IFRS financial statements are first prepared. The term should not be confused with a company's transition date. A company that prepares its first IFRS financial statements for the year ended December 31, 2014, therefore has an adoption date of January 1, 2014.

Reporting date

Reporting date is defined as the closing balance sheet date for the first IFRS financial statements. For example, a company that files its first IFRS financial statements for the year ended December 31, 2014, has a reporting date of December 31, 2014.

A company may apply a standard that has been issued at the reporting date, even if that standard is not mandatory, as long as the standard permits early adoption. With limited exception, the same IFRS standards must be used for all financial statement periods presented.

For example: If a company with a reporting date of December 31, 2014, elects to apply an issued standard whose mandatory application date is June 30, 2015 but which permits early adoption, it must apply that standard to all financial years presented, even if one of the periods precedes the issue date of the standard.

The transition guidance in individual standards, and the guidance in IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, for changes in accounting policies apply only to existing

IFRS users and are not used by first-time adopters unless the respective standard or IFRS 1 requires otherwise. The IASB has stated that it will provide specific guidance for first-time adopters in all new standards.

Selecting IFRS accounting policies

A number of IFRS standards allow companies to choose between alternative policies—for example, the fair value model or the cost model for measurement of investment property under IAS 40, *Investment Property*. In certain areas, IFRS also has less prescriptive guidance than US GAAP. First-time adoption of IFRS represents a one-time opportunity for US companies to comprehensively reassess and change their accounting policies. Companies should carefully select their accounting policies, with a full understanding of the implications on both the opening IFRS balance sheet and future financial statements.

KEY US CONSIDERATION

Changes to accounting policies subsequent to first-time adoption need to comply with the criteria in IAS 8 and, for SEC registrants, would typically require receipt of a preferability letter from the SEC. In their first-time adoptions of IFRS, many foreign private issuers intentionally established their IFRS policies to be as close as possible to US GAAP to minimize the reconciling items reported in their Annual Form 20-F filings. Now that the US GAAP reconciliation has been eliminated for FPIs applying IFRS, some of those companies are considering whether they should use different IFRS policies, but may find it challenging to justify and report an accounting policy change.

Companies need to be thoughtful and strategic in selecting the accounting policies to be applied to the opening IFRS balance sheet. Though many companies may be tempted to take the path of least resistance—to choose accounting policies most similar to their US GAAP policies—that path may prove less expedient than it appears. Starting with a “clean sheet of paper” that considers all the possibilities may be a better approach. The goal should be the selection of policies that result in information that is reliable and relevant to the economic decision-making needs of users.

The role of professional judgment

While many accounting policies will be derived directly from IFRS standards and interpretations, in some instances knowing how to apply those standards or interpretations may not be obvious. Because IFRS is less prescriptive than US GAAP, there may be a wider range of acceptability under IFRS in certain areas. For these reasons, the use of sound and well-documented professional judgment becomes even more important in an IFRS reporting environment. Management will need to exercise judgment to develop and apply accounting policies that faithfully present the economics of transactions and are decision-useful to readers of the financial statements.

Can US GAAP be used?

IAS 8 states that where there are no specific standards or interpretations applicable to a transaction, management should refer to the following sources and consider their applicability in this order:

- IFRS standards and interpretations that deal with similar and related issues
- Definitions, recognition criteria, and measurement concepts for assets, liabilities, income and expenses in the ISAB's Framework

In considering the above, the standard allows companies to take into consideration the most recent pronouncements of other standard-setting bodies that use a similar conceptual accounting framework, other accounting literature and accepted industry practices to the extent they do not conflict with IFRS standards, interpretations and Framework.

This question is frequently asked by US companies when they find that IFRS does not contain the same level of detailed application guidance and interpretations found in US GAAP. Companies mistakenly infer that IFRS guidance is insufficient or missing. IAS 8 incorporates a hierarchy for developing and applying an accounting policy when no IFRS standard specifically applies to a transaction, event or condition.

Although IAS 8 allows companies to look to other standard-setters and industry practices, including US GAAP, for accounting guidance, US companies will need to resist the natural tendency to automatically default to US GAAP. Relying on the guidance of another standard-setter or on industry practice should be the last resort.

KEY US CONSIDERATION

US companies are more likely than non-US companies to conclude IFRS guidance is insufficient because of a difference in perception. Because US GAAP has more bright lines, industry-specific guidance, and detailed rules and exceptions, companies are likely to look for that level of detail in IFRS principles. They generally will not find it. However, US companies should not simply default to US GAAP. Instead, they will need to apply the hierarchy outlined at right. In the majority of cases they will find an IFRS principle that is relevant to their circumstances, and they will need to exercise judgment to develop an appropriate policy. Only after thorough exploration of IFRS standards, interpretations and framework should US companies look to US GAAP for guidance.

OPTIONAL EXEMPTIONS AND MANDATORY EXCEPTIONS FROM RETROSPECTIVE APPLICATION

Optional exemptions

First-time adopters can elect to apply all, some, or none of the optional exemptions. The exemptions are designed to provide companies some relief from full retrospective application. This will simplify the task of preparing the first IFRS financial statements for many companies. However, the application of the exemptions is not necessarily straightforward. Some exemptions allow for alternative methods of applying relief, while others have conditions attached.

The following chart outlines the optional exemptions available as of the publication of this guide:

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FIGURE 2-2

Optional exemptions		
Business combinations	Apply standards in force at reporting date	Share-based payment transactions
Fair value as deemed cost		Insurance contracts
Employee benefits		Decommissioning
Cumulative translation differences		Leases
Compound financial instruments		Fair value measurement of financial assets and financial liabilities at initial recognition
Assets and liabilities of subsidiaries, associates, and joint ventures		Service concession arrangements
Designation of previously recognized financial instruments		Borrowing costs
		Investments in subsidiaries, jointly controlled entities, and associates

Business combinations

A company choosing to apply this exemption is not required to restate business combinations to comply with IFRS 3R, *Business Combinations*, where control was obtained before the transition date. The exemption gives relief to companies by not requiring them to recreate information that may not have been collected at the date of the business combination. The exemption is available to all transactions that meet the definition of a business combination under IFRS 3R. The classification under previous GAAP is not relevant for determining whether the exemption can be applied. The exemption also applies to acquisitions of investments in associates and joint ventures. This means that entities taking advantage of the exemption will not have to revisit past acquisitions of associates and joint ventures and establish fair values and amounts of goodwill under IFRS. However, application of the exemption is complex, and certain adjustments to transactions under previous GAAP may still be required.

When the exemption is applied:

- Classification of the combination as an acquisition or a pooling of interests does not change.

- Assets and liabilities acquired or assumed in the business combination are recognized in the acquirer's opening IFRS balance sheet, unless IFRS does not permit recognition.
- Deemed cost of assets and liabilities acquired or assumed is equal to the carrying value under previous GAAP immediately after the business combination.
- Assets and liabilities that are measured at fair value are restated to fair value in the opening IFRS balance sheet, with the offset being recorded in equity (for example, available-for-sale financial assets).

Assets and liabilities that were not recognized under a company's previous GAAP immediately after the business combination are recognized on the opening IFRS balance sheet only if they would be recognized in the acquired entity's separate IFRS balance sheet.

For example: Company C prepares its first IFRS financial statements for the year ending December 31, 2010. The date of transition to IFRS is January 1, 2009, and the opening IFRS balance sheet is prepared as of that date. Company C will apply the business combinations exemption.

Company C acquired Company D in 2008. Company D had in process research and development (IPR&D) that met the conditions in IFRS for capitalization at the time of the acquisition. The IPR&D was measured and recorded at fair value by Company C in its original accounting for the business combination, but was then immediately written off as required by US GAAP.

Company C should recognize an intangible asset in its opening IFRS balance sheet at an amount equal to the fair value of the IPR&D at the date of acquisition, less accumulated amortization to the date of transition. This will require judgment in determining an appropriate useful life to assign to the intangible asset. As goodwill was already adjusted for this item at the time of the business combination under US GAAP (because the intangible was initially recognized by Company C before being written off), the corresponding adjustment should be made against retained earnings.

Under IFRS 1, when recognizing an asset or liability associated with a business combination prior to the transition date, the recording of the offsetting debit or credit depends on the nature of the entry.

Most assets or liabilities will be adjusted through retained earnings. Two adjustments, however, are recorded against goodwill arising from prior business combinations:

- Goodwill is increased for an intangible asset recognized under previous GAAP that does not qualify for recognition as an asset under IAS 38, or goodwill is decreased for an intangible asset that was subsumed in goodwill under previous GAAP and qualifies for recognition as a separate intangible asset under IAS 38 (both instances should be rare when US GAAP is the previous GAAP).
- Goodwill is impaired at the transition date after applying IAS 36.

KEY US CONSIDERATION

The issuance of IFRS 3R and FAS 141R, *Business Combinations*, substantially converged the accounting for business combinations under IFRS and US GAAP, respectively. However, differences remain in the recognition and measurement of noncontrolling interests (NCI) and contingencies. Under IFRS, an acquirer can elect a policy to measure NCIs either at fair value or their proportionate share of the acquiree's identifiable net assets. Under US GAAP, NCIs are always measured at fair value.

Under IFRS, contingent assets of an acquiree are not recognized; however, all contingent liabilities are recognized if they can be *reliably measured*. Under US GAAP, a contingent asset may be recognized as a result of business combination, and all contractual contingent assets and liabilities are recognized while a non-contractual contingent asset or liability is recognized only if it is *more likely than not* that it will give rise to an asset or liability.

US companies need to be aware of these remaining differences as business combinations are completed in the coming years and adjust for these differences, if applicable, in the IFRS opening balance at the transition date. Consider, for example, a noncontractual contingent liability that may not have been recognized under FAS 141R because it did not meet the *more-likely-than-not* threshold should be recognized in the IFRS opening balance sheet if it can be *reliably measured*.

Goodwill impairment testing at transition date

Goodwill must be tested for impairment at the date of transition to IFRS, using the impairment testing method required by IAS 36.

KEY US CONSIDERATION

IAS 36 uses the term cash-generating unit (CGU), which is defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Similar to US GAAP, IAS 36 requires goodwill acquired in a business combination to be allocated to the operations that will benefit from the synergies of the combination. However, IAS 36 states that goodwill must be allocated to the CGU, or groups of CGUs, that represent the lowest level within the company at which goodwill is monitored for internal management purposes, and specifies that the group of CGUs shall not be larger than an operating segment (as defined in IFRS 8, *Operating Segments*). US GAAP (FAS 142, *Goodwill and Other Intangible Assets*), uses the term "reporting unit" for purposes of allocating and testing goodwill for impairment, which may be different from a CGU under IFRS. A reporting unit is an operating segment or a component (one level below an operating segment). FAS 142 also provides specific guidance on what constitutes a component, when components may be aggregated, and when an operating segment can be considered a reporting unit.

The impairment measurement model is also different between IAS 36 and FAS 142. IAS 36 uses a one-step goodwill impairment test based on the discounted cash flows of the CGU or groups of CGUs to which the goodwill is allocated. FAS 142 uses a two-step impairment test for goodwill, first comparing the fair value of the reporting unit to its carrying amount and then measuring goodwill impairment using the implied fair value of goodwill.

The differences in both the impairment measurement models and the definition of the levels at which goodwill is assigned and tested may result in impairment testing differences at the date of transition.

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If a company chooses to forgo the exemption and restate a business combination that occurred prior to the transition date in accordance with IFRS 3R, then all business combinations that took place after that restated business combination must also be restated in accordance with IFRS 3R. In addition, from the date that a company applies IFRS 3R to its business combinations, it must also comply with IAS 27R and IAS 36.

Example: A company plans to file its first IFRS financial statements for the year ended December 31, 2014, with two years of comparative financial statements. The company's transition date is January 1, 2012. The company chooses to restate an acquisition that occurred in October 2008 in accordance with IFRS 3R. All acquisitions that occurred after October 2008 must also be restated in accordance with IFRS 3R, even if they occurred before the transition date. In addition, the company must also comply with IAS 27R and IAS 36 beginning at October 2008.

Fair value as deemed cost

Companies can elect to remeasure property, plant and equipment at fair value at the transition date and use that fair value as their deemed cost. The “fair value as deemed cost” exemption may be applied on an asset-by-asset basis. This exemption may also be applied to investment property if an entity elects to use the cost model in IAS 40, *Investment Property*, or to intangible assets that meet both the recognition and revaluation criteria in IAS 38, *Intangible Assets* (including reliable measurement of original cost and the existence of an active market). A company may not use these elections for other assets or for liabilities.

This exemption was created so that companies would not have to recreate depreciated cost records for fixed assets, a significant simplification for many companies around the world. A company that applies the fair value as deemed cost exemption at the IFRS transition date is not required to revalue these assets in subsequent periods. When the exemption is applied, deemed cost is the basis for subsequent depreciation and impairment tests. Though it is unlikely that many US companies will need this exemption, some may want to consider taking advantage of it for strategic reasons.

A previous revaluation may be used as deemed cost only if it resulted in a carrying amount that was broadly comparable to fair value or was based on a

price index that was applied to cost. The exemption may be applied to any individual item of property, plant and equipment.

Employee benefits

Under IAS 19, a company may recognize actuarial gains and losses from defined benefit and similar plans either by applying the “corridor approach” (the method commonly used under US GAAP) or any other systematic method that results in accelerated recognition. Retrospective application of the corridor approach would require companies to obtain actuarial valuations from a plan's inception date to compute the proper cumulative unrecognized actuarial gains and losses as of the transition date in accordance with IAS 19. IFRS 1 provides an exemption from IAS

19 by allowing companies to recognize in opening retained earnings all previously unrecognized actuarial gains and losses from inception of the plans. Such actuarial gains and losses are not subsequently recycled through profit and loss. Companies that elect this exemption are still allowed to apply the corridor approach prospectively from the IFRS transition date.

Cumulative translation differences

Retrospective application of IAS 21, *The Effects of Changes in Foreign Exchange Rates*, would require a company to determine the foreign currency translation differences in accordance with IFRS from the date on which a foreign operation was formed or acquired. The exemption allows a company to apply IAS 21 prospectively. All cumulative translation gains and losses as of the transition date are reset to zero through an adjustment to opening retained earnings. Such an adjustment to retained earnings is permanent, and gains or losses on subsequent disposals of foreign operations will exclude translation differences that arose before the transition date. Translation differences arising after the transition date are recorded in other comprehensive income. In our experience, we would expect many US companies to elect this exemption.

Compound financial instruments

IAS 32 requires a company to split a compound financial instrument at inception into separate liability and equity components. The IFRS 1 exemption

provides that if the liability component is no longer outstanding at the transition date, a first-time adopter does not have to separate it from the equity component. Any US company that has issued compound financial instruments in the past and where the liability component is not outstanding at the transition date will likely elect this exemption. If the liability component is outstanding at the transition date, companies will need to bifurcate and measure the components in accordance with IAS 32.

KEY US CONSIDERATION

Companies that have issued compound financial instruments (many of which are classified as debt under US GAAP) must bifurcate these instruments into their debt and equity components from inception and remeasure the debt component using the effective interest method at the transition date. This change in classification and measurement will generally result in increased interest expense in the company's income statement and may impact debt-to-equity and interest coverage ratios, which are common debt covenant requirements.

Assets and liabilities of subsidiaries, associates, and joint ventures

A parent and its subsidiaries might adopt IFRS at different dates for strategic or regulatory reasons. For example, a US parent company might prepare its first IFRS financial statements at December 31, 2014, while its nonpublic subsidiary in France might not be allowed to adopt IFRS for statutory reporting purposes until some later date. This exemption allows a subsidiary to measure its assets and liabilities either at the carrying amounts included in its parent's consolidated IFRS financial statements or on the basis of IFRS 1 as applied to its statutory financial statements at its own date of transition. When a subsidiary elects to use the carrying amounts in its parent's consolidated financial statements, those carrying amounts are adjusted, where relevant, to exclude consolidation and acquisition adjustments.

For many US parent companies, it will be common that the parent adopts IFRS for consolidated group reporting later than some of its foreign subsidiaries. When a parent adopts IFRS after a subsidiary, the parent must measure the subsidiary's assets and

liabilities in the consolidated financial statements using the subsidiary's existing IFRS carrying values. Most of the IFRS 1 voluntary exemptions cannot be used on an existing IFRS-reporting subsidiary. The subsidiary's carrying values are adjusted, where relevant, to include consolidation and acquisition adjustments, but companies may not "double dip" in the pool of exemptions (i.e., a reporting entity gets only one chance to use the IFRS 1 exemptions; a subsidiary cannot use the exemptions again when its parent adopts IFRS for consolidated reporting). Parent companies may elect different IFRS accounting policies than their subsidiaries, but they would need to conform those policies when preparing consolidated IFRS financial statements.

This scenario poses strategic considerations that companies should consider as early as possible. US parent companies whose subsidiaries have already adopted, or are in the process of adopting IFRS will want to be closely involved with their subsidiaries' IFRS policy and IFRS 1 exemption decisions. Since IFRS 1 does not allow exemptions to be applied twice, in most instances, companies with subsidiaries that have adopted IFRS will need to live with the exemption decisions made at the subsidiary level.

Example 1: Company A, a US company, has a subsidiary in Barbados that has already adopted IFRS and filed its IFRS financial statements with the Barbados taxing authority. In conjunction with its adoption, the subsidiary opted to use fair value as deemed cost for certain property, plant and equipment as allowed by the IFRS 1 optional exemptions. When Company A converts to IFRS, it must carry over the value of the Barbados subsidiary's property, plant and equipment at the depreciated deemed cost currently on the subsidiary's books. Accordingly, Company A cannot use the fair value as deemed cost exemption again for the Barbados subsidiary at its own transition date.

Example 2: Company B, a US company, has a UK subsidiary that adopts IFRS for statutory reporting purposes in 2008 with a transition date of January 1, 2007. In applying IFRS 1, the subsidiary elects the employee benefits exemption and recognizes all cumulative actuarial gains and losses in opening retained earnings at January 1, 2007. The subsidiary adopts the corridor approach for recognition of actuarial gains and losses prospectively.

Company B adopts IFRS for its consolidated financial statements in 2010 with a transition date of January 1, 2009. In applying IFRS 1, Company B also elects the employee benefits exemption to recognize

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cumulative actuarial gains and losses in opening retained earnings at January 1, 2009. Instead of using the corridor approach, the Parent decides to adopt a policy of recognizing actuarial gains and losses immediately in the Statement of Comprehensive Income (SOI). The UK subsidiary's cumulative actuarial gains and losses (for the period from January 1, 2007, through January 1, 2009) may not be recognized in opening retained earnings at the Parent's transition date (January 1, 2009) because the subsidiary already used that exemption. However, Company B must conform the subsidiary's IFRS accounting policies to its own and would therefore present the subsidiary's annual actuarial gains and losses in the consolidated SOI rather than deferring a portion through use of the corridor method. This difference in IFRS accounting policies will require continued tracking and consolidation adjustments going forward. In this example, Company B could have achieved greater efficiencies by managing the UK subsidiary's IFRS policy elections to ensure consistency with its own financial reporting objectives.

The criteria for when IFRS 1 should be applied, discussed in the beginning of this book, are of critical importance when assessing the impact of subsidiaries adopting IFRS. In Example 1, suppose the subsidiary in Barbados had converted to IFRS because the company anticipated that it would eventually obtain debt financing from a Barbados bank, but in the end, the parent company loaned it the necessary funds. If the IFRS statements were never provided to an external party, were not intended to be in compliance with IFRS in all respects, and if the company never had reason to explicitly represent that the statements were in compliance with IFRS, then the subsidiary could apply the optional exemptions of IFRS 1 again, as part of the parent company's conversion to IFRS.

It is crucial for US companies to understand how and why their subsidiaries converted to IFRS, whether the subsidiaries qualify for application of IFRS 1 during the parent company's conversion, and how the subsidiaries' decisions factor into the parent company's reconciliation and disclosures upon conversion. Companies will want to strategically assess and plan for IFRS adoption by subsidiaries to align

with the parent's financial reporting objectives and minimize the need for consolidation adjustments (e.g., to conform IFRS policies) in the future.

Designation of previously recognized financial instruments

Entities will have to classify their financial assets and liabilities as if they had always applied IFRS. IAS 39 permits a financial instrument to be designated on initial recognition as a financial asset or financial liability at fair value through profit or loss (provided it meets certain criteria) or as available for sale. However, IFRS 1 allows an exemption from retrospective application by permitting such designations to be made at the date of transition.

For example: If an entity can demonstrate at the date of transition that a portfolio of identified financial instruments was managed together and there was evidence of a recent actual pattern of short-term profit taking, it would be permitted to designate the financial instruments at fair value through profit or loss.

KEY US CONSIDERATION

Designations under this exemption must be in place at the transition date. US companies will need to plan accordingly to ensure appropriate financial instrument classification in their first IFRS financial statements.

While FAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, allows any financial instrument to be designated under the fair value option, IAS 39 requires the designation as at fair value through profit or loss only to be used in certain prescribed situations that result in more relevant information, or for contracts that contain one or more embedded derivative. Accordingly, certain financial assets and liabilities measured at fair value under FAS 159 may not qualify for the same treatment under IAS 39 if the company is unable to demonstrate that it meets the criteria.

Share-based payment transactions

IFRS 1 provides first-time adopters certain accommodations for applying IFRS 2 to equity instruments granted before the date of transition. The following table summarizes the available options:

Award grant date	Requirements
On or before November 07, 2002*	A first-time adopter is encouraged but not required to apply IFRS 2 to equity instruments granted on or before this date.
After November 07, 2002, but before the date of transition to IFRS	<p>For vested awards at transition date: A first-time adopter is encouraged but not required to apply IFRS 2. If the entity elects to apply IFRS 2, it may do so only if the entity has publicly disclosed fair value of such equity instruments determined on the <i>measurement date</i> as defined in IFRS 2.</p> <p>For unvested awards at transition date: The entity is required to apply the provisions of IFRS 2.</p>
After the date of transition to IFRS	Apply IFRS 2 to all awards.

* The date the IASB issued the IFRS 2 exposure draft.

First-time adopters are also encouraged, but not required, to apply IFRS 2 to liabilities arising from share-based payment transactions that were settled before the date of transition to IFRS.

KEY US CONSIDERATION

Although the quantity of unvested, pre-November 2002 grants at the transition date is likely to be low, most US companies with such grants would have measured and disclosed the fair value of those share-based payments in accordance with FAS 123 or FAS 123R, and therefore could, in most cases, present such grants in opening retained earnings at the transition date. Alternatively, US companies with unvested, pre-November 2002 grants could apply the transition provisions of IFRS 2 as written in that standard and avoid recognizing stock compensation expense for the unvested portion of those grants. However, because the reported results would not be comparable, detailed disclosures regarding those grants would be required in the notes to financial statements.

Insurance contracts

Companies that issue insurance contracts need not restate comparatives for IFRS 4, *Insurance Contracts*. This exemption is available only to companies that have an adoption date before January 1, 2006. Accordingly, it is unlikely that many US companies will use this exemption.

KEY US CONSIDERATION

Under US GAAP, multiple pronouncements and related interpretations have been issued to prescribe accounting for specific industries. In contrast, IFRS intentionally avoids industry-specific standards where possible, asserting that the underlying principles in the standards should generally be fit for application in all industries. This difference in approach causes numerous industry-specific accounting topics to appear un- or underrepresented in IFRS. Industries such as insurance, extractive, healthcare, and others will likely encounter more challenges in the near term than other industries because IFRS may not currently address specific accounting in these highly specialized industries. Though it is unlikely IFRS will ever have as much industry-specific guidance as US GAAP, the IASB has acknowledged that certain industries have unique accounting concepts that require different or additional guidance, and it is working to catch up to the identified needs.

In the meantime, companies should use the guidance in IAS 8 to determine the most appropriate method of accounting for areas where they believe IFRS guidance is limited. In addition, companies should recognize that any industry-specific reporting requirements dictated by regulatory agencies are generally incremental to IFRS financial reporting and are still required unless otherwise indicated by the regulator (e.g., federal banking and state insurance regulators).

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Changes in existing decommissioning, restoration, and similar liabilities included in the cost of property, plant and equipment

International Financial Reporting Interpretations Committee (IFRIC) 1, *Changes in Existing Decommissioning, Restoration, and Similar Liabilities*, requires any changes in decommissioning liabilities (commonly known in the United States as “asset retirement obligations” or “AROs”) to be added or subtracted from the carrying value of the related asset and depreciated over the remaining life of the asset. IFRS 1 allows first-time adopters to apply a shortcut method for measuring the ARO and related depreciated asset cost at the transition date. Companies can elect to measure the ARO at the transition date in accordance with IAS 37 and then “back into” the amount of the ARO that would have been included in the cost of the related asset at the time the liability first arose by discounting the liability to that date using historic risk-adjusted rates. The company would then calculate the accumulated depreciation on that discounted amount as of the transition date using the current estimate of the useful life and the depreciation policy adopted under IFRS.

KEY US CONSIDERATION

The accounting for AROs can differ between IFRS and US GAAP in terms of both initial recognition and subsequent measurement. IFRS (IAS 16, IAS 37, and IFRIC 1) requires a provision to be recorded when there is a present obligation (legal or constructive) as a result of constructing or acquiring a long-lived asset. The ARO is discounted using a pretax discount rate reflecting current market assessments of the time value of money and risks specific to the liability. Future cash outflows and the discount rate are adjusted if necessary each balance sheet date to reflect current conditions.

US GAAP (FAS 143, *Accounting for Asset Retirement Obligations*) recognizes AROs resulting from a legal obligation and specifies use of a credit-adjusted, risk-free rate for discounting purposes. Different discount rates are used for subsequent adjustments depending on whether there are increases or decreases to the expected future cash outflows. US companies will need to reassess the recognition and measurement of AROs under IFRS at the transition date and will likely elect this exemption to streamline the measurement exercise.

Leases

IFRIC 4, *Determining Whether an Arrangement Contains a Lease*, requires an assessment of whether a contract or arrangement contains a lease. The assessment should be carried out at the inception of the contract or arrangement. First-time adopters must apply IFRIC 4, but can elect to make this assessment as of the date of transition based on the facts at that date, rather than at inception of the arrangement.

Example: The owner of a co-generation facility and a natural gas provider entered into a natural gas supply contract. The parties to the contract will need to analyze the arrangement under IFRIC 4 to determine whether the arrangement should be accounted for as a single element—that is, a natural gas supply contract—or whether there is an embedded lease within it; for example, a lease of (1) the pipeline used to transport the natural gas to the cogeneration facility and/or (2) the underlying land. Under US GAAP, EITF 01-08, *Determining Whether an Arrangement is a Lease*, provides guidance on determining whether an arrangement contains a lease. The EITF grandfathered any arrangements that were entered into prior to June 2003 and have not been modified or extended subsequent to that date. Using the lease exemption, companies can choose to perform the embedded lease assessment either at the date of transition or at the arrangement inception date for those contracts that were grandfathered under the US rules.

Fair value measurement of financial assets and financial liabilities at initial recognition

The current guidance in IAS 39 states the transaction price of a financial instrument is generally the best evidence of fair value, unless fair value is evidenced by comparison with other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets.

At initial recognition, a company may recognize as a gain or loss on the difference between this fair value measurement and the transaction price (i.e., “day one” gain or loss) only if the measurement of fair value is based entirely on observable market inputs without modification. Otherwise, IAS 39 does not allow the recognition of a day one gain or loss and forces initial recognition at the transaction price, which is considered the best evidence of fair value. Subsequent measurement and recognition would follow the guidance as defined IAS 39.

IAS 39 originally required only retrospective recognition of the day one gain or loss. The standard was amended in December 2004 to allow a company, including a first-time adopter, to measure these financial instruments at initial recognition either:

- Prospectively for transactions entered into after October 25, 2002 (the date when the equivalent US GAAP requirements became effective and hence IFRS and US GAAP were converged in this area), or
- Prospectively for transactions entered into after January 1, 2004 (which roughly corresponds with the date the amended IAS 39 standard was published)

It is unlikely that many US companies will apply the exemption because of the early dates it is available.

KEY US CONSIDERATION

The recognition criteria for a day one gain or loss under US GAAP was subsequently changed with the issuance of FAS 157, *Fair Value Measurement*. FAS 157 allows the measurement of fair value using a valuation technique and the recognition of an initial gain or loss even if the measure of the fair value is based on a valuation model that uses significant entity-specific inputs. As a result, more companies are recognizing day one gains or losses since the adoption of FAS 157 than are currently permitted under IFRS. This will be a measurement difference at the date of transition regardless of how the exemption is applied (i.e., full retrospective application or prospective application as of the specified dates).

Service concession arrangements

IFRIC 12, *Service Concession Arrangements*, applies to contractual arrangements in which a private sector operator participates in the development, financing, operation, and maintenance of infrastructure for public sector services. First-time adopters may elect to use the transitional provisions of IFRIC 12 rather than full retrospective application. When it is impractical for a company to apply IFRIC 12 retrospectively to the start of the earliest period presented, the IFRIC 12 transition provisions allow a company to:

- Recognize financial and intangible assets that existed at the start of the earliest period presented.
- Use the previous carrying amounts as the carrying amount at that date (no matter how they were previously classified).
- Test the financial and intangible assets recognized at that date for impairment.

Borrowing costs

IFRS first-time adopters may apply IAS 23, *Borrowing Costs*, using the following guidelines:

- If the accounting treatment for capitalized interest required by IAS 23 is different from the company's previous accounting policy, the company should apply IAS 23 to borrowing costs related to qualifying assets capitalized on or after January 1, 2009, or the date of transition to IFRS, if later.
- Alternatively, companies can designate any date before January 1, 2009, and apply the standard to borrowing costs relating to all qualifying assets capitalized on or after that date.

KEY US CONSIDERATION

IAS 23 was recently converged with FAS 34, *Capitalization of Interest Cost*, making the IFRS treatment of capitalized interest similar to US GAAP. Therefore, it is unlikely that many US companies will need to use this exemption.

Investments in subsidiaries, jointly controlled entities and associates

In separate financial statements (i.e., stand-alone, unconsolidated parent-company-only financial statements) IAS 27R requires a company to account for its investment in subsidiaries, jointly controlled entities and associates either at cost or at fair value in accordance with IAS 39. In the opening IFRS balance sheets of their separate financial statements, first-time IFRS adopters can measure their investment in one of the following manners:

- At cost, determined in accordance with IAS 27R
- At deemed cost, which is defined as:
 - Fair value (determined in accordance with IAS 39) at the company's IFRS transition date, or

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- Previous GAAP carrying amount at the IFRS transition date.

Because US companies generally are not required to prepare such separate financial statements, it is unlikely that many US companies would use this exemption.

Summary of optional exemptions

As seen in the preceding paragraphs, the selection and application of the optional exemptions can be complicated. Careful consideration and analysis should be applied to ensure the most appropriate actions are taken. The following chart summarizes the previously described elections available to companies under IFRS 1.

Exemption	Choice	Exemption applies to all items?*
Business combinations	<p>For all transactions qualifying as business combinations under IFRS 3R, a company can choose to:</p> <ul style="list-style-type: none"> • Not restate business combinations before the date of transition. • Restate all business combinations before the date of transition. • Restate a particular business combination, in which case all subsequent business combinations must also be restated and the IAS 36 impairment guidance must be applied. 	No
Fair value as deemed cost	<p>For property, plant and equipment, a company can choose to measure the value using:</p> <ul style="list-style-type: none"> • Cost in accordance with IFRS. • Fair value at the date of transition as deemed cost. • A revaluation carried out at a previous date (such as an IPO) as deemed cost, subject to certain conditions. <p>This exemption can also be applied to intangible assets that meet the criteria for revaluation in IAS 38 and to investment properties where the cost method in IAS 40 is applied. The exemption may not be used for any other assets or for liabilities.</p>	No
Employee benefits	<p>Recognition of all cumulative actuarial gains and losses as an adjustment to opening retained earnings is allowed. Deferral of the recognition of future actuarial gains and losses using the corridor approach in IAS 19 may still be applied prospectively.</p>	Yes
Cumulative translation differences	<p>The cumulative translation reserve may be reset to zero.</p>	Yes

September 2008

Pricewaterhouse Coopers

Exemption	Choice	Exemption applies to all items?*
Compound financial instruments	A compound financial instrument does not need to be bifurcated if the liability component is not outstanding at the transition date.	No
Assets and liabilities of subsidiaries, associates and joint ventures	A subsidiary that adopts IFRS later than its parent can elect to apply IFRS 1 or to use the carrying amounts of its assets and liabilities included in the consolidated financial statements, subject to eliminating any consolidation adjustments. If a parent adopts IFRS later than its subsidiary, the parent, in its consolidated financial statements, must measure the assets and liabilities of the subsidiary at the same carrying amounts as in the IFRS financial statements of the subsidiary, adjusting for normal consolidation entries.	No
Designation of previously recognized financial instruments	A company may choose to designate a financial instrument as a financial asset or financial liability “at fair value through profit or loss” or may designate a financial asset as available-for-sale at its transition date.	No
Share-based payment transactions	A company may choose (but is not required) to apply IFRS 2 to any equity instruments that were granted before November 7, 2002, or that were granted after that date and vested before the date of transition, but only if the company has previously disclosed publicly the fair value of the instruments, determined at the measurement date. In addition, a company may choose (but is not required) to apply IFRS 2 to a liability relating to a cash-settled share-based payment that was settled prior to the date of transition to IFRS.	Yes
Insurance contracts	A company that issues insurance contracts and has a date of adoption before January 1, 2006, may choose not to restate comparatives for IFRS 4. The company applies its previous GAAP to insurance contracts for its comparatives.	No

(continued)

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Exemption	Choice	Exemption applies to all items?*
Changes in existing decommissioning, restoration (AROs), and similar liabilities included in the cost of property, plant and equipment	<p>When accounting for asset retirement obligations, first-time adopters may apply a shortcut method by:</p> <ul style="list-style-type: none"> • Measuring the liability at transition date in accordance with IAS 37. • Estimating the amount of the liability that would have been included in the cost of the related asset when the liability first arose. • Calculating the accumulated depreciation on that discounted amount, as of the date of transition to IFRS. 	No
Leases	A company may elect to assess whether an arrangement contains a lease at the date of transition, rather than at the inception of the arrangement.	No
Fair value measurement of financial assets and financial liabilities at initial recognition	<p>First-time adopters can choose to measure their “day one” profits on initial recognition of financial instruments either:</p> <ul style="list-style-type: none"> • Retrospectively to all transactions. • Prospectively for all transactions entered into <i>after</i> October 25, 2002. • Prospectively for all transactions entered into <i>after</i> January 1, 2004. 	No
Service concession arrangements	Companies may elect to apply the transitional provisions of IFRIC 12, rather than full retrospective application.	No
Borrowing costs	<p>If the accounting treatment for capitalized interest required by IAS 23 is different than a company’s previous accounting policy, the company should apply IAS 23 to borrowing costs related to qualifying assets capitalized on or after January 1, 2009, or the date of transition to IFRS, if later.</p> <p>Alternatively, companies can designate any date before January 1, 2009 and apply the standard to borrowing costs relating to all qualifying assets capitalized on or after that date.</p>	No

Exemption	Choice	Exemption applies to all items?*
Investments in subsidiaries, jointly controlled entities and associates	In their separate financial statements, first-time adopters can measure their investment in subsidiaries, jointly controlled entities and associates at either: <ul style="list-style-type: none"> • Cost, determined in accordance with IAS 27R; • Deemed cost, defined as fair value (determined in accordance with IAS 39) at the company's IFRS transition date, or • Deemed cost, defined as previous GAAP carrying amount at the IFRS transition date. 	No

*This column designates whether the exemption should be applied to all transactions ("Yes") or only selected transactions based on the guidance in IFRS 1 ("No"). This designation does not apply to assets and liabilities of a subsidiary that has already adopted IFRS. In that case (where a parent becomes a first-time adopter later than its subsidiary), IFRS 1 requires the parent to use the "same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the parent acquired the subsidiary." Once a subsidiary has adopted IFRS, the carrying amounts of assets and liabilities of that subsidiary cannot be adjusted later when the parent adopts IFRS (except as necessary to conform to the parent's policies).

Mandatory exceptions from retrospective application

There are also several mandatory exceptions to full retrospective application of IFRS. As described in detail below, some of these exceptions may or may not have an impact on US companies:

Expected to impact US companies	Not expected to impact many US companies
Hedge accounting	Derecognition of financial assets and financial liabilities
Estimates	Assets classified as held for sale and discontinued operations
Noncontrolling interests	

Hedge accounting

This exception requires companies to recognize hedging relationships in the opening balance sheet (i.e., at the transition date) if the hedging instrument is of a type that would qualify for hedge accounting under IFRS. However, hedge accounting can be applied to those hedging relationships subsequent to the transition date only if all of the IAS 39 hedge accounting criteria are met.

Companies should first consider whether their hedges under previous GAAP are of a type that qualify for hedge accounting under IAS 39. If they qualify, companies must follow the detailed guidance in IFRS 1 to recognize the hedging instrument and the hedging relationship in the opening balance sheet at the transition date. Hedge accounting after the transition date may be applied only if all the IAS 39 hedge accounting criteria are met. If the criteria are not met (e.g., documentation does not exist because the shortcut method for hedge effectiveness testing was used under US GAAP), the company should apply IAS 39 guidance for discontinuing hedge accounting until the criteria are met.

If hedges are of a type that do not qualify for hedge accounting under IAS 39, the hedging relationship must not be reflected in the opening balance sheet at the transition date. For example, a hedging relationship in which a company combines a purchase option and a written option with a different counterparty is not allowed to be designated as a hedging relationship under IFRS but allowed under US GAAP. Instead, the related derivatives must be recognized at fair value with a corresponding adjustment to retained earnings.

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Example: Company A holds a plain vanilla interest rate swap to fix the interest on its variable-rate debt. The company concluded the swap was of a type that qualifies for hedge accounting under IAS 39. Therefore, the company should retrospectively apply IAS 39 to the swap at the transition date and reflect the hedging relationship in its opening balance sheet. Under US GAAP, the swap qualified for the shortcut method for hedge effectiveness testing; therefore, the company did not test for and document effectiveness annually. Because IAS 39 does not allow the shortcut method and requires contemporaneous documentation (i.e., documentation in place as of the transition date) of retrospective and prospective effectiveness testing, the swap would not meet the criteria for hedge accounting under IFRS after the transition date and the guidance for discontinuing hedge accounting must be applied. Hedge accounting would be applied prospectively only from the date that the hedge relationship is fully designated and documented as required by IAS 39.

KEY US CONSIDERATION

US companies that have significant hedging activities, particularly those that currently use the shortcut method, should assess their hedging instruments and strategies using IAS 39 criteria sufficiently in advance of their conversion to IFRS. By ensuring the necessary designations and documentation are prepared contemporaneously—even prior to adoption of IFRS—a company can mitigate the risk that the hedge accounting treatment will need to be discontinued under IAS 39 during first-time adoption of IFRS.

The decision tree on the opposite page outlines the application of the hedge accounting exception.

Estimates

IFRS 1 prohibits the use of hindsight to adjust estimates made under previous GAAP unless there is objective evidence of an error. A company should adjust the estimates made under previous GAAP only when the basis of calculation does not comply with IFRS.

IFRS 1 requires the following for estimates made under a previous GAAP:

- Estimates made at the same date under the previous GAAP should be used for the opening IFRS balance sheet, unless there is objective evidence of an error.
- Estimates made under previous GAAP should be revised if necessary to comply with IFRS, but they should reflect conditions present at the date of transition.
- An entity may need to make estimates under IFRS at the date of transition to IFRS that were not required at that date under previous GAAP. To achieve consistency with IAS 10, *Events after the Reporting Period*, those estimates under IFRS shall reflect conditions that existed at the date of transition to IFRS. In particular, estimates at the date of transition to IFRS should reflect current market conditions for items such as market prices, interest rates and foreign exchange rates.

For example: A constructive liability that was not recognized under US GAAP should be included in the opening IFRS balance sheet using the estimates for the expected future cash outflows and discount rates that existed at that time.

The requirements of IFRS 1 in connection with estimates are summarized in the following chart:

FIGURE 2-4

Estimates

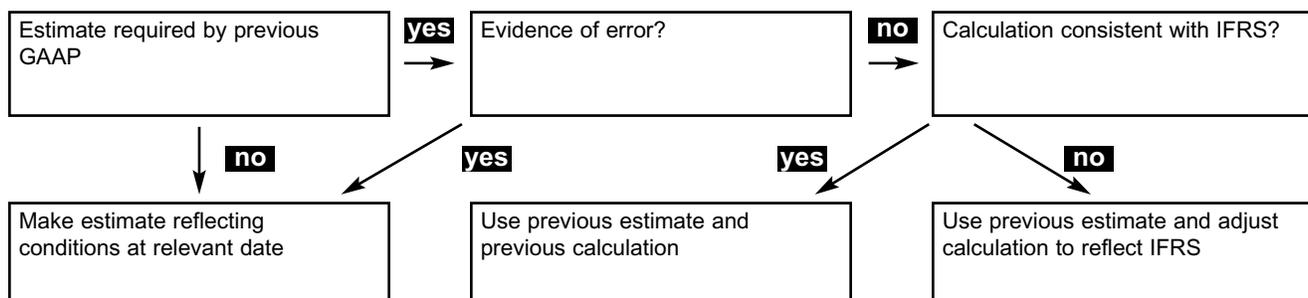
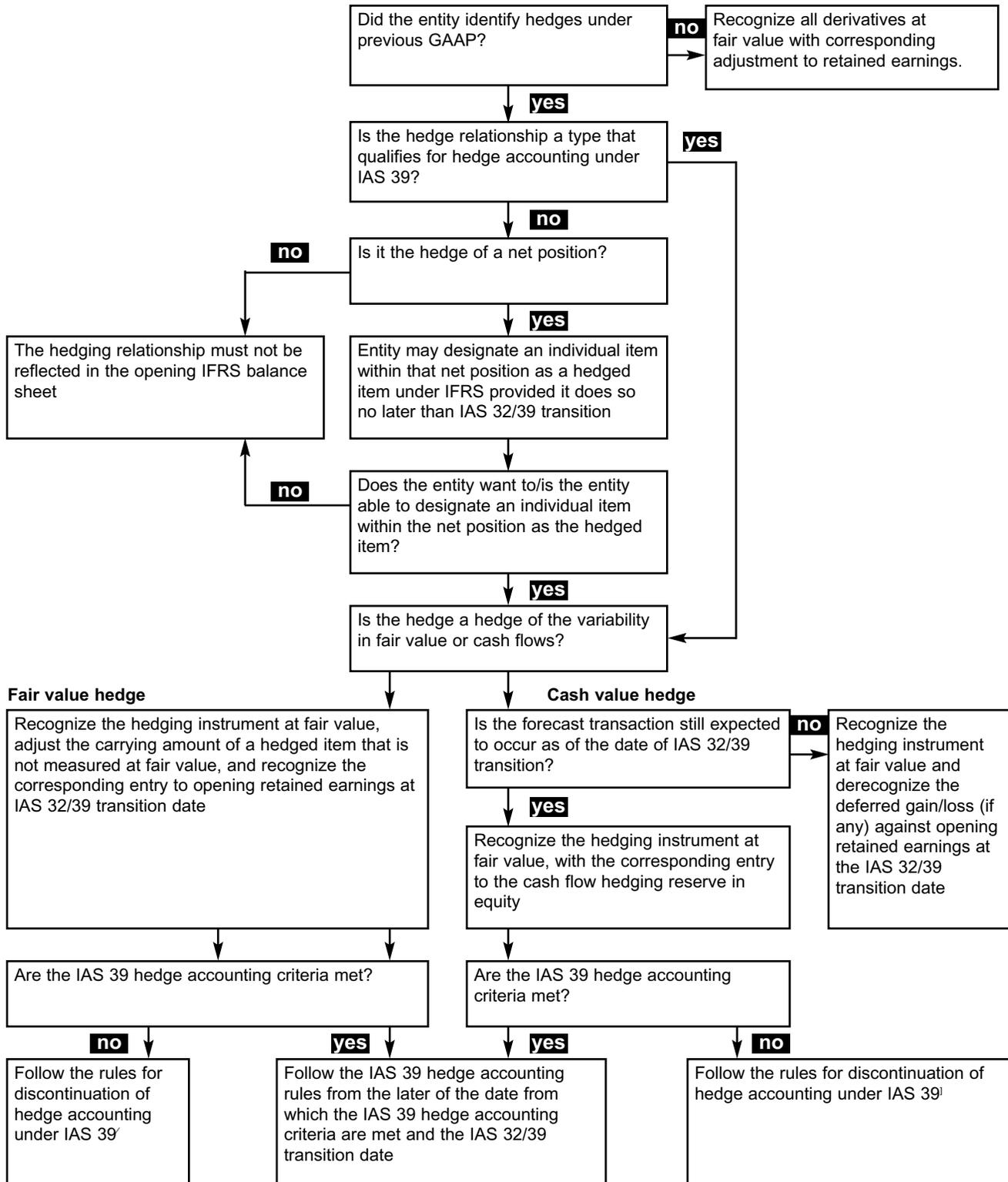


FIGURE 2-3



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NOTES TO DECISION TREE

[†] The only entries recognized in the opening balance sheet at the transition date should be the derivative at fair value and the hedged item measured in accordance with the normal IFRS measurement rules for that type of asset/liability. Any adjustments are recognized against opening retained earnings.

[‡] The carrying amount of the hedged item is adjusted by the lesser of a) that portion of the cumulative change in the fair value of the hedged item that reflects the designated hedged risk and was not recognized under previous GAAP, and b) that portion of the cumulative change in the fair value of the hedging instrument that reflects the designated hedged risk and, under previous GAAP, was either i) not recognized or ii) deferred in the balance sheet as an asset or liability.

[§] For example, for a financial asset, the adjustment made to the carrying value of the hedged item is amortized to profit or loss. The amortization is based on a recalculated effective interest rate at the date amortization begins and should be amortized fully by maturity.

[¶] The net cumulative gain/loss included in equity remains in equity until a) the forecast transaction subsequently results in the recognition of a non-financial asset or liability, b) the forecast transaction affects profit and loss, or c) circumstances subsequently change and the forecast transaction is no longer expected to occur, in which case, any related net cumulative gain/loss that had been recognized directly in equity is recognized in profit or loss.

Example: Company A, a US registrant, is converting to IFRS with a transition date of January 1, 2011. At December 31, 2011, in accordance with FAS 5, *Accounting for Contingencies*, and FIN 14, *Reasonable Estimation of the Amount of a Loss—an interpretation of FAS 5*, the company had a \$2 million liability for an ongoing lawsuit where the loss was probable, and a range of loss had been identified as between \$2 million and \$8 million, with no specific amount more likely than any other.

As the company identified its US GAAP to IFRS conversion adjustments in the third quarter of 2012, it settled the case for \$8 million. Under the provisions of IFRS 1, the company is required to measure the liability in accordance with IAS 37 using the information available at the transition date. Thus, the settlement of the obligation cannot be a factor in measurement at the transition date. Under IAS 37, the company would be required to record the midpoint of the estimated range (as opposed to the low end of the range under FIN 14). Therefore, in the IFRS opening balance sheet, the company would reflect a \$5 million liability for the lawsuit. The difference between the US GAAP liability and IFRS liability of \$3 million would be recorded in opening retained earnings. In its 2012 IFRS financial statements, when the settlement of \$8 million was agreed to, the company would increase the liability by \$3 million to reflect the change in estimate in 2012 with the additional expense recognized in the income statement.

Noncontrolling Interests

IAS 27R requires certain amounts to be allocated between owners and noncontrolling interests. This exception for first-time adopters requires prospective

application from the date of transition to IFRS for the following requirements of IAS 27R:

- a. the requirement that total comprehensive income is attributed to the owners of the parent and to the noncontrolling interests;
- b. the requirements for accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and
- c. the requirements for accounting for a loss of control over a subsidiary.

Similar to the business combination exemption, this exception provides relief from requiring companies to gather information and calculate allocations between owners and noncontrolling interests under IFRS for transactions in periods prior to the transition date. However, if a first-time adopter elects to apply the business combination standard retrospectively to past business combinations, it must also apply the IAS 27R requirements from that date forward.

Assets classified as held for sale and discontinued operations

This mandatory exception is applicable only for companies with IFRS adoption dates before January 1, 2006, so it is unlikely to apply to most US companies. Therefore, first-time adopters in the United States will need to retrospectively apply IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*, to the transition date.

KEY US CONSIDERATION

IFRS 5 requires that a discontinued operation:

- Represent a separate major line of business or geographical area of operations,
- Is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations, or
- Is a subsidiary acquired exclusively with view to resale

The requirement that a discontinued operation be a “separate major line of business or geographical area of operations” is a higher threshold than under US GAAP. This may mean that certain components (as defined in FAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*) that met the discontinued operations criteria of FAS 144 will not receive discontinued operations presentation under IFRS 5.

Derecognition of financial assets and financial liabilities

The IFRS guidance dealing with derecognition of financial assets and financial liabilities should be applied only to transactions that occurred on or after January 1, 2004. However, a company may apply the derecognition requirements in IAS 39 retrospectively from a date of the company’s choosing, provided that the information required by IAS 39 was obtained at the date of those transactions.

DISCLOSURES AND OTHER CONDITIONS

The first IFRS financial statements should provide all of the disclosures IFRS requires, in addition to the specific disclosures required by IFRS 1, to explain the impact of the transition to IFRS. There are no exemptions from the disclosure requirements of any standards except for certain aspects of IFRS 6, *Exploration for and Evaluation of Mineral Resources*, and IFRS 7, *Financial Instruments: Disclosures*. However, because of the effective dates applicable to the exemptions in those standards, it is unlikely US companies will be allowed to use them, so they are not discussed in detail here.

Reconciliations in the first IFRS financial statements

The first IFRS financial statements should include a reconciliation of:

- Equity from previous GAAP to IFRS at the transition date and at the end of the latest period presented in the company’s most recent annual financial statements under previous GAAP.
- Net profit from previous GAAP to IFRS for the last period in the company’s most recent annual financial statements under previous GAAP.

The reconciliations should give sufficient detail to enable users to understand the material adjustments to the balance sheet and income statement and to distinguish changes in accounting policies from the correction of errors identified during transition. A sample reconciliation footnote is included at the end of this guide.

KEY US CONSIDERATION

A conversion to IFRS may lead to the identification of errors in the previous GAAP financial statements. IFRS 1 requires errors to be disclosed separately from adjustments because of accounting policy changes in the reconciliation from previous GAAP to IFRS. US registrants will need to be particularly mindful of such findings because of the regulatory requirements governing the identification and disclosure of errors.

Other disclosures in the first IFRS financial statements

The disclosures required by IAS 36 should be provided when impairment losses are recognized in the opening IFRS balance sheet. These disclosures are substantial and include (among others):

- The amount and financial statement line items impacted by the impairment.
- The impairment amount recorded for each reported segment.
- For material impairments:
 - The events leading to the recognition of the impairment.
 - A description of the asset or cash-generating unit.

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- What constitutes the remaining recoverable amount of the asset or cash-generating unit.
- The discount rates used in the impairment analysis.
- Significant assumptions used in the impairment analysis.
- The amount of any unallocated goodwill and the reasons it is unallocated.

In addition, when fair value is used as deemed cost, the aggregate fair values and the aggregate adjustment to the previous carrying amounts should be disclosed for each line item. Finally, a company should also explain material adjustments to the cash flow statement.

A company that applies the optional exemption to classify a financial asset or financial liability as “at fair value through profit or loss” must disclose:

- The fair value of the item.
- The carrying amount under previous GAAP.
- The classification under previous GAAP.

Challenges for US companies in providing IFRS disclosures

Although the level of disclosures required by US GAAP and the SEC are significant, the disclosures required in a set of IFRS financial statements are even more extensive in certain areas. Aside from the IFRS 1 disclosures described above, which are required only in the first year of IFRS adoption, annual IFRS financial statements require ongoing disclosures that can be more voluminous, and in some cases more challenging, than disclosures under US GAAP.

The greater use of management judgment in establishing accounting policies in an IFRS framework will require companies to pay special attention to ensure disclosures of those policies are sufficient. Disclosure of management’s judgments is critical to the transparency and overall quality of IFRS financial reporting. The challenge in providing some of the annual IFRS disclosures is not necessarily in their complexity, but in the level of judgment that must be applied when deciding what to disclose and in gaining comfort with disclosing the level of detail required by some IFRS standards.

Some examples of IFRS disclosure requirements that are more significant than current US GAAP disclosures include:

- **Summary of significant accounting policies**—These familiar US GAAP note disclosures may need to be even more descriptive under IFRS. IAS 1, *Presentation of Financial Statements*, focuses on clear disclosure of the measurement bases used in preparing the financial statements (e.g., historical cost, current cost, fair value, net realizable value, or recoverable amount), as well as any other policies used that are relevant to an understanding of the financial statements.
- **Judgments used in applying accounting policies**—IAS 1 also specifically requires disclosure of the judgments management has made that can significantly affect the amounts recognized in the financial statements. For example:
 - factors considered in determining whether certain ownership interests constitute control and require consolidation rather than associate (i.e., equity method) accounting;
 - factors considered in determining whether an available-for-sale financial asset is impaired under IAS 39;
 - judgments made in determining when the significant risks and rewards of ownership have transferred to a buyer for purposes of recognizing revenue
- **Sources of estimation uncertainty**—IAS 1 requires detailed disclosure about the assumptions and other major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. For applicable assets and liabilities, the financial statement notes must include details on their nature and carrying amount at the end of the period. This disclosure is intended to address estimates that require management’s most difficult, subjective or complex judgments; the greater the number of variables and assumptions affecting the future resolution of the uncertainty, the greater the potential for a material adjustment to the amount of

the assets and liabilities and the greater need for transparent disclosure. Typical areas involving significant estimation uncertainty include impairment testing, income tax provisions, and fair value measurement for derivatives and other financial instruments. Examples of the types of disclosures an entity might make are:

- the nature of the assumption or other estimation uncertainty;
 - the sensitivity of carrying amounts to the methods, assumptions, and estimates including the reasons for the sensitivity;
 - the expected resolution of an uncertainty and the range of possible outcomes with the next financial year; and
 - an explanation of changes made to past assumptions if the uncertainty remains unresolved.
- **IFRS 7, *Financial Instruments: Disclosures***—IFRS 7 requires detailed qualitative and quantitative disclosures about the nature and extent of risks arising from financial instruments including credit, liquidity and market risks and how management manages those risks. Such disclosures include detailed sensitivity analysis for each type of market risk to which the company is exposed at the end of the reporting period. US registrants will be prepared to provide some of these disclosures because they are similar to the liquidity disclosures required in Management’s Discussion and Analysis (MD&A) under SEC Regulation S-K. However, the IFRS 7 disclosures are more comprehensive and may require the capture of new data.
- **Capital risk management strategy and ratios**—A company is required to disclose its objectives, policies and processes on managing capital. IAS 1 requires the following disclosure based on information provided internally to the entity’s key management personnel:
 - Qualitative information about the entity’s objectives, policies and processes for managing capital, including:
 - A description of what the entity manages as capital
 - When an entity is subject to externally imposed (for example, by regulators) capital requirements, the nature of those requirements, and how those requirements are incorporated into the entity’s management of its capital
 - How the entity is meeting its objectives for managing capital
- **Summary quantitative data about what the entity manages as capital**
- **Whether there have been any changes in the above from the previous period**
- **Whether the entity has complied with any externally imposed (for example, by regulators) capital requirements to which it is subject and, if not, the consequences of such noncompliance**
- **Rollforwards of balance sheet accounts**—In some instances, companies were required to provide rollforwards of certain balance sheet accounts (e.g., valuation allowances) as part of the financial statement schedules in the Form 10-K. However, the IFRS requirement for rollforwards covers more balance sheet accounts and requires inclusion of the rollforwards in the notes to the financial statements. For example, detailed rollforwards are required for: property, plant and equipment (gross and accumulated depreciation), intangible assets (gross and accumulated amortization), deferred tax assets and liabilities, and provisions.
- **Disclosure of expenses by nature**—IAS 1 allows the presentation of expenses in the income statement based on either their nature or function, whichever provides information that is reliable and more relevant. Companies that elect a functional presentation of expenses within the income statement are required to separately disclose the nature of the expenses in the notes to the financial statements (including depreciation, amortization, and employee benefits expense).
- **Key management compensation**—Companies are required to disclose compensation for “key management personnel” (as defined within IAS 24, *Related Party Disclosures*) by the following categories:

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- Short-term employee benefits
- Post-employment benefits
- Other long-term benefits
- Termination benefits
- Share-based payments

This list is not all-inclusive but provides a sample of the types of additional financial statement disclosures required by IFRS. Please refer to the PwC publication *Illustrative Corporate Consolidated Financial Statements* for a more extensive example of IFRS financial statements and notes.

KEY US CONSIDERATION

Some of the IFRS disclosures discussed above may already be required for US registrants under the SEC's integrated disclosure system, but may be made outside the audited financial statements. Examples include critical accounting policies and liquidity and capital resources in MD&A, valuation and qualifying accounts in Financial Statement Schedule II to the Annual Report on Form 10-K and executive compensation disclosures in proxy statements. The disclosures required under IFRS must be made in the financial statements and are covered by the independent auditor's opinion. Additionally, inclusion of this information in the notes to financial statements removes the safe harbor protection previously available.

IFRS 1 and the publication of interim financial information

IFRS, including IFRS 1, does not require interim reporting, but provides guidance on what a company should report when it publishes interim financial information. IAS 34, *Interim Financial Reporting*, allows companies preparing interim reports the option of presenting either full IFRS financial statements or condensed interim financial information. IAS 34 sets out the minimum contents of condensed reporting. A company that publishes interim financial information for a period covered by the first IFRS financial statements must also follow the additional requirements of IFRS 1 (e.g., disclosure of the reconciliation from previous GAAP to IFRS and other IFRS 1 disclosures) if that interim financial information is prepared in accordance with IFRS.

Publication of condensed interim financial information

A company may find that the first published financial information under IFRS is in the form of interim financial statements. For example, a company whose first annual IFRS reporting date is December 31, 2014, may decide to report its interim March 31, 2014, financials using IFRS. Therefore, the interim statements would become the first IFRS financial statements. The interaction of the reconciliation requirements of IFRS 1 and the requirement of IAS 34 to present all information "material to an understanding of the current interim period" may require the production of extensive interim financial statements.

IFRS 1 requires the reconciliation of equity and the profit and loss under previous GAAP at the end of the comparable interim period, as well as the reconciliations expected for the first full IFRS financial statements. It does not require the company to publish a full set of financial statements as a first interim financial statement.

IAS 34 sets out the concept of an "interim financial report," which allows the primary financial statements to be condensed and keeps accounting policies and disclosures to a minimum. Entities are permitted to reduce disclosures and condense line items in an interim financial report because they would have made "full disclosures" in their previously published annual financial statements. Traditional interim financial statements focus on the operational and financial changes of the reporting entity since the last full set of financial statements. The requirements of IAS 34 could therefore be more burdensome than companies realize.

What happens if the detailed information implied by "full disclosures" is not available? The financial statements published under US GAAP may use recognition and measurement criteria that are different from IFRS, or may not provide all the information that must be disclosed in full IFRS financial statements or all of the same line items.

The interim financial report must bridge the gap between the information published under previous GAAP and the information that will appear in the first complete set of IFRS financial statements. A company must include either all necessary information in the interim financial report, or cross-

references to another document that includes the necessary information.

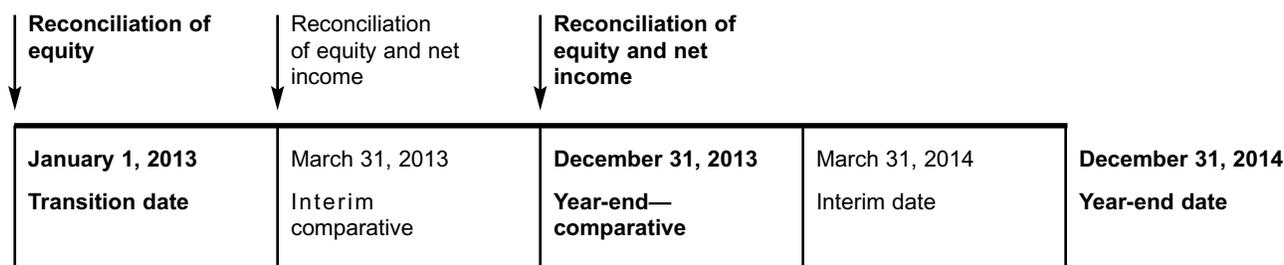
Neither IFRS 1 nor IAS 34 includes a checklist of required information. Disclosure depends on the company's specific circumstances. Companies making the transition to IFRS for the year ended December 31, 2014 that have published annual financial statements under previous GAAP for year-end 2013 may have to report a great deal of additional information to avoid misleading users of the IFRS interim financial statements. Also, the more complex the business or organization, the more disclosures are required. Companies may have to include additional line items or subtotals in the financial statements to communicate significant changes in figures.

Interim reconciliation requirements of IFRS 1

IFRS financial reports published for interim periods covered by the first IFRS financial statements should include two additional reconciliations: net income for the comparative interim period and equity at the end of that period. The first IFRS interim report published for interim periods covered by the first IFRS financial statements must also include the same reconciliations that will be included in the first annual IFRS financial statements.

The diagram below illustrates the reconciliations that must be made in the quarterly interim IFRS financial report for the three months ended March 31, 2014, by an entity adopting IFRS for its December 31, 2014, financial statements, assuming only one year of comparatives is required.

FIGURE 2-5



Historical summaries

A company may elect to present a summary of historical data for periods prior to the IFRS transition date. IFRS 1 does not require such information to be presented in accordance with IFRS. A company can also elect to present additional comparative information under the previous GAAP. When historical summaries or comparative information under a previous GAAP is presented, the information should be labeled clearly as not complying with IFRS, and the nature of the main adjustments to comply with IFRS should be described.

Amendments to IFRS 1

Amendments to other standards commonly impact IFRS 1. It is reasonable to expect that additional amendments may be made in the future as more

countries adopt IFRS and as new standards and interpretations are published. Companies should monitor developments in this area as they proceed through their conversion projects.

Early adoption of IFRS

The SEC may propose allowing certain US registrants to adopt IFRS voluntarily, in advance of an eventual mandatory adoption date for all US registrants. A number of companies may find an early move to IFRS advantageous, especially those that embody some combination of the following characteristics:

- Operates internationally, with a heavy physical or business presence overseas.
- Competes in an industry where many competitors already use IFRS.

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- Plans a major system conversion or implementation in the next five years.
- Prefers to seek capital from outside the United States.
- Anticipates significant strategic acquisitions or divestitures internationally in the next few years.
- Seeks to be a directional leader in its industry or in the US market.
- Desires flexibility in its conversion time-frame to avoid “working under the gun.”
- Has limited resources available internationally to produce US GAAP financial statements.

Companies that adopt IFRS early may recognize some or all of the following benefits:

- Better access to limited IFRS-knowledgeable resources.
- Earlier realization of cost efficiencies generated by using a common financial reporting language.
- More flexibility in designing a conversion plan and integrating IFRS into business processes and systems.
- Enhanced access to global capital and potentially lower cost of capital.
- Increased comparability to competitors and peers using IFRS.
- Enhanced ability to influence regulators and standard-setters on IFRS matters over companies not yet using IFRS.

Though the benefits of early adoption may outweigh the risks, companies should be aware of some challenges they may face by adopting early. For example, the FASB and IASB have ambitious agendas, and companies should expect both standard-setters to issue significant new standards as well as amendments to previously issued standards. Though many are joint projects and therefore should result in fairly similar standards, companies converting to IFRS early will likely need to learn and apply both the US and international standards concurrently (US standards for existing reporting prior to their first IFRS financial statement filing and international standards for properly converting their opening IFRS balance sheet).

A related issue with new standard setting is timing relative to a company’s IFRS transition date. Consider, for example, a company that decides to early adopt and plans to issue its first IFRS financial statements for the year ended December 31, 2012. This company’s date of adoption is January 1, 2012, and its date of transition (assuming that two years of comparatives are required by the SEC) will be January 1, 2010. If the IASB issues a new standard in 2011 that is effective for annual periods beginning after December 31, 2011, the company will need to apply that new standard to its opening balance sheet effective January 1, 2010. Such timing issues make for a moving target, since the company would likely have identified its necessary opening balance sheet conversion adjustments well before the effective date of the new standard, and it would need to go back and adjust all periods to reflect the new standard.

APPENDIX: SAMPLE IFRS RECONCILIATION NOTE FOR FIRST INTERIM FINANCIAL STATEMENTS

This Appendix presents an illustrative example of the reconciliation disclosures required by IFRS 1 using a fictional company, ABC Co. (“the Company”). The example assumes the Company’s first IFRS financial statements are for the year ended on December 31, 2014, with a transition date of January 1, 2013 (only one year of comparative financial information is required). The Company’s first interim financial report under IFRS is for the quarter ended March 31, 2014. ABC Co. prepared US GAAP annual financial statements for the year ended December 31, 2013, and prepared quarterly reports throughout 2013.

The intent of the example is to illustrate the periods to be reconciled and the type of disclosures required to explain the related adjustments. The example is not comprehensive and is not intended to reflect all possible accounting entries that would be necessary for a first-time adopter.

Note 5. Transition to IFRS

5.1 Basis of transition to IFRS

5.1.1 Application of IFRS 1

The Company’s financial statements for the year ended December 31, 2014, will be the first annual financial statements that comply with IFRS. The Company has applied IFRS 1 in preparing these consolidated interim financial statements.

The Company’s transition date is January 1, 2013. The Company prepared its opening IFRS balance sheet at that date. The reporting date of these interim consolidated financial statements is March 31, 2014.

In preparing these interim consolidated financial statements in accordance with IFRS 1, the Company has applied the relevant mandatory exceptions and certain optional exemptions from full retrospective application of IFRS.

5.1.2 Exemptions from full retrospective application-elected by the Company

- (a) Business combinations exemption
The Company has applied the business combinations exemption in IFRS 1. It has not restated business combinations that took place prior to the January 1, 2013, transition date.
- (b) Fair value as deemed cost exemption
The Company has elected to measure certain items of property, plant and equipment at fair value as at

January 1, 2013. The application of this exemption is detailed in Note 5.2.2(b).

- (c) Cumulative translation differences exemption
The Company has elected to set the previously accumulated cumulative translation adjustments to zero at January 1, 2013. This exemption has been applied to all subsidiaries in accordance with IFRS 1. The application of this exemption is detailed in Note 5.2.2(f).
- (d) Employee benefits exemption
The Company has elected to recognize all cumulative actuarial gains and losses at January 1, 2013. The application of this exemption is detailed in Note 5.2.2(g). The remaining optional exemptions are not applicable to the Company.

5.1.3 Exceptions from full retrospective application followed by the Company

The Company has applied the following mandatory exceptions from retrospective application.

- (a) Hedge accounting exception
Management has claimed hedge accounting from January 1, 2013, only if the hedge relationship meets all the hedge accounting criteria under IAS 39. The application of this exemption at the opening balance sheet date of January 1, 2013, is detailed in Note 5.2.2(h).
- (b) Estimates exception
Estimates under IFRS at January 1, 2013, are consistent with estimates made for the same date under US GAAP.

All other mandatory exceptions in IFRS 1 were not applicable because there were no significant differences in management’s application of US GAAP in these areas.

5.2 Reconciliations between IFRS and US GAAP*

The following reconciliations provide a quantification of the effect of the transition to IFRS. The first reconciliation provides an overview of the impact on stockholders’ equity of the transition at January 1, 2013, March 31, 2013, and December 31, 2013. The following five reconciliations provide details of the impact of the transition on:

- stockholders’ equity at January 1, 2013 (Note 5.2.2)
- stockholders’ equity at March 31, 2013 (Note 5.2.3)
- stockholders’ equity at December 31, 2013 (Note 5.2.4)
- net income March 31, 2013 (Note 5.2.5)
- net income December 31, 2013 (Note 5.2.6)

* IFRS 1.40 requires an explanation of the material adjustments to the statement of cash flows as a result of transition to IFRS if a statement of cash flows was presented under previous GAAP. Such explanations have been omitted in this illustrative example

Preparing Your First IFRS Financial Statements: Adopting IFRS

5.2.1 Summary of stockholders' equity

(in millions of \$)	Jan. 1, 2013	Note	Mar. 31, 2013	Note	Dec. 31, 2013	Note
Total stockholders' equity reported under US GAAP	14,850		15,750		16,650	
Restatement of inventory costing method from the LIFO method to the FIFO method	400	5.2.2 (a)	500	5.2.3 (a)	370	5.2.4 (a)
Consolidation of inventory of subsidiary	50	5.2.2 (a)	50	5.2.3 (a)	50	5.2.4 (a)
Elimination of investment in associate	(35)	5.2.2 (a)	(35)	5.2.3 (a)	(35)	5.2.4 (a)
Recognition of noncontrolling interest†	(15)	5.2.2 (a)	(15)	5.2.3 (a)	(15)	5.2.4 (a)
Restatement of the XYZ PPE to fair value at transition	750	5.2.2 (a)	729	5.2.3 (b)	667	5.2.4 (a)
Recognition of impairment provisions using the guidance in IAS 36	(500)	5.2.2 (b)	(488)	5.2.3 (b)	(450)	5.2.4 (b)
Goodwill adjustments	200	5.2.2 (c)	200	5.2.3 (c)	200	5.2.4 (c)
IPR&D related adjustments	1,125	5.2.2 (d)	1,031	5.2.3 (d)	750	5.2.4 (d)
Cumulative translation adjustment†	300	5.2.2 (f)	300	5.2.3 (f)	300	5.2.4 (f)
Pension adjustments†	(100)	5.2.2 (g)	(100)	5.2.3 (g)	(100)	5.2.4 (g)
Discontinuance of hedge accounting†	—	5.2.2 (h)	(50)	5.2.3 (h)	(75)	5.2.4 (h)
Deferred tax and other noncurrent liability adjustments	(1,250)	5.2.2 (e)	(1,300)	5.2.3 (e)	(1,220)	5.2.4 (e)
Total adjustments	925		822		442	
†Total adjustments above were reclassified within equity	(185)		(135)		(110)	
Total stockholders' equity reported under IFRS	15,590		16,437		16,982	

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5.2.2 Reconciliation of stockholders' equity at January 1, 2013

(in millions of \$)	Note	US GAAP	Effect of Transition to IFRS	IFRS
Assets				
Cash and cash equivalents		5,000	—	5,000
Short-term securities		2,000	—	2,000
Accounts receivable less allowances		5,000	—	5,000
Inventories	(a)	4,500	450	4,950
Other current assets, including deferred taxes		3,500	—	3,500
Total current assets		20,000	450	20,450
Property, plant and equipment	(b)	15,000	250	15,250
Goodwill	(c)	2,000	200	2,200
Other intangible assets, net of accumulated amortization	(d)	500	1,125	1,625
Investments in associates	(a)	500	(35)	465
Other assets including deferred taxes		4,000	—	4,000
Total assets		42,000	1,990	43,990
Current liabilities				
Trade accounts payable		1,600	—	1,600
Accrued expenses		6,400	—	6,400
Accrued taxes		2,000	—	2,000
Total current liabilities		10,000	—	10,000
Noncurrent liabilities				
Long-term debt		13,000	—	13,000
Pension liabilities		500	—	500
Accrued postretirement benefits other than pensions		1,500	—	1,500
Other noncurrent liabilities, including deferred taxes	(e)	2,150	1,250	3,400
Total noncurrent liabilities		17,150	1,250	18,400
Stockholders' equity				
Share capital		500	—	500
Cumulative translation adjustment	(f)	300	(300)	—
Retired earnings	(i)	14,250	925	15,175
	(a)	—	15	15
Accumulated other comprehensive loss	(g), (h)	(200)	100	(100)
Total stockholders' equity		14,850	740	15,590
Total liabilities stockholders' equity		42,000	1,990	43,990

Preparing Your First IFRS Financial Statements: Adopting IFRS

Explanation of the effect of the transition to IFRS

The following explains the material adjustments to the balance sheet and income statement.

(a) *Inventory and consolidation*

- i. Under US GAAP, the Company applied the LIFO method of inventory measurement for both book and tax purposes. Under IFRS, LIFO is not an acceptable inventory costing method. Accordingly, the Company has restated its opening balance sheet retrospectively assuming that the first-in, first-out (FIFO) inventory costing methodology had been applied. The impact of this change in inventory valuation was an increase of \$400 million at January 1, 2013.
- ii. In addition, one subsidiary had been excluded from consolidation under US GAAP because the Company determined that it was not the primary beneficiary of the entity's activities. However, the Company has a currently exercisable purchase option to purchase a controlling interest in the assets of the entity, which consisted entirely of inventory. This entity was consolidated under IFRS. Inventory related to this entity totaled \$50 million.

The total increase to inventory as a result of IFRS differences was \$450 million.

As a result of the consolidation, the company recorded entries described above to consolidate the previously unconsolidated entity, eliminate the investment in the associate, and record the related noncontrolling interest.

(b) *Property, plant and equipment*

- i. Management has applied the fair value as deemed cost exemption with respect to certain plant machinery, buildings and land of its XYZ subsidiary. The valuation of the property performed at January 1, 2013, assessed its fair value as \$1.75 billion, an increase of \$750 million from its carrying amount under US GAAP of \$1.0 billion.
- ii. Impairment

Information on impairment losses recognized at January 1, 2013

The impairment charge of \$500 million arose in the manufacturing CGU "Factory Blue," which is the Company's manufacturing plant in Any State, USA, following a decision to reduce the manufacturing output allocated to the operation. This was a result of a redefinition of the Company's allocation of manufacturing volumes across all CGUs to benefit from advantageous

market conditions. The Company reassessed the depreciation policies in the CGU and estimated that the useful lives and residual values of property, plant and equipment will not be affected following this decision.

The recoverable amount of this CGU was estimated based on value-in-use calculations as this was determined to be higher than fair value less costs to sell. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated growth rates stated below. The growth rate does not exceed the long-term average growth rate for the manufacturing business in which the CGU operates. The following are key assumptions used in the value-in-use calculation.

Gross margin [†]	30%
Growth rate [‡]	1.8%
Discount rate [§]	10.5%

[†] Budgeted gross margin

[‡] Weighted average growth rate used to extrapolate cash flows beyond the budget period

[§] Pretax discount rate applied in cash flow projections.

Management determined the budgeted gross margin based on past performance and its expectations for the market development. The weighted average growth rates used are consistent with the forecasts included in industry reports. The discount rates used are pretax and reflect specific risks in relation to the relevant CGU.

A change in management's gross margin estimate by 10% would increase the impairment by \$50 million. If management reduces the growth rate by 10%, impairment would increase by \$3 million. An increase in the discount rate by 10% would also increase impairment by \$5 million.

This CGU was not considered impaired under US GAAP because the estimated cash flow projections on an undiscounted basis exceeded the carrying amount of the CGU.

As a result of the adjustments described in (b)(i) and (ii) to the opening IFRS balance sheet, total PP&E increased by \$250 million.

(c) *Goodwill*

One special-purpose entity previously unconsolidated under US GAAP, because the Company concluded that it was not the primary beneficiary of the entity's activities, has been consolidated under IFRS. Goodwill related to this entity totaled \$200 million.

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Goodwill had been tested for impairment at January 1, 2013.

Goodwill was allocated to CGUs for the purpose of impairment testing. Each of those CGUs represented the Company's investment in each country of operation. No impairment was identified at January 1, 2013. A segment-level summary of the goodwill allocation is presented below.

At January 1, 2013

(in millions of \$)	Segment A	Segment B	Total
US	800	600	1,400
UK	200	300	500
Other	100	200	300
	1,100	1,100	2,200

The recoverable amount of this CGU was estimated based on value-in-use calculations as this was determined to be higher than fair value less costs to sell. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated growth rates stated below. The growth rate does not exceed the long-term average growth rate for the business in which the CGU operates.

Key assumptions used for value-in-use calculations

	Segment A			Segment B		
	US	UK	Other	US	UK	Other
Gross margin [†]	29.0%	30.0%	26.0%	36.0%	28.0%	27.0%
Growth rate [‡]	1.8%	1.8%	1.9%	1.3%	1.1%	1.4%
Discount rate [§]	10%	10.7%	12.8%	11.0%	11.8%	13.5%

These assumptions have been used for the analysis of each CGU within the business segments.

[†] Budgeted gross margin

[‡] Weighted average growth rate used to extrapolate cash flows beyond the budget period

[§] Pretax discount rate applied to the cash flow projections

Management determined the budgeted gross margin based on past performance and its expectations for market development. The weighted average growth rates used are consistent with the forecasts included in industry reports.

The discount rates used are pretax and reflect specific risks relating to the relevant segments.

(d) *Other intangible assets*

As part of the acquisition of ABC Technologies in 2012, the Company recorded at fair value and then immediately expensed \$1.5 billion of in process research and development under US GAAP. The amount of \$1.125 billion has been recognized, net of \$375 million accumulated amortization, as other intangible assets in the IFRS opening balance sheet to properly reflect the net unamortized balance of the costs as of the transition date.

(e) *Deferred tax adjustments (other noncurrent liabilities)*

The change in deferred taxes represents the deferred tax effects on the adjustments necessary to transition to IFRS.

(f) *Cumulative translation adjustment*

As allowed by IFRS, the company reset its cumulative translation adjustment account to zero at January 1, 2013.

(g) *Pension adjustment*

The Company has elected to apply the IFRS 1 employee benefits exemption. Accordingly, cumulative net actuarial losses totaling \$100 million recorded in accumulated other comprehensive loss under US GAAP were recognized in opening retained earnings at January 1, 2013.

(h) *Hedge accounting exception*

The company held interest rate swaps at the transition date related to variable rate debt instruments. Under US GAAP, the swaps qualified for hedge accounting with changes in fair value recorded in other comprehensive income. The hedging relationship was carried over in the opening balance sheet because it is of a type that qualifies for hedge accounting under IFRS. However, because management had used the shortcut method, it did not have sufficient documentation at the transition date to continue hedge accounting under IAS 39. As a result, the company has discontinued hedge accounting and will record future changes in the fair value of the hedging instrument directly in profit and loss.

(i) *Retained earnings*

Other than for reclassification items, all of the above adjustments were recorded against the opening retained earnings at January 1, 2013.

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5.2.3 Reconciliation of stockholders' equity at March 31, 2013

(in millions of \$)	Note	US GAAP	Effect of Transition to IFRS	IFRS
Assets				
Cash and cash equivalents		4,700	—	4,700
Short-term securities		2,500	—	2,500
Accounts receivable less allowances		6,000	—	6,000
Inventories	(a)	5,000	550	5,550
Other current assets, including deferred taxes		2,500	—	2,500
Total current assets		20,700	550	21,250
Property, plant and equipment	(b)	14,500	241	14,741
Goodwill	(c)	2,000	200	2,200
Other intangible assets, net of accumulated amortization	(d)	475	1,031	1,506
Investments in associates	(a)	525	(35)	490
Other assets including deferred taxes		4,500	—	4,500
Total assets		42,700	1,978	44,687
Current liabilities				
Trade accounts payable		2,100	—	2,100
Accrued expenses		6,400	—	6,400
Accrued taxes		500	—	500
Total current liabilities		9,000	—	9,000
Noncurrent liabilities				
Long-term debt		13,100	—	13,100
Pension liabilities		525	—	525
Accrued postretirement benefits other than pensions		1,600	—	1,600
Other noncurrent liabilities, including deferred taxes	(e)	2,725	1,300	4,025
Total noncurrent liabilities		17,950	1,300	19,250
Stockholders' equity				
Share capital		500	—	500
Cumulative translation adjustment	(f)	300	(300)	—
Retired earnings	(i)	15,200	822	16,022
	(a)	—	15	15
Accumulated other comprehensive loss	(g), (h)	(250)	150	(100)
Total stockholders' equity		15,750	687	16,437
Total liabilities stockholders' equity		42,700	1,987	44,687

Explanation of the Effect of the Transition to IFRS

The following explains the material adjustments to the balance sheet at March 31, 2013.

<i>(a) Inventory</i>	(in millions of \$)
Restatement of inventory costing method from LIFO to FIFO	500
Consolidation of subsidiaries previously excluded from US GAAP consolidation	<u>50</u>
Total impact—increase to inventory	550

As a result of the consolidation, the company recorded entries described above to consolidate the previously unconsolidated entity, eliminate the investment in the associate, and record the related noncontrolling interest.

(b) Property, plant and equipment

Restatement of XYZ property, plant and equipment to fair value	750
Impact of impairment losses recognized under IFRS	(500)
Additional depreciation on net property, plant and equipment adjustments	<u>(9)</u>
Total impact—increase to property, plant and equipment	241

(c) Goodwill

Consolidation of subsidiaries previously excluded from US GAAP consolidation resulted in the recognition of additional goodwill of \$200 million. See Note 5.2.2(e).

(d) Other intangible assets

As part of the acquisition of ABC Technologies in 2012, the Company recorded at fair value and then immediately expensed \$1.5 billion of IPR&D under US GAAP. The amount of \$1.125 billion has been recognized as other intangible assets in the IFRS opening balance sheet and will be amortized over its remaining useful life of 3 years.

For the three-month period ended March 31, 2013, the Company recognized \$94 million of IPR&D amortization in cost of sales.

(e) Deferred tax adjustments and other noncurrent liabilities adjustments.

The change in deferred taxes represents the deferred tax adjustments on the adjustments necessary to transition to IFRS.

(f) Cumulative translation adjustment

The cumulative translation adjustment account was reset to zero at January 1, 2013. There were no additional changes in the CTA account for the three months ended March 31, 2013.

(g) Pension adjustment

The Company has elected to recognize all cumulative actuarial gains and losses as of January 1, 2013. For the period ended March 31, 2013, the Company recognized \$100 million in retained earnings related to cumulative net actuarial losses, which had been recorded in accumulated other comprehensive loss under US GAAP.

(h) Hedge accounting exception

Management had applied the “shortcut” method for hedge effectiveness testing for its existing interest rate swaps on variable rate debt instruments under US GAAP. All changes in fair value were recorded in accumulated other comprehensive income. Under IFRS, although the hedging relationship was reflected on the opening balance sheet, it did not qualify for hedge accounting prospectively because of differences in documentation requirements. As a result, an additional \$50 million in unrealized losses were recognized in the income statement under IFRS during the period ended March 31, 2013.

(i) Retained earnings

Other than for reclassification items, all of the above adjustments were recorded against the opening retained earnings at January 1, 2013, or reflect the income and retained earnings impact for the three-month period ended March 31, 2013.

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5.2.4 Reconciliation of stockholders' equity at December 31, 2013

(in millions of \$)	Note	US GAAP	Effect of Transition to IFRS	IFRS
Assets				
Cash and cash equivalents		5,000	—	5,000
Short-term securities		3,000	—	3,000
Accounts receivable less allowances		5,000	—	5,000
Inventories	(a)	4,500	420	4,920
Other current assets, including deferred taxes		2,000	—	2,000
Total current assets		19,500	420	19,920
Property, plant and equipment	(b)	13,000	217	13,217
Goodwill	(c)	2,000	200	2,200
Other intangible assets, net of accumulated amortization	(d)	400	750	1,150
Investments in associates	(a)	600	(35)	565
Other assets including deferred taxes		4,000	—	4,000
Total assets		39,500	1,552	41,052
Current liabilities				
Trade accounts payable		1,500	—	1,500
Accrued expenses		5,500	—	5,550
Accrued taxes		2,500	—	2,500
Total current liabilities		9,000	—	9,500
Noncurrent liabilities				
Long-term debt		10,200	—	10,200
Pension liabilities		450	—	450
Accrued postretirement benefits other than pensions		1,550	—	1,550
Other noncurrent liabilities, including deferred taxes	(e)	1,150	1,220	2,370
Total noncurrent liabilities		13,350	1,220	14,570
Stockholders' equity				
Share capital		500	—	500
Cumulative translation adjustment	(f)	300	(300)	—
Retired earnings	(i)	16,125	442	16,567
	(a)	—	15	15
Accumulated other comprehensive loss	(g), (h)	(275)	175	(100)
Total stockholders' equity		16,650	332	16,982
Total liabilities stockholders' equity		39,500	1,552	41,052

Explanation of the Effect of the Transition to IFRS

The following explains the material adjustments to the balance sheet at December 31, 2013.

(a) Inventory	(in millions of \$)
Restatement of inventory costing method from LIFT to FIFO	370
Consolidation of subsidiaries previously excluded from US GAAP consolidation	<u>50</u>
Total impact—increase to inventory	420

As a result of the consolidation, the company recorded entries described above to consolidate the previously unconsolidated entity, eliminate the investment in the associate, and record the related noncontrolling interest.

(b) *Property, plant and equipment*

Restatement of XYZ property, plant and equipment to fair value	750
Impact of impairment losses recognized under IFRS	(500)
Additional depreciation on net property, plant and equipment adjustments	<u>(33)</u>
Total impact—<i>increase to property, plant and equipment</i>	217

(c) *Goodwill*

Consolidation of subsidiaries previously excluded from US GAAP consolidation resulted in the recognition of additional goodwill of \$200 million. See Note 5.2.2(c).

(d) *Other intangible assets*

Opening retained earnings adjustment related to IPR&D acquired as part of the Company's acquisition of ABC Technologies in 2012	1,125
Amortization for the year ended December 31, 2013	<u>(375)</u>
Net other intangible adjustment	750

(e) *Deferred tax adjustments and other noncurrent liabilities adjustments.*

The change in deferred taxes represents the deferred tax adjustments on the adjustments necessary to transition to IFRS.

(f) *Cumulative translation adjustment*

The cumulative translation adjustment account was reset to zero at January 1, 2013. There were no additional changes in the CTA account for the three months ended December 31, 2013.

(g) *Pension adjustment*

The Company has elected to recognize all cumulative actuarial gains and losses as of January 1, 2013. On January 1, 2013, the Company recognized \$100 million in retained earnings related to actuarial losses recorded in US GAAP accumulated other comprehensive loss.

(h) *Hedge accounting exception*

Management had applied the "shortcut" method for its existing interest rate swaps on its variable rate debt instruments under US GAAP. All changes in fair value were recorded in accumulated other comprehensive income. Under IFRS, although the hedging relationship was not adjusted on the opening balance sheet, it did not qualify for hedge accounting going forward due to different documentation requirements. As a result, an additional \$75 million in unrealized losses were recorded under IFRS during the year ended December 31, 2013.

(i) *Retained earnings*

Other than for reclassification items, all of the above adjustments were recorded against the opening retained earnings at January 1, 2013, or reflect the income and retained earnings impact for the three-month period ended December 31, 2013.

5.2.5 Reconciliation of net income for three months ended March 31, 2013

(in millions of \$)	Note	US GAAP	Effect of Transition to IFRS	IFRS
Sales		7,500	—	7,500
Cost of sales	(a)	5,000	3	5,003
Gross profit		2,500	(3)	2,497
Other operating income		(100)	—	(100)
Selling and marketing costs		500	—	500
Administrative expenses		200	—	200
Other operating expenses		100	—	100
Operating profit/(loss)		1,800	(3)	1,797
Finance costs—net	(b)	(150)	(50)	(200)
Share of profit of associates		25	—	25
Profit before tax		1,675	(53)	1,622
Income tax expense (benefit)	(c)	725	(14)	711
Profit from ordinary activities after tax		950	(39)	911
Profit for the period		950	(39)	911

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(a) Costs of sales were impacted by:		(a) Interest expense on interest rate swaps for which the shortcut method was applied under US GAAP
(i) Inventory costing method change—quarterly change in LIFO reserve	(100)	(b) Tax impacts of adjustments
(ii) Additional depreciation on net adjustments to PPE	9	
(iii) Amortization of IPR&D	94	
Net decrease to cost of sales	3	

5.2.6 Reconciliation of net income for year ended December 31, 2013

(in millions of \$)	Note	US GAAP	Effect of Transition to IFRS	IFRS
Sales		27,000	—	27,000
Cost of sales	(a)	20,000	439	20,439
Gross profit		7,000	(439)	6,561
Other operating income		(100)	—	(100)
Selling and marketing costs		2,000	—	2,000
Administrative expenses		600	—	600
Other operating expenses		500	—	500
Operating profit/(loss)		4,000	(439)	3,561
Finance costs—net	(b)	(700)	(50)	(750)
Share of profit of associates		100		100
Profit before tax		3,400	(489)	2,911
Income tax expense (benefit)	(c)	1,525	(196)	1,329
Profit from ordinary activities after tax		1,875	(293)	1,582
Profit for the period		1,875	(293)	1,582

(a) Costs of sales were impacted by:		(b) Interest expense on interest rate swaps for which the shortcut method was applied under US GAAP
(i) Inventory costing method change—quarterly change in LIFO reserve	30	(c) Tax impacts of adjustments
(ii) Additional depreciation on net adjustments to PPE	33	For additional information related to this article please contact:
(iii) Amortization of IPR&D	376	John Barry
Net decrease to cost of sales	439	US IFRS Leader
		PricewaterhouseCoopers
		646.471.7576
		Email: john.j.barry@us.pwc.com

IFRS Implications for Income Taxes

By Joan Rood and Laura Kinney, Financial Executive

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Transitioning to IFRS will have a noticeable effect on corporate taxes, due to the intertwined relationship of the tax rules and regulations embedded in U.S. GAAP.

Recognizing that U.S. companies compete for capital in a global marketplace, in late August the U.S. Securities and Exchange Commission moved to allow some large companies to begin using International Financial Reporting Standards as early as next year.

Then, if certain milestones are met, a decision will be made on moving to require certain U.S. companies to use it by 2014 and all to do so by 2016.

The commission voted unanimously to propose for comment a roadmap for conversion, with eventual adoption. This transition will not only impact financial statement preparers, it also will have a noticeable effect on tax professionals, due to the intertwined relationship of the tax rules and regulations embedded in U.S. generally accepted accounting principles.

The following addresses several projected implications that a transition to IFRS may have on tax rules and regulations.

TAX TREATMENT OF LIFO INVENTORIES

The most profound and best-known effect that IFRS will probably have on U.S. tax law concerns the treatment of inventories. Upon adopting IFRS, a company using the last-in, first-out (LIFO) cost-flow assumption for determining its cost of goods sold for tax purposes will likely have to request permission from the Internal Revenue Service to change to an alternative method—such as the first-in, first-out (FIFO) method or the weighted average method.

That's because IFRS does not permit a company to use LIFO for financial reporting purposes. In addition, the tax code prohibits firms from using LIFO for tax purposes if they don't for financial reporting purposes under a provision known as the "LIFO conformity rule."

If a company changes its accounting method from LIFO to something else, it must restate opening inventory in the year of the change as if it had used the new method in prior periods. If the new opening inventory balance is greater than what it would have been under LIFO, the firm must recognize the difference as income over the following four years through a Sec. 481(a) adjustment to eliminate any income distortion from changing inventory methods.

This adjustment essentially represents the cumulative tax benefit the company obtained by using LIFO. For many companies, the Sec. 481(a) adjustment will be substantial, because the beginning inventory amount under LIFO includes purchases from many years earlier. Thus, the company's adjustments would be very large and would result in "phantom" taxable income over the spread period.

This taxable income from the Sec. 481(a) adjustment is phantom income in the sense that there is no current economic gain to the company. Instead the income reflects the tax benefits that the firm received by using the LIFO method instead of the new method. Conversely, if a company has a negative Sec. 481(a) adjustment, likely due to the effects of deflation on its inventory, then it can deduct the adjustment in the year of the change.

If U.S. companies must convert to IFRS, the resulting Sec. 481(a) adjustments will produce significant tax revenue for the federal government. That revenue, however, will not be "scored," and thus could not be used to offset proposed federal spending.

For this reason, it is likely that Congress would repeal the LIFO method prior to any effective date for conversion to IFRS, so that it can "score" the revenue gains from the resulting Sec. 481(a) adjustments. In fact, such legislation has already been introduced.

IFRS Implications for Income Taxes

A bill to repeal LIFO inventory accounting for tax purposes and permit a 10-year Sec. 481 (a) adjustment period was introduced by Rep. Charles Rangel (D-N.Y.) last October. Rangel estimated that the legislation—H.R. 3970, the Tax Reduction and Tax Reform Act of 2007—would produce approximately \$106 billion of federal tax revenue in fiscal years 2008 through 2017.

The legislation also contains several controversial tax provisions and many political pundits don't think it will proceed through Congress this year. But some experts think it will be politically easier for Congress to repeal LIFO now that the SEC announced its intention to require U.S. companies to convert to IFRS.

LOWER OF COST OR MARKET: REVERSAL OF INVENTORY WRITE-DOWNS

Another possible substantive consideration regarding inventories involves the lower of cost or market (LCM) method and the reversal of write-downs. An entity may write down inventory for several reasons, including decline in selling price, increase in costs of completion or the direct selling costs.

Because of the IFRS requirement to measure inventory at the lower of cost and net realizable value in each period, an entity must write down the inventory below cost, to the expected recoverable amounts as the impairments occur. If however, the conditions necessitating the write-down cease to exist, the entity applying IFRS must then reverse the writedown. The reversal is limited to the amount originally written down, bringing the item back up to cost. An entity would then incur income in a period when it reverses the write down of inventories.

Though IFRS allows for the reversal of the write-down, U.S. GAAP prohibits it. Under U.S. GAAP, when inventory is written down, the new reduced amount is considered to be the new cost of the inventory. Thus, entities switching to IFRS from U.S. GAAP will be changing their accounting to recognize new income from reversing the write-downs.

The federal tax rules for LCM and inventory write-downs generally follow U.S. GAAP. Section 471 of the

Internal Revenue Code, which specifies that an inventory method must “clearly reflect income” and “conform as nearly as may be to the best accounting practice.” The courts have interpreted “best accounting practice” as meaning complying with GAAP.

Since U.S. GAAP allows inventory to be valued at either cost or LCM, the tax regulations specify that this method is also acceptable for tax purposes. However, the tax rules limit the application of LCM to non-LIFO methods.

A taxpayer may not apply LCM to inventory accounted for under LIFO. Even though LIFO-method taxpayers may not use the LCM for tax purposes, they still may use the LCM for financial reporting purposes without violating the LIFO conformity rule.

A transition by U.S. companies from U.S. GAAP to IFRS could have two effects on LCM. First, companies that have to convert from LIFO to another method for book purposes may elect LCM for tax purposes once they receive permission from the IRS to adopt a non-LIFO method.

Second, the conversion to IFRS would create an interesting legal question. Since IFRS would represent the new generally accepted accounting principles, would taxpayers on LCM have to apply LCM for tax purposes the same way it is applied under IFRS and reverse any inventory write-downs for subsequent market increases?

Doing so would mean companies would recognize unrealized income. The tax rules define the concepts of cost and market in the context of LCM, but are silent on the market-reversal issue, presumably because market reversals are not permitted under U.S. GAAP.

If U.S. companies must convert to IFRS, would the Treasury Department and IRS amend the Treasury Regulations to state that market reversals are not required? Or would they follow the rationale used by the courts and require market reversals because such reversals would be required under generally accepted accounting principles?

Until the IRS issues new rules or regulations, however, taxpayers applying IFRS should not reverse inventory write-downs for tax purposes.

ADVANCE PAYMENTS

There are two conformity requirements in the federal tax rules regarding revenue recognition from advance payments. Ordinarily, taxpayers must report advance payments for tax purposes upon receipt.

But there are two provisions that allow taxpayers to defer recognition of certain advance payments up to the period in which they report such payments as income for financial statement purposes.

Under the first provision, an accrual-method taxpayer can elect to use a “deferral method” for advance payments related to, among other items, the sale of goods, provision of services and use of property ancillary to the provision of services. Under the deferral method, if the taxpayer reports revenue from advance payments in its financial statements in the year the revenues are received, it must likewise report such revenues for tax purposes. Otherwise it may defer recognition for tax purposes until the following taxable year.

The second deferral rule for advance payments permits a taxpayer to defer advance payments related to the sale of goods for tax purposes until it would normally report such receipts under its accounting method.

This deferral provision does not apply to advance payments for inventorable goods when the payments exceed a reasonable estimate of inventory costs and the taxpayer has a sufficient supply of goods to fill the order. A taxpayer using this second deferral rule to account for an advance payment cannot also use the first accrual provision.

Generally, under both U.S. GAAP and IFRS, revenue is recognized from the sale of goods when the risks and rewards of ownership of the goods have passed to the buyer; but they have similar, though not identical, additional criteria that must be met for recognizing revenue.

Moreover, there is much interpretative guidance pertaining to the basic U.S. GAAP criteria that is absent under IFRS, which makes the IFRS rules more principles-based in this area.

Accordingly, when converting to IFRS, a company that receives advance payments will have to determine how it will apply the principles-based IFRS criteria when recognizing accounting income from these advance payments.

If it determines that these advance payments should be included in income earlier than they had been under U.S. GAAP, then the company may be accelerating recognition of such payments for tax purposes if it uses one or both of the tax deferral provisions available for advance payments.

R&D COSTS

Another potential administrative burden for companies that adopt IFRS involves the treatment of research and development costs. In general, under U.S. GAAP companies must expense both research and development costs as incurred.

Under IFRS, companies must treat R&D costs separately. Research costs (the costs associated with the origination of the new “scientific or technical knowledge and understanding”) are expensed as incurred.

Development costs (the costs of applying the research to a plan or design for production), must be capitalized if those costs create an asset and meet certain other criteria. Specifically, the asset must meet the definition of an intangible asset, it must be likely that future economic benefits attributable to the asset will flow to the entity and the costs of the asset must be reliably measured.

Capitalized costs under IFRS are essentially amortized over the life of the asset they help create if that asset has a finite, useful life. If the asset to which such costs are capitalized does not have a finite useful life, the asset is tested annually for impairment and any resulting decrease in value is written off for book purposes.

A company’s treatment of R&D costs is independent of the treatment for book purposes. Section 471 permits taxpayers to expense or capitalize R&D costs. If a firm capitalizes R&D costs, they are amortizable over a period of not less than 60 months, beginning with the month the taxpayer first realizes benefits from such expenditures, if they are not otherwise capitalized to property that is subject to depreciation or amortization.

Companies that expense R&D costs for both book and tax purposes will have book-tax differences after adopting IFRS if they chose to continue to expense these costs for tax purposes. So, either they keep two separate books, or request permission from the IRS

IFRS Implications for Income Taxes

to switch their tax method to avoid the administrative burden of applying two methods.

Electing to capitalize R&D costs for tax purposes, however, will not eliminate the administrative burden of tracking the book-tax difference related to R&D expenses because the timing of the subsequent deductions for capitalized amounts will likely differ for book and tax purposes. For this reason, many companies are likely to retain their current method of expensing R&D costs.

The tax considerations discussed here are some of the implications that companies may face when converting from U.S. GAAP to IFRS. When it comes to tax reporting, companies must re-examine their procedures for identifying and measuring book-tax differences.

If firms want to change their tax method, they'll have to follow the IRS rules for doing so—including filing a Form 3115, Application for Change in Accounting Method—unless the IRS announces a different procedure for methods affected by IFRS.

TAKEAWAYS

- A U.S. transition to IFRS will not only impact the preparation of financial statements, it will have a noticeable effect on tax issues, due to the intertwined relationship of tax rules and regulations with GAAP.
- The most profound and best-known effect of IFRS concerns the treatment of inventories. Under IFRS, a firm using the LIFO cost-flow assumption for determining cost of goods sold for tax purposes will likely have to request permission from the IRS to change to an alternative method—such as FIFO.
- Another issue involves the treatment of R&D costs. That's because under IFRS, companies must treat R&D costs separately and those expensing these costs for both book and tax purposes will have book-tax differences if they keep doing so.

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IFRS: The Right Move toward Convergence: What IFRS Will Mean to US Tax Executives

By PricewaterhouseCoopers

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The question appears to no longer be “if” but “when”—when will the US join the rest of the developed world in adopting International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB)?

WHAT IFRS WILL MEAN TO US TAX EXECUTIVES

The conversion to IFRS will have a pervasive impact on today’s global tax function . . . The involvement of tax professionals is important at every stage of the IFRS conversion process.

US companies may be able to elect to use IFRS as early as 2009. The implications to the tax executive go well beyond the potential impact on a company’s effective tax rate or income tax related disclosures in the financial statements. The move to IFRS has broad implications to the tax function, potentially impacting a company’s global cash tax obligations, international tax planning and underlying systems, processes and controls.

The potential for converting to IFRS is a topic being discussed at the executive and board of director levels of an increasing number of US multinational companies. Companies are organizing cross-functional teams to address the various aspects of a potential move to IFRS. **It is essential that the tax executive be part of the IFRS conversion process at a very early stage.**

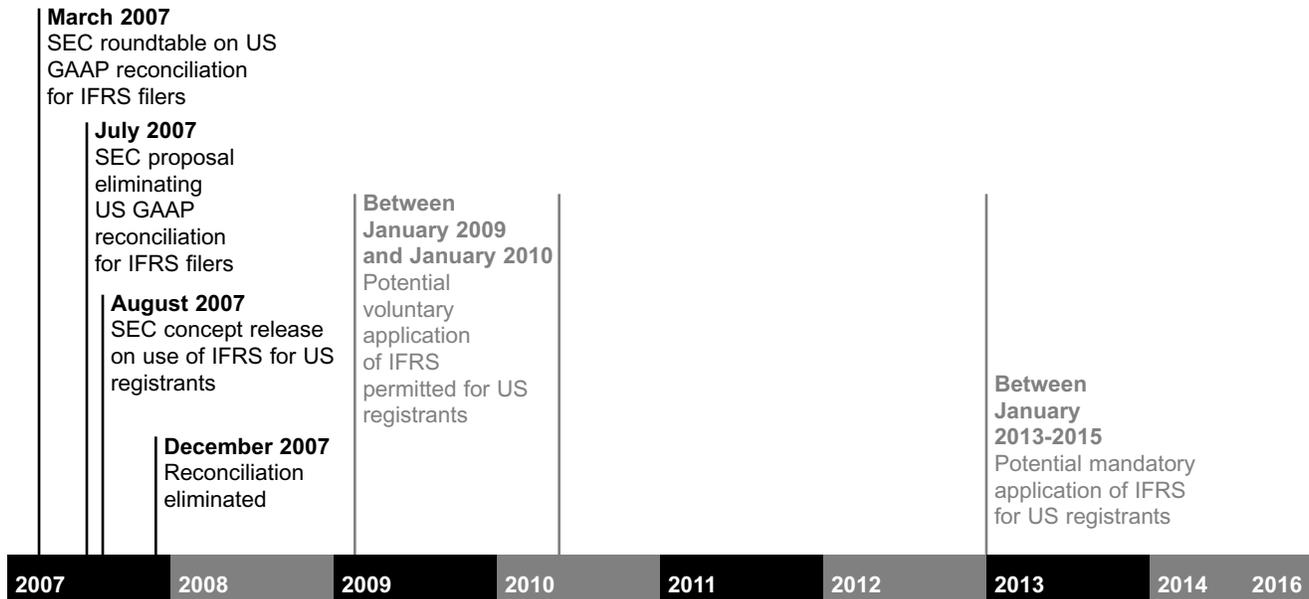
Potential timetable for the US move to IFRS

Since the European Union adopted IFRS in 2005, over 100 countries have moved to require or permit the use of IFRS. The European Union, Australia, Canada, Brazil, India, Japan, China and other major markets have either already converted to IFRS or are in the process of doing so. IFRS is also widely used in Eastern Europe and Russia.

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FIGURE 4-1

Estimating the transition timeline



Momentum toward the adoption of IFRS for US financial reporting accelerated in the wake of two SEC moves in the second half of 2007. The first was a decision to eliminate the requirement for foreign private issuers using IFRS as their primary reporting framework to provide a reconciliation to US GAAP as part of their filings with the SEC. The second was the issuance of an SEC concept release requesting comment on allowing US companies to use IFRS as a primary reporting framework. Responses to this proposal have been favorable, with approximately two-thirds of respondents favoring a mandatory adoption date.

A move to IFRS may be both inevitable and advantageous for US multinationals. One projected timeline estimates that IFRS could be mandatory in the US by 2013-2015, while early adoption options may be available as early as 2009.

IFRS offers a promise of a single worldwide standard for financial reporting. IFRS will enhance comparability and transparency, which will be beneficial to all stakeholders. A single standard should create cost efficiencies for global companies and, with fewer

rules and exceptions, help to reduce complexity and the risk of errors.

A pervasive change in framework

Gaining an understanding of IFRS is essential for the tax executive responsible for a company's global tax function. The move to IFRS involves a fundamental change in the framework of how US companies measure pre-tax income and the principles governing accounting for income taxes.

Tax executives recognize that the move to IFRS will potentially impact a company's effective tax rate and other aspects of tax accounting and reporting. However, the move to IFRS will have significantly broader implications to the tax executive. The pre-tax and other financial accounting aspects of IFRS have a myriad of tax method of accounting considerations. IFRS will have other implications on US taxes, international tax planning, state and local taxes and transfer pricing determinations. Additionally, processes, controls and systems for tax reporting and compliance will need to be modified as underlying accounting systems change to IFRS.

The involvement of tax professionals is important at every stage of the IFRS conversion process. Proper assessment of the tax impact of each potential accounting change requires insight into the applicable tax rules and regulations (in the various tax jurisdictions) as well as knowledge of the detailed differences among US GAAP, existing statutory accounting and IFRS.

Cash tax implications—US and non-US

The move to IFRS could have a significant impact on both US and foreign cash taxes of a company. In most jurisdictions, financial reporting is often the starting point in determining taxable income for tax filing purposes. As financial accounting policies change from existing GAAP to IFRS, companies will need to consider the implications of such changes on cash taxes.

To start, there are a significant number of potential differences between IFRS and US GAAP which could materially affect pre-tax accounting income. Examples of such differences include the accounting for revenue, leases, asset impairments, classification and measurement of financial instruments, hedging activity and stock-based compensation, to name a few.

In the US, tax methods of accounting do not necessarily follow the “book” method of accounting. As a result, a conversion to IFRS will require an analysis of each new accounting policy for its related tax implications, including a determination as to whether it is permissible or advisable to conform the related tax method of accounting to the new book accounting method. It is important to remember that a tax accounting method does not automatically change because the book accounting method changes. Rather, the consent of the IRS Commissioner must be obtained to change an accounting method for US tax purposes.

IFRS also is a major tax issue for companies using the LIFO method to value inventories. IFRS does not permit the use of LIFO, and the tax law does not permit the use of LIFO unless the method is used for

financial reporting purposes. Unless this LIFO conformity requirement is changed through legislation, US companies currently using LIFO will face a tax cost with a change to IFRS for financial reporting. Under current law, the effect of the change from LIFO to FIFO (known as the §481(a) adjustment) may be spread over four years, though Congress is considering repealing the LIFO method and allowing a longer spread period. Tax executives with companies using LIFO should be closely monitoring the debate in Washington on this issue.

Similar accounting method considerations will need to be given to a company’s non-US operations. As more jurisdictions permit or require use of IFRS as the basis for statutory reporting, the related cash tax implications will need to be analyzed. For those countries that pursue an “independent approach” (i.e., requiring that a set of “tax accounts” be prepared “independently” from the IFRS accounts), the impact will primarily be felt in the deferred tax area with rather limited impact on cash taxes. Examples of countries with an independent approach include the Netherlands, Poland and Norway.

In contrast, for those countries that have a “(quasi-)dependent approach” (i.e., the measure of a company’s taxable profits is computed mainly in accordance with its financial accounts), and which permit or require adoption of IFRS at the legal entity level, it is likely that the adoption of IFRS will have an impact on a company’s cash tax position. Examples of countries with a (quasi-) dependent approach, include the UK, Spain, Portugal, Switzerland and Luxembourg.

The degree of impact on cash taxes will ultimately depend upon the extent to which each individual tax authority is willing to embrace IFRS principles in the tax law. As there is an increasing trend in a number of countries adopting IFRS principles into local tax law, more attention will need to be focused on the cash tax implications of the various financial accounting policy decisions made during the conversion to IFRS.

INTERNATIONAL TAX CONSIDERATIONS

The cash tax implications go well beyond differences in accounting for items of revenue and expense. The move to IFRS may have an impact on international tax planning considerations as well.

In jurisdictions where statutory accounting forms the basis of classification of debt versus equity for tax purposes, a review will need to be made of financing structures and the impact IFRS has on them to determine the related tax implications. Similarly, in some jurisdictions, the characterization of a transaction as a lease is often dependent on the accounting for statutory purposes.

The use of fair value measurement is also an important aspect of IFRS and used more frequently in certain areas. For example, under IFRS companies can elect to measure property, plant equipment and investment property at fair value, and certain financial instruments may be required to be carried at fair value. These measurement concepts could have a significant impact on debt-to-equity and other balance sheet ratios, resulting in limitations on interest deductibility.

Conversion to IFRS is also likely to have a significant impact on other aspects of international tax planning, including cash repatriation. Changes in a foreign entity's cash tax liability will need to be reviewed for foreign tax credit implications, including Subpart F high-tax exception determinations. A review will also need to be made of E&P computations for consistency with existing accounting methods and, where appropriate, consideration given to changing E&P accounting methods to conform with the policies being adopted in the IFRS conversion process. Lastly, the ability to make distributions from foreign affiliates may be affected to the extent that the accounting under IFRS results in a significant change in distributable reserves on the statutory books of particular foreign entities.

The impact of these various international tax considerations will vary by company and by industry. Therefore, to the extent international tax and cash repatriation planning is an important aspect of a company's overall tax and treasury strategy, it will be important for the tax executive to gain insight into the potential pre-tax implications of IFRS, even if the move to IFRS for external reporting is on the longer-term horizon.

TAX ACCOUNTING—THE MOVE TOWARD CONVERGENCE

Despite similarities in the approaches to accounting for income taxes under US GAAP and IFRS, there are still certain key differences between the two accounting standards.

While today there are approximately 15 to 20 differences between the standards, after convergence there may only remain 3 to 4 major differences, including FIN 48 and FAS 123R.¹ The remaining differences in policies and principles, combined with the impact of applying IFRS on pre-tax accounting income and shareholders' equity, could have a substantial impact on a company's tax provision and effective tax rate.

One of the more important tax accounting differences that will likely remain after the convergence is the accounting for uncertain tax positions. The IASB has indicated that its current intention is not to adopt the recognition, measurement and disclosure requirements of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). This means that US companies moving to IFRS may again need to change the way they account for and disclose uncertain tax positions.

Unlike the benefit recognition model of FIN 48, under IFRS today, a liability for tax uncertainties is based on the amount of taxes expected to be paid to the tax authorities. IFRS does not specify a two-step

¹ After the current FASB/IASB convergence project with regard to income taxes becomes effective, there may still be differences between IFRS and US GAAP in tax accounting principles. Examples include accounting for uncertain tax positions, deferred taxes on share-based payments, deferred taxes related to the effect of a change in an entity's tax status and specific exemptions applicable under FAS 109, such as those for leveraged leases and disclosure requirements.

process of recognition and measurement, nor does it prescribe a specific approach to measurement. The IASB has tentatively decided to move to a model with no recognition threshold for uncertainties and measurement using weighted average probability.

IFRS currently has no specific disclosure requirements for uncertain tax liabilities. However, there is a proposed exposure draft that would modify IAS 12 to provide general disclosure guidance for uncertain tax positions. This proposed disclosure is less prescriptive than FIN 48.

Other tax considerations

State and local tax

The move to IFRS will have other important implications for the tax executive. It may affect a company's overall state and local tax position. State and local taxes will be impacted by the changes in the federal income tax base. Fair value measurement and other changes in the balance sheet may impact net worth and affect franchise and property taxes where the book accounting treatment forms the basis for taxation. Additionally, changes in revenue recognition policies and fair value measurement may affect various state apportionment factors.

Systems, processes and controls

For US multinational companies, systems, processes and controls used within the tax department have been primarily designed to deliver information to meet the financial statement reporting requirements of US GAAP, along with various tax compliance and reporting requirements. Recent developments in tax and financial reporting have increased the importance of these systems and processes as companies have sought to automate and enhance their tax processes to reduce risk and increase efficiency. A change in the underlying accounting to IFRS will require tax departments to perform a review of their systems and processes for gathering tax-related data. Systems and processes that have been used to track or compute book-tax differences, record the tax treatment of stock-based compensation, or calculate the tax provision will need to change. Transfer pricing documentation, as well as APA's and tax rulings that may have been based on US GAAP or local statutory accounting, may need to be recast onto an IFRS

basis in order to provide comparability between preadoption and post-adoption periods. Along with the changes in systems and processes, public companies will need to review and update internal controls around tax accounting and reporting for compliance with Sarbanes-Oxley.

Compensation, benefits and human resources

Compensation and benefit plans must also be addressed in view of the differing tax systems worldwide and their impact on tax deductibility of stock options and other compensation-based rewards. A switch from US GAAP to IFRS could affect the processes required to calculate results-based compensation in an organization's worldwide subsidiaries. Pensions will also be affected as there are differences between the two sets of standards in accounting for unrealized gains and losses and in the treatment of vested prior service costs. The tax executive will need to work closely with human resources and other groups to review the potential tax implications of IFRS conversion on global compensation, equity and pension plans.

Finally, the tax executive will need to focus on training and development of people to address the change to IFRS. This will include not only education around the pre-tax and tax accounting differences, but also any associated changes in the systems, processes and controls utilized in the tax function. Given the current demand for tax resources, it will be important for tax executives to invest in people to ensure that the tax function is prepared to meet the challenges presented by a conversion to IFRS.

MOVING FORWARD

The move to IFRS in the US is rapidly building momentum. Over 100 countries have moved to require or permit the use of IFRS. With recent SEC developments, the optional or mandatory use of IFRS for US companies may only be a question of time.

Financial reporting is going through a dramatic change with the move to IFRS. However, a conversion to IFRS is more than a financial accounting exercise. The conversion to IFRS will have a pervasive impact on an organization.

IFRS: The Right Move toward Convergence: What IFRS Will Mean to US Tax Executives

For the tax executive, the conversion to IFRS will affect major aspects of the tax function. It will require a detailed understanding of the interaction between financial reporting, local country statutory accounting and tax. It will be imperative for the tax executive to be involved from the start of an IFRS conversion project in order to analyze the implications on the company's reported effective tax rate, cash taxes, tax planning, and systems, processes, controls and resources.

Adoption of IFRS may include both tax opportunities and pitfalls. As the impact on your company's taxes may be substantial, you should prepare now in order to influence the outcome.

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The Effects of IFRS on Information Systems

By KPMG

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EXECUTIVE SUMMARY

IFRS—Today's Challenge

Many U.S. companies are considering how extensively they may be affected by the expected shift from U.S. GAAP to International Financial Reporting Standards (IFRS).

IFRS conversion has posed a significant challenge to those organizations that have undertaken it in almost 100 countries worldwide. Indeed, many companies have found that while their conversion initially appeared to be an accounting challenge, it quickly evolved into a multifaceted business initiative involving systems and processes, people and change management, and other business considerations. To accomplish these initiatives, organizations generally establish a project management organization (PMO) with oversight by C-level management and with participants representing accounting, IT, process, controls, change management, and tax.

The complexity of an IFRS conversion results from circumstances both inside and outside organizations, including:

- The intricacies of the technical accounting standards
- The overlap with local and international regulatory considerations
- The need to implement the conversion across business units and countries
- The number of separate information systems in use within many organizations
- The limited number of IT professionals with IFRS technical knowledge and the ability to interpret and translate it into IT changes.

Effects on Information Systems

Worldwide, companies have spent considerable time, money, and other resources to convert to IFRS—and many of them report that a substantial component of

their conversion costs were IT related. Nonetheless, many companies also report benefits from the IFRS conversion, including consistency of processes and applications that have helped improve the global IT architecture.

Implementation experience in Europe indicates that the cost of IFRS conversion for U.S. companies is also likely to be significant—depending on how they approach and plan the effort. For example, in the initial phases of conversion many European organizations focused heavily on the technical accounting involved in this change and neglected information systems—a strategy that ultimately resulted in higher conversion costs overall.

The effect of IFRS conversion on IT systems arises from differences in the accounting treatment between current accounting standards and IFRS. Conversion may create a need for:

- New data
- Changed calculations
- Changes in reporting.

To facilitate these changes, information systems may need to be implemented, modified, remapped, or reconfigured. Timing and resource constraints may create a need to implement tactical, short term strategies while transitioning to a long-term approach that integrates with the overall business and information systems strategies. These strategic and tactical decisions should be made early in the project life cycle to prevent duplication of effort, changes in approach, cost extensions, and overruns at a later stage.

Other Considerations

The degree of complexity of any conversion will be compounded by the need for alignment with other regulatory initiatives, such as Sarbanes-Oxley (S-O) and Basel II. The increasing number of international regulations facing organizations will likely create

The Effects of IFRS on Information Systems

interdependencies—between initiatives, resources, processes, and change activities—that organizations will need to manage carefully.

A strategic focus on the information systems underlying these initiatives, including proper planning and consideration of interdependencies, should result in a more efficient process and optimize the benefits derived from conversion. Indeed, to achieve success in an IFRS conversion initiative, leaders should view it in the context of the entire business, the information systems portfolio, and the organization's IT governance program.

What's more, to the extent that the organization is

Key IT take-aways

- IFRS is accounting-driven but it will drive major changes to IT systems as well as business processes and personnel.
- Experience indicates that IT costs are generally over 50 percent of the cost of IFRS conversion.
- Organizations benefit when they identify and integrate the efforts of the IT team early in the IFRS conversion process.
- IT efforts will comprise a mix of short- and long-term projects within the organization's overall IFRS initiative.
- The IFRS conversion effort provides opportunities for achieving synergies with other IT projects and strategic initiatives, such as an ERP implementation.

undergoing transformational projects—such as large ERP (enterprise resource planning) conversions, process change, migration to shared service centers, or other regulatory implementations—it should plan and execute the IFRS conversion initiative in alignment with those transformation projects. By taking this approach, the organization can help ensure that all initiatives share potential efficiencies, avoid duplication of effort, and benefit from efforts to identify business requirements and standardize systems and processes.

A Call to Action

In a regulatory environment increasingly focused on strengthening financial reporting controls, organizations need to effectively manage their IFRS conversions so that the result is sustainable, accurate, and controlled. Such a comprehensive effort calls for:

- Scoping all components of the project appropriately, and not only focusing on the technical accounting issues
- Designing business data flows, processes, and “systems” that are robust and sustainable, rather than short-term solutions that might be cumbersome or more expensive in the long run
- Rolling out effective project strategies to deliver the desired outcomes
- Managing the change in a manner that comprehensively addresses accounting and reporting, data, technology, processes, controls and compliance, tax, and organizational change management and user readiness.

To succeed, the IFRS conversion initiative must reflect its broad influence on the organization—although accounting-driven, it is fundamentally a business initiative. What's more, it is not new: Europe and Australia, for example, have been addressing IFRS conversion issues for a number of years. U.S. companies should seek to learn from their successes and challenges and benefit from their experiences.

BACKGROUND

IFRS Explained

International Financial Reporting Standards (IFRS) comprise “a single set of high-quality, global accounting standards that require transparent and comparable information in general-purpose financial statements.”¹

Drivers for Converting to IFRS

Widespread adoption of IFRS will help world markets achieve:

- Consistent global financial reporting (This capability would enable organizations' financial statements to be understood in the global marketplace, facilitate access to global capital markets, and encourage the development of new business.)
- Comparable reporting of financial information between organizations operating in multiple countries

¹ International Accounting Standards Board (IASB), iasb.org/news/iasb.asp

- Facilitation of group decision making for multinational organizations through common and consistent accounting standards.

FIGURE 5-1: IFRS Adoption



Most countries with significant economic activity have already adopted IFRS, or have plans to adopt it for domestic listed companies, and are considering using IFRS for statutory reporting.

Source: KPMG International, 2008

Impacts on Organizations Converting to IFRS

The conversion to IFRS may represent a fundamental change to the financial reporting framework of many organizations. In addition to accounting and reporting changes, organizations can expect far-reaching implications for business processes, personnel, and information systems. For large, multinational organizations with complex group structures, the process to convert to IFRS will consist of a program of multiple projects, each with its own country and organization-specific requirements, as illustrated in Figure 1.

ACCESS IFRS IMPACT AND DEVELOP A CONVERSION WORK PLAN

The degree of change resulting from the conversion to IFRS will vary significantly between organizations. Every organization must carefully consider how changing its accounting basis to IFRS will affect its

own, specific information systems.

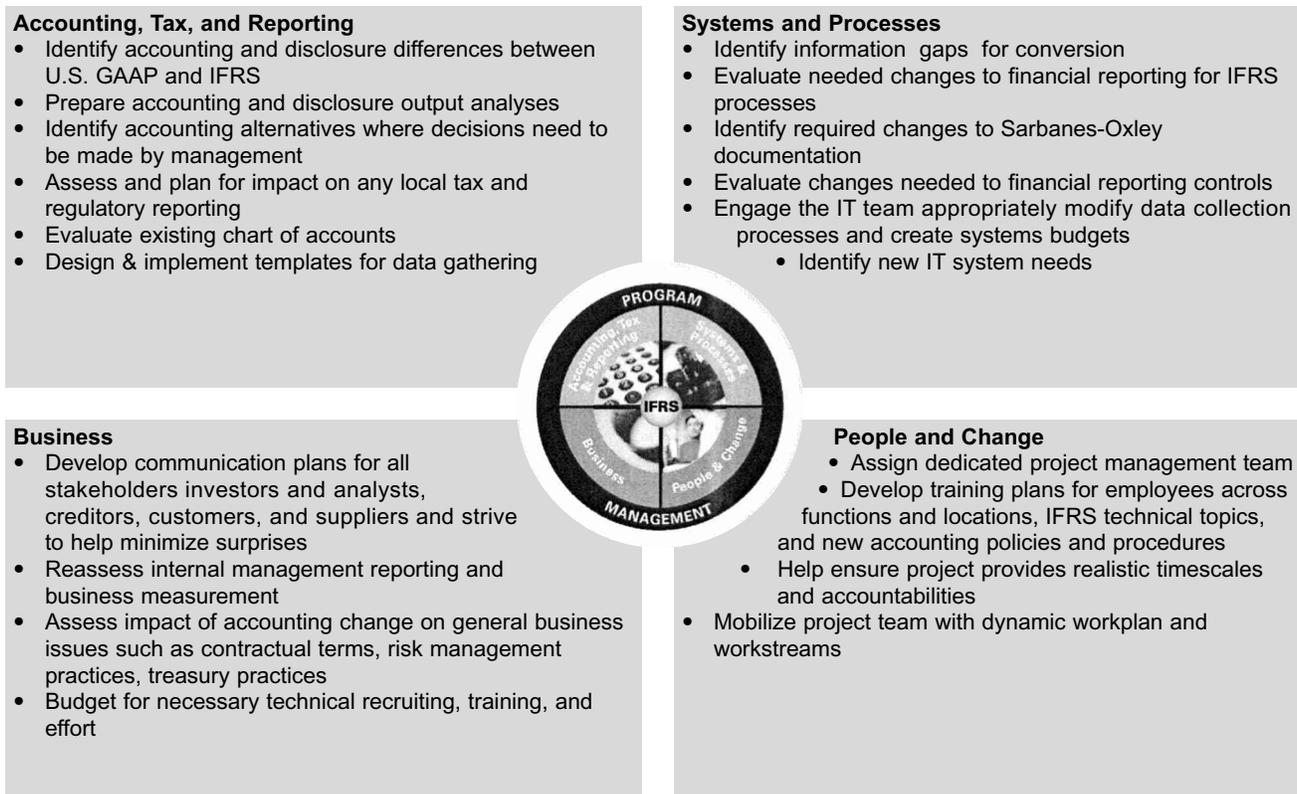
The effort required to convert to IFRS will vary within countries and by industry, and it will drive changes throughout organizations. Information systems could be significantly affected by these changes, which will typically result from variations in the accounting policies and differences in accounting disclosure requirements.

Assessment Phase

Figure 2 provides a framework for the assessment phase of an IFRS initiative. Adopting this approach can help organizations assess the effect that conversion to IFRS may have on their accounting and reporting, data, technology, processes, controls and compliance, tax, people and change, and supporting information systems. The framework for the assessment process will assist in determining the scale of the IFRS conversion as well as the scope of the change management effort.

The Effects of IFRS on Information Systems

FIGURE 5-2: The Assessment Framework



Source: KPMG LLP (U.S.), 2008

Translating the Numbers

An organization must have a detailed understanding of the differences in accounting policies and procedures under IFRS as compared to local GAAP policies, and the potential impact and risk to information systems and controls, before it can determine the information systems changes required. This effort is time consuming, and it should take place during the assessment phase of the conversion—it is the foundation for determining the potential IT ramifications and for translating the accounting differences to technical system specifications.

One of the difficulties organizations often face in creating technical specifications is a lack of understanding of the detailed end-to-end flow of data from

the source systems (including models or spreadsheets) to the general ledger.

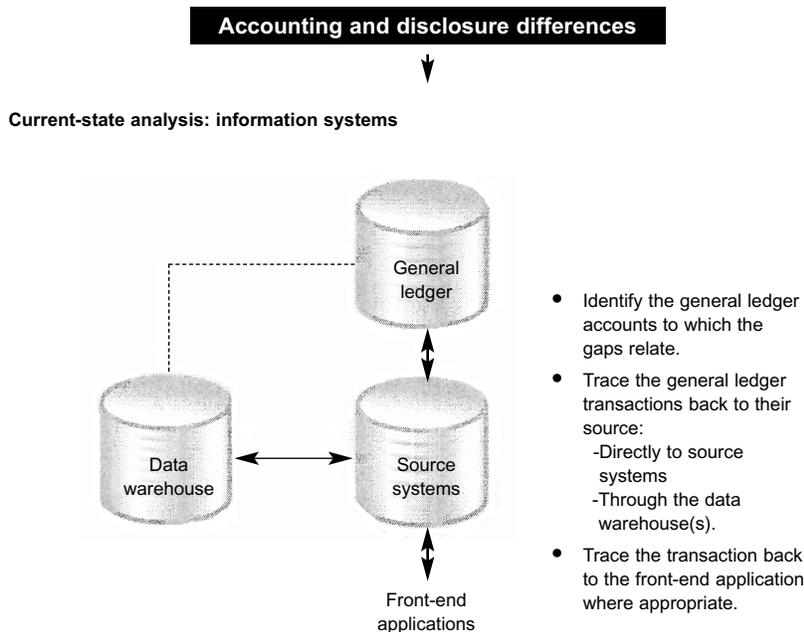
Figure 3 outlines the process that organizations may adopt to identify the information systems impacts. For illustrative purposes, the organization's complexity has been simplified.

Effects on Information Systems

IFRS conversion affects information systems in many ways, from the initiation of transactions through the generation of financial reports, even if merely through the creation of new accounts in the general ledger. The following table details some of the categories of changes that may be required.

FIGURE 5-3: IT Effects of IFRS

Process of identifying the information systems impacts of IFRS



Source: KPMG LLP (U.S.), 2008

Type of Change	Details	Information Systems Impacts
New Data Requirements	New accounting disclosure and recognition requirements may result in: <ul style="list-style-type: none"> • More detailed presentation of information • New data elements or fields to be recorded • Information to be calculated on a different basis. 	Changes to allow for the capture of new or changed data
Changes to the chart of accounts	There will almost always be a change to the chart of accounts due to re-classifications and additional reporting criteria.	Creation of new accounts and deletion of accounts that are no longer required.
Reconfiguration of existing systems	Existing systems may already have capabilities built in to cater for specific IFRS changes, particularly the larger Enterprise Resource Planning (ERP) systems and high-end general ledger packages.	Reconfiguration of existing software to enable accounting under IFRS.
Modifications to existing systems	New reports and calculations required to accommodate IFRS. New reports and calculations required to accommodate IFRS. Spreadsheets and models used by management as an integral part of the financial reporting process should be included when considering the required systems modifications.	Amendments such as: <ul style="list-style-type: none"> • New or changed calculations • New or changed reports • New models.

(continued)

The Effects of IFRS on Information Systems

Type of Change	Details	Information Systems Impacts
Selection and implementation of new systems	Where previous financial reporting standards did not require the use of a system, or the existing system is inadequate for IFRS reporting, it may be necessary to implement new software.	Implementation of software in the form of a new software development project or the selection of a package solution.
Interface and mapping changes	<p>With the introduction of new source systems and the decommissioning of old systems, interfaces may need to be changed or developed and there may be changes to existing mapping tables to the financial system.</p> <p>Where separate reporting tools are used to generate the financial statements, the mapping to these tools will require updating to reflect changes made to the chart of accounts.</p>	<p>Interfaces may be impacted by:</p> <ul style="list-style-type: none"> • Modifications made to existing systems • The need to collect new data • The timing and frequency of data transfer requirements.
Consolidation of entities	Under IFRS, there will potentially be changes to the number and type of entities that need to be included in the group consolidated financial statements. For example, the definition of “control” may be different under IFRS.	Consolidation systems and models will need to be updated to account for changes in consolidated entities.
Reporting packs	<p>Reporting packs may need to be modified to:</p> <ul style="list-style-type: none"> • Gather additional disclosure information from branches or subsidiaries operating on a standard general ledger package • Collect information from subsidiaries that use different financial accounting packages. 	<p>Reporting packs and the accounting systems used by subsidiaries and branches to provide financial information will need to be modified.</p> <p>Reporting tools used by subsidiaries and branches to provide financial information will need to be modified.</p>
Financial reporting tools	<p>Reporting tools can be used to:</p> <ul style="list-style-type: none"> • Perform the consolidation and the financial statements based on data transferred from the general ledger • Prepare only the financial statements based on receipt of consolidated information from the general ledger. 	Mappings and interfaces from the general ledger will need to be modified.

Many of the individual IFRS accounting topic areas will require information systems changes. An example of one that could have a major effect on information systems is accounting for fixed assets. The table below shows the accounting today under U.S. GAAP and how it could change with IFRS as well as the possible information systems effects arising from these changes.

IFRS ACCOUNTING TREATMENT**Fixed Assets**

A company buys a new building.

- U.S. GAAP: Capitalize cost of building and depreciate over life of building—e.g., 40 years
- IFRS: Allocate total costs to applicable asset components: building, roof, fixtures, etc.; then, capitalize the components and depreciate over their useful lives—e.g., building still has 40 more years; roof 10 years; fixtures 5 years

POSSIBLE INFORMATION SYSTEMS EFFECTS²

Currently (U.S. GAAP)—real estate system feeds building cost to fixed asset system, which then calculates depreciation on the building and feeds the data to the general ledger.

Under IFRS, client systems would have to address the following:

- Real estate system would need to track and allocate costs
- Fixed asset system would need different depreciable life categories to support additional depreciation calculations
- Post-acquisition costs would need to be evaluated for capitalization or expense.

The modifications or new systems may result in:

- New data requirements
- Interface and mapping changes
- Changes to the chart of accounts
- Changes to reporting packs
- Changes to financial reporting tools
- Modifications to account for documentation and archiving.

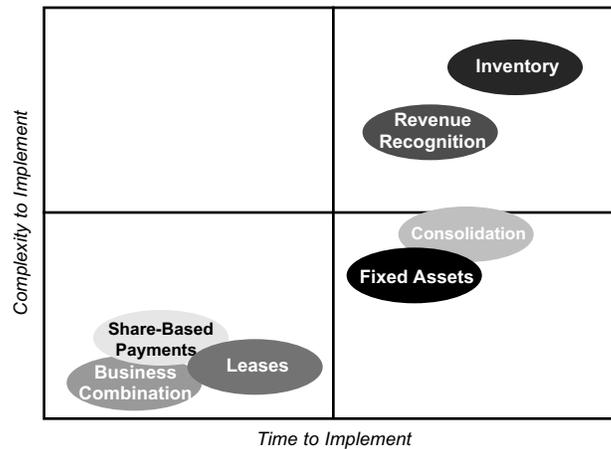
Organizations may choose to develop spreadsheet models external to the core systems to manage some of these new requirements.

² The information systems effects are examples only and will vary according to each organization's specific circumstances.

The Effects of IFRS on Information Systems

Figure 4 provides examples of accounting areas in which IFRS can affect IT systems. (This chart illustrates one company-specific situation and is not intended to be a general representation of the IT impact of IFRS for all companies.)

FIGURE 5-4: Time and Complexity of IT Changes



- Fixed Assets** Moderate changes were required to the fixed-assets front-end application and source systems to conform to IFRS requirements. Changes will be moderately complex and relatively time consuming to implement.
- Inventory** The company changed its inventory accounting from LIFO to FIFO, which required changes to the front-end systems and sub-ledgers. Change classified as highly complex and expected to occur during the next three quarters, parallel to a system upgrade currently scheduled for the same time frame.
- Share Based Payments** The process is based on end-user computing applications and manual controls. Changes will be required to the spreadsheets. No significant system change.
- Consolidation** The company decided to take the opportunity to make significant changes to its legacy consolidation system. The changes will be of moderate complexity and relatively time consuming.
- Revenue Recognition** Changes to revenue recognition were needed with impact to sales and billing front-end applications. In this case, the changes was classified as highly complex with moderate amount of time required to implement.
- Business Combination** The company has a long history of acquisitions and mergers that will be evaluated under IFRS. The process is highly manual and dependent on end-user computing solutions (spreadsheets). Changes will be of low complexity with a short time to implement.
- Leases** Changes to leasing front-end application will be required. The change will be implemented through configuration change and is therefore classified as low complexity with a short to moderate time frame.

Source: KPMG LLP (U.S.), 2008

A conversion process is complex and can be expensive, so some companies will choose a low-cost, expedient spreadsheet option in the short term, with the understanding that they will need to ultimately invest in a long-term source conversion. Those who choose the short-term option should remember that it is only less expensive in the short term and may actually be more expensive in the long term as well as not permitting companies to achieve cost savings. Over time, managing the risks of converting to and reporting under IFRS will be critical, and doing so will require an investment of time and resources.

DESIGN THE CONVERSION CHANGES

A long-term approach integrated with the overall business objectives requires leaders to make strategic and tactical decisions early in the conversion project life cycle. Doing so may limit unnecessary costs resulting from duplication of effort or changes in the approach at a later stage.

Organizations have differing structures, systems, and industry-specific circumstances, preventing a “one-size fits all” approach to the conversion to IFRS. The assessment phase will reveal whether it is possible to reconfigure or modify the current systems to enable compliance with IFRS. Where this reconfiguration is not possible, organizations may need to purchase new systems; where financial or time constraints exist, they may need to develop work-arounds, such as spreadsheets, to produce the required information.

The decisions around the development of the solution should be made during the design phase of an IFRS conversion initiative. To develop a robust short- and long-term approach to conversion, organizations should consider the following:

- Whether to make changes at the group, company, or source system levels
- How to cope with multiple reporting requirements
- How to decide when to cut over from the local U.S. GAAP general ledger to the IFRS general ledger
- What data is available to comply with new accounting policies
- Whether to buy a new system or make modifications to existing systems
- How IFRS affects internal control over financial reporting
- What are the most appropriate methods to harmonize internal and external reporting
- How to manage the risks of model driven remedies used as short-term solutions
- What are the effects of conversion on the internal and external audit functions
- Are there additional competing regulatory requirements?

Management should address these questions early in the conversion life cycle. Their decisions will guide how they address the ramifications to information systems and how they limit unnecessary costs resulting from duplication of effort or changes in approach at a later stage.

The financial impact of the information systems changes is likely to be significant and may be a major consideration for management when determining the approach to information systems changes. Costs can vary according to:

- Organization size
- Industry
- Level of IFRS adoption within each country
- Existing information systems preparedness for IFRS.

Costs are likely to arise from:

- The modification or reconfiguration of new systems
- Vendor maintenance and ongoing support
- Employment of additional resources
- Project management
- Training needs
- Implementing both a short-term solution to meet tight deadlines and a more robust long-term solution at a later stage to address the same problem.

The strategic and tactical IFRS conversion decisions should be conducted within the organization’s information systems governance framework to closely align any significant IT changes with the organization’s strategic business goals.

The Effects of IFRS on Information Systems

Identifying the Appropriate Level for Systems Changes

Changes to information systems may be made at different levels in an organization's financial reporting process—for example, at the group level, at the company level, and at the source level. To determine the appropriate level, management must consider various factors, including those outlined in Figure 5 on the next page.

Achieving Synergies in Transformational Initiatives

To the extent that the organization is engaged in transformational projects such as large ERP conversions, process change, migration to shared-service centers, or other implementations, it should plan and execute the IFRS conversion initiative in alignment with those projects. Because an IFRS conver-

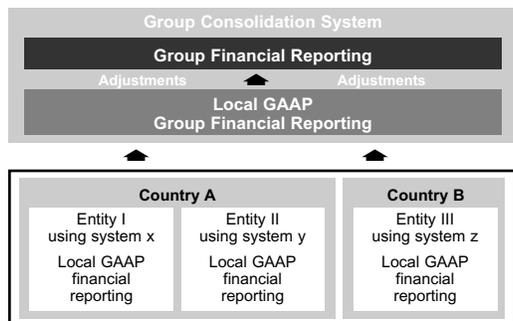
sion affects the organization's financial reporting and the underlying systems and processes that ultimately produce that reporting, it will likely have significant interdependencies with other transformational projects.

The table below provides examples of transformation projects and potential IFRS considerations. In each case, management was able to gain efficiencies in both time and effort by coordinating their transformation projects with the IFRS initiatives. Key IFRS efforts including identification of data flows, processes, and systems were made easier by work already done for the transformation initiative. The shift to IFRS also can be a catalyst for undertaking a project such as the migration to a shared services center. Indeed, organizations that perceive the IFRS conversion effort as an opportunity for business improvement can leverage the effort in a variety of important ways.

Example Transformation Project	IFRS Synergies Achieved
Regional shared services	<p>A global consumer markets company had subsidiaries worldwide with disparate systems and processes. Although management knew a shared services business model could help it achieve cost and efficiency benefits, it was reticent to begin such a comprehensive effort.</p> <p>As part of the IFRS conversion project, the company standardized its accounting policies for inventory, fixed asset, and consolidations (among others) and modified or replaced its procurement, supply chain, fixed asset, and general ledger applications at many locations. It also modified its business process procedures and controls.</p> <p>Management realized that the newly standardized business model and the extensive understanding of detailed business processes and systems would greatly aid in the migration to a regional shared service center. When it undertook this project, leveraging the IFRS conversion activities enabled it to save considerable time and money.</p>
Global ERP implementation	<p>A large financial institution was undergoing a global SAP implementation when it embarked on an IFRS conversion initiative. Once the company determined its future accounting policies under IFRS, the process of conversion was assisted by the SAP implementation in process. For example, the Company had developed a detailed understanding of its business processes and practices as a part of the requirements planning (blueprinting) phase of the implementation project, including the detailed data sources and structures. These activities greatly aided the IFRS IT impact analysis.</p> <p>The company had to repeat certain aspects of its global template blueprinting phase to accommodate the changes due to IFRS. Additionally, the use of a parallel accounting strategy (recommended by SAP) for IFRS conversion added additional complexities. Nonetheless, the close coordination of the IFRS and SAP implementation activities yielded the most efficient process for each initiative.</p>

FIGURE 5-5: Levels of System Changes

Integration at Group Level

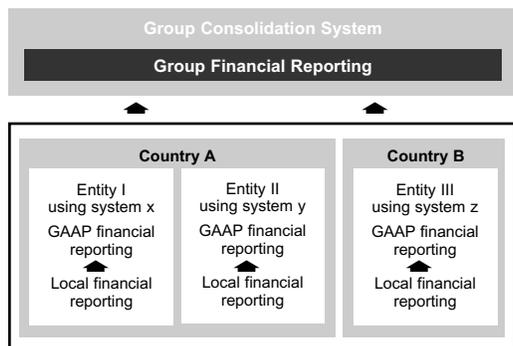


Individual entities prepare financial reporting based on local GAAP. This financial reporting is converted to IFRS during the group consolidation process.

Organization Suitability

- Individual entities in certain countries do not have to report separately.
- Only a few simple adjustments are required and are made at the top level during the consolidation.
- Information to make conversion adjustments is readily available.

Integration at Reporting-Unit Level

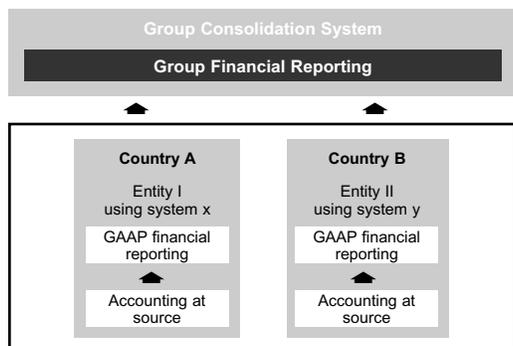


Individual entities prepare financial reporting based on local GAAP and then convert that information to IFRS before sending the reporting to the group level for consolidation.

Organization Suitability

- Individual entities in each country are required to report separately.
- Group structures are complex.
- Consolidated entities are numerous.
- All required source data is readily available.

Integration at Source Level



Individual entities make changes to source systems to enable IFRS accounting and reporting from source systems.

Organization Suitability

- Daily financial statements are required.
- Complex calculations affected by reporting requirements are performed at the source.
- Capturing new data requires changes at the source.
- Integration at this level is a practical option when source systems and the general ledger are fully integrated.

Source: KPMG LLP (U.S.), 2008

The Effects of IFRS on Information Systems

BUILD, IMPLEMENT, AND ROLL OUT

The build, implement, and roll-out phase of an IFRS conversion project usually requires the involvement of resources from all areas of the business, including finance, the front-office, executive management, tax, and information technology. The involvement of IT in this phase is critical to the overall project success, and it can account for a substantial part of the project cost. Changes to information systems will include changes to data, applications, technology, controls, and related business processes. It will require a strong focus on change management activities and should be guided by a project management office (PMO). The PMO should take a formal program management approach to managing the conversion, potential effects on other ongoing transformational projects, and the necessary changes representing all aspects of the business.

During the implementation of an IFRS conversion, the IT organization should confirm its understanding of the new data requirements and configure or build applications systems to meet those requirements. An effective system development life cycle (SDLC) is an essential enabler for successfully configuring or building applications systems in accordance with the requirements. The IT organization can expect to be involved in all phases of the implementation of the IFRS conversion, including configuring or building

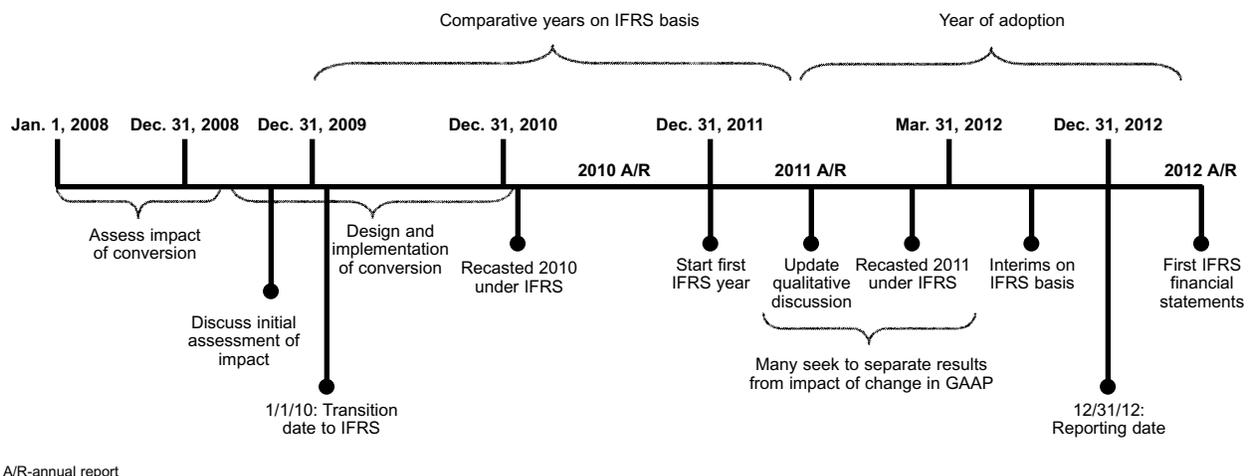
application systems, thoroughly testing changes, and managing the cutover process. As new processes and changes to application systems are built, leadership should consider how these new processes and controls affect the existing control environment. New controls will likely be needed to maintain integrity in transaction processing.

Prior to rollout, the PMO should design and execute strategies and plans to effectively communicate with and train users on the modifications to business processes and application systems. All users should be appropriately trained on the new accounting policies as well as the effects those policies have on the supporting IT infrastructure. The company should also evaluate whether any of the modifications result in the need for additional skill sets or knowledge.

First Year of IFRS Reporting

During the first year of IFRS reporting (and depending on how the regulations evolve in the U.S.), companies may have to provide comparative year figures under IFRS for the two prior years. These comparative years would have been reported previously under U.S. GAAP.

Figure 6 illustrates the stages in the first-time adoption reporting process for an organization that is required to produce its first IFRS reports as of, for example, December 31, 2012 (actual dates are unknown at the time of publication).

FIGURE 5-6: Example IFRS Transition Milestones and Timeline

Source: KPMG LLP (U.S.), 2008

Cutover from Existing GAAP to IFRS Reporting

Source systems are usually mapped to the general ledger, which has been set up to produce financial statements under local standards. To enable reporting under IFRS, an additional ledger (IFRS general ledger) may exist, either in parallel or through adjustments.

At some stage, a cutover will be required from the local general ledger to the IFRS general ledger so that

IFRS becomes the primary basis of accounting. This effort will require the organization to map the changes to link the source systems to the IFRS general ledger without the need for IFRS adjustments.

Cutover can be undertaken at any point; however, system cutovers generally happen in stages. Throughout the process, careful planning and execution is required because the timing will affect the nature and volume of adjustments, as demonstrated in the table below.

Timing of Cutover	Example Effects	Example Considerations ³
First day of the year in which IFRS reporting commences	No adjustments will be required for current-period financial information. IFRS changes will flow through sub-systems to the general ledger.	Applicable to small or less complex organizations or where few changes are required.
Cutover made over time, after the first day of the year in which IFRS reporting commences	As source systems are modified, IFRS adjustments will be replaced by automatic feeds directly from the source systems.	For large/complex organizations with many changes, strict control will need to be maintained over this phased cutover process.
Cutover prior to first day of the year in which IFRS reporting commences	This action results in the need for a mixture of adjustments: <ul style="list-style-type: none"> • Where cutover changes for IFRS have been made, adjustments for conversion back to local standards are necessary for dual reporting requirements • Where cutover changes to IFRS are still required, adjustments for conversion to IFRS are necessary to allow full IFRS reporting in the following year and to restate comparative figures in the year of transition. 	Careful planning is required to prevent errors occurring in the existing and IFRS general ledgers.

³ These controls are examples only. Control design would require detailed analysis based on specific information systems characteristics and business needs. Controls cannot be totally effective in all circumstances and some residual risks may remain.

The alternative cutover options provide organizations with the flexibility to undertake a phased approach to IFRS adoption. Such an approach allows cutover of the accounts affected by IFRS to be aligned with the organization's business approach.

OTHER CONSIDERATIONS

Ongoing Multipurpose Reporting

Some countries may require statutory reporting in addition to IFRS on an ongoing basis. For example, the local tax authorities may require tax returns to be prepared using a local standard rather than IFRS.

Organizations that are required to perform multipurpose reporting on a regular basis will need to develop permanent, robust, and well-controlled solutions. One approach is to assign the adjustments required to produce additional reporting to specific accounts in the standard chart of accounts. These accounts are then selected as appropriate to produce reporting under a particular standard or for the purposes of management.

In a complex systems environment with multipurpose reporting requirements, the standard chart of accounts redesign involves more than just adding new accounts or regrouping accounts. This effort can be a complex, time consuming, technical exercise. Consolidation systems are structured on the basis of the standard chart of accounts, which must therefore be revised before the redesign of consolidated systems.

A large insurance company incorporating 20 entities with independent general ledgers has 180 accounts affected by IFRS. The organization is unable to cut over all accounts prior to the first year of conversion, and it has therefore adopted a phased approach. It developed a detailed reconciliation model to track the 3,600 IFRS adjustments that will be posted on a monthly basis. As future changes are made to the information systems, the number of adjustments required will decrease.

Tax Considerations

Making a transition from U.S. GAAP will affect tax reporting, tax accounting, and the underlying data sources and processes associated with an organization's tax function. The involvement of tax professionals is important at every stage of the IFRS conversion process because for U.S. companies, tax systems, processes, and controls have been primarily designed to deliver information to meet the financial statement reporting requirements of U.S. GAAP. IFRS conversion will require companies to review and possibly modify these systems, processes, and controls for collecting tax-sensitive information, computing book-tax differences, tracking deferred taxes, and preparing the footnote under IFRS. Companies may also need to consider the ability to handle multiple or changing reporting requirements that may arise during the transition.

Managing the Risks of Short-Term Solutions Based on Spreadsheets

With long lead times required for modifications to legacy systems, limited skilled resources to make the changes, and strict IFRS deadlines, organizations are increasingly considering end-user developed spreadsheets and model solutions. These models can potentially be used as a short-term remedy to provide the necessary adjustments to convert local financial statements to IFRS.

In most cases, these models gradually will be replaced by modifications to core systems. However, they may still be used for certain specialized reporting requirements and therefore could be managed using some of the methods outlined in the table below.

Spreadsheets or models that are used as short-term remedies to provide the necessary adjustments to convert local GAAP to IFRS are generally not subject to the same stringent controls normally built into integrated financial packages. This can significantly increase the risk of errors. Strict controls will need to be implemented to manage, monitor, and reconcile the flow of data between models and other systems.

Risks	Managing the Risks ⁴
<p>Models and spreadsheets are generally not subject to the input, processing, output, and program change management controls traditionally built into typical integrated financial packages, which significantly increases the risk of errors.</p>	<ul style="list-style-type: none"> • Design appropriate built-in controls, version control, security, and change management procedures. • Perform independent model reviews to identify errors before models are used. • Undertake user acceptance testing as part of the development process. • Implement strict controls to monitor and reconcile the flow of data between models and other systems.
<p>The introduction of numerous intermediary models between subsystems and the general ledger increases the risk of information not passing or passing inaccurately to the general ledger.</p>	<ul style="list-style-type: none"> • Consider reliability of data in warehouses. • Perform regular reconciliations to source data. • Determine if appropriate security over data warehouses is in place.
<p>Input to models and spreadsheets may be obtained from existing data warehouses where data may not be as reliable as data contained in core systems. The overall control environment may be weakened through the excessive use of spreadsheets.</p>	<ul style="list-style-type: none"> • Increase management awareness of the risks that models pose to the overall control environment. • Develop long-term plans for replacement of models with core systems.
<p>Moving substantial financial processes from the generally tightly controlled information systems arena into less controlled user domain may result in increased security, segregation of duties, data integrity, and operational issues.</p>	

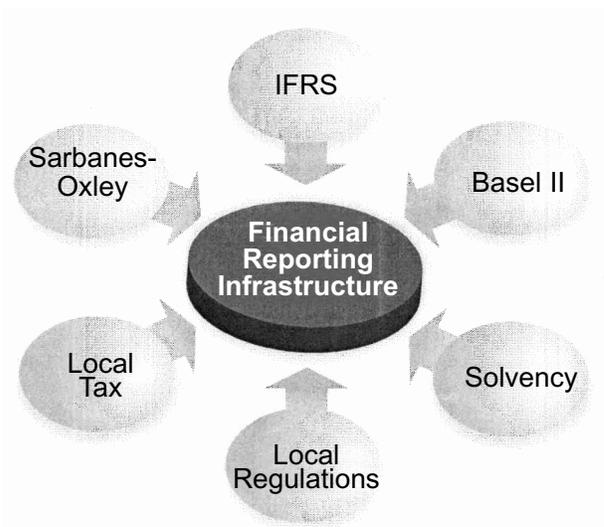
⁴ These methods of managing risks are examples only. Detailed analysis based on the specific circumstances of the organization would be required to determine the appropriate risk management methods. These methods may not be totally effective in all circumstances and some residual risks may remain.

Other Requirements

IFRS conversion projects should not be considered in isolation. Large, complex multinationals will need to carefully consider the interdependencies between IFRS projects and other regulatory initiatives.

In addition to IFRS, global organizations are facing an increasing number of regulations, including Sarbanes-Oxley, country-specific corporate governance legislation, and Basel II. Many of these regulatory initiatives are being rolled out concurrently and will affect the overall financial reporting infrastructure, as shown in Figure 7.

FIGURE 5-7: IFRS Challenges to Reporting Structures

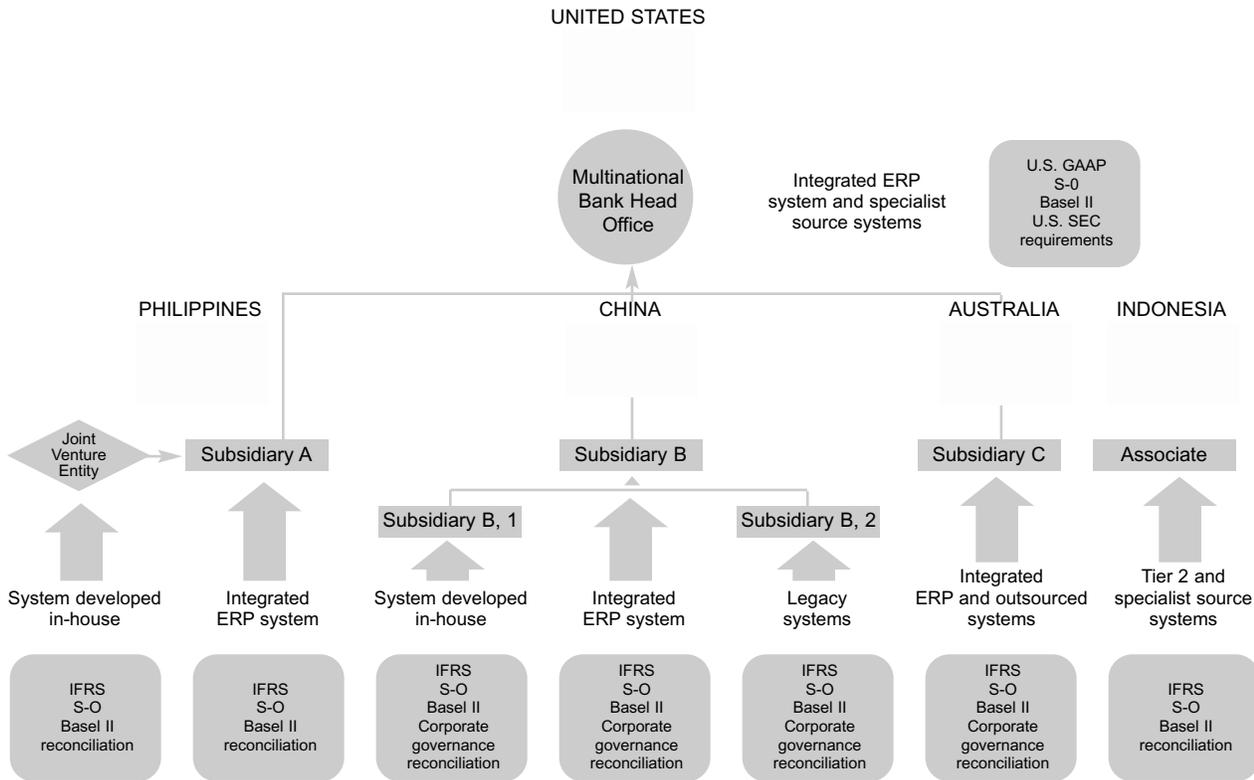


Source: KPMG LLP (U.S.), 2008

The Effects of IFRS on Information Systems

Figure 8 on the next page illustrates that the conversion to IFRS represents a significant challenge for large multinationals with complex group structures, differing information systems, and country-specific legislation.

FIGURE 5-8: Multinational Bank With Complex Reporting Environment



Source: KPMG LLP (U.S.), 2008

For multinational organizations (such as the one pictured in Figure 8), the process to convert to IFRS will consist of a program of multiple projects, each with its own country- and organization-specific requirements. The IFRS project should be planned and executed with consideration of, and in conjunction with, the other regulatory initiatives and requirements that apply to the organization. Issues specific to certain of these regulatory initiatives are outlined below.

Sarbanes-Oxley

Section 404 of the Sarbanes-Oxley Act of 2002 requires management to document and assess internal control over financial reporting, to report on the assessment, and to subject the assessment to audit by the organization's independent auditor (except for small issuers).

The conversion to IFRS may substantially influence a significant proportion of the internal controls over financial reporting due to:

- Excessive use of uncontrolled end-user developed models
- Budgetary constraints
- Lack of available skilled resources
- Time constraints resulting in emphasis on implementation rather than the internal controls.

This weakening of the internal controls over financial reporting may affect the organization's ability to comply with S-O; consequently, S-O and IFRS conversion initiatives should be closely aligned.

Corporate governance legislation

Many countries are affected by local corporate governance legislation, which typically requires management to develop a sound system of internal controls in support of the financial reporting process.

The approach taken for IFRS conversion may negatively affect a significant proportion of the internal controls over financial reporting, a situation that in turn may affect the organization's ability to comply with local corporate governance legislation. IFRS and corporate governance requirements should therefore be closely aligned.

Basel II

Basel II is an evolving regulation addressing the capital adequacy of internationally active banks. IFRS and Basel II have different objectives, but they also have a number of similarities. Data requirements are likely to overlap substantially, so as part of the IFRS

initiative, leaders should carefully consider Basel II data and reporting requirements to help enable the organization's systems to cope with the demands of these two standards.

Industry-based regulations

Companies often must comply with a variety of industry-based regulations that have extensive data requirements. Management should take steps to avoid overlapping or redundant compliance efforts and duplicative internal reporting efforts.

The Effect of IFRS on Internal and External Audit

With the move to IFRS, many accounting processes and information systems responsible for financial reporting and the preparation of financial statements will change, in turn affecting the organization's governance structure and internal control over financial reporting. Management will need to assess and report on the reliability of these new processes, information systems, and related controls, and provide adequate documentation and data for both internal and external auditors.

Integrating the internal and external auditors into the change management process of the IFRS conversion may help manage their expectations and facilitate the post-conversion audits. An effective governance model should provide for ongoing communication with auditors.

The Effects of IFRS on Information Systems

Typical risks and example controls are outlined in the table below.

Risks to the Audit Process	Controls ⁵
Inadequate documentation of changed processes can be problematic.	Produce updated Sarbanes-Oxley documentation as part of the development of the new processes, using a standard format and approach.
Manipulation of data in models or spreadsheets may eliminate the audit trail from the general ledger to the source system.	<ul style="list-style-type: none"> • Develop models so that calculations may be re-performed. • Produce comprehensive documentation of the models. • Implement a strict change management process over the development of models. • Build in functionality to allow traceability of transactions. • Undertake user acceptance testing as part of the development process.
Key controls to provide integrity and accuracy of financial reporting information may not be implemented, or may be bypassed.	<ul style="list-style-type: none"> • Design and implement appropriate information systems general controls. • Implement strong application input, processing and output controls.
Complexity of the management of numerous transition adjustments may result in transactions not being posted to the general ledger.	<ul style="list-style-type: none"> • Design and implement controls over completeness and accuracy when posting adjustment transactions to the general ledger.

⁵ These controls are examples only. Control design would require detailed analysis based on specific information systems characteristics and business needs. Controls cannot be totally effective in all circumstances and some residual risks may remain.

LOOKING AHEAD

Legislated deadlines for IFRS reporting should be seen as only one milestone of the conversion initiative. In most cases, significant effort will still be required after this date to replace the short-term remedies with more robust long-term solutions, to refine internal and external reporting, and to strengthen controls over newly implemented solutions.

Post-Conversion Activities

The magnitude of the required information systems changes, amendments, or alterations will, by necessity, vary significantly between organizations. All required systems changes may not be made prior to the first year of accounting on an IFRS basis. Many organizations make the most essential changes first

and then address the others with short-term solutions such as spreadsheet models. Consequently, the systems changes that result can extend past the IFRS conversion date and be implemented over a number of years.

In the planning phase, organizations should assess whether current information systems adequately support the organization's business goals. The need to change, amend, or alter the information systems for IFRS may become the driver for modernization or replacement of legacy systems. The information systems function should undertake any such program in conjunction with the broader business to achieve the desired result in line with the overall business strategy.

To enable the organization to succeed, the IFRS conversion initiative must reflect the true impact on the entire organization—it is far more than just the numbers.

IFRS Primer for Audit Committees

By the AICPA

May, 2008

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HISTORY AND BACKGROUND

The movement toward adoption of a single set of high-quality global accounting standards for use by organizations around the world continues to gather momentum in the U.S. and around the globe.

In the U.S., this movement began to take hold in 2002, when the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued the so-called Norwalk Agreement, in which they acknowledged their commitment to developing high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. The two bodies have been working together towards that end, in a process referred to as “convergence,” ever since.

The IASB is an independent accounting standard-setter based in London, UK. It consists of 14 members from nine countries, including the United States. The IASB issues accounting standards titled International Financial Reporting Standards (IFRS). The European Union adopted IFRS for publicly held companies in 2005.

In 2007, the U.S. Securities and Exchange Commission (SEC) adopted rules to accept from Foreign Private Issuers their financial statements prepared in accordance with IFRS as issued by the IASB without reconciliation to U.S. GAAP. Also, the SEC published a “Concept Release” to obtain information on allowing U.S. issuers to prepare financial statements in accordance with IFRS—which are not yet “converged” with U.S. GAAP—for purposes of complying with the rules and regulations of the SEC. Congress, which has the ultimate authority, is likely to become involved in the debate.

As of late 2007, nearly 100 countries require or allow the use of IFRS by publicly traded companies, and others are planning to do so in the near future.

WHY SHOULD AUDIT COMMITTEES BE CONCERNED NOW?

While the SEC has not given U.S. companies a choice to file using IFRS, they are now exploring the use of IFRS for U.S. companies. And, given the SEC’s support for a single set of global accounting standards, it is reasonable to believe the SEC may require adoption of IFRS by U.S. registrants by a date certain in the not-too-distant future. Therefore, it is important that audit committees gain an understanding of IFRS—and also be prepared to ask their companies’ management a number of questions (see IFRS Considerations and Questions for Audit Committees tool, page 2) to determine their readiness, if given a choice for adoption of—or if they are required to adopt—IFRS.

OVERVIEW OF IFRS FIRST-TIME ADOPTION BY A COMPANY

- IFRS I provides detailed guidelines for first-time adoption of IFRS
 - It requires an opening IFRS statement of financial position at the date of transition to IFRS.
 - There are 10 optional exemptions from retrospective application of particular accounting requirements and 4 mandatory exemptions prohibiting retrospective application.
 - It requires an entity to comply with each IFRS effective at the end of its first IFRS reporting period.
 - It requires disclosures that explain how the transition from U.S. GAAP to IFRS affected the entity’s reported financial position, financial performance and cash flows.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS): CONSIDERATIONS AND QUESTIONS FOR AUDIT COMMITTEES

PURPOSE OF THIS TOOL: International Financial Reporting Standards (IFRS) are being used worldwide by nearly 100 countries that either require or allow its use for the preparation of financial statements for publicly held companies. Convergence of U.S. GAAP with IFRS is happening. In addition, there is a possibility that the SEC will give U.S. companies an option to follow IFRS rather than U.S. GAAP, or require them to switch to IFRS, before convergence is achieved. Audit committees should anticipate this significant change and inquire of the CEO and CFO as to the readiness of the company, and their implementation plan for moving to IFRS if/when required.

Some considerations for filing of IFRS financial statements:

- Multinational companies may benefit from the use of common financial reporting systems that follow IFRS worldwide
- IFRS may ease financial statement comparability with other companies that use IFRS worldwide
- IFRS is intended to facilitate cross-border investments and access to global capital markets

Questions the audit committee should consider in its own deliberation include:

- Has the audit committee discussed the adoption of IFRS with the company?
- Does the audit committee feel that management understands how IFRS adoption will affect the company and its financial reporting process?
- Does the audit committee feel that management understands the full extent of the changes to the company and its financial reporting process?
- Does the audit committee have an oversight plan for IFRS adoption by the company for implementation and progress?
- What impact does IFRS adoption have on the ongoing responsibilities of the audit committee for internal control and financial statement disclosures?
- How will the audit committee members become financially literate on IFRS and learn the key differences between IFRS and U.S. GAAP?
- How will the audit committee understand and question the accounting policy choices made by management on the transition to IFRS? IFRS contains less detail than U.S. GAAP and their application may require more professional judgment. Therefore, it will take the company some time to evaluate its choices for accounting policies. Also, depending upon the accounting policy chosen, processes and/or systems (e.g., fixed assets, share-based systems, inventory, others) may be affected.
- How will the audit committee inform the board of directors and the compensation committee, etc., about the impacts of the company's transition to IFRS?
- How will the audit committee know if management's education goals for shareholders and analysts are being met?

Questions the audit committee should review with management include:

- Are any of the company's foreign subsidiaries or joint ventures currently using IFRS?
- Has the company done a readiness assessment of IFRS adoption?
- What are the challenges, risks and cost/benefits of IFRS adoption?

- What is the level of knowledge of IFRS within the company?
- What type and level of education on IFRS will be needed by the company's employees and other stakeholders?
- What steps should the company be taking to prepare for adoption of IFRS if an option is granted?
- Does the company have a transition plan (e.g., assessment, conversion, sustain) that includes key conversion activities (IFRS 1—First-time Adoption of IFRS, etc.), timetable and resources required, as well as project and change management?
- If IFRS is adopted, how will this affect the company's way of doing business (e.g., changes to IT and other internal systems; risk monitoring and controls; relationships with external companies; contractual arrangements; outsourcing arrangements; inventory accounting; budgeting and forecasting; key performance indicators; compensation; joint ventures and alliances; subsidiaries; legal issues; etc.)?
- What are the changes to accounting policies and other policies? What is the potential financial impact of those changes? Is there an accounting impact on the defined pension plan? Are there any off-balance sheet items that would be brought on to the balance sheet or vice versa? What are the disclosure impacts?
- Are there any process or contract changes resulting from differences in hedge accounting guidelines?
- What are the tax impacts of IFRS adoption (e.g., pre-tax income; differences in tax accounting on a company's effective tax rate; the company's cash taxes in U.S. and foreign jurisdictions; tax-reporting processes; etc.)?
- What are the treasury (e.g., debt agreements and financial covenants, dividend policy, etc.) impacts of adoption to IFRS?
- How is management making system changes or implementing new systems today, in recognition of possible changes in the future?
- How is management implementing new accounting standards today, in recognition of possible changes in the future?
- Are there particular accounting issues under IFRS for the industry in which the company operates (e.g., insurance, oil and gas, etc.)?
- Will external advisors be used to help with the transition to IFRS, and what are their qualifications and roles?
- What is the company's approach to identifying issues, resolving the issues and communicating this information to the audit committee?
- What is the company's plan on education of stakeholders (e.g., investors, analysts, lenders, creditors) so they understand the changes to the accounting policies and the financial statements? How will the company handle the restatement of comparative periods and its possible impact on investors?
- What is the company's plan for communicating to stakeholders regarding the transition to IFRS?
- Has a formal risk assessment been documented with respect to IFRS? Has the IFRS risk assessment been integrated with existing risk assessment information?

RESOURCES

For additional information, visit these Web sites:

- AICPA
 - International Financial Reporting Standards (IFRS)—An AICPA Backgrounder at www.ifrs.com
 - For the latest information on the status of IFRS and educational opportunities visit www.ifrs.com
 - International Versus U.S. Accounting: What in the World Is the Difference? course information at www.cpa2biz.com
- IASB
 - Memorandum of Understanding with the FASB: <http://www.iasb.org/Current+Projects/Memorandum+of+Understanding+with+the+FASB.htm>
 - IFRS summaries: <http://www.iasb.org/IFRS+Summaries/IFRS+and+IAS+Summaries+English+2008/IFRS+and+IAS+Summaries+English.htm>
- FASB
 - Overview of International Activities: <http://www.fasb.org/intl/>
- SEC
 - International Financial Reporting Standards Road Map: <http://www.sec.gov/spotlight/ifrsroadmap.htm>

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IFRS May Prompt Revamp of Pay Plans

By Sarah Johnson, CFO.com/US

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THE DIFFERENCES BETWEEN U.S. AND INTERNATIONAL ACCOUNTING RULES COULD AFFECT THE WAY AMERICAN COMPANIES COMPENSATE THEIR EMPLOYEES

Companies that adopt international financial reporting standards will need to reexamine their compensation and employee benefit plans. The switchover from U.S. generally accepted accounting principles to IFRS will not only translate into tweaks regarding how companies account for such programs—but could also change plan design because of the way international rules affect corporate financial statements, according to Deloitte.

“The interplay between the broader impact of the transition to IFRS will require companies to assess their compensation philosophy and plan design,” said Deloitte Tax partner Grace Melton during a recent webcast. She says companies will want to review employment agreements to assess how IFRS affects specific levels of executive compensation, as well as the impact on broad-based types of compensation plans.

Melton considers compensation and benefit plans one of the “most high profile” areas to be affected by IFRS, and her warning highlights the extra workload the transition is likely to bring to U.S.-based finance departments. Under the Securities and Exchange Commission plan, most publicly traded companies would have up to eight years to prepare for IFRS, but the impact will be felt beyond corporate finance, spilling over into human resources and information technology departments, say experts.

One way a switch to IFRS may affect compensation relates to how some companies would be forced

to rejigger metrics for performance-based pay. For example, if executives’ performance is tied to company revenue, then the timing differences between when IFRS users and U.S. GAAP users recognize revenue would have an affect on executive payouts.

Indeed, PricewaterhouseCoopers suggests that companies should reassess if bonus targets and metrics need to be revised, and whether changes to compensation agreements should be rewritten ahead of a switch to IFRS.

Before companies begin to tackle those questions, however, they may want to first compare differences in how IFRS and GAAP treat specific pay programs. For instance, valuations of stock-option grants can differ, depending on whether a company uses the international rule known as IFRS 2, or the U.S. rule FAS 123(R), the standards for accounting for share-based payments.

In addition, IFRS requires companies to record their expense for awards with graded vesting on an accelerated basis. Under U.S. GAAP, companies can choose between taking that method or they can amortize the entire grant on a straight-line basis. In turn, companies that use the latter method would, for example, treat one stock option grant that vests 25 percent over four years as four separate grants for the purposes of expensing, Melton noted.

Another “significant” change for current GAAP users, according to Melton, is the changes employers will have to make related to estimating payroll taxes for share-based payments. For U.S. GAAP, the liability is recognized when an award is exercised. On the other hand, IFRS requires that liability to be recognized earlier, at the grant date or as the employee’s services are provided.

Adoption in United States—the Two Sides of the Story

EDITOR'S COMMENTARY

As previously noted, views vary regarding whether U.S. companies should be allowed or eventually required to use International Financial Reporting Standards (IFRS). This chapter is designed to help readers consider both perspectives and develop a deeper understanding of long-term implications of IFRS adoption that are sometimes overlooked. The section opens with “The Impact in the United States of Global Adoption of IFRS.” This article is based on a 2007 white paper written by Donna Street (who is also a coeditor of this volume) at the request of the Council of Institutional Investors (CII). The council’s comment letter to the Securities and Exchange Commission (SEC) regarding the concept release on allowing U.S. issuers to prepare financial statements in accordance with the IFRS, which introduced the white paper to the SEC, is also reprinted in this volume. In its comment letter, the council expresses concerns associated with International Accounting Standards Board (IASB) funding, the E.U. IFRS endorsement process, and lack of investor representation on the IASB.

Arguments explored in Street’s paper supporting IFRS adoption include the following:

- For companies in certain industries, the IFRS would enhance comparability with competitors.
- The IFRS present opportunities to U.S. companies that operate globally.
- All SEC registrants should be provided the same options. Otherwise, some U.S. companies, particularly those in certain industries, may be at a competitive disadvantage.
- Use of the IFRS by U.S. companies would represent a step towards achieving a single set of high-quality accounting standards.

Arguments against IFRS adoption presented in the paper include the following:

- Significant differences between the IFRS and U.S. generally accepted accounting principles (GAAP) remain. Therefore, the IFRS and U.S. GAAP are not comparable. (Also, see the articles “Buckle Up” and “US GAAP vs. IFRS: The Basics”).
- Changes need to occur internationally and in the United States to reach the goal of a single set of common, high-quality standards that can be adopted in the United States.
- All U.S. accountants and auditors are not adequately versed in the IFRS.
- All U.S. companies should be required to use the same standards and not be provided with an option to use the IFRS.
- More improvements in the IFRS are needed before these standards are adopted in the United States.
- “European” IFRS will destroy all hopes for convergence and a global set of accounting principles.

- Elimination of U.S. GAAP contradicts the general sentiment in the United States that it is important to maintain control of establishing the accounting standards utilized by U.S. companies.
- Requiring U.S. companies to use the IFRS will limit the influence of the Financial Accounting Standards Board (FASB), SEC, and other U.S. organizations in shaping the accounting standards used by United States and other companies accessing U.S. markets.
- The IFRS do not provide a comprehensive set of standards suitable for the U.S. market.
- Enhanced lobbying will limit the IASB's ability to maintain the IFRS' status as principles based. Thus, the acceptance of the IFRS will not result in the desired move from the current rules-based approach of U.S. GAAP.

Some of the issues covered by Street are revisited in the other articles included in this chapter. "Closing the GAAP" explores the merits of a U.S. multinational organization being able to move all accounting operations into "one service center that would do it all." Additionally, the article addresses major discrepancies between the IFRS and U.S. GAAP that will significantly affect several U.S. companies when converting to the IFRS. These include issues associated with accounting for inventory (for example, last in, first out inventory accounting is not allowed under the IFRS), the need to rewrite and re-sign existing debt covenants, accounting for research and development, differences in accounting for business combinations, and the treatment of minority noncontrolling interests. Companies, again, are encouraged to start preparing now for the inevitable move to the IFRS.

In "Achieving a Global Standard: Convergence or Adoption?," Deloitte addresses the importance of convergence efforts between now and 2011 when significant turnover will occur at the IASB as the terms of several board members expire, including that of Chair Sir David Tweedie (see also 2008 amendments to the IASB and FASB memorandum of understanding [MOU] in the "What You Will Need to Know About IFRS" section). Deloitte especially highlights the importance of carefully following joint IASB and FASB standards to be developed in the next couple of years. Specifically, this time period will reveal whether there will still be differences between IFRS and U.S. GAAP converged standards or whether the IASB and FASB will adopt the same standards word by word.

In "Single Minded," KPMG's Mark Vaessen introduces new challenges and questions that require careful consideration as the international debate on IFRS continues. Vaessen suggests that the focus on convergence of the IFRS and U.S. GAAP will need to evolve to the development of high quality standards through cooperation with all jurisdictions that apply the IFRS and those that are committed to doing so in the future. Such an evolution will necessitate FASB working alongside other national standard setters including those in the European Union to provide "input to, and challenge of," the IASB's proposals. Among other things, Vaessen praises the recently announced review of the governance of the International Accounting Standards Committee Foundation (IASCF), including the "greater involvement of regulators to provide a structured and ongoing dialogue between the trustees and their stakeholder representatives."

We encourage readers to consider the impact on the future development of the IFRS and the independence of the IASB that may be associated with changes to the IASCF constitution. In a discussion document that was outstanding at the time this collection went to press, the IASCF trustees propose that the foundation's constitution be revised to

- establish a formal link between the organization and a monitoring group comprising representatives of public authorities and international organizations that have requirements for accountability to public authorities.

- expand the membership of the IASB to 16 members and add new guidelines regarding the geographical diversity of the members of the IASB.

The initial membership of the monitoring group would include the responsible member of the European Commission, the managing director of the International Monetary Fund, the chair of the IOSCO Emerging Markets Committee, the chair of the International Organization of Securities Commissions (IOSCO) Technical Committee, the commissioner of the Japan Financial Services Agency, the chairman of the U.S. SEC, and the president of the World Bank. This monitoring group would have the responsibility of approving the selection of IASCF trustees (who then would select IASB members).

When the IASB was formed, the SEC lobbied heavily for the initial IASCF constitution to require that IASB members be selected primarily based on technical competence with geographic representation playing a secondary role. Under the proposed constitutional changes, the emphasis on “professional competence and practical experience” would remain paramount. However, a geographic component would be added to “strengthen the legitimacy of the IASB in the view of the countries choosing to adopt IFRS.” Normally, the IASB should comprise four members from Asia and Oceania, four members from Europe, four members from North America, one member from Africa, one member from South America, and two members appointed from any area, subject to maintaining overall geographical balance.

The proposed constitutional changes are expected to be approved by the IASCF trustees in early 2009 and may have far reaching implications, especially in light of issues raised in John House’s “EU Fears US Influence.” John House explains why the SEC’s decision to drop the 20-F reconciliation for foreign registrants reporting under the IFRS “as promulgated by the IASB” did not meet with European approval. Of specific concern, any U.S.-listed European company applying present or future E.U. “carve outs” (see the CII comment letter to SEC in this section[a1]) as opposed to the full IFRS still has to prepare a reconciliation to U.S. GAAP in its SEC 20-F filing. House further explains that the European Union is concerned with the IASB changing its standards to meet a set of targets established by the SEC (that is, the focus on the MOU with FASB and the corresponding convergence with U.S. GAAP). See also the “Single Minded” article in this chapter.

As highlighted frequently throughout this volume, it is difficult to question the tremendous merits of a single set of high quality globally recognized standards. However, as noted in several of the articles included in the “Adoption in the United States—The Two Sides of the Story” chapter, the road ahead for achieving a global standard, suitable for use in the United States, will be challenging. Readers should fully consider not only the pros, but also the cons associated with a hasty U.S. move to the IFRS. CPAs need to actively engage in the dialogue regarding the transition from U.S. GAAP to the IFRS in an effort to ensure that the eventual move unfolds in a well planned manner.

The Impact in the United States of Global Adoption of IFRS

By Professor Donna L. Street, Australian Accounting Review

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Although numerous differences remain between US Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), the differences are being eliminated at an unprecedented pace. The ongoing, steadfast convergence of US GAAP and IFRS, which has followed the formation of the International Accounting Standards Board (IASB) in 2001, clearly reflects the commitment of both the US Financial Accounting Standards Board (FASB) and SEC to promote and assist the IASB in the development of one set of high-quality accounting standards that are accepted globally.

Several notable events in 2007 highlight the dedication of the US to global accounting standards. In April 2007, the FASB and IASB agreed that all future major projects will be conducted jointly. That same month a 'Framework for Advancing Transatlantic Economic Integration between the United States and the European Union' was signed by US President Bush, European Council President Merkel and European Commission (EC) President Barroso. Among other things, the agreement included a commitment to promoting conditions for US GAAP and IFRS 'to be recognized in both jurisdictions without the need for reconciliation by 2009 or possibly sooner' (Bush, Merkel and Barroso 2007). Then in July the SEC (2007a) issued a long awaited proposal and request for comment regarding the elimination of the 20-F reconciliation for foreign registrants reporting under IFRS 'as issued by the IASB'. A few months later, on 15 November, the SEC Commissioners voted unanimously to drop the 20-F reconciliation for companies using IFRS as adopted by the IASB.

An additional SEC (2007b) concept release was issued in August 2007, posing questions aimed at determining whether US-headquartered registrants should also be allowed the option to report under IFRS. While the concept release was outstanding at the time this paper went to press, exceptions were that the SEC would announce the Commission's deci-

sion regarding whether to allow US registrations to use IFRS by the close of 2008. If the decision were affirmative, the SEC decision would be expected to include a timetable for not only allowing the use of IFRS, but also possibly a timetable for the adoption of IFRS in the US.

This paper presents the pros and cons of the use of IFRS by US companies. The quest for one set of high-quality accounting standards recognised globally is clearly the ideal goal. However, before making a decision on the use of IFRS in the United States (US), the Securities Exchange Commission (SEC) should develop a blueprint to ensure that prerequisites for achieving a true global standard are satisfied and that convergence will continue. An 'improve and then adopt' approach appears to represent the best way forward for the US.

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In October 2007, the US Senate Subcommittee on Securities, Insurance, and Investment held hearings addressing the acceptance of IFRS in the US. Testifying before this subcommittee, FASB Chair Herz stated that the ultimate goal of the FASB is a common, high quality global financial reporting system that can be used for decision-making purposes across the world's capital markets. Previously that year, Herz stated at a conference hosted by the Financial Executives International (FEI) that the emerging single global standard should be IFRS, not US GAAP.

With the SEC contemplating the future of US GAAP, this paper considers the pros and cons of the use of IFRS by US-headquartered registrants. Before

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turning to the issue of acceptance of IFRS in the US, a brief background on US GAAP convergence with international standards follows.

BACKGROUND

With the US playing a significant role, much progress has been made towards convergence and achieving one set of global accounting standards in recent years. However, historically progress towards convergence, or as it was then known, harmonisation, materialised at an extremely slow pace. In the US, prior to the 1990s the FASB focused almost exclusively on the development of high-quality domestic standards. As illustrated by Street and Shaughnessy (1998), comparability with the standards of other major accounting standard setters, including the then International Accounting Standards Committee (IASC), occurred in few areas. This lack of harmonisation was, to a large extent, the result of limited agenda coordination and cooperation between the FASB, IASC and other major standard setters.

Street (2007b) provides an overview of the US evolution from the FASB's pre-1990s domestic focus towards a global focus on accounting standard setting. Among other things, she discusses in detail the FASB's first strategic plan for international activities (issued in 1991), the Board's role as a member of the G4 + 1 working group and the Board's resulting collaborative efforts with the other major English-speaking standard setters and the International Accounting Standards Committee (IASC),¹ the Board's role in encouraging the restructuring of the IASC, and the 2002 Memorandum of Understanding (MOU) with the IASB.² She also provides an overview of the SEC's 2005 Roadmap to Convergence agreement with the European Commission (EC) and the Roadmap's initial impact on convergence efforts of the FASB and the IASB. Overall, Street's analysis illustrates how, beginning in the early 1990s, the FASB underwent a major transformation by progressing from a national accounting standard setter focused on domestic issues to a Board committed to

collaborating with the IASC and later the IASB to achieve one set of high-quality globally accepted standards.

In testimony before a subcommittee of the US Senate, IASB Chair Tweedie (2007a) highlights the role of the US in the quest for the establishment of a set of high quality globally accepted accounting standards. Tweedie (2007a) stated:

... the SEC and the FASB were deeply involved in the establishment of the restructured IASB, and the structure, governance and independence of the IASB are largely modeled on the FASB's.

THE SEC DECISION TO DROP THE 20-F RECONCILIATION FOR FOREIGN REGISTRANTS USING IFRS

The SEC Roadmap to Convergence detailed the steps that should occur before the elimination of the 20-F net income and shareholders' equity reconciliations for foreign registrants reporting under IFRS. One of the key steps noted was evidence of sufficient progress in converging IFRS and US GAAP. However, support for dropping the reconciliation to a larger extent stemmed from the need to invigorate US capital markets. A study commissioned by New York political leaders Senator Schumer and Mayor Bloomberg (2007) suggested the city could lose its status as the world financial centre within ten years without a major shift in regulation and policy. The study further indicated that New York City financial markets are stifled by stringent regulations and high litigation risks. A high-priority goal set forth in the report was the recognition of IFRS without reconciliation for foreign SEC registrants and promoting global convergence of accounting standards.

The New York City report argued that doing away with the reconciliation without delay would eliminate unnecessary costs and remove a barrier for foreign issuers. Such an action would clearly communicate to the global financial services community that the US respects and honours approaches developed

¹ See also Street (2005: 127).

² In response to the SEC Roadmap for Convergence, the IASB and FASB issued an updated MOU in February 2006. The new MOU reiterates the Boards' commitment to convergence of standards and was accompanied by a revised work program for 2006-2008 aimed at achieving this goal.

outside its borders. Eliminating the reconciliation *in conjunction with accelerating convergence* of accounting standards would unleash the potential to improve US markets and facilitate access to US markets by non-domestic companies using IFRS.

At a Roadmap Roundtable hosted by the SEC in March 2007, companies, investors, rating agencies, accounting firms and others spoke ‘in one voice’, also encouraging the SEC to eliminate the reconciliation as soon as possible. Roundtable participants believed the main benefit would be to significantly reduce costs for some companies. Participants also indicated that the reconciliation imposed costs in terms of ease, timing and ability of foreign private issuers to come to the US markets. However, an important caveat is that investors at the Roundtable connected convergence and ending the reconciliation. While Roundtable participants generally supported removing the reconciliation, if eliminating it would cause convergence to cease, they would not. This important issue of convergence is revisited below.

As noted previously, in November 2007, with the extent of sufficient convergence between IFRS and US GAAP still a debatable issue, in line with recommendations of the political leaders of New York City and the SEC Roundtable participants, the SEC Commissioners voted to drop the reconciliation for foreign registrants using IFRS as issued by the IASB. The point of whether US-headquartered registrants should be allowed, or required, to use IFRS, however, remained unresolved.

SEC DEBATES THE USE OF IFRS BY US COMPANIES

The SEC’s 2007 proposal to allow US-based registrants to use IFRS sparked considerable debate. Adding fuel to the flame was the expectation that the SEC would eventually set a date for the adoption of IFRS by US companies. Notably, at the 2007 SEC Roadmap Roundtable, former SEC Chief Accountant, and author of the SEC’s Roadmap to Convergence, Nicolaisen indicated that the SEC should not only allow US companies to use IFRS, but that it should additionally consider that all US companies use the same standards as non-domestic companies.

Following up on Nicolaisen’s comment, at the annual International Organization of Securities Commissions (IOSCO) conference, SEC Commissioner Campos (2007) also broached the possibility of the SEC eventually requiring US companies to use IFRS. Referring to ‘some provocative new ideas’ emerging at the SEC Roadmap Roundtable, Campos noted that the previously ‘taboo’ topic of allowing US companies the choice to report under IFRS, as opposed to US GAAP, makes good sense. In the long term, it is hard to argue against one set of standards as the optimal target. Campos acknowledged that there will be difficulties, limitations and constraints on achieving such a goal, but if people are not willing to at least discuss acceptance of a global standard, we should ask why not.

Thus, in early 2008 the US was engaged in a debate on the merits and disadvantages of allowing, or eventually requiring, US companies to use IFRS.

REASONS FAVOURING THE USE OF IFRS BY US SEC REGISTRANTS

(1) For companies in certain industries, IFRS would enhance comparability with competitors

Gannon, Sogoloff and Madla (2007) of Deloitte explain that US companies may prefer IFRS if their major competitors report under IFRS. This would include companies in the banking, insurance, motor vehicle manufacturing, pharmaceutical and telecommunications industries. According to these authors, comparability in reporting would level the playing field, thereby providing investors an ‘apples-to-apples’ perspective when comparing results.

(2) IFRS presents opportunities to US companies that operate globally

Gannon, Sogoloff and Madla (2007) also suggest that IFRS offers US companies, particularly those operating globally, several potential opportunities, including:

- Standardisation of accounting and financial reporting policies—A consistent set of accounting policies and financial statements in each country where local reporting is required and improves comparability of financial information and tax planning.

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- Centralisation of processes—By moving towards company-wide IFRS use, a company could reduce reliance on local accounting resources for statutory reporting purposes, develop standardised training programs and eliminate divergent accounting systems.
- Improved controls—Standardised reporting would allow companies to assign one worldwide owner for statutory reporting, yielding better control over the quality and issuance of financial statements in other locations.
- Better cash management—Dividends that can be paid from subsidiaries may be based on local financial statements. Allowing the use of a consistent standard across countries can help improve cash flow planning.

In the same vein, IASB Chair Tweedie (2007a) explains that as the use of IFRS spreads, the accounts of US companies' foreign subsidiaries are more frequently based on IFRS. Allowing the use of IFRS by US companies would therefore reduce compliance costs associated with consolidating the accounts of foreign subsidiaries and the potential for error associated with the conversion and consolidation exercise.

(3) All SEC registrants should be provided the same options. Otherwise, some US companies, particularly those in certain industries, may be at a competitive disadvantage

Johnson (2007) of BDO states that US-headquartered registrants should be given the same option as non-US registrants to use IFRS. Otherwise, US companies will be at a competitive disadvantage. Johnson illustrates his point by reference to differences in revenue recognition rules under IFRS and US GAAP for the tech industry. Under IFRS, a company can report revenue growth faster due to the principles-based nature of IFRS, which provides more flexibility in the timing of revenue recognition. This is especially significant for emerging tech companies because customers, investors and analysts view revenue recognition as the easiest way to assess such a company's worth. Two companies with the same product and similar financial health could be viewed differently by customers because of the US GAAP company's

delay in revenue recognition. Therefore, given the option, to avoid competitive disadvantage, US-based tech companies may prefer IFRS.

Following a similar line of thinking, at the SEC Roadmap Roundtable, Jones, Director of External Reporting and Accounting Policies and Procedures at Dupont, indicated that from a competitive view, following the elimination of the reconciliation for foreign registrants, US issuers such as DuPont should also be allowed the option of using IFRS.

Summarising feedback received at the SEC Roadmap Roundtable, SEC Director of Corporation Finance White (2007) reports that a number of finance and accounting executives of multinational corporations in the US expressed similar views. These multinationals are already using IFRS for various reasons, whether at their international subsidiaries or for reporting purposes with various regulators in other jurisdictions. They believe that preparing their SEC filings based on IFRS could improve disclosure and reporting processes overall, in terms of transparency and internal consistency.

(4) Use of IFRS by US companies would represent a step towards achieving a single set of high-quality accounting standards

Testifying before a US Senate Subcommittee, AICPA Vice-President Professional Standards and Services Landes (2007) stated that providing US issuers an IFRS option will represent another significant step towards achieving the larger goal of a single set of high-quality, comprehensive standards to be used by public companies in the preparation of transparent and comparable financial reports globally. He, however, clarified that the AICPA believes that international convergence should be considered holistically. If IFRS are to serve as a basis for US issuers' reporting, there first needs to be changes in the auditing, regulatory and legal environments. This issue is further discussed below. Landes further stressed that if US issuers are allowed an IFRS option, it is crucial that the convergence work of the FASB and IASB continue.

REASONS US COMPANIES SHOULD NOT BE ALLOWED TO USE IFRS

In testimony before a US Senate Subcommittee, IASB Chair Tweedie (2007a) stressed that clearly there is global momentum towards accepting IFRS as a common financial reporting language. However, he conceded that the IASB's success is incomplete as a number of countries remain notably absent from the list of IFRS adopters. These include two major economic powers: the US and Japan. While voicing commitment to convergence, at the close of 2007, neither of these countries allowed domestic companies to use IFRS.

While support exists for the use of IFRS by US companies, many believe a decision to allow US companies to use IFRS is premature.

(1) Significant differences between IFRS and US GAAP remain. Therefore, IFRS and USGAAP are not comparable

IASB Chair Tweedie (2007b) predicts that by '2011-12, US and international accounting should be pretty much the same—with 150 countries using IFRS and several others using USGAAP. That adds up to about 170 countries accounting in much the same way.' However, others contend that the convergence of US GAAP and IFRS is in its early stages and that Tweedie may be overly optimistic.

In testimony before a Subcommittee of the US Senate, FASB Chair Herz (2007) stated that, although the FASB and IASB have made significant progress in improving and converging IFRS and US GAAP, work is incomplete and improvements are needed in a number of important areas. He indicated that many differences remain between US GAAP and IFRS that can result in significant differences in the numbers reported under the two sets of standards. Thus, although the IASB and FASB have made steady progress towards convergence, Herz estimates that it will take many more years to reach the goal of full convergence using the two Boards' current approach.

Academic research supports Herz's position. Street, Nichols and Gray (2000) and Blanco and Osma (2004) examined the net income 20-F reconciliations of a small number of companies using International Accounting Standards (IAS) to access

US markets prior to 2001. Both studies suggest that IAS and US GAAP were converging. However, more recent research on larger samples suggests a different story.

With the widespread adoption of IFRS by the EU member states, Australia and others, the significance of 20-F adjustments by larger numbers of 'IFRS-based' SEC registrants is under investigation. Street, Gray and Linthicum (2007) find that adoption of IFRS in 2005 resulted in divergence, as opposed to convergence, with US GAAP for 135 European companies listed in the US filing 'IFRS-based' financial statements. During the pre-IFRS period of 2002-2004, European and US GAAP net income measures were generally comparable (not significantly different). However, following the switch to IFRS in 2005, IFRS net income was significantly higher than US GAAP net income. Furthermore, the gap between 2004 IFRS and US GAAP net income significantly exceeded the difference between European GAAP and US GAAP net income.

A recent survey by Citigroup yields similar results, thereby supporting the conclusion that 'the glut of differences between the two sets of standards causes major swings' (Jetuah 2007). For 73 European SEC registrants, the 2005 and 2006 20-F reconciliations contain 426 reconciling differences; most of the reconciling items are attributable to the treatment of tax, pensions, goodwill and intangible assets, and financial instruments. Eighty-two per cent of the companies had higher net income under IFRS, with IFRS net income, on average, being 23% higher than US GAAP net income (based on the mean). The median IFRS net income was about 6% higher under IFRS.

While the survey covers only two years, Citigroup concludes that the median is dropping, thereby indicating some differences are being removed. Yet, book value for 70% of the companies surveyed is lower under IFRS. On average, IFRS returns on equity are much higher. Citigroup believes the 'differences could well result in investors and/or analysts arriving at different conclusions about the financial position and performance of business depending on the GAAP used.' Citigroup further notes that the option to use IFRS rather than US GAAP would provide a boost to book earnings and returns.

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(2) *Changes need to occur internationally to reach the goal of a single set of common, high-quality standards that can be adopted in the US*

FASB Chair Herz (2007) believes that, prior to allowing US-based SEC registrants to use IFRS, a blueprint should be developed that addresses a variety of institutional issues. Internationally, the unresolved issues include strengthening the IASB as an independent, global standard setter by establishing mechanisms to ensure the sufficiency and stability of its funding and staffing (see also Landes 2007). Herz further notes the importance of examining the post-issuance endorsement processes that currently exist in many jurisdictions to reduce or eliminate 'as-adopted' versions of IFRS. These endorsement systems are inconsistent with the goal of a single set of high-quality standards. The issue is revisited later in the paper.

(3) *Changes need to occur in the US to reach the goal of a single set of common, high-quality standards that can be adopted in the US*

Herz (2007) and Wyatt (2007) highlight several prerequisites to achieving a true global standard. Herz argues that timetables need to be identified and established in the US to achieve changes to the financial reporting infrastructure necessary to support the move to an *improved version* of IFRS, including:

- training and educating issuers, auditors, investors, and other financial statement users about IFRS
- examining how a transition to IFRS will affect audit firms and audit standards
- establishing how a move to IFRS would change regulatory agency policies, contractual arrangements or state legal requirements that are currently based on US GAAP reports
- assessing the impact of this transition on private companies and not-for-profit enterprises that currently use US GAAP
- enabling the use of more principles-based accounting standards and less specialised industry accounting requirements.

Herz believes the blueprint for a move to IFRS should also itemise the steps US public companies would need to implement to align to IFRS, including

training, system changes, internal control changes and various contractual matters.

A move to IFRS at a rapid pace would additionally require, *inter alia*, investments in systems, personnel, new reporting formats and modifications to the internal control system over financial reporting. Significant costs could result from re-negotiating contracts, lending agreements and debt covenants, and compensation agreements tied to US GAAP. Tax advisors, as well as regulators, would need to comprehend the implications of moving to IFRS.

Indeed, Herz (2007) stresses that

... moving all US public companies to an *improved*³ version of IFRS will be a complex process. A smooth transition will not occur by accident, and to manage this change, we suggest that a blueprint for coordinating and completing the transition should be developed and agreed to by all major stakeholders in the process. The blueprint should identify the most orderly, least disruptive, and least costly approach to transitioning to an *improved* version of IFRS and should set a target date or dates for US registrants to move to IFRS that allows adequate time for making the many necessary changes.

Herz anticipates that the many required changes to the US financial reporting infrastructure should take a number of years to complete. During this time, the FASB and IASB should continue their joint effort to develop common, high-quality standards in key areas where neither US GAAP nor IFRS provides relevant information for investors.

(4) *US accountants and auditors are not adequately versed in IFRS*

Wyatt (2007) elaborates on the education issue raised by Herz and states that most US accountants and auditors are not currently trained in IFRS. Thus, acceptance of IFRS in the US would necessitate substantial continuing professional education for those in practice as well as extensive, unprecedented changes in the curricula of US universities. Presently, US universities do not have courses devised to assist in the IFRS educational process. While the development of the necessary educational materials and curricula should not require a lengthy time period, Wyatt believes the process is unlikely to commence until IFRS are further along in their development stage.

³ Emphasis added.

In a bulletin describing the upcoming move to IFRS in Canada, the Canadian Accounting Standards Board also stresses that the transition to IFRS requires education, not only for auditors and in the universities, but also for public companies, their investors, lenders and advisors (AcSB 2006). Thus, the need for a transition period prior to acceptance of IFRS in the US should not be overlooked by the SEC or be taken lightly.

(5) *All US companies should be required to use the same standards and not be provided with an option to use IFRS*

Herz (2007) indicates that in general the FASB is opposed to allowing US companies to select between different accounting standards for economically similar transactions

because of the added cost and complexity such choices create for investors and others trying to use financial information, and the added cost and complexity involved in developing a US financial reporting and educational infrastructure to support a two-GAAP system for US public companies.

Herz (2007) testified before a US Senate Subcommittee indicating the FASB does not support providing US companies with the choice between IFRS and US GAAP. Alternatively, the Board prefers to move all US public companies to an improved IFRS over a transition period of several years following the blueprint recommended by Herz.

(6) *More improvements in IFRS are needed before these standards are adopted in the US*

The FASB favours an improve and adopt approach to IFRS. According to Herz (2007), in the interim the IASB and FASB should continue to work together to develop standards where both the existing IFRS and US GAAP standards are in need of improvement. Ideally, the jointly developed standards would then be adopted, as issued, by companies in the US and internationally. In other areas, the FASB envisions that US public companies would adopt IFRS standards 'as is' over a period of years to eventually complete the movement to an improved version. This approach allows financial statement users around the world to benefit from the continued, cooperative efforts by the FASB and IASB to improve, simplify and converge financial reporting in areas where

existing US GAAP and IFRS are clearly deficient. This approach, at least in the interim, addresses to some extent concerns expressed by many that convergence efforts and the quest for one set of high quality globally accepted standards may be derailed by the European Commission, especially if the US move to IFRS is accelerated, as explained below.

(7) *'European' IFRS will destroy all hopes for convergence and a global set of accounting principles*

The SEC, FASB, IASB and others have voiced serious concerns about the emerging 'flavours of IFRS'. While the SEC Roadmap to Convergence focuses exclusively on acceptance of IFRS 'as issued by the IASB', the EU retains its ability to selectively adopt IFRS and does not appear ready to adopt without reservation future IFRS as promulgated by the IASB (Street and Linthicum 2007; Larson and Street 2006).

During an October 2007 panel discussion, FASB Chair Herz and IASB member Leisenring addressed the threat to achieving global standards, stressing that the primary obstacle to convergence concerning members of the FASB and the IASB is the EU position. Leisenring specifically stated that 'the biggest threat to convergence lies in the European Commission' (Rappeport 2007). He argued that the mission of the IASB will fail completely if Europe's tweaking of IFRS is tolerated and allowed to continue.

A European version of IFRS greatly complicates matters for EU companies as the reconciliation exemption applies only to those companies using IFRS as issued by the IASB. The only exception is a two year transition period granted by the SEC for a small number of European companies using the IAS 39 carve out. With EU companies legally obligated to follow the EC's regulations, any future deviations in EU-endorsed IFRS from IFRS as issued by the IASB will lead to EU companies again having to reconcile their books for a US listing.

Street and Linthicum (2007) encourage their readers to consider the impact on convergence of inconsistencies in the objectives of the SEC and EC. The SEC believes convergence of IFRS and US GAAP should focus on addressing 'the toughest, most intractable and problematic standard setting issues such as financial instruments, performance reporting, revenue recognition, pensions, leases, and consolidation policy' (Erhardt 2005). While the current

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efforts of the IASB and FASB are consistent with the SEC's objective of 'advancing the frontiers of accounting', Street and Linthicum question whether the Boards' work program is in favour with the EU. For example, EU Commissioner for the Internal Market and Services McCreevy (2005) has noted that convergence cannot be allowed to destabilize the IFRS platform in Europe, and cautions that convergence is not an invitation for standard setters to advance the 'theoretical frontiers' of accounting. 'Revolutionary' new standards will not be acceptable as the 'IFRS train' has just 'left the station'. The SEC has not set a timetable for addressing the issues noted by Erhardt, but the implication is that IFRS and US GAAP must improve, and that progress towards change should be evident if IFRS is to be accepted for use in the US. Therefore, it is possible that the stable platform objective will hinder the change and convergence desired by the SEC as McCreevy's message to the IASB contradicts the SEC position.

(8) Elimination of US GAAP contradicts the general sentiment in the US that it is important to maintain control of establishing the accounting standards utilised by US companies

Bukspan and Joas (2007) stress that the SEC's willingness to explore, giving US companies a choice between IFRS and US GAAP, may 'be interpreted as a not-so-gentle nudge toward a looming exit for US GAAP and could bring a sea of change for the future role of US GAAP and of the FASB'. This view is of course consistent with statements made by Nicolaisen and Campos referred to previously in this paper.

In May 2007, a poll was conducted at the Financial Services Executives Forum in New York City attended by several hundred CFOs and other finance professionals. The results of the poll reveal that a vast majority are willing to accept an IFRS-based standard or a converged set of standards. However, when queried concerning whether they are prepared to give up control of establishing accounting standards, 68% responded 'no' and another 7% were unsure. Bukspan and Joas (2007) believe that the latter reflects US sentiment in general, given the historical strength of the US capital markets relative to global markets. Despite the shortcomings of US GAAP,

Bukspan and Joas believe that the US market is not likely to be prepared to embrace a completely new set of standards that are in an evolutionary stage and are yet to be tested.

Responses to a survey by 142 members of the American Association of Individual Investors indicate that the attitudes of individual investors are in line with the CFO's sentiments. The study conducted by McEnroe and Sullivan (2006) reveals that a large majority of individual investors believe the US should maintain control of accounting standards used for US listings. A smaller majority believe there should be a global set of accounting principles for all stock exchanges.

(9) Requiring US companies to use IFRS will limit the influence of the FASB, SEC and other US organisations in shaping the accounting standards used by US and other companies accessing US markets

Tarca (2005) describes the impact of adoption of IFRS in Australia, which historically followed a standard-setting model similar to the US. Her major points provide a preview of what the future would likely hold for the US if IFRS were adopted.

- The Australian Accounting Standards Board no longer develops standards from inception. The Board cannot independently determine the content of standards, but is constrained to ensure that Australian standards are not inconsistent with IFRS. The Board does not have control over its work program, which is aligned with that of the IASB, so that matters under consideration by the IASB are also considered by the Australian Board.
- Lobbying efforts of the corporate sector must be directed more at the IASB than the Australian Board. Australian companies have less influence in international standard setting than they had in national standard setting.
- The federal government is more removed from the standard-setting process now that Australian standards are based on IFRS. Given the government's support for harmonisation with IFRS, it is unlikely to intervene in the standard-setting process to allow Australian standards to be incompatible with IFRS.

As noted previously, US investors, in general, apparently are not prepared to give up control of establishing accounting standards as has occurred in Australia and other countries.

Tarca's point on lobbying is consistent with Wyatt's (2007) view that, upon acceptance of IFRS, lobbying is redirected from the national standard setter to the IASB (see also Zeff 2002). According to Wyatt, pressures on the IASB will eventually exceed those ever faced by any national standard setter and make development of principles-based standards a massive challenge.

(10) IFRS does not provide a comprehensive set of standards suitable for the US market

Bukspan and Joas (2007) describe IFRS as a 'work in progress' that does not cover some areas of accounting. When an IFRS standard does not address a matter, IAS 8 requires companies to look to the most recent pronouncements of other standard setters. In a review of 2005 IFRS accounts, the SEC staff identified substantial variation in accounting for insurance contracts and in reporting of extractive industry exploration and evaluation activities in the absence of an extensive IFRS standard for these activities.

Following this same line of logic, Street and Linthicum (2007) refer to enforcement concerns and evidence that a substantial learning curve exists for many first-time IFRS users. These authors recommend that, prior to allowing the use of IFRS in the US, the SEC should develop a strategy for industries where US GAAP provides industry-specific standards, but where IFRS is presently silent. If the SEC allows use of IFRS without clarifying what rules to follow in the absence of an IFRS, comparability will likely be greatly impeded.

(11) Enhanced lobbying will limit the IASB's ability to maintain IFRS' status as principles-based. Thus, the acceptance of IFRS will not result in the desired move from the current rules-based approach of US GAAP

Both the study commissioned by the political leaders of New York City and Bukspan and Joas (2007) highlight the need for convergence towards principles-based, as opposed to rules-based, accounting standards in the US. Some are of the view that a move to IFRS will represent a step in this direction. For exam-

ple, Tweedie (2007a) indicates his hope is that the standards emerging from the FASB and IASB joint work program will be very different from the style of many existing US standards (and IFRS). He stresses that the IASB is firmly committed to a principles-based approach and he furthermore believes the convergence program will help guide US GAAP away from the prescriptive rules constituents have demanded from the FASB.

Wyatt (2007), however, begs to differ and explains that the FASB's departure from the underlying concepts set forth in the Conceptual Framework has in numerous instances been the result of political interference, either from disagreement with SEC thinking, or more frequently, effective lobbying by the business community signalling to the FASB and/or US Congress that the direction of an FASB proposal would cause harm to the US economy (see also Zeff 2002). The result of this political interference is often issuance of a US standard that departs from the Conceptual Framework and that is more rules-based than principles-based.

According to Wyatt, no one understanding accounting standard setting can possibly believe that the IASB will be immune from the political forces that have caused the FASB so much anguish and have lead to the issuance of bad US standards. He states that 'multiple governments with differing priorities and multiple business communities with various interests to protect will generate even greater pressures on the IASB than the FASB has faced'. Thus, the principles-based versus rules-based debate represents a red herring. Future IFRS will likely look more like FASB standards than principles-based standards. While principles-based standards are an admirable goal, the evolution of standards, be they US GAAP or IFRS, will continue to be influenced by forces unrelated to accounting concepts. While rules-based standards will continue to be issued, Wyatt is hopeful that they will at least be issued on a diminished basis.

In line with Wyatt's thinking, PwC (2007) reports that both the IASB and FASB 'fail to acknowledge other key forces that influence standard setting in the EU—specifically, the . . . endorsement process at the European Commission level. Likewise, some believe that the SEC greatly influences the application of US GAAP and occasionally influences the

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actual content of standards'. Thus, the belief that IFRS are the route to global principles-based standards is most likely flawed.

CONCLUSION

As the SEC continues to consider the future of IFRS in the US, this paper presents the pros and cons of allowing or requiring US companies to use IFRS. According to Tweedie (2007a)

The objective of the IASB is to have a single set of high quality, principle based standards used worldwide. Clearly, a system will not be truly global if the United States does not participate. It is for this reason the IASB has placed such high priority on convergence with US GAAP.

It is difficult to suggest that the pursuit of this goal is anything other than ideal. However, as outlined in this paper, it appears that, at least for the immediate future, the arguments against adopting, or allowing, the use of IFRS in the US outweigh the benefits.

Notably, the SEC should develop a blueprint to ensure that several prerequisites to achieving a true global standard are satisfied prior to requiring, or even allowing, US companies to use IFRS (Herz 2007; Wyatt 2007). These include *inter alia*:

- establishing timetables to achieve changes to the financial reporting infrastructure necessary to support the move to an improved version of IFRS, including training and educating issuers, auditors, investors and other financial statement-users about IFRS
- determining how a transition to IFRS will affect audit firms and audit standards
- envisioning how a move to IFRS would change regulatory agency policies, contractual arrangements, or state legal requirements that are currently based on US GAAP reports.

Also of great significance is ensuring that convergence continues to progress. If the move to IFRS is made prematurely in the US, many believe convergence could be derailed by the EU's endorsement process (Street and Linthicum 2007; Larson and Street 2006; Rappeport 2007). In conclusion, FASB Chair Herz' (1997) recommendation to improve and then adopt IFRS seems to be the best way forward for the US.

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Closing the GAAP

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When the U.S. finally converts its corporate accounting to the more globally utilized International Financial Reporting Standards (IFRS) from Generally Accepted Accounting Principles (GAAP), companies like United Technologies Corp. (UTC) are likely to take a huge hit because of differences in how such items as inventory are handled. No matter, Margaret Smith, UTC's controller, is one of the biggest proponents for making the switch—and as soon as possible. “With 62% of our revenues coming from international locations, and with more than 180 offices abroad, we're watching this process carefully,” says Smith, a vice president at the \$55 billion conglomerate. “While initially it would cost us more, there would be big savings in being able to move all our accounting operations into one service center that could do it all.”

This must be music to the ears of Christopher Cox, the chairman of the Securities and Exchange Commission (SEC), who has been pushing for a rule to allow U.S. filers to jump voluntarily to IFRS as early as next year. Cox has been insisting since he first took over the SEC about the need for convergence in accounting, financial standards and regulation to accommodate increasingly global markets and economies, and a global switch to IFRS would allow investors to compare financials from around the world. As Cox told a meeting of the American Institute of CPAs in January, “There is a risk that the rapid increase in global trading and investment is getting ahead of the ability of accounting standards and financial analysis to provide investors with comparable information in a form they can readily use and understand. That's why it's important . . . that we do everything within our power to ensure that financial reporting information from different countries is comparable and reliable.”

Unfortunately, many U.S. senior financial executives and experts are singing a different tune—one that reflects fears that companies and the accounting

profession itself may simply not be ready to make too hasty a conversion. If regulators move too quickly, before the discrepancies between IFRS and GAAP are resolved, they argue that the move to IFRS could turn out to be worse than the Sarbanes-Oxley Act in terms of expense and distraction from business. “The SEC is not ready to look at corporate filings in IFRS,” says Christine Fabio, Financial Executives International's vice president for technical activities. “There are practical issues between GAAP and IFRS that need to be reconciled. Any IFRS filing mandate should be phased in over five to 10 years.”

UTC's inventory accounting issue provides a good case in point. Many U.S. firms use what is called ‘last in, first out’ (LIFO) methodology to account for inventory. When they do this, under U.S. tax law, they are also required to use LIFO for inventory in their tax filings, too. IFRS doesn't accept LIFO, and even proponents like Smith concede that until companies know whether the IRS will continue to accept LIFO they would be forced to wait. “Making that change, if the IRS forces us to change too, would cost us a one-time \$50 mil million,” notes UTC's Smith, who sits on the executive committee on corporate reporting of Financial Executives International (FEI). “So even if we did get an option to switch over to IFRS, we'd probably wait to see what the IRS does about that.”

Inventory is not the only potential minefield. Other significant issues to be resolved include:

- The need to rewrite and re-sign existing debt covenants and other contracts, most if not all of which have been based on GAAP treatments rather than IFRS;
- The handling of research and development, which is an expense charged to operations under GAAP, but which under IFRS has research charged to operations and development depreciated;

Closing the GAAP

- The differences in business combination accounting, with GAAP permitting no contingent liabilities after a merger while IFRS allows contingent liabilities; and
- The treatment of minority non-controlling interests, which are calculated at fair market value under GAAP, but can be calculated at fair market value or book value under IFRS.

These are only a few areas that would bring change to U.S. corporate accounting with a switch to IFRS. A white paper released by PriceWaterhouseCoopers in January sets out at least 30 areas where companies may have to contend with the change.

None of this comes as a surprise to the SEC or the Financial Accounting Standards Board. Both agencies have been working with the International Accounting Standards Board for many years trying to align GAAP and IFRS, in anticipation of eventual adoption of those standards in the U.S. Like most politically complicated processes, convergence has not moved forward as fast as globalization might require.

Meanwhile, there is also the question of whether there are enough accountants familiar with IFRS to handle internal and external audits. Certainly, it's true that U.S.-based multinationals are already using IFRS accounting standards for their international subsidiaries, which means they have staff abroad already trained in its intricacies. The big accounting firms are also already providing accounting services to those subsidiary operations, as well as to foreign corporate clients in places like Europe or Hong Kong, which are using the IFRS standard, and are conducting audits of those companies' books.

"We've been training certain of our professionals on IFRS for a couple of years, because we have clients reporting using IFRS, whether directly or through reporting to their foreign parent," says Samuel J. Ranzilla, partner for professional practice at KPMG. "Even so, the training of our professionals for the implementation of IFRS by U.S. public companies will be a significant undertaking on our part."

He says that the company has developed several plans for how it would handle the training, but explains that it is waiting to decide which one to use. "We're waiting to see the proposed rule from the SEC

before we execute on a plan," he says. "A training effort like this has to be sensitive to the timing of implementation, to assure that our professionals are trained just in time to use their training shortly after its delivery." If they get trained and then don't apply their new knowledge for a year or two, he explains, they could lose a lot of their facility with the new standard.

The training of the vast army of accountants and auditors that would inevitably be required once all public companies, large and small, converted over to IFRS, will take considerable time. At present, there is not even one U.S. college textbook on IFRS accounting, and university accounting departments offer, at best, only one course in IFRS accounting. (That compares to 30 to 50 course hours required to be credentialed for GAAP.) "We have a second-year elective on global financial reporting," says Mary Barth, a professor of accounting and senior associate dean of academic affairs at Stanford University's Graduate School of Business, "so it's in the works here."

But Stanford has an advantage, thanks to Barth who is one of only two U.S. representatives on the International Accounting Standards Board (IASB). The IASB oversees the IFRS in a similar fashion to the way the Financial Accounting Standards Board (FASB) regulates the implementation of GAAP.

One area where there seems to be broad agreement on is on the advantages to the investor of IFRS. "With GAAP, it is all about the numbers," says Bob Burns, director of policy and research at the Center for Audit Quality (CAQ), a non-profit Washington-based group that tries to "bring together" and address the issues of investors, auditors and corporate finance officers. "IFRS, in contrast, is numbers and disclosure about what's going on. So all in all, I think investors may get more information from IFRS statements."

With GAAP, it is all about the numbers. With IFRS, it is about the numbers and disclosure. Investors get a lot more information
—CAQ's Burns

Says Barth, "I cannot think of any area where GAAP offers more disclosure than IFRS. And IFRS has more disclosure in the area of financial risk. It's true that the U.S. does quarterly reports, while most IFRS countries only have semiannual reports, but if the SEC wants to insist on quarterly reports they could stay."

UTC's Smith says financial reports done using IFRS will be longer. "You have to do much more disclosure, explaining why you did what you did," she says. "If you look at companies that went from GAAP over to IFRS, the footnotes get much longer. So investors are getting a lot more information. So I guess it's good for investors in that they'll be able to know more, but they'll have to read it, or listen to the analysts' call."

While much has been said about how U.S. GAAP and IFRS systems are based on different approaches—GAAP is more rules-based and IFRS more principles-based—IASB representative Barth down-

The rules/principles dichotomy is not as big as people make out. IFRS is less of a secret society of accounting.

—Stanford's Barth

plays those differences. "I'm biased, of course," she laughs. "But I think the rules/principles dichotomy is not as big as people are making out. With IFRS, you

have a set of rules to make sure principles are met. In many ways, it can be easier to understand than GAAP. It's less of a secret society of the accounting staff."

She may be in a minority. "IFRS is a different mindset," says FEI's Fabio. "With GAAP you have a lot of bright-line rules, and a lot of second-guessing about those rules. With IFRS, you get principles, instead of rules, so things won't be as black and white. Companies will have to use a lot more judgment in the accounting."

The U.S. litigious nature adds another complicating element. U.S. courts abhor ambiguity, and a system in which two similar enterprises with two different sets of accountants can come up with opposite answers to an accounting issue by following a principle is sure to end up being adjudicated in court, where it will result in a rule. Then, says KPMG's Ranzilla, the challenge will be for both the U.S. and the IASB to avoid a gradual trend towards national IFRS's, and a piling up of new rules. "The American legal system is a challenge we face," agrees Barth.

In its January white paper, PWC urged companies to begin preparing now for a future conversion. The firm recommends that corporate finance departments do their own cost/benefit analyses of the conversion to IFRS. As well, they suggest that manage-

ments look at change management strategies designed to smooth the path. The impact of IFRS accounting policies on reported results needs to be measured, and plans need to be made to educate investors about these impacts in advance. PWC also advises that companies that have overseas operations should begin planning now for ways to centralize their accounting functions once the U.S. operation is also on the IFRS system.

No doubt, just as with SOX, a significant chunk of the panic that inevitably precedes the first filing with a new system will prove to be irrational; only 313 early SOX filers failed to pass their Section 404 internal control audits. But companies that are worried about their income statements and balance sheets getting whacked with IFRS are not all Chicken Littles. Smith still believes that companies are more ready than they realize for IFRS, and ultimately the plusses of the new system will outpace negatives. "I think corporate America—especially the larger global companies—will get on board IFRS quickly," predicts United Technologies' Smith. Most of them, she notes, have people overseas already working with IFRS. "You need only look at Europe," Smith points out "They had to make their transition to IFRS by 2005, and they didn't even finish writing the standards until 2004. If they can do it there, where some of the countries had very arcane accounting standards, we can do it here."

Despite Cox's enthusiasm, most experts expect regulators to recommend ample ramp-up time. The recent PWC white paper predicts that the SEC will allow U.S.-based companies to file their financial reports using IFRS on an optional basis sometime in 2009 or 2010, with a mandate to switch over by 2013. Sam Ranzilla, a partner for professional practice at KMPG, agrees with that prediction. For smaller companies, he anticipates an even more generous rule—with the SEC giving them until as late as 2015. This would follow how the SEC has treated smaller enterprises when it came to SOX filings.

"It's not clear to me how long this process will take," says Stanford University's Barth. "We're all still guessing, but I'd certainly be surprised if they said, okay, starting next year all companies will use IFRS. I'd be less surprised if they said that starting next year some, or any, public company could choose to

Closing the GAAP

make the change.” She adds, “I hope they put a deadline on it, though. The worst of all possible worlds would be to have a long period of parallel systems.”

Regardless of the timetable, IFRS is coming to the U.S.—and soon. Cox made sure of that recently by allowing non-U.S. competitors to file in the U.S. using IFRS. Of course, that puts U.S. companies at a com-

petitive disadvantage since they must still file using GAAP here and IFRS in the rest of the world.

“Even if regulators make IFRS optional, they’re all going to switch,” predicts Allan Afterman, a consultant and author of several books on SEC regulations and financial reporting. “It’s a foregone conclusion that in four to five years, most or all U.S. companies will be using IFRS.”

Convergence or Adoption? A Look at Convergence Efforts

By Deloitte

August, 2008

A LOOK AT CONVERGENCE EFFORTS

The anticipated decision that the Securities and Exchange Commission (SEC) will give U.S. companies the green light to use International Financial Reporting Standards (IFRS) is spurring debate on the direction of the convergence plans between the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB). While a quick glance at the agendas of the two standard-setters reveals some major projects in the works, the scope and timeline to complete those projects remains uncertain.

Discussion on convergence will be in full swing at the upcoming joint meeting between the IASB and FASB in October. Financial executives should take note of the pace and activity of the standard setting process in upcoming months as it may serve as an indicator of what companies might expect on the IFRS front.

Are the standard setters headed for a change in overall direction of their convergence efforts or will they keep the status quo?

The answer to this question will depend, in large part, on how quickly IFRS finds its way into the U.S. At their joint meeting in April 2008, the IASB and FASB debated the future of their convergence efforts assuming mandatory adoption of IFRS in all major capital markets by 2013. They contemplated a “quiet period” where no new standards would be issued and effective at least a year before that date. A quiet period is a good thing as it offers financial executives a chance to take a breath and consider what adopting IFRS means for their organization.

With this timing, the standard-setters would need to complete all major projects by mid-2011. Another factor potentially driving this timing is that by June 30, 2011, there will be considerable turnover at the IASB, including the chairman and vice chairman.

Historically, the world’s standard-setters, including the FASB, have focused on converging their national standards with IFRS. The thought was that

over time, through the standard-setting process, national standards would morph into global ones. However, an increasing number of jurisdictions have achieved the ultimate goal of convergence via outright adoption of IFRS as a local reporting requirement. This is the case in Australia, South Africa, and Europe. Soon, that will include Argentina, Brazil, Canada, Chile, India, and Korea. So the closer we get to the adoption of IFRS in the U.S., there will be greater pressure on the FASB to minimize changes to U.S. GAAP, which will permit a smoother full-scale conversion to IFRS. Ultimately, the standard-setters will need to decide how much change is tolerable and possible within the next couple of years.

While the convergence efforts originally undertaken between FASB and IASB to formally converge U.S. GAAP and IFRS (marked by the “Norwalk Agreement” in 2002) have come a long way, it has proven to be difficult to converge standards. Although convergence has increased the similarity of selected standards, it has not resulted in complete conformity, as evidenced by important areas of business combinations and share-based payments. One thing to watch out for is how new standards will be developed over the next two-to-three years. That is, will there still be differences in converged standards or will the IASB and FASB adopt exactly the same standard—word for word?

Given the inevitability of IFRS here in the U.S., it’s important that any changes to U.S. GAAP over the next few years conform with IFRS. Interestingly, the FASB may consider doing just that in the context of the income tax project: the FASB is considering issuing a revised version of IAS 12, *Income Taxes*, to replace Statement 109, *Accounting for Income Taxes*. This would signify a significant shift in the FASB’s policy on convergence. Before making such an important decision, the FASB is seeking input from constituents on the overall direction of the income tax project and what the FASB’s policy should be on convergence going forward. So we may see an evolution over the next few months of what convergence is and what convergence isn’t.

Convergence or Adoption? A Look at Convergence Efforts

SEC ROUNDTABLE SUMMARY

The SEC hosted a two-panel roundtable on IFRS in Washington D.C. on August 4, 2008. Participants included investors, issuers, auditors and others with financial reporting experience, while members of FASB and IASB observed.

The roundtable contained an open dialogue on participants' recent experiences with IFRS, including how IFRS and U.S. GAAP performed during the recent subprime crisis. SEC Chairman Christopher Cox provided opening and closing remarks that touched upon the main themes of the session.

The SEC also confirmed that it was moving forward with its plans to release an IFRS implementation "roadmap," in the near future.

Among the major topics of discussion were the following:

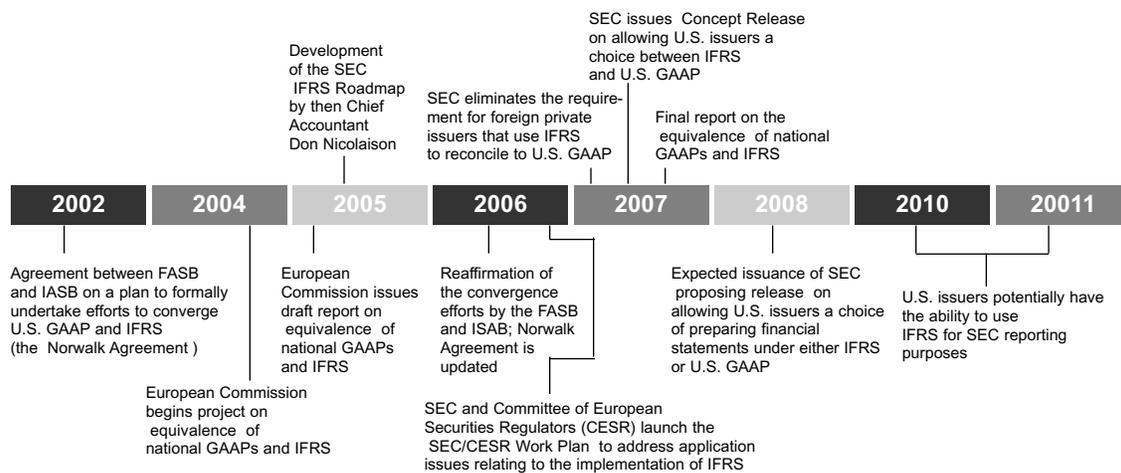
- IFRS performance during market turmoil: Most roundtable participants believed that IFRS held up well under the current period of market turmoil, perhaps even outperforming U.S. GAAP. Reasons for this included the fact that IFRS generally results in accounting that more accurately reflects the underlying economics; the use of QSPEs is not permitted under IFRS; and IFRS requires more robust disclosures that increase

transparency. However, many participants acknowledged that there are areas of improvement that should be made to IFRS.

- Fair value challenges: Participants acknowledged that fair value presents significant challenges under both IFRS and U.S. GAAP, and that improvement is needed.
- Fresh perspective: Several participants suggested that the transition to IFRS allows companies to take a fresh look at their accounting policies and procedures. Converting to the IFRS allows organizations to step back and think about whether they are accounting in the most efficient and effective manner; handling disclosures correctly; emphasizing transparency; and getting accounting outcomes that closely and accurately follow the true economics of the transactions.
- Conversion timelines: Some panelists stressed the importance of getting a specific timeline for conversion to IFRS, contending that it will likely take companies longer than they may intuitively expect to complete their conversion activities, and noting that sufficient time is required for planning and execution.

For additional information on the roundtable see Deloitte's "Heads Up" newsletter at www.deloitte.com/us/headsup.

FIGURE 10-1: IFRS Timeline



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Single Minded

By Mark Vaessen, Accountancy

February, 2008

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The IFRS part is in full swing, says Mark Vaessen, but as new guests arrive, there are fresh challenges and questions that need careful consideration and warrant international debate

In November 2007, the US standard-setter, the Financial Accounting Standards Board (FASB), responded to the US Securities and Exchange Commission's (SEC's) concept release on the potential use of International Financial Reporting Standards (IFRS) by US registrants. In its response, the FASB proposed that the US should develop a plan to transition all US public companies to IFRS. This notable suggestion follows only shortly after a major breakthrough in the US, when the SEC announced that foreign companies with SEC-registered securities would no longer have to reconcile to US GAAP if they use IFRS as issued by the IASB, and this with immediate effect.

Both the SEC announcement and the FASB response to the SEC concept release are clear illustrations of a growing support in the US, at least at a policy-maker level, for IFRS.

If, as the FASB proposes, the SEC would require its domestic companies to apply IFRS, it would be following a substantial global trend—more than 100 countries now use the standards as the basis for financial reporting—as both traditional economic powers, such as the EU and Japan, and emerging economies such as China, Brazil and India, decide that IFRS are the future of financial reporting in what are increasingly global capital markets.

Despite the dramatic uptake of IFRS, the possibility of having a single set of globally accepted accounting standards for long seemed an unattainable prize. Now it is becoming a very real possibility. But as the end game draws nearer, new challenges and questions arise that do need careful consideration and warrant international debate.

JOINT DEVELOPMENT OF IMPROVED IFRS

The call from the FASB for the establishment of a 'blueprint' for the US transition to IFRS is not for the immediate unconditional adoption of IFRS. Instead, it calls for the adoption of an improved version of the standards, after other structural issues regarding the IASB and within the US have been dealt with. The FASB believes that the best way to make improvements should be through the continued joint development of standards by the IASB and FASB. This raises an interesting point.

For the last five years, two-way convergence between IFRS and US GAAP has been one of the main drivers behind the IASB's work programme, but would it still need to be two-way in the next phase we are entering into?

From a US perspective, it is clear that further convergence between IFRS and US GAAP will ease the transition of US companies to IFRS and therefore may be a welcome activity during this transition period. The current objective of convergence efforts, where convergence is seen as selecting between the higher quality standard of the two boards, will however need reconsideration. For the next phase, the focus rather should be on the development of high quality IASB standards, through cooperation with all those jurisdictions that apply IFRS and those that are committed to doing so in the future. This would include the FASB working alongside other national standardsetters, including those in the EU, to provide input to, and challenge of, IASB proposals.

Single Minded

PURE IFRS

Another challenge remains the issue of ‘pure’ IFRS (as issued by the IASB) versus national or regional adaptations, such as IFRS ‘as adopted by the EU’.

In its response to the SEC, the FASB calls for the elimination of jurisdictional adoption mechanisms. This is probably unrealistic in the short term, and should not be allowed to derail an otherwise worthwhile endeavour. Instead, the focus must be on building consensus among those who have responsibility for establishing and monitoring accounting standards (such as the SEC and the EC) that IFRS issued by the IASB are of sufficiently high quality and appropriately balance costs and benefits so that there is no incentive for jurisdictional versions to differ from IFRS as issued by the IASB.

This point was made eloquently by EU commissioner Charlie McCreevy in a recent speech, in which he made a strong plea for the endorsement of accounting standards to disappear from the political limelight. For that to happen, the commissioner said, new standards needed to reflect the real needs of stakeholders. Or in other words, the IASB must develop standards that are truly ‘generally accepted’, which can only occur if its constituents have confidence that the IASB’s due process gives adequate considerations to their perspectives and comments.

The IASB and their trustees at the IASCF Foundation (IASCF) have a significant role to play in making the existing adoption mechanisms defunct. Appropriate governance and oversight of the IASB and IASCF activities, including transparency in the setting of the IASB’s agenda, the development of standards in a more open and inclusive manner and the building of consensus around generally accepted standards before their release will ensure that the risk of a new standard not being adopted by each jurisdiction becomes negligible. The recently announced review of the governance of the IASCF, including the greater involvement of regulators to provide a structured and ongoing dialogue between the trustees and their stakeholder representatives, is a major step in the right direction.

Other more structural issues, as also pointed out by the FASB in its response to the SEC, include the need for sufficient and stable funding levels for the

IASB and ensuring appropriate staffing levels at the IASB. These will also need to be addressed as part of the governance review.

RISK OF REGULATORY INTERPRETATIONS

Even a single set of standards issued by the IASB and adopted by all will not lead automatically to a single GAAP in practice. The role of regulators in the interpretation of GAAP is equally important. They will need to exercise restraint from interpreting IFRS in a vacuum.

Over the past few years, we have seen a few unfortunate examples of regulators seeking unilaterally to give national interpretations of IFRS. This is undesirable, as it defeats the objective of global GAAP.

Internationally, through the International Organisation of Securities Commissions (IOSCO), the Committee of European Securities Regulators (CESR) and the SEC are making encouraging progress in agreeing regulatory frameworks that help to maintain the position of the IFRIC as the only interpretative body for IFRS. The effective implementation of these frameworks in practice is going to be key if IFRS as issued by the IASB is not to fragment into jurisdictional versions as a result of regulatory interpretation.

The SEC currently holds the power to set accounting standards for its registrants and has a history of influencing, supplementing or at least interpreting standards issued by the FASB—to whom it defers to take a lead on initial standard-setting activities. In a global IFRS world, one would hope that the SEC plays a significantly different role in respect of IFRS (as issued by the IASB).

CULTURAL CHANGE

Perhaps the most significant challenge will be the most difficult to define—how to initiate a change in mindset in a traditionally litigious US environment. Much has been said about principles versus rules; maybe too much. But the IASB is committed

Perhaps the most significant challenge will be the most difficult to define—how to initiate a change in mindset in a traditionally litigious US environment

to try to deliver the former, and notably the US will need to consider how to manage change, through education and training, in cultural behaviour and mindset, that would be required to accommodate an accounting system that necessitates less reliance on detailed guidance and more on judgment.

The FASB is realistic about its timeframe for IFRS adoption: it notes that the move to IFRS would be a complex, multi-year endeavour. It is right. The transition to IFRS was achieved successfully in the EU and elsewhere only with tremendous effort and investment from preparers, auditors, investors and

regulators over a two-to-three-year period between announcement and implementation. The transition in the US is unlikely to require any less effort.

The difference this time is that the standards are already implemented globally by thousands of companies and used by millions of investors. The IFRS party is in full swing and new guests are welcome, particularly if they have knowledge and experience to contribute. By agreeing the way forward together internationally, we can all look forward to a future based on a truly single global financial reporting framework.

EU Fears US Influence

By John House, Accountancy

August, 2007

This article first appeared in the August, 2007 issue of *Accountancy* magazine®.

The SEC's recent surprise announcements over the use of IFRS have not met with European approval. John House Explains why.

Sparks flew at the International Accounting Standards Board's meeting with its Standards Advisory Council at the end of June. The reason was the EU's response to the US Securities and Exchange Commission's announcement that it will end reconciliation to US GAAP for foreign listers.

'This may be a giant step for the SEC but it's a small step for Europe,' said Heinz Joachim Neubürger, SAC member and chairman of the executive board of the German Accounting Standards Board.

This may be a giant step for the SEC, but **it's a small step for Europe**

The EU has said it is not satisfied with the historic proposal made in June by the SEC to allow foreign registrants to list on US stock exchanges using International Financial Reporting Standards instead of US GAAP. If the proposal goes ahead it will significantly bolster the IASB's mission to develop a single set of accounting standards for the whole world.

In 2005 the SEC said if a joint convergence project between the IASB and the US Financial Accounting Standards Board produced converged, high quality standards it would consider lifting its requirement that IFRS statements must be reconciled to US GAAP. In the same year the EU had adopted IFRS, and with 400 of its companies listed in the US, it has been eager for the SEC to accept IFRS ever since.

SURPRISE OBJECTION

It might seem surprising then that the EU is not welcoming the news that the SEC is definitely planning to drop the reconciliation requirement for IFRS. The SEC's announcement in June that its five commis-

sioners had voted unanimously in favour of eliminating the need for reconciliation to US GAAP for full IFRS financial statements was met with censure from the European parliament Economic and Monetary Affairs Committee. It called on Charlie McCreevy, EC internal markets commissioner, to 'step in to ensure that the role [European] legislators play in international accounting standard-setting is not undermined'.

Under the SEC's proposal, foreign issuers would be exempt from reconciliation only if they comply with full IFRS as published by the IASB. This would mean that European companies which apply IFRS endorsed by the EU would still have to reconcile to US GAAP as the EU has not adopted parts of the controversial financial instruments standard, IAS 39.

SAC member Neubürger said the SEC's proposal effectively bars IFRS as endorsed by the EU, which presents EU companies with a difficult choice—either follow the rules of your own jurisdiction, or follow those of the US. 'Retaliation is already being spoken about,' he said.

CARVE-OUT

The IASB was not impressed. Deputy chairman Tom Jones said: 'The EU should not have insisted on the carve-out,' and 'if the SEC drops the reconciliation for the EU it would have to drop it for all the other countries who apply incomplete IFRS'.

SAC member Adir Inbar told *Accountancy* that the EU is worried about losing sovereignty over the standards used in Europe. Some elements in the EU have always thought it was risky to allow a private sector body like the IASB to provide the region's accounting rules. Since the IASB-FASB convergence

EU Fears US Influence

project began, the European Commission has felt uncomfortable with the IASB changing its standards to meet a set of targets set by the US SEC.

In the European parliament's response to the SEC proposal, MEPs said: 'The IASB has already imported certain parts of US GAAP, without considering either the implications for the quality of IFRS or the implications for the jurisdictions which require companies to apply IFRS.'

In addition to announcing that it wants to drop the reconciliation, the SEC also said in June that it will issue a concept release on allowing US domestic issuers to use IFRS instead of US GAAP. Inbar says the EU may be anticipating that the US will adopt IFRS in the near future. Leading accounting experts are already speculating that this will happen by the middle of the next decade (see *Accountancy*, July, p85).

International Federal Reporting Standards for Private Companies

EDITOR'S COMMENTARY

Momentum toward a transition to International Financial Reporting Standards (IFRS) for U.S. public companies also raises the question of the use of the IFRS for U.S. private entities (PEs). The AICPA's Private Companies Financial Reporting Committee (PCFRC) has been considering this issue for some time. In a letter to the Financial Accounting Standards Board (FASB) addressing the Securities and Exchange Commission's (SEC's) concept release on allowing U.S. issuers to prepare financial statements in accordance with the IFRS, Committee Chair Judith O'Dell stated the following:

The PCFRC supports the current efforts to converge U.S. and international accounting standards as that process is currently functioning, insofar as those efforts result in higher quality accounting standards. Moreover, the PCFRC believes a comprehensive parallel initiative for private company financial reporting, involving the key constituents of that reporting, is necessary if the SEC initiative moves forward. Such a parallel initiative would help ensure that any changes in the accounting standards setting structure in the U.S. would consider the needs of and make sense for constituents of U.S. private company financial reporting.

We selected the pieces included in this section on the basis of our belief that an adoption of the IFRS for U.S. public companies carries inevitable implications for private entities. Therefore, it is important for U.S. practitioners and business entities (both public and private) to follow forthcoming changes in the U.S. standard setting structure with an eye toward the nature and magnitude of the impact the IFRS may have on U.S. PEs.

This chapter's readings begin with the AICPA's 2008 announcement that the institute now recognizes the International Accounting Standards Board (IASB) as an accounting standard setter. The following pieces address the potential impact of the AICPA announcement, given that, in 2009, the IASB will release the standard *IFRS for Private Entities*. Two articles by Paul Pacter, director of standards for PEs at the IASB, provide updates on the IASB project and indicate that, given the recent AICPA decision, CPAs could give a fair presentation opinion of financial statements based on the IFRS for PEs.

The PE section also includes a roadmap based on five models the PCFRC is presently discussing with interested parties in an effort to "get the dialogue started" on what represents the way forward for U.S. PEs. Under one of these models, as suggested in the Pacter pieces, U.S. based PEs would adopt the forthcoming IFRS for PEs. Some of the models are based on the continuation of U.S. generally accepted accounting principles (GAAP). The PCFRC is monitoring all convergence projects of FASB and the IASB to make sure U.S. private company specific issues are addressed while revised standards are still in the development stage.

In the November 2007 issue of “Defining Issues,” KPMG argues that models calling for the continuation of U.S. GAAP should not be considered.¹ KPMG states that “the full benefits of a single set of high-quality accounting standards can arguably be made available only when it is applied by all business entities, whether public or private.” KPMG indicates that maintaining two sets of accounting standards in the United States would force unnecessary costs on companies subject to statutory filings or other reporting requirements based on U.S. GAAP and on the users and auditors of those companies’ financial statements. Under an IFRS regime, use of U.S. GAAP by PEs would significantly increase the cost of capital for those converting from U.S. GAAP to the IFRS when going public. Furthermore, it would be inconsistent to prefer a single set of accounting standards for all but PEs. KPMG also notes that the adoption of the IFRS by U.S. PEs would assist universities in bringing more order to their curriculums and would not expose students to course decisions that should not weigh so heavily in the determination their career choices. The firm concludes that as the IFRS movement unfolds for SEC registrants, it will also likely lead to the promotion of the IFRS for PEs.

In contrast to KPMG’s adamant support for the use of the IFRS by all U.S. companies, as previously noted, PCFRC is exposing five models and views vary throughout the profession regarding which represents the best way forward for U.S. PEs. For example, some highlight that unlike multinationals, smaller U.S. companies with no foreign subsidiaries or competitors may be less likely to benefit from a transition to the full IFRS. For those with no cross-border operations, IFRS adoption might prove to be very costly. For some, the move to the IFRS will necessitate not only the need to evaluate disclosure controls and procedures and internal control over financial reporting but would also require training in the new accounting standards. For these companies, the desire to maintain U.S. GAAP may be strong. However, some IFRS proponents believe that, after initial conversion costs are absorbed, certain domestically focused U.S. companies and smaller companies with less depth in accounting resources may benefit from the fact that the international standards and their guidance are relatively streamlined in comparison to U.S. GAAP. Again, the option of the IFRS for PEs may also be very attractive for these companies.

*CFO Magazine*² quotes Chair Judith O’Dell following a fall 2008 PCFRC meeting as saying that while the SEC currently proposes requiring public companies to change from GAAP to the IFRS around 2014, the outlook for private companies “is far from settled.” According to O’Dell, one potential drawback of the IFRS is the uncertainty around inventory valuations. The U.S. Tax Code, as currently enforced by the IRS, requires that, if a company adopts the last in, first out (LIFO) method, which results in favorable tax treatment for many companies, the company must also use LIFO in its financial statements. Because LIFO is not permissible under the IFRS; a change to an acceptable method could portend larger tax payments. However, we note that, as alluded to by Margaret Smith in “Closing the GAAP” and addressed by Rood and Kinney in “IFRS Implications for Income Taxes,” the issue regarding LIFO is contingent on what the IRS does in the future. The IRS could drop the LIFO conformity rule, thereby, allowing U.S. companies to use the more relevant first in, first out or weighted average measures of inventory for financial reporting purposes while continuing to reap tax savings by using LIFO for tax purposes. An alternate scenario may see the IRS removing LIFO for tax purposes regardless of what inventory methods are allowed for financial reporting purposes in the United States. With Congress looking for new sources of revenue, it may well be changes in the IRS Code, not the

¹ The report only broaches the topic of the International Financial Reporting Standards and private entities and covers many additional topics, so it is not reprinted in this volume. Alternatively, we provide a summary of the relevant segment. See KPMG (2007). “How the IFRS Movement Will Affect Financial Reporting in the U.S.,” *Defining Issues* (November): 07-34.

² Hyatt, J. (2008). “Switching to IFRS is Inevitable for Private Companies—Eventually,” *CFO Magazine* (November 1).

IFRS, that kills LIFO and the associated tax savings long enjoyed by many U.S. companies. Estimates of the amount of tax revenue that could be associated with the elimination of LIFO have exceeded \$20 billion.

Following the same meeting, PCFRC member Jerry Murphy explained that although private companies are not required to file audited financial statements with the SEC, they often prepare them for lenders, investors, and potential acquirers. Some of these companies favor converting to the IFRS, because the international standards are simpler and likely cheaper to prepare. In line with the KPMG position, Murphy stated that keeping public and private companies on the same standard “will make it easier for us to do business,” in terms of giving outsiders confidence in private company financial statements.

We encourage those working in the private sector and their auditors to not only consider the four pieces addressing the IFRS and PEs included in this volume, along with the KPMG position, but also to follow the work of the IASB and the PCFRC;³ carefully consider the five models set forth in the PCFRC roadmap; and become actively engaged in dialogue with the PCFRC in an effort to ensure that forthcoming changes in the U.S. accounting standard setting structure adequately address the needs of, and make sense for, PE financial reporting.

Hans-Peter Rudolf of Crowe Chizek explains in his article that the adoption of the IFRS affects not only large multinationals but also growth-oriented small and mid-sized companies.⁴ Rudolf suggests that the adoption of the IFRS in the United States can be compared to the Sarbanes-Oxley Act of 2002 and other corporate governance requirements, which although directed at public entities, eventually influenced PEs and not-for-profits.

Rudolf highlights that in recent years an increasing number of growth-oriented small and mid-sized U.S. based companies have started looking overseas for new investors or alternative sources of financing. Along with companies contemplating overseas acquisitions or dispositions, managers of these entities will likely be required to deal with IFRS in the “very near future.” Readers should consider the implications of Rudolf’s comments along with the last two articles in our PE section by AICPA Vice President James Metzler that encourage small firm practitioners to “position themselves and their firms as the leading IFRS experts in their local markets.”

³ The International Accounting Standards Board provides project updates at www.iasb.org. Private Companies Financial Reporting Committee updates are available at www.pcfrc.org. The AICPA’s www.ifrc.com Web site includes an “IFRS for Private Entities” blog area.

⁴ The Rudolf article is not included in this volume given that only a segment of the piece addresses the impact of the IFRS on the midmarket. See Rudolf, H. (2008). “Parlez-Vous IFRS?” *MidMarket Advantage* (Winter) p. 1-4.

News Release: AICPA Council Votes to Recognize the International Accounting Standards Board as a Designated Standard Setter

By AICPA

May, 2008

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AMELIA ISLAND, Fla. (May 18, 2008)—The governing Council of the American Institute of Certified Public Accountants voted to designate the International Accounting Standards Board in London as an accounting body for purposes of establishing international financial accounting and reporting principles.

The amendment to Appendix A of AICPA Rules 202 and 203 gives AICPA members the option to use International Financial Reporting Standards (IFRS) as an alternative to U.S. generally accepted accounting principles.

“The AICPA recognizes that international accounting standards are gaining wider use and acceptance in global capital markets and in the United States,” said Barry C. Melancon, president and CEO of the AICPA. “This small but important rule change will enable CPAs to better perform their professional obligations to clients, financial reporting constituents and the public.”

Appendix A to Rules 202 and 203 of the AICPA’s Code of Ethics sets forth the standard setters that have been designated by Council. Under Rule 202, a member who performs professional services shall comply with the standards promulgated by the designated bodies. Additionally, a member may not say that financial statements are in accordance with generally accepted accounting principles unless they follow the standards promulgated by a standard setter listed in Appendix A of Rule 203.

The Securities and Exchange Commission (SEC) decided last year to allow foreign companies to report using IFRS without reconciling to U.S. GAAP.

Other bodies designated by Council to promulgate accounting standards are the Financial Accounting Standards Board (FASB), the Governmental Standards Accounting Board (GASB), and the Federal Accounting Standards Advisory Board (FASAB). Council’s action now adds the IASB to the list of designated accounting bodies.

FASB will continue to set standards in the U.S.

The AICPA’s Board of Directors proposed the rule change to Council after hearing recommendations of a task force at the Board’s April 2008 meeting. The task force recognized that the accelerating pace of international acceptance of IFRS is leading toward future establishment of a single set of global accounting standards for public companies. The Board agreed that Council should re-assess in three to five years whether the designation of IASB remains appropriate.

With Council’s vote to designate IASB, the AICPA’s Auditing Standards Board (ASB) and the Accounting and Review Services Committee (ARSC) will now prepare clarifying language on how audit, review and compilation reports can be modified when reporting on financial statements prepared in accordance with IFRS.

The AICPA plans to publicly announce tomorrow a new site, IFRS.com, which officially launched on May 15. The new Web site was designed in partnership with CPA2Biz to help CPAs and financial professionals understand IFRS and navigate the differences between international standards and U.S. generally accepted accounting principles.

TEXT OF AICPA COUNCIL RESOLUTIONS

The Code of Professional Conduct, *Appendix A—Council Resolution Designating Bodies to Promulgate Technical Standards*, was amended as set out below:

BE IT RESOLVED, That the International Accounting Standards Board (IASB) be designated as the body which is authorized to establish professional standards with respect to international financial accounting and reporting principles under Rule 202 (Compliance With Standards) and Rule 203 (Accounting Principles) of the AICPA Code of Professional Conduct; and

AICPA Council Votes to Recognize the International Accounting Standards Board

BE IT FURTHER RESOLVED, That the Council shall re-assess, no sooner than three years but no later than five years after the effective date of this resolution, whether continued recognition of the IASB as the body designated to establish professional standards with respect to international financial accounting and reporting principles under Rule 202 and Rule 203 is appropriate.

AICPA Code of Professional Conduct—Appendix A Council Resolution Designating Bodies to Promulgate Technical Standards will now read as follows.

International Accounting Standards Board

RESOLVED, That the International Accounting Standards Board (IASB) is hereby designated as the body to establish professional standards with respect to international financial accounting and reporting principles pursuant to Rule 202 and Rule 203; and

BE IT FURTHER RESOLVED, That the Council shall re-assess, no sooner than three years but no later than five years after the effective date of this resolution, whether continued recognition of the IASB as the body designated to establish professional standards with respect to international financial accounting and reporting principles under Rule 202 and Rule 203 is appropriate.

ABOUT THE IASB

The International Accounting Standards Board is an independent, privately-funded accounting standard-setter based in London, UK. Fourteen board members come from nine countries and a variety of functional backgrounds.

The IASB's mission is to develop a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements. The IASB follows a rigorous, open due process to develop standards and cooperates with national accounting standard setters around the world.

The IASB is governed by the International Accounting Standards Committee Foundation formed in 2001 to be the parent entity of the board. IASB assumed accounting standard-setting responsibilities from its predecessor body, the International Accounting Standards Committee, on April 1, 2001. Trustees of the foundation appoint board members in accordance with the foundation's constitution.

ABOUT THE AICPA

The American Institute of Certified Public Accountants (www.aicpa.org) is the national, professional association of CPAs, with more than 350,000 members, including CPAs in business and industry, public practice, government, education, student affiliates, and international associates.

The Institute sets ethical standards for the profession and U.S. auditing standards for audits of private companies, federal, state and local governments, and non-profit organizations. It develops and grades the Uniform CPA Examination nationwide.

The AICPA maintains offices in New York, Washington, D.C., Durham, N.C., Ewing, NJ, and Lewisville, TX.

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Should U.S. Private Companies Use IFRS for SMEs?

By Paul Pacter, Financial Executive

October, 2007

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The International Accounting Standards Board (IASB) has released an exposure draft (ED) to adopt a simplified, self-contained International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). IFRS for SMEs is less than 15 percent of the size of full IFRS (currently around 2,700 pages).

There doesn't appear to be any reason why private companies in the U.S. couldn't use IFRS for SMEs.

This substantial reduction was achieved by removing choices for accounting treatments, eliminating topics and detailed implementation guidance that are not generally relevant to SMEs, simplifying methods for recognition and measurement, substantial disclosure reductions and “plain English” redrafting. Since full IFRS were designed to meet the needs of equity investors in companies in public capital markets, they cover a wide range of issues, contain a sizeable amount of implementation guidance and include disclosures appropriate for public companies.

Users of the financial statements of SMEs (or private companies in the U.S.) don't have those needs, but, rather are more focused on shorter-term cash flows, liquidity and solvency issues, such as: *If I make a loan, will the interest and principal be paid? If I extend credit, will my invoice be paid?*

Also, the full standards impose a burden on SME preparers—a burden that has been growing as IFRS become more detailed and more countries begin to use them. Thus, in developing the proposed IFRS for SMEs, IASB's twin goals were to meet user needs while balancing costs and benefits from a preparer perspective.

In most countries, many or even all entities have a statutory obligation to prepare financial statements that conform to a required set of generally accepted accounting principles (GAAP). Often, an audit is required by law (with tiny companies often exempted). Those statutory financial statements are normally filed with a government agency or put on a website

and thus are available to creditors, suppliers, employees, governments and others.

In Europe, where there are over 20 million business enterprises, more than 5 million SMEs have a statutory audit and reporting obligation. Virtually every European country has developed its own simplified national GAAP for SMEs—some countries have two or even three levels of SME GAAP. The same is true in Asia and elsewhere across the globe.

This begs the question: Why shouldn't SMEs just use existing national GAAP in each country? Consider the following:

1. **Lack of comparability in global markets.** The world's business markets are integrated, even for small companies. In most jurisdictions, half to three-quarters of all SMEs, including the very small ones, have bank loans. Banks operate across borders and rely on financial statements in making lending decisions, establishing terms and interest rates and monitoring loans.

Banks want data they can understand and compare. Companies buy and sell goods and services across borders. Vendors want to evaluate the financial health of buyers before they sell goods or services on credit, and this is especially true when the buyer is an SME. Buyers use a supplier's financial statements to assess the prospects of a viable long-term business relationship.

Credit rating agencies try to develop ratings uniformly across borders. Development institutions, such as the World Bank, International Monetary Fund (IMF) and regional development banks, use financial statements for resource allocation decisions. Accounting differences reduce understandability, obscure comparisons and lead to sub-optimal decisions.

2. **Information quality.** The accounting standards for SMEs in many countries have not been developed with the needs of lenders, vendors

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and other external users in mind. This has harmed small companies' access to capital or, at a minimum, raised the cost of capital, particularly in small and developing countries. In jurisdictions that require small companies to use full IFRS, the quality of implementation often is problematic.

- 3. Burden.** As IFRS have gained greater acceptance around the world, many countries have adopted them or have developed national GAAP based on IFRS. Today, IFRS are required for listed companies in over 80 countries and permitted for listed firms in another 25 countries. As for unlisted (private) companies, 20 countries require full IFRS for all and another 14 countries require them for some.

Many other countries that do not require IFRS directly are increasingly converging their national standards with IFRS, which means that, de facto, IFRS are being "pushed down" to private companies, which often don't have the expertise or ability to bear the costs of complying.

- 4. Other shortcomings.** Many countries lack country-specific textbooks, guidance, training materials and software for implementing national standards. This diminishes comparability even within a country, as different requirements are interpreted differently. National standards mean that country-specific auditing methodologies are needed. Developing national standards is costly.

COMPANIES THAT CAN USE IFRS FOR SMES

Decisions on which entities should use IFRS for SMEs rest with national regulatory authorities and standard-setters. However, IASB has clearly stated that IFRS for SMEs is intended for an entity with no public accountability that is preparing general-purpose financial statements.

An entity has public accountability (and therefore should use full IFRS) if either its debt or equity securities are publicly traded, or it is a financial institution such as a bank, insurance company, securities broker/dealer, pension fund or mutual fund. Within

the very large and broad group of remaining entities, each jurisdiction will have to decide which entities should be required or permitted to use IFRS for SMEs.

General-purpose financial statements that comply with IFRS for SMEs would enable an auditor to express an opinion on whether those statements present fairly (or present a true and fair view of) financial position, operating results and cash flows.

IFRS for SMEs is intended to be a stand-alone document. When deciding on its content, IASB focused on a typical entity with about 50 employees—not as a quantified size test for defining SMEs but, rather, to help it decide the kinds of transactions and other events and conditions that companies of that size will likely encounter.

ORGANIZATION OF THE ED

The exposure draft (ED) is issued in three documents: The draft IFRS for SMEs itself, implementation guidance (consisting of illustrative financial statements and a disclosure checklist) and the basis for the IASB's conclusions. IFRS for SMEs is organized topically, and it has 38 sections and a glossary.

The proposed IFRS for SMEs reflects five broad types of modifications:

- 1. Topics omitted.** Some topics in full IFRS are omitted because they are not relevant to a typical SME. These include hyperinflation, equity-settled share-based payment, extractive industries, interim reporting, lessor accounting finance leases, recoverable amount of goodwill, earnings per share, segment reporting and insurance contracts.
- 2. Simpler choice.** Where full IFRS provide an accounting policy choice, only the simpler option is in IFRS for SMEs. An SME is permitted to use the other option by cross-reference to the relevant IFRS. Examples include historical cost-depreciation models for investment property and property, plant and equipment and intangibles; expensing all borrowing costs; the indirect method for reporting operating cash flows; and one method for all government grants.

EXAMPLES OF RECOGNITION AND MEASUREMENT SIMPLIFICATIONS UNDER IFRS

- Financial instruments
 - Two categories of financial asset rather than four. This eliminates the complex and intent-driven classifications.
 - A clear and simple principle for derecognition—if the transferor has any significant continuing involvement, do not derecognize.
 - Much-simplified hedge accounting.
- Goodwill impairment—an indicator approach rather than mandatory annual impairment calculations.
- Expense all R&D.
- The cost method for associates and joint ventures (rather than the equity method or proportionate consolidation).
- Fair value for agriculture only if “readily determinable without undue cost or effort.”
- Complex “corridor approach” for defined-benefit plans omitted.
- Share-based payment—intrinsic value method.
- Finance leases—simplified measurement of lessee’s rights and obligations.
- First-time adoption—less[amount of] prior period data would have to be restated

3. Recognition and measurement simplifications.

Some principles in full IFRS for recognizing and measuring assets, liabilities, income and expenses have been simplified (see the box above.)

4. Reduced disclosures. Over three-quarters of the disclosures in full IFRS have been eliminated.**5. Plain English.** IFRS principles have been rewritten for clarity and ease of translation.**NEXT STEPS**

The comment deadline on the ED was October 1—although an extension to November 30 was proposed (no decision was made by press time). During the exposure period, IASB has been conducting roundtable meetings with SMEs and small audit firms. IASB has organized field tests of the proposals in the ED with approximately 100 small companies—with FEI helping in the U.S.

A final standard is expected by the end of 2008 and would be effective according to decisions in each jurisdiction that adopts IFRS for SMEs.

Most American accountants are surprised to learn that millions of SMEs around the world have statutory reporting and audit obligations. That’s because the situation in the U.S. is so different—there are roughly 5 million limited-liability corporations and roughly 15 million more partnerships, proprietorships and other forms of ownership.

By law, only a relative handful of those are required by law to publish U.S. GAAP financial statements, audited or unaudited—generally the 15,000 SEC registrants plus a few other regulated entities. Sometimes, lenders or contracts impose such requirements. But for the vast majority of American private companies, there is no requirement to prepare U.S. GAAP statements.

So, could private companies in the U.S. use IFRS for SMEs? There does not appear to be any reason why not—provided that the basis of presentation note clearly explains that the statements conform to IFRS for SMEs. If audited, the auditor would report on conformity with the IFRS for SMEs.

Paul Pacter (ppacter@iasb.org) is the Director of Standards for Small and Medium-sized Entities (SMEs) at the International Accounting Standards Board (IASB) in London.

Simplifying IFRS for Private Entities

By Paul Pacter, Financial Executive

November, 2008

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In the October 2007 issue of Financial Executive, Paul Pacter reviewed IASB's project to develop an International Financial Reporting Standard tailored especially for small, nonpublicly accountable—or private—companies, which were then known as “small and mid-sized entities or SMEs.” Pacter is director of Standards for Private Entities at the International Financial Accounting Standards Board in London.

At that time, the board had issued an Exposure Draft for comment and field tests of the ED were underway around the world by real, private companies.

Now, one year later, the 162 comment letters have been analyzed, and 116 field tests have been completed. IASB has begun redeliberating the proposals in the ED, with a view to issuing a final standard in first quarter 2009.

What's next and what can private companies expect based on the decisions the board has made?

For this issue's IFRS section, we asked Pacter to bring readers up to date, then discuss what's next and what private companies can expect based on the decisions the board has made.

—IFRS Section co-developers Cheryl de Mesa Graziano and Ellen M. Heffes

COMMENT LETTERS

The main nontechnical issues raised in the comment letters related to making the final standard a stand-alone document; retaining accounting policy options; anticipating future changes to full IFRS; the need for further disclosure simplifications; changing the title of the document; considering which entities should be eligible to use the standard; and use of fair value.

Additionally, most comment letters raised technical issues related to specific sections in the ED.

Topics that received the most comments—generally in favor of further simplifications—included: consolidation; amortization of goodwill and other indefinite life intangibles; component depreciation and annual review of residual values; financial instruments; requirements for statements of cash flows and changes in equity; measurements for impairments and finance leases; share-based payment; employee benefits; and income taxes.

FIELD TESTS

At the 2008 board meeting, staff presented an overview of the issues identified as a result of the field tests of the ED. Overall, participants encoun-

tered few significant problems in applying the ED, and they generally said they found it to be understandable and appropriate. The single most problematic area was determination of fair value where market prices or active markets are not available.

The second most significant area causing problems was the nature, volume and complexity of disclosures.

WORKING GROUP

IASB has a working group of more than 40 experts on financial reporting by private entities (including several U.S. financial executives), which met on April 10-11. The group prepared two comprehensive reports for the board: one with recommendations relating to scope, recognition, measurement and presentation; and the other relating to disclosures.

BOARD REDELIBERATION

In May, the board began redeliberating the proposals in the ED. Redeliberations continued in June, July and September, and the board addressed the few remaining issues in October and November.

Simplifying IFRS for Private Entities

Here are some selected issues and the board's tentative decisions:

Title of the standard. It should be changed to "IFRS for Private Entities," with "private entities" defined the same as "small and medium-sized entities" (SMEs) in the ED.

Stand-alone standard. Requirements currently available by cross-reference to full IFRS will be either addressed in the final standard or eliminated.

Accounting policy options. In general, all options in full IFRS should be available to private entities. The body of the standard should include the simpler option. The more complex options should be in a separate appendix.

Small listed entities. They should not be included in the intended scope of the standard.

Entities that receive funds in a fiduciary capacity. If holding funds in a fiduciary capacity is a sideline to an entity's principal business (for example, a utility company or travel agency that takes deposits), the entity should be permitted to use the standard if it otherwise qualifies.

Restatements. An "undue cost or effort" principle should not be added wherever the standard requires restatement. The exemption for 'impracticability' is sufficient.

Fair value measurement. Clearly describe in simple language what the basis for measurement is rather than use the generic term "fair value."

Subsidiary of an IFRS entity. If a subsidiary of an entity using full IFRS wishes to use the recognition and measurement principles in full IFRS, it must also provide the disclosures required by full IFRS.

Financial statement presentation. The standard should incorporate the 2007 revisions to IAS 1, Presentation of Financial Statements. This would mean, among other things, that private entities would present a statement of comprehensive income.

Consolidated financial statements. These should be required for all private entities that are parent entities.

Combined financial statements. The description of combined financial statements should be retained in the "IFRS for Private Entities," with some additional guidance added.

Accounting policy hierarchy. The final standard should be clear that management may, but is not required to, consider the requirements and guidance in full IFRS in deciding on accounting policies.

Financial instruments. The board decided:

- To reorganize Section 11 on financial instruments to make it easier both to identify which instruments are within the scope and to apply the section if a private entity has only very simple financial instruments.
- Not to add "available for sale" as a category.

- Not to allow straight-line amortization of premiums and discounts as an elective accounting policy alternative to the effective interest rate (EIR) method.
- Not to permit a "shortcut method" for hedge accounting.
- Not to allow debt instruments to be hedging instruments.
- To add guidance on the types of risks eligible for hedge accounting and on factoring.

The board will confirm at a future meeting whether private entities may follow IAS 39/IFRS 7 in full in lieu of following Section 11.

Inventories. The board rejected last-in, first-out (LIFO) as an inventory costing method.

Associates and jointly controlled entities. The cost model, equity method and fair value through profit or loss model should be accounting policy options, as proposed in the ED, with one exception: the cost model would not be permitted for an investment that has a published price quotation.

Investment property. Both the cost model and the fair value through profit or loss model should be options.

Property, plant and equipment. Both the cost and revaluation models should be options. The cost of an item of PPE should be allocated to its significant parts, with each part depreciated separately (component depreciation) only when the parts have significantly different patterns of benefit consumption.

A private entity should reassess residual value, useful life and depreciation method for an asset only if there is an indication of change since the last reporting date.

Intangible assets including goodwill. The board considered, but rejected, an amortization approach for indefinite life intangibles including goodwill. Both the expense model and the capitalization model should be options for development costs.

Business combinations. Intangible assets and contingent liabilities acquired in a business combination should be separately recognized if their fair value can be measured reliably (an "undue cost or effort" exemption should not be added).

Leases. Leases should be classified as either operating or financing, according to their substance. The board did not support accounting for all leases as operating leases.

Equity. An entity that issues a compound financial instrument should classify its components separately as financial liabilities, financial assets or equity instruments (sometimes known as split accounting). The staff will present a recommendation for the distinction between debt and equity at a future board meeting.

Revenue. The percentage of completion method should be applied when recognizing revenue from services and construction contracts, as proposed in the ED. Further examples will be added.

Government grants. All grants will be measured at the fair value of the asset (received or receivable). The option in the ED to apply IAS 20, Accounting for Government Grants and Disclosure of Government Assistance for certain grants will be removed.

Borrowing costs. Both the expense model and the capitalization model should be options.

Share-based payment. The staff is researching alternatives for measuring equity-settled SBPs by private entities and will present a recommendation at a future board meeting.

Impairment of nonfinancial assets. Perform an impairment test only if there is an indication that an asset may be impaired, as proposed in the ED. However, the approach for determining the impairment loss once an impairment is indicated should be similar to IAS 36, Impairment of Assets and, hence, should include the concepts of “recoverable amount,” “value in use” and “cash-generating units.”

Post-employment benefits. The board continues to study whether all actuarial gains and losses and past service cost should be recognized immediately in profit or loss and, in what circumstances, private entities might be allowed to measure the defined benefit obligation at a current liquidation amount.

Income taxes. The board rejected a taxes payable with disclosure approach for deferred tax. However, it identified two possible ways to simplify deferred tax recognition and measurement that take into account the needs of users of private entity financial statements and cost-benefit considerations. Staff will present recommendations at a future meeting.

Discontinued operations and assets held for sale. Discontinued operations should be segregated, including in data covering prior periods. There should be no “held for sale” classification for nonfinancial assets. Instead, the decision to sell an asset should be added as an impairment indicator.

Disclosures. The ED had proposed roughly 400 required disclosures—a substantial reduction from the requirements of full IFRS. In September, the board agreed to many further disclosure simplifications based on comment letters and field testing.

REMAINING STEPS

Board redeliberations will continue until all issues have been resolved, probably through this month. Thereafter, the staff will prepare a revised draft standard that reflects all of the board’s decisions in redeliberations. Board members will review and comment on those drafts with a goal of balloting on a final standard early in 2009. A vote of at least nine members of the board is required to approve a standard.

The final standard would not have a specified effective date but, rather, would be effective whenever a jurisdiction chooses to adopt it. The IASC Foundation is developing comprehensive training materials that it expects to make available, without charge.

COULD STANDARD BE USED IN THE U.S.?

In May, the governing Council of the American Institute of Certified Public Accountants voted to designate IASB as a recognized accounting standard setter (in addition to FASB), thereby providing the AICPA’s members with the option to use IFRS without any need to reconcile to U.S. GAAP figures. This designation applies to all IFRS, including the planned IFRS for Private Entities.

Thus, an auditor could give a “fair presentation” opinion on financial statements prepared using the IFRS for Private Entities.

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Roadmap Ahead for Private Company Accounting Standards: GAAP Models for Private Companies

By the Private Company Financial Reporting Committee, AICPA

April, 2008

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BACKGROUND AND PREMISE

Private companies contribute half of the United States' economic output. There are more than 22 million private businesses in the U.S., compared to approximately 17,000 public companies.

Assuming that IFRS becomes GAAP for public companies, an opportunity arises to determine what set of GAAP best suits the needs of private company financial reporting constituents. The importance of private companies to the U.S. economy demands a well-researched and rigorous assessment of the various GAAP options for private companies. Establishing a proper GAAP model for private companies that addresses the needs of their constituents and cost-benefit considerations is key to the continued health of the private company sector.

The following pages contain possible models for private company accounting, assuming that public companies will be required to comply with IFRS. These initial models are only starting points to facilitate a discussion of the topic.

MODEL 1—IFRS WITH SME OPTION

Description

IFRS exists as GAAP in the U.S. for all companies (public and private). Similar to their international counterparts, U.S. private companies have the option of following IFRS for SMEs. If private companies elect not to follow that option, then they may elect to follow IFRS or another comprehensive basis of accounting (e.g., cash-basis, tax-basis.)

Possible Pros of IFRS for SMEs

- Simplified, self-contained set of accounting principles developed for private companies.

- Avoid current problem of GAAP requirements for public companies that lack relevance/decision usefulness for private company financial reporting constituents.
- Condensation and simplification would provide a more manageable reference document for internal management and external users of private company financial statements, many of whom do not have a strong background in financial accounting.
- Based on IFRS and therefore possessing a level of comparability with U.S. public company financial statements, and international companies.
- Allows for comparability of private company financial statements across borders.
 - Credit rating agencies and lenders try to develop uniform ratings across borders. Following IFRS for SMEs would facilitate that effort.
 - Many private companies have suppliers and other business relationships overseas. Utilization of financial statements between entities is improved when parties are following the same accounting standards.
 - Equity investors (venture capital) often provide funding across borders.
- Time and effort to prepare private company financial statements reduced.
- No effort required to develop differential standards for private companies in the U.S.
- Places greater emphasis on principle-based standards and the need for professional judgment, with less reliance on detailed rules.
- Certain differential standards, thought to be needed for private companies in the U.S., may already be addressed in the IFRS for SMEs standard.

Roadmap Ahead for Private Company Accounting Standards: GAAP Models for Private Companies

Possible Cons of IFRS for SMEs

- IFRS-based accounting provides little benefit to private companies and is mostly useful to public companies that need to operate internationally.
- The positions taken on some important technical issues in IFRS for SMEs may not find general acceptance in the U.S. private company marketplace.
- The conversion to IFRS for SMEs would cause significant increases in costs and workload
 - Education, IT, revamping financial systems and processes, audit methodologies, etc.
- Conversion costs outweigh benefits.
- Preparers, users, and practitioners who work with private company financial statements are unfamiliar with IFRS. The learning curve would be difficult.
- Some may consider IFRS for SMEs a “dumb-downed” approach and second class to full IFRS.
- The more principles-based IFRS for SMEs may not be adequate in the litigious U.S. marketplace.
- When a private company has a particular issue that is not addressed under IFRS for SMEs, inconsistent accounting can occur, which would reduce comparability.
- Loss of industry-specific accounting guidance

Model in Operation

IFRS for SMEs is set by the IASB and updated according to the final plan eventually adopted by the IASB. A separate U.S. accounting board could exist to provide input into the IASB standard setting process. U.S. private company constituents would influence the standard setting process through the channels established by the IASB and the U.S. accounting board.

MODEL 2—U.S. ADAPTED VERSION OF IFRS FOR SMES

The IFRS for SMEs standard is tailored to suit the needs of private company financial reporting constituents in the U.S.

Possible Pros

- The needs of U.S. private company financial reporting constituents are prioritized and incorporated.
- Linkage to the IFRS for SME standard, resulting in a level of comparability between U.S. private company financial statements and the financial statements of similar entities outside the U.S.
- Simplified, self-contained set of accounting principles developed for private companies.
 - Avoid current problem of GAAP requirements for public companies that lack relevance/decision usefulness for private company financial reporting constituents.
 - Condensation and simplification would provide a more manageable reference document for internal management and external users of private company financial statements, many of whom do not have a strong background in financial accounting.
- Certain differential standards, thought to be needed for private companies in the U.S., may already be addressed in the IFRS for SMEs standard.
 - Advanced starting point.
- Places greater emphasis on principle-based standards and the need for professional judgment, with less reliance on detailed rules.
- Maintain certain industry-specific accounting guidance.

Possible Cons

- IFRS-based accounting provides little benefit to private companies and is mostly useful to public companies that need to operate internationally.
- The conversion to IFRS for SMEs would cause significant increases in costs and workload
 - Education, IT, revamping financial systems and processes, audit methodologies, etc.
- Conversion costs outweigh benefits.
- Preparers, users, and practitioners who work with private company financial statements are unfamiliar with IFRS. The learning curve would be difficult.

- Some may consider IFRS for SMEs a “dumb-downed” approach and second class to full IFRS.
- The more principles-based IFRS for SMEs may not be adequate in the litigious U.S. marketplace.
- Confusion will result trying to incorporate U.S. differential standards into the IFRS for SMEs standard.
- Diminished ability to compare U.S. private companies with those in other countries, especially if a large number of differences are allowed.

Model in Operation

An accounting board in the U.S. would need to exist to adapt the IFRS for SMEs standard to suit the needs of U.S. private company constituents. This body would continue to maintain the literature, monitoring IASB changes to the IFRS for SMEs, deciding if such changes are appropriate in the U.S., and developing changes to the literature to reflect needs and circumstances in the U.S. private company marketplace. A funding mechanism would need to be identified for this board and effort. Private company constituents would influence the standard setting process by commenting to this board and to the IASB on proposed standards.

MODEL 3—IFRS WITH DIFFERENTIAL REPORTING

Description

IFRS is modified, to suit the needs of private company financial reporting constituents, by deleting some requirements or embedding different treatments in the standards.

Possible Pros

- Strong linkage to IFRS, and therefore possessing a level of comparability with U.S. public company financial statements, and international companies.
- Applies an approach already undertaken with U.S. GAAP (i.e., creation of PCFRC) to the “new” IFRS GAAP.

- Minimizes possible confusion stemming from two sets of GAAP in the U.S.
- Reduces the risk of different interpretations of IFRS that apply equally to public companies and private companies.
- The needs of private company constituents would be accommodated within a single set of accounting standards, enhancing consistency and comparability between private and public companies.
- Time and effort to prepare private company financial statements reduced, compared to public companies complying with full IFRS.
- Places greater emphasis on principle-based standards and the need for professional judgment, with less reliance on detailed rules.

Possible Cons

- IFRS may cover topics or options that are not relevant to many private companies. Further, the considerable amount of explanatory information and guidance accompanying IFRS often deals with complexities that most private companies never encounter. Thus the effort to cull out non-relevant topics from IFRS and introduce differential standards for private companies would be long and complicated.
- IFRS-based accounting provides little benefit to private companies and is mostly useful to public companies that need to operate internationally.
- The conversion to IFRS with differential reporting would cause significant increases in costs and workload
 - Education, IT, revamping financial systems and processes, audit methodologies, etc.
- Conversion costs outweigh benefits.
- Preparers, users, and practitioners who work with private company financial statements are unfamiliar with IFRS. The learning curve would be difficult.
- Some may consider IFRS with differential standards a “dumb-downed” approach and second class to full IFRS.
- The more principles-based IFRS may not be adequate in the litigious U.S. marketplace.

Roadmap Ahead for Private Company Accounting Standards: GAAP Models for Private Companies

- Confusion will result trying to incorporate U.S. differential standards into IFRS.
- Diminished ability to compare U.S. private companies with those in other countries, especially if a large number of differences are allowed.
- Possible loss of industry-specific accounting guidance.

Model in Operation

An accounting board in the U.S. would need to exist to incorporate differential standards for private companies into IFRS. This board would continue to maintain the literature, modifying IFRS as necessary to reflect the needs and circumstances existing in the U.S. private company marketplace. A mechanism would need to be identified to fund this board and their work. Private company constituents would influence the standard setting process by commenting on proposed IFRS standards and proposed differential standards.

A decision will need to be made as to whether each differential treatment should be elected individually, or whether a private company should apply all of the differential treatments available (“all-or-nothing”). The advantage of choosing differential options individually is that it enables private companies to decide whether a permitted option or the pertinent basic standard best meets the needs of their external users. Also, a mix-and-match approach allows private companies to apply only the options that best reflect their particular circumstances. On the other hand, financial statement users may be concerned about the flexible aspect of differential reporting. This characteristic can hinder comparability.

MODEL 4—SEPARATE U.S. PRIVATE COMPANY GAAP—REVISED

Description

Current U.S. GAAP is reviewed, modified, and developed into a comprehensive and self-contained set of accounting standards for private companies. This GAAP would be for private companies with and without significant external financial statement users, and would be sensitive to the needs of owner managed enterprises.

Possible Pros

- The needs of U.S. private company financial reporting constituents are prioritized.
- Simplified, self-contained set of accounting principles developed for private companies.
 - Avoid current problem of GAAP requirements for public companies that lack relevance/decision usefulness for private company financial reporting constituents.
 - Eliminate needless accounting complexities and costs for private companies.
- Private company constituents already know U.S. GAAP and therefore intensive education or training efforts would not be necessary.
- No conversion costs
- Maintain industry-specific accounting guidance
- Time and effort to prepare private company financial statements reduced.

Possible Cons

- Not based on IFRS and therefore making comparability with U.S. public company and international company financial statements more difficult.
 - Credit rating agencies and lenders try to develop uniform ratings across borders. This model would hamper that effort.
 - Many private companies have suppliers and other business relationships overseas. Utilization of financial statements between entities would be made more difficult under this model.
 - This model may not be helpful to equity investors (venture capital) who provide funding across borders.
- Maintaining a separate body of GAAP, apart from IFRS, would add confusion to the marketplace.
 - Are there really two correct ways to account for transactions? Or should a transaction be accounted for and disclosed the same way, regardless of the nature or size of the company?
- Private companies wishing to “go public”, would need to convert to IFRS.

- U.S. GAAP for private companies would be more rules-based and less principles-based.
- Some may consider U.S. GAAP for private companies to be second class to IFRS.

Model in Operation

An accounting board would need to exist to review and modify current U.S. GAAP. This revised U.S. GAAP for private companies would need to be maintained and updated, similar to the current process for setting U.S. GAAP. Private company constituents would influence the standard setting process by commenting on proposed standards, similar to the way they do currently. A mechanism for funding the standard setting board and their work would need to be identified.

MODEL 5—SEPARATE U.S. GAAP—MAINTAINED AND UPDATED IN FUTURE

Description

Current U.S. GAAP would be maintained, as is, for use by private companies. The literature would be updated periodically for needed changes and improvements, keeping an eye on standard setting activities at the IASB and circumstances developing in the private company arena. This model does not contemplate the initial review and significant modification of current U.S. GAAP, as contemplated in model 4.

Possible Pros

- The needs of U.S. private company financial reporting constituents are prioritized.
- Avoid the further addition of GAAP requirements that lack relevance/decision usefulness for private company financial reporting constituents.
- Avoid any further needless accounting complexities and costs for private companies
- Private company constituents already know U.S. GAAP and therefore intensive education or training efforts would not be necessary.
- No conversion costs
- Maintain industry-specific accounting guidance

Possible Cons

- Maintaining current U.S. GAAP, as is, does not allow for modifications that would eliminate current standards that lack relevancy and decision usefulness for private company constituents.
- Not based on IFRS and therefore making comparability with U.S. public company and international company financial statements more difficult.
 - Credit rating agencies and lenders try to develop uniform ratings across borders. This model would hamper that effort.
 - Many private companies have suppliers and other business relationships overseas. Utilization of financial statements between entities would be made more difficult under this model.
 - This model may not be helpful to equity investors (venture capital) who provide funding across borders.
- Maintaining a separate body of GAAP, apart from IFRS, would add confusion to the marketplace.
 - Are there really two correct ways to account for transactions? Or should a transaction be accounted for and disclosed the same way, regardless of the nature or size of the company?
- Private companies wishing to “go public”, would need to convert to IFRS.
- U.S. GAAP for private companies would be more rules-based and less principles-based.
- Some may consider U.S. GAAP for private companies to be second class to IFRS.

Model in Operation

An accounting board would need to exist to monitor current U.S. GAAP and update it in the future. Private company constituents would influence the updating process by commenting on proposed revisions, similar to the way they do currently. A mechanism for funding the board and its work would need to be identified.

Small Firm Perspective: How Do You Talk About IFRS to Your Clients?

By James C. Metzler, CPA, AICPA Vice President

August, 2008

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It makes sense to talk to your clients about International Financial Reporting Standards (IFRS) because even the smallest companies are increasingly doing business in the global marketplace. According to the U.S. Small Business Administration, exports by U.S. small businesses soared fourfold—to \$400 billion—between 1992 and 2007. And it's expected that half of U.S. small businesses will be involved in international trade in the next 10 years. After probing their clients a bit, many practicing CPAs will quickly discover that even their smallest business clients are involved in or contemplating international transactions in some fashion. Our neighbor to the north, Canada, has called for full adaptation of IFRS in 2011 for publicly accountable entities. Thus, the many U.S. businesses that have ties to Canada will have the acronym "IFRS" suddenly appear on their radar. To date, nearly 100 countries have required or permitted IFRS for public companies, and it's expanding rapidly. It's easy to envision that IFRS will one day be adopted by private companies as the globalization of business and convergence of standards continue at today's rapid pace.

SEIZING INTERNATIONAL BUSINESS OPPORTUNITIES

The discussion about financial reporting on IFRS with clients is much more about their seizing international business opportunities than preparing financial statements. In fact, international opportunity is the starting point of the conversation.

No doubt your clients are already hearing about possible business ventures overseas through their trade associations, trade press and even at their local business group meetings. Most companies are being approached by foreign businesses that either want to sell to them, provide services or purchase goods and

services from them. This happens either by direct contact or through the Internet by random solicitation or dedicated B2B portals. Many clients already know what products and services they can sell or buy and who to approach, but they do not know how to do it. International transactions give rise to the need for your clients to seek credit approvals from sources outside the U.S. as well as to grant credit to potential customers.

This need is not limited to supplier/customer credit but applies more significantly to bank credit, bonding agents, brokers, insurance companies and other financial institutions. With the current position of the U.S. dollar, private companies of all sizes are actively being approached by foreign acquirers. They are asking these U.S. targets to prepare their financial statements using IFRS so they can better compare the company's performance with the performance of operations in their own countries.

Your knowledge about international business will be valuable as you help them navigate through the financial aspects that would enable them to be well-positioned to seize or increase their business internationally or be acquired or merge.

Now is the time to begin or expand these conversations with your clients. The topic is perfect over lunch, coffee or any casual setting. The conversation should begin with more probing questions than answers on your part, such as:

- What sales opportunities exist for your products/service outside the U.S.?
- What supplier and outsourcing opportunities are there for your business outside the U.S.?
- What are the merger opportunities?
- If you had a capital source outside the U.S. to expand, what successes do you envision?

Small Firm Perspective: How Do You Talk About IFRS to Your Clients?

TURNING THE TOPIC TO IFRS

Once an understanding is reached of the extent of present client activity internationally and the future opportunities are probed, the discussion can move to the financial reporting and where it is headed. Let them know that the U.S. is on a path toward moving to IFRS and that these standards could bring some benefits, such as helping everyone “speak the same language” in financial reporting, which could help make international business easier even for the smallest of businesses. Let them know that the economies of standardization of the financial reporting process would mitigate having to bear additional accounting fees by having statements prepared under two different methods. If the client asks about the differences, it only makes sense to describe the general

differences that may apply specifically to their business, such as LIFO or fixed assets differences. Some of the challenges should also be pointed out, such as how existing debt covenants may be affected.

The conversation should end with a commitment to keep the client updated as developments occur. They may trigger a more in-depth discussion of evaluating the conversion to IFRS sooner rather than later.

HELPFUL RESOURCES

Firms may want to consider providing clients with a copy of the AICPA IFRS Backgrounder available online from www.IFRS.com. The site also features FAQs and other informative material.

Small Firm Perspective: Meeting Clients' Needs in the IFRS Environment

By James C. Metzler, CPA, AICPA Vice President
August, 2008

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If you are a small practitioner, it's very much in your interest to know about International Financial Reporting Standards (IFRS). For decades, changes in the global marketplace—and particularly in international accounting standards—appeared to have little direct impact on CPAs in smaller firms. That's no longer the case. The United States is heading toward convergence with international standards. That makes sense because even the smallest companies are increasingly doing business in the global marketplace. According to the U.S. Small Business Administration, exports by U.S. small businesses soared fourfold—to \$400 billion—between 1992 and 2007. And it's expected that half of U.S. small businesses will be involved in international trade in the next 10 years.

These developments do not apply exclusively to public companies and large businesses because changes in financial reporting have an impact on clients across the spectrum. Your clients and potential clients may not be aware yet of the shift toward international standards and the effects of reporting their financial results using IFRS—and that's exactly why now is the time to develop expertise in this area. There are many opportunities today for practitioners who are “fluent” in the language of IFRS to assist companies that choose to adopt IFRS or who see potential business opportunities in this global economy.

CPAs who understand IFRS will be in a unique position to share their knowledge. IFRS knowledge is already in demand from businesses of all sizes and firms are finding themselves assisting companies that were not their clients previously. CPAs with IFRS expertise are viewed as a valuable asset and are being called upon to familiarize, educate and evaluate the effects of a conversion, and oftentimes lead clients' efforts in adapting these standards in their businesses.

Small firm practitioners can help their clients and network of contacts with activities:

- Smaller firms that are members of international CPA associations will be called upon more frequently by their overseas members. U.S. firm members will be called upon to assist with the smaller foreign subsidiaries and divisions located in the U.S. that are now able to file with the Securities and Exchange Commission using IFRS. In addition, international firm members will more readily call upon smaller firms fluent in IFRS to help them with engagements outside the U.S. in their home countries.
- With the current position of the U.S. dollar, private companies of all sizes are actively being approached by foreign acquirers. They are asking these U.S. targets to prepare their financial statements using IFRS so they can better compare the company's performance with the performance of operations in their own countries. CPA firms are being called upon to perform the actual conversions of financial statements from U.S. GAAP to IFRS and for project management of the conversion process.
- High-level briefings of company stakeholders, audit committees, credit grantors and other financial statement users on such topics as where IFRS is headed, the significant differences and the strategic business considerations that need to be considered. Other audiences include business organizations, trade associations and civic business groups.
- Formal education programs for company stakeholders, audit committees, credit grantors and other financial statement users, including local bankers, bonding companies, insurance professionals, investment professionals and any local constituency that uses financial statements or advises businesses and their owners.

Small Firm Perspective: Meeting Clients' Needs in the IFRS Environment

- In-depth consulting on making the optimal choice for companies deciding between U.S. GAAP vs. IFRS reporting.
- Assisting businesses and credit grantors in making key decisions by explanation and interpretation of financial statements received that are prepared based on IFRS.

Why small firms? First and foremost, it's easy to envision that IFRS will one day be adopted by private companies as the globalization of business and convergence of standards continue at today's rapid pace.

Secondly, there are more than 17,000 public companies, the majority of which are small public companies spread throughout the U.S. along with many divisions that are separate entities. All will need to consider IFRS.

Now is the time for small firm practitioners to position themselves and their firms as the leading IFRS experts in their local markets. When they do, you will be ready to speak the language of IFRS and assist your clients in achieving their goals.

International Federal Reporting Standards and the Credit Crisis

EDITOR'S COMMENTARY

Throughout 2008, the U.S. Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) faced tremendous external pressures and challenges to independent standard settings as critics worldwide claimed that fair value accounting contributed to the credit crisis. In the United States, the Securities and Exchange Commission (SEC) undertook a congressionally mandated review of the impact of fair value accounting on the credit crisis. On the other side of the Atlantic, the European Commission (EC) insisted that modifications be made to International Accounting Standard (IAS) 39, *Financial Instruments: Recognition and Measurement*, to create a “level playing field with the US.” In October, the IASB, with the support of the International Accounting Standards Committee Foundation (IASCF) trustees, responded by issuing amendments to IAS 39 that were not subject to due process. The EC then asked for additional changes to the international standard that would be effective for the period ended December 31, 2008, suggesting that the failure of the IASB to respond satisfactorily could lead to another “carve out” of IAS 39.

By year end, some of the dust had settled and pressures on accounting standard setters eased. In the United States, the SEC delivered its report to Congress and recommended against suspension of fair value accounting standards.

From a global perspective, the G20 finance ministers enumerated what they perceived to be the main causes of the credit crisis. Fair value accounting was absent from the list. The G20 ministers also called upon the key global accounting standard setting bodies to work intensively toward the objective of creating a single high-quality global standard.

Although the ongoing credit crisis illustrates the need for high quality global accounting standards and “a level playing field” between the IFRS and U.S. GAAP, the crisis also clearly demonstrates the threat to independent standard setting associated with political, media, and other external pressures coming to bear on the independent standards setting process. This chapter provides an overview of the efforts of the IASB throughout 2008 to navigate the crisis and highlights the unavoidable reality that efforts of the IASB and FASB to achieve sufficient convergence of the IFRS and U.S. GAAP prior to the SEC’s 2011 review of the boards’ progress will take place in the context of perhaps the most turbulent global economy in recent history.

The chapter's tracking of the IASB's rapid response to the crisis throughout 2008, as well as monitoring the board's future efforts,⁵ is of vital importance to U.S. practitioners and entities as the SEC decision unfolds regarding whether the IASB is ready to assume the role of setting the accounting standards used by U.S. companies. How IASB weathers the storm associated with the credit crisis will likely play a significant role in the SEC's decision-making process regarding the implementation and logistics of an IFRS adoption and any role the IASB might ultimately play in setting accounting standards applicable to U.S. entities.

⁵ Readers wishing to follow the board's activities post-2008 may visit the IASB Web site "Credit Crisis" section (www.iasb.org/About+Us/About+the+IASB/Response+to+the+credit+crisis.htm) and Deloitte's IAS PLUS Web site "Credit Crunch" section (www.iasb.org/About+Us/About+the+IASB/Response+to+the+credit+crisis.htm). The latter covers both the IASB and the Financial Accounting Standards Board's response to the crisis

International Accounting Standards Board's Response to the Credit Crisis

By Professor Donna Street

January, 2009

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This article provides an overview of the International Accounting Standards Board's (IASB's) response throughout 2008 to concerns arising over, among other things, fair value accounting and off-balance-sheet entities that peaked during the global credit crisis. Summarizing the board's position on the credit crisis, the IASB indicates that it "recognizes the need to clarify International Financial Reporting Standards (IFRS) to address new market developments."¹ To achieve this goal, the board's activities through 2008 initially focused on addressing the recommendations of the Financial Stability Forum; later in the year, the board focused on recommendations of the G20 leaders.

FINANCIAL STABILITY FORUM REPORT ON ENHANCING MARKET AND INSTITUTIONAL RESILIENCE

This section begins with a review of the recommendations of the Financial Stability Forum and then describes IASB's key responses to the forum's recommendations. The IASB actions highlighted in the section include, but are not limited to, the amendment of International Accounting Standard (IAS) 39, *Financial Instruments: Recognition and Measurement*,² and IFRS 7, *Financial Instruments: Disclosures*; formation of an expert advisory panel on fair value in illiquid markets; creation of an advisory group to review reporting issues related to the credit crisis; publication of educational guidance on the

application of fair value measurement when markets become inactive; and the hosting of a series of roundtables on the global financial crisis.

On April 7, the Financial Stability Forum issued a report to the G7 finance ministers and central bank governors that included recommendations for enhancing market and institutional resilience.³ Main international bodies and national authorities in key financial centers collaborated with the IASB in preparing the report. Three of the recommendations specifically address enhancements to financial reporting:

1. *Off-balance-sheet*. The IASB should improve the accounting and disclosure standards for off-balance-sheet vehicles on an accelerated basis and work with other accounting standard setters toward international convergence.
2. *Fair value in illiquid markets*. The IASB should enhance the board's guidance on valuing financial instruments when markets are no longer active and should set up an expert advisory panel in 2008.
3. *Disclosure*. The IASB should strengthen its standards to achieve better disclosures about valuations, methodologies, and the uncertainty associated with valuations.

On April 11, the G7 finance ministers and central bank governors endorsed the report's recommendations. Regarding the IASB's role, the G7 stated the following:

¹ See www.iasb.org/About+Us/About+the+IASB/Response+to+the+credit+crisis.htm.

² International Accounting Standards (IASs) were issued by the International Accounting Standards Board's (IASB's) predecessor, the International Accounting Standards Committee (IASC), between 1973 and 2001. The IASB assumed the role of international accounting standard setter in 2001 and began issuing the International Financial Reporting Standards (IFRS). The IASs and the IFRS collectively are referred to as the IFRS. The IASs were issued by the IASC and inherited by the IASB when it assumed the role of global standard setter in 2001.

³ See www.fsforum.org/publications/r_0804.pdf.

International Accounting Standards Board's Response to the Credit Crisis

We have identified the following recommendations among the immediate priorities for implementation **within the next 100 days**.⁴ The International Accounting Standards Board (IASB) and other relevant standard setters should initiate urgent action to improve the accounting and disclosure standards for off-balance sheet entities and enhance its guidance on fair value accounting, particularly on valuing financial instruments in periods of stress.⁵

Facing a 100 day deadline, the IASB took immediate action. At a joint meeting with the Financial Accounting Standards Board (FASB) April 21-22, discussion focused on each board's strategy for addressing the credit crisis and how the boards would respond to the Financial Stability Forum report. Following the meeting, the IASB announced that its response to the three previously listed recommendations of the forum would form the core of the board's response to the credit crisis. The IASB's progress in addressing these recommendations as of the close of 2008 follows.

OFF BALANCE SHEET VEHICLES

Consolidation

Prior to April, the IASB already had two agenda items directly related to off-balance-sheet items: consolidation and derecognition. Both projects are part of the memorandum of understanding (MOU) with FASB and were assigned priority to accelerate their completion.⁶

A major concern of the Financial Stability Forum, as well as the G20, is the use of special structures by reporting entities, particularly banks, to manage securitizations and other more complex financial arrangements. Critics question whether current consolidation requirements lead to the correct things being brought onto the balance sheet and whether financial statements convey the extent to which reporting entities are exposed to risks from these types of structures. Responding to these concerns,

the IASB issued an exposure draft of a new consolidation standard in December.

The exposure draft sets forth a new principles-based definition of control of an entity that would apply to a wide range of situations and be more difficult to evade by special structuring. Enhanced disclosures are also proposed. Announcing the proposals, David Tweedie, chair of the IASB, stated the following:

The proposals involve tightening the requirements for consolidation and expanding disclosures to give an overall view of companies' involvement with off balance sheet entities. They therefore go a long way to addressing concerns investors have expressed about how entities are accounting for some complex entity structures and uncertainties about the risks the entities face as a result of being involved with such structures.

We have moved quickly to deal with these issues and consulted widely through working groups in public round tables. However, the continued input of both users and investors is crucial to ensure that our proposals will help improve transparency and increase investor confidence in financial statements.⁷

The exposure draft and updates on the project are available on the IASB Web site.⁸

Derecognition

IAS 39 derecognition requirements for financial instruments are fundamentally different from U.S. generally accepted accounting principles (GAAP). Additionally, many believe the derecognition requirements of IAS 39 are overly complex. Thus, in April 2005, the IASB and FASB instructed their staffs to begin a research project to develop a new approach to derecognition of financial instruments that would improve both IAS 39 and FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125*. The staffs were also directed to consider the feasibility of

⁴ Emphasis added.

⁵ See www.iasb.org/About+Us/About+the+IASB/Response+to+the+credit+crisis.htm.

⁶ The updated memorandum of understanding issued by the IASB and Financial Accounting Standards Board (FASB) in September 2008 following the Securities and Exchange Commission's (SEC's) release of the roadmap for IFRS adoption in the United States is included in this volume.

⁷ See www.iasb.org/News/Press+Releases/IASB+publishes+proposed+new+Consolidation.

⁸ See www.iasb.org/NR/rdonlyres/649AC252-6ABD-4B5F-99A0-69619BCFE7F6/0/Consolidation_summary_0808.pdf.

developing a broader derecognition standard applicable to all assets. The joint project was moved from research to active status in July 2008.

A draft staff paper prepared for the boards' consideration sets out a possible approach to derecognition based on the existence, or otherwise, of the legal rights to a financial asset by the entity. At the close of 2008, staff analysis was focused on assessing the feasibility of the approach in regard to securitized assets and the treatment of servicing contracts. The staff was also considering other possible approaches to derecognition of financial assets to assess whether they would represent a significant improvement to existing requirements. Expectations were that an exposure draft would be issued during the first quarter of 2009 with a standard to follow in late 2009 or early 2010. Again, the IASB's progress can be followed by visiting its Web site.⁹

A communiqué issued by the G8 finance ministers following their June 14 meeting highlighted the urgency of both the consolidation and derecognition projects. In the communiqué, the ministers indicated that, among other things, the IASB should "accelerate its reviews of accounting issues around off-balance sheet entities and valuation in illiquid markets." The next section addresses the latter issue, which also represents the second recommendation of the Financial Stability Forum.

FAIR VALUE IN ILLIQUID MARKETS

In a July 3 speech, E.U. Commissioner Charlie McCreevy discussed, among other things, the IASB's efforts to address the valuation of illiquid financial assets. McCreevy stated that the solution lies in improved valuation techniques and not in disregarding fair value changes entirely. He noted the following:

There have been calls to temporarily disregard fair value accounting in order to neutralise possible pro-cyclical effects and avoid having to write-down assets. Intervention right now risks adding to the confusion and creating even greater distrust in companies' accounts. What is needed is additional guidance on the valuation of complex and illiquid financial instruments. This has also been underscored in a report published by the Committee of European Banking Supervisors (CEBS) last month. It highlighted a number of accounting issues that may require further attention of accounting standards setters in order to improve consistency, comparability and transparency of valuation practices.¹⁰

Also in July, the E.U. Committee of European Securities Regulators (CESR) invited comment on the draft statement *Fair Value Measurement and Related Disclosures of Financial Instruments in Illiquid Markets*. Announcing release of the draft statement, the CESR highlighted that "setting standards, formally interpreting standards and issuing general interpretation of existing standards lies with the IASB/IFRIC.¹¹ The work conducted by CESR remains under the domain of the application of current IFRS, as CESR Members' role regarding IFRS is the enforcement of financial information."¹²

However, not all were supportive of independent standard setting. In June, French President Nicolas Sarkozy sent a letter to the European Commission proposing to modify or suspend mark to market accounting requirements for some financial assets of banks. During an October 1, press conference, European Commission President José Manuel Barroso commented on the global financial crisis and appeared supportive of Sarkozy's proposal. Barroso stated "We must refine the rules on the evaluation of complex assets. This includes adapting our accounting rules to a new situation. In particular if other markets also apply changes, we don't want EU banks in a situation of disadvantage as compared for other markets."¹³ The financial analyst community quickly responded to these challenges to independent standard setting.

⁹ See www.iasb.org/Current+Projects/IASB+Projects/Derecognition/Derecognition.htm.

¹⁰ See www.iasplus.com/crunch/crediterunch.htm#0807mccreevy.

¹¹ The International Financial Reporting Interpretations Committee is the international counterpart of the U.S. Emerging Issues Task Force.

¹² See www.iasplus.com/crunch/crediterunch.htm#0807cesr.

¹³ See www.iasplus.com/europe/0810barroso.pdf.

International Accounting Standards Board's Response to the Credit Crisis

Preceding a summit called by the European Union and Sarkozy to establish a common European position on regulation, the Certified Financial Analysts (CFA) conducted a poll of its E.U. based members. Released on October 2, the CFA's findings reveal that 79 percent of the respondents do not support suspension of fair value standards under the IFRS. Eighty-five percent believe suspension of fair value standards would further decrease confidence in the European banking system. In a letter to Sarkozy, the CFA stressed that any weakening of accounting rules would not improve market stability and would further undermine investor confidence.

Echoing the same sentiment, along with the Council of Institutional Investors (CII) and the Center for Audit Quality (CAQ), on October 1, the CFA issued a joint statement to a U.S. audience. The three organizations stated the following:

In the interest of investor confidence and the health of our capital markets and overall economy, we urge the SEC to resist calls from those with a questionable commitment to transparency and to reject any proposal that would suspend fair value accounting."^{14, 15}

Thus, the beginning of October found the IASB faced with conflicting views from constituents on how the Financial Stability Forum's recommendation to address fair value in illiquid markets should be addressed. The remainder of this section provides background on the original version of IAS 39 and discusses improvements made to IAS 39 in 2004 in response to the European Union's threat to "carve out portions of the standard for use in Europe." Next, October 2008 amendments to IAS 39 and IFRS 7, in response to the recommendation of the Financial Stability Forum, are discussed. Finally, additional demands on the IASB regarding IAS 39 made by the European Union are addressed.

The Original IAS 39

Before reviewing recent revisions to IAS 39, it is important to briefly consider the history of the standard and the European Union's "carve out." In the late 1990's, the IASB's predecessor, the International Accounting Standards Committee (IASC) faced pressure from the International Organization of Securities Commissions (IOSCO) to meet an important deadline. In 1995, the IASC and IOSCO agreed to a work program to be completed before IOSCO would consider endorsing the IASs for cross-border listings. In March 1999, the IASC completed the work program by issuing IAS 39. Following 5 limited revisions (in November 2000), the standard became effective for years beginning on or after January 1, 2001.¹⁶

The original version of IAS 39 followed FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, with minor modifications. In line with FASB Statement No. 115, IAS 39 includes fair value through profit (trading), available for sale, and held to maturity portfolios. The original IAS 39 was, however, more stringent on reclassifications between portfolios. As explained in paragraph 104A of the IAS 39 basis for conclusions (as revised in October 2008), FASB Statement No. 115 permits a security to be reclassified out of the trading category in rare situations. FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*, permits a loan to be reclassified out of the available for sale category if the entity has the intention and ability to hold the loan for the foreseeable future or until maturity. The original IAS 39 did not permit such reclassifications.

¹⁴ In the United States, the Financial Institutions Bailout Bill restates the SEC's authority to suspend the application of FASB Statement No. 157, *Fair Value Measurements*, if the SEC determines that it is in the public interest and protects investors. The SEC responded with a congressional mandated report by the close of 2008 recommending against suspending fair value accounting standards.

¹⁵ See www.cii.org/UserFiles/file/CAQ%20CII%20CFA%20statement%20on%20FV.pdf.

¹⁶ Paragraph 8 of the IAS 39, *Basis for Conclusions*, explains that, in December 2000, a Financial Instruments Joint Working Group (JWG) made up of representatives of accounting standard setters (including FASB) and professional organizations from a range of countries, published a draft standard and basis for conclusions entitled *Financial Instruments and Similar Items*. The draft standard proposed far-reaching changes to accounting for financial instruments. The JWG proposals included measuring virtually all financial instruments at fair value. Feedback during the comment period suggested that much more work would be needed before a comprehensive fair value accounting model could be introduced.

E.U. IAS 39 Carve Out

In 2002, the European Union announced it would require all listed companies to adopt the IFRS for consolidated accounts in 2005. However, the European Union also began to develop a complex endorsement process (see the CII comment letter to the Securities and Exchange Commission (SEC) in “Pros and Cons” section) that requires each IFRS to be individually scrutinized before being endorsed for use in Europe. Some European banks utilized the mechanism to lobby against E.U. endorsement of IAS 39. The banks argued adoption of IAS 39 in Europe would cause significant fluctuations arising from short term swings in the market.¹⁷ The IASB responded noting volatility is a feature of the market and financial statements should reflect this volatility.¹⁸ Banks should report economic reality so investors can understand and evaluate how management is handling this volatility.¹⁹ Capital markets demand transparency and companies should strive to faithfully capture and report economic reality.

To encourage endorsement of IAS 39 prior to E.U. adoption of the IFRS, the IASB issued some improvements to the standard. At the request of the European Central Bank, in February 2004, the IASB limited the fair value option recently introduced into IAS 39.^{20, 21} In March, the IASB made an accommodation for European banks by creating a portfolio hedging mechanism.

Not satisfied with the IASB’s improvement efforts, the European Commission adopted a compromise solution that removed the most controversial fea-

tures of IAS 39 but that still allowed European companies to comply with IAS 39 as promulgated by IASB. On October 1, 2004, the European Commission adopted a temporarily amended version of IAS 39. Explaining the temporary nature of the carve out, the European Commission indicated that it expected the IASB to resolve the dilemma and issue a revised IAS 39 during 2005 that would “keep everyone happy.”²² The carve outs related to the fair value option and hedge accounting.

The European Commission’s October 2004 carve out was in direct conflict with the position of the SEC at a time when it was debating whether to drop the 20-F reconciliation requirement for foreign registrants using the IFRS. Earlier in 2004, the SEC cautioned the European Commission not to water down IAS 39, indicating such a move could endanger convergence efforts between U.S. GAAP and the IFRS.²³ In 2007, the SEC eliminated the 20-F reconciliation for nondomestic registrants following the IFRS as promulgated by the IASB. However, companies already using the E.U. carved-out version of IAS 39 were provided a 2-year grace period. The exemption affected only a couple of registrants as the vast majority of U.S. listed European companies follow IAS 39 as promulgated by the IASB.

In June 2005, the IASB issued an additional amendment to IAS 39, thereby, establishing a new approach to the fair value option. In response, E.U. Commissioner McCreevy noted the revised text appeared likely to be endorsed.²⁴ The European Commission endorsed the new approach prior to the end of the year.

¹⁷ Walton, P. (2004), “IAS 39: ‘Where Different Accounting Models Collide,’” *Accounting in Europe* 1, p. 5-16.

¹⁸ The IASB also faced considerable opposition to its proposals on insurance accounting. Unable to produce a comprehensive standard in time for E.U. adoption, IFRS 4, *Insurance Contracts*, which focuses only on disclosure, was issued. IFRS 4 represents a watered-down version of the IASB’s original proposal, thereby reflecting the impact of tremendous lobbying from the insurance industry led by American International Group Inc. (AIG) (See Wei, L. [2003] “FASB Hears Update on International Insurance Accounting,” *Dow Jones Newswires* [November 25, 2003]).

¹⁹ See Street, D.L. (2005) *G4+1 from the Inside: Its Role in the Evolution of the International Accounting Standard Setting Process*, Institute of Chartered Accountants in England and Wales, p. 127.

²⁰ As part of the effort to converge the IFRS and U.S. generally accepted accounting principles, FASB, in 2007, issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*.

²¹ Walton, P. (2004), “IAS 39: ‘Where Different Accounting Models Collide,’” *Accounting in Europe* 1, p. 5-16.

²² Mills, R. and O’Neill, D. (2005), “IAS 39 the Problem Child,” *Accountancy Ireland* (April 1) 37 (2), p. 11.

²³ “When Three Tribes Go To War,” *Accountancy* (April 3, 2004), p. 6.

²⁴ Reuters (2005), *Agreement of Fair Value Reporting in the EU Imminent* (April 5).

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At the close of 2008, the only difference between IAS 39 as issued by IASB and the E.U. carved out version was that the latter offers greater flexibility with respect to hedge accounting for certain financial instruments.

Response to the Carve Out

Responding to the IAS 39 carve out, the Constitution Review Committee of the International Accounting Standards Committee Foundation (IASCF)²⁵ trustees stated the following:

. . . IAS 39 is the result of an extended consultation process, in which the issues have been intensively deliberated over the past year. So long as standards are developed in such a deliberate, well-informed and open manner, it needs to be recognized that failure to accept particular standards on a national or regional basis will impair the consistency and quality of accounting standards that the world's markets demand.²⁶

Walton explains that confrontation over IAS 39 in Europe is difficult to understand as (1) IAS 39 was developed and approved by the IASC, which included the European Commission as an observer, 18 months before the commission announced its intent to require that listed companies prepare consolidated financial statements based on the IASs; and (2) opposition from French banks surfaced during the development of IAS 39 and the European Commission knew of this opposition.²⁷ Therefore, it is hard to understand the European Commission subsequently failing to take responsibility for its decision and deflecting opposition to the IASB. Walton cautions that the European Commission carve out calls into question the commission's desire to have high quality standards. He recommends that European banks consider Ross Watts and Jerold Zimmerman's argument²⁸ that companies that lobby the hardest are those that fear their economic interest will be most

damaged by a standard. In the case of IAS 39, Walton argues the lobbying was aimed at a standard that increases transparency.²⁹

Hindsight suggests that instead of applying patches to IAS 39 to appease Europe perhaps the IASB should have comprehensively reconsidered IAS 39. When the newly formed IASB debated endorsing existing IASs, some board members believed IAS 39 should not be endorsed. They noted that IAS 39 is a bad standard originally viewed as an interim standard that provided a compromise solution enabling the IASC to meet IOSCO's deadline.

October 2008 Amendment to IAS 39

When the credit crisis began to unfold, the IASB firmly supported fair value accounting. However, as the crisis worsened, fair value accounting became even more controversial. Jennifer Hughes reported that opponents of fair value accounting included

. . . a number of, but not all, banks and insurers who believe that it is making their balance sheets unnecessarily weaker by forcing them to report current depressed prices that do not reflect their longer-term expectations. Those in favour, which includes most regulators and auditors, believe that using market prices reflects the economic reality, however harsh that may be.³⁰

Hughes further noted that a political storm stirred with French and Italian leaders, among others, insisting the IASB modify the fair value accounting rules.

Taking a different position, U.K. Prime Minister Gordon Brown stated, "Some people are looking for a get-out-of-jail-free card and an easier way of registering their financial position than is the truth." He cautioned that changing the accounting is not a quick solution. The world has to find a "level playing field" and not just "a breathing space. It's just a lot of money put on one side of the accounts to make things look better."³¹

²⁵ The International Accounting Standards Committee Foundation (IASCF) is the parent body of the IASB.

²⁶ Constitution Review Committee to the IASC Foundation Trustees (2004), "Preliminary Recommendations by the Constitution Committee to the IASC Foundation Trustees for Consideration at the 25 October Trustee's Meeting," (October 20), p. 2.

²⁷ Walton, P. (2004), "IAS 39: Where Different Accounting Models Collide," *Accounting in Europe* 1, p. 5-16.

²⁸ Watts, R. and Zimmerman J. (1978), "Toward A Positive Theory of the Determination of Accounting Standards," *Accounting Review* 54, p. 112-134.

²⁹ See also "Analysis—In the Hotseat—About Schmid," *Accountancy* (May 20, 2004), p. 45.

³⁰ Hughes, J. (2008). "Fair Value Accounting Rules Eased," *Financial Times* (October 14).

³¹ Ibid.

Faced with some European banks highlighting that U.S. GAAP provided competitors' alternatives that the IFRS did not provide and mounting political pressure, the IASB members made their distaste clear. However, the board accepted that the credit crisis represented an "extreme situation," and Chair Tweedie eventually took the position that, if IAS 39 had to be modified, the changes would best be made by an accounting standard setter and not politicians.³²

In early October, the IASB began to work quickly on emergency fixes. An October 3 press release announced that the board would immediately assess inconsistencies in how IAS 39 and U.S. GAAP address reclassifications between portfolios and whether to eliminate any differences. Furthermore, the IASB would determine the board's position as part of a public meeting the week of October 13. The IASCF trustees unanimously agreed that the IASB could "suspend normal due process" and that the reclassification decisions could take effect in the third quarter of 2008.³³

On October 10, the Financial Stability Forum published a report addressing the implementation to date of its April recommendations. The report acknowledged the significant efforts of accounting standard setters and urged them to accelerate their work to enhance and converge guidance on the valuation of instruments in inactive markets.

The IASB and FASB responded by working concurrently and speedily to ensure the boards' guidance was "equivalent" and "had the same effect across borders." The boards aimed to create a "level playing field," thereby, being consistent with and supportive of the statements of European leaders and Finance Ministers through the Economic and Financial Affairs Council of the European Union (ECOFIN).

After an October 4 meeting, the European G8 members concluded that revisions to IAS 39 must guarantee that

European financial institutions are not disadvantaged vis-à-vis their international competitors in terms of accounting rules and of their interpretation. In this regard, European financial institutions should be given the same rules to reclassify financial instruments from the trading

book to the banking book including those already held or issued. We urge the IASB and the FASB to work quickly together on this issue in accordance with their recent announcement. We also welcome the readiness of the Commission to bring forward appropriate measures as soon as possible. This issue must be resolved by the end of the month.

In an October 9 press release, the IASCF trustees responded to the European G8 mandate stating "any moves to go beyond the position taken by European leaders and the Finance Ministers in the ECOFIN Council in this respect would result in the creation of a new unlevel playing field."

On October 13, the IASB issued amendments to IAS 39 and IFRS 7. The amendments allow companies to reclassify some (1) nonderivative financial assets out of the held-for-trading category in rare circumstances and (2) loans and receivables out of the held-for-trading or available-for-sale categories if the entity has the intention and ability to hold the assets for the foreseeable future.

In paragraph 104 of the amendment's basis for conclusion, the IASB explains the following:

BC104B The Board noted that allowing reclassification, even in limited circumstances, could allow an entity to manage its reported profit or loss by avoiding future fair value gains or losses on the reclassified assets.

BC104C The Board was also informed that, in practice under US GAAP, reclassification out of the trading category of SFAS 115 is extremely rare.

However, the Board noted that the possibility of reclassification of securities and loans under US GAAP is available and that entities applying IFRS do not have that possibility.

BC104D The Board therefore decided to permit non-derivative financial assets to be reclassified out of the held-for-trading category in the same circumstances as are permitted in SFAS 115 and SFAS 65. . . . In addition, the Board decided that a financial asset that would have met the definition of loans and receivables (if it had not been designated as available for sale) should be permitted to be transferred from the available-for-sale category to loans and receivables, if the entity intends to hold the loan or receivable for the foreseeable future or until maturity. The Board decided that this substantially aligns the accounting for reclassifications of loans and receivables with that permitted under US GAAP.

³² Ibid.

³³ IASCF (2008). "Trustees Support IASB's accelerated steps on the credit crisis," October 9 press release.

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BC104E The Board normally publishes an exposure draft of any proposed amendments to standards to invite comments from interested parties. However, given the requests to address this issue urgently in the light of market conditions, and after consultation with the Trustees of the IASC Foundation, the Board decided to proceed directly to issuing the amendments. In taking this exceptional step the Board noted that the amendments to IAS 39 relaxed the existing requirements to provide short-term relief for some entities. The Board also noted that the amendments were a short-term response to the requests and therefore the Board decided to restrict the scope of the amendments.

In their dissenting opinion, IASB members Jim Leisenring and John Smith stated the following:

DO1 . . . The amendments to IAS 39 are asserted to level the playing field with US GAAP. It accomplishes that with respect to the reclassification of financial instruments to the held-to-maturity category of loans and receivables from other classifications. However, once reclassified, the measurement of impairment and when that measurement is required are quite different and a level playing field in accounting for these instruments is not achieved. Messrs Leisenring and Smith would have been willing to support the alternative approach considered by the Board that would have closely aligned the impairment requirements of US GAAP with IFRS.

DO3 Messrs Leisenring and Smith both believe that the current requirements in IFRS for reclassification are superior to US GAAP and that the accounting for impairments in US GAAP is superior to the requirements of IAS 39.

DO4 Furthermore, Messrs Leisenring and Smith do not believe that amendments to standards should be made without any due process.

Responding to requests for clarification of the amendments, the IASB explained that any reclassification made on or after November 1, 2008 becomes effective from the date of reclassification. However, reclassifications before November 1, 2008 can take effect from July 1, 2008. Providing further clarification, the board emphasized that a reclassification cannot be applied retrospectively before July 1, 2008.

Hughes reported that the change

. . . will allow companies to easily shift their holdings from being marked to fair, or current market, values and instead report them at amortized cost. Thus, companies will not

have to report any further falls in market prices and any gains will be spread evenly over the lifetime of the asset.³⁴

Hughes also noted that the amended IAS 39 will enable European banks to more easily shield assets from the scrutiny of marking to market prices. She views the amendments as a “retreat by the IASB, which had defended staunchly fair value, and only came after intense political pressure.”

DISCLOSURE

October Amendments to IFRS 7

Also in October, IFRS 7 was amended to require additional disclosures about reclassifications associated with the new amendment to IAS 39. Companies using the new rules would disclose the effects of the reclassification on the financial statements. The IASB considers such disclosures useful because the reclassification of a financial asset can have a significant effect on the financial statements.

October Exposure Draft Improving Disclosures About Financial Instruments

In light of market conditions, users and others have recommended enhanced disclosures about fair value measurements along the line of those included in FASB Statement No. 157, *Fair Value Measurements*. On October 15, the IASB responded with the exposure draft *Improving Disclosures about Financial Instruments Proposed Amendments to IFRS 7*. The proposed amendments are intended to enhance disclosures about fair value measurements and the liquidity risk of financial instruments. The proposed amendments require disclosures about

1. the level of the fair value hierarchy into which fair value measurements are categorized in their entirety. This requirement would apply both for fair values included in the statement of financial position and for other fair values that are disclosed but not included in that statement.
2. the fair value measurements resulting from the use of significant unobservable inputs to

³⁴ Hughes, J. (2008). “Fair Value Accounting Rules Eased,” *Financial Times* (October 14).

valuation techniques. For these measurements, the disclosures include a reconciliation from the beginning balances to the ending balances.

3. the movements between different levels of the fair value hierarchy, and the reasons for those movements.

The IASB believes requiring disclosures based on a fair value hierarchy will improve comparability about the effects of fair value measurements and increase convergence of the IFRS and U.S. GAAP. Although the IASB considered using the FASB Statement No. 157 fair value hierarchy, the board proposed a hierarchy using IAS 39 and IFRS 7 terminology until the IASB completes its fair value measurement project. The proposed hierarchy does not affect any measurement or recognition requirements.

The exposure draft also proposes additional disclosures for instruments with fair value measurements in level 3. These disclosures would inform users about the effects of fair value measurements that use the most subjective inputs.

Following the issuance of IFRS 7 in 2007, the board had been told that some of the disclosure requirements about the nature and extent of liquidity risk were unclear and difficult to apply and did not always result in useful information for financial statement users. Thus, the IASB also proposed amendments to IFRS 7 that would

1. clarify that liquidity risk disclosures are required only for financial liabilities that will result in the outflow of cash or another financial asset.
2. require entities to provide quantitative disclosures based on how they manage liquidity risk for derivative financial liabilities.
3. require entities to disclose the remaining expected maturities of nonderivative financial liabilities if they manage liquidity risk on the basis of expected maturities.
4. strengthen the relationship between qualitative and quantitative disclosures about liquidity risk.

Although the effective date of the IFRS and amendments to the IFRS is usually 6-18 months after issue, the urgent need for enhanced disclosures demands earlier application. Hence, the anticipated effective date is periods beginning on or after July 1, 2009.

OCTOBER EDUCATIONAL GUIDANCE ON APPLICATION OF FAIR VALUE MEASUREMENTS IN INACTIVE MARKETS

In May, the IASB set up an expert advisory panel to identify valuation and disclosure issues encountered in practice in the current market environment. The panel met 7 times to consider application of fair value when markets become inactive. On September 16, the IASB staff released draft guidance emanating from discussions of the expert advisory panel. The panel met on October 10 to discuss comments received on the document. Then, on October 31, the IASB published finalized educational guidance on application of fair value measurement when markets become inactive.³⁵

The guidance includes a summary document prepared by IASB staff and the final report of the expert advisory panel. The staff summary document is consistent with documents issued by FASB on October 10 and the SEC on September 30. The report of the expert advisory panel summarizes its meetings and identifies practices that experts use for measuring the fair value of financial instruments when markets become inactive. The report provides information and educational guidance about the processes used and the judgments made when measuring and disclosing fair value.

The work of the panel also aided the IASB in addressing the issues of disclosure along with fair value measurement and off-balance-sheet accounting. Feedback from the panel was incorporated in October amendments to IFRS 7 and will be utilized in the development of the forthcoming IFRS on fair value measurement.

³⁵ The education guidance can be found online at www.iasb.org/expert-advisory-panel.

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IASB Chair Tweedie stated the following:

The expert advisory panel has provided useful input to a number of projects and we are moving quickly to incorporate their valuable contributions into our standards. Round-table discussions in Asia, Europe and the United States, to be held jointly with the FASB, will provide additional opportunities to gather views on where further enhancements may be required. Added to this, the joint IASB - FASB high level advisory group now being set up will provide advice to both boards on the reporting lessons from the credit crisis.³⁶

ONGOING ACTIVITIES AT THE CLOSE OF 2008

In an October 20 news release, the IASB and FASB

. . . reiterated the importance of working cooperatively and in an internationally coordinated manner to consider accounting issues emerging from the global crisis. The boards also emphasized the role of high quality financial reporting in helping enhance confidence in the financial markets by responding in a timely manner that improves transparency and provides greater global consistency in financial reporting.³⁷

In addition to agreeing to the appointment of the expert advisory group previously discussed, the boards agreed to

- public roundtables in Asia, Europe, and North America designed to gather input on reporting issues stemming from the current global financial crisis.
- common long-term solutions to accounting for financial instruments.

Advisory Group

At their October meeting, the IASB and FASB agreed to appoint a global advisory group including regulators, preparers, auditors, investors and other financial statement users. The advisory group will work with the boards to ensure that reporting issues arising from the global economic crisis are considered in

an internationally coordinated manner. The October 2008 IASB update states the following:

The advisory group will comprise senior leaders with broad international experience with financial markets. The boards will task this high level advisory group with considering how improvements in financial reporting could help enhance investor confidence in financial markets. The group will also be charged with identifying the accounting issues requiring urgent and immediate attention of the boards as well as issues for longer-term consideration. The high level advisory group will also draw upon work already under way in a number of jurisdictions on accounting and the credit crisis.

The boards will seek to identify external chairs and members of the group as soon as possible to enable the advisory group to begin its work expeditiously. In developing their approaches on issues resulting from the discussions the boards will follow appropriate due process. In the interest of transparency, the advisory group will meet in public session with Webcasting facilities available to all interested parties.³⁸

A November 14 press release noted that the work of the advisory group will be completed in a 4-6 month period.³⁹ Recommendations of the group will be jointly considered by the IASB and FASB. Any decisions to act on the recommendations will be subject to appropriate and robust due process. Prior to the close of 2008, members of the advisory group had been announced.

Roundtables

As previously noted, in October, the IASB and FASB agreed to hold public roundtables to gather input on reporting issues stemming from the current global financial crisis. Roundtables were held in London on November 14; Norwalk, Connecticut on November 25; and Tokyo on December 3.

The roundtables allowed the IASB and FASB to consider input from a wide range of stakeholders and to identify accounting issues that may require the urgent and immediate attention of the boards to improve financial reporting and enhance investor

³⁶ See www.iasb.org/News/Press%20Releases/IASB%20publishes%20educational%20guidance%20on%20the%20application%20of%20fair%20value%20measurement%20when%20markets%20become.htm.

³⁷ See www.iasb.org/News/Press+Releases/IASB+and+FASB+commit+to+a+global+approach+to+enhance+market+confidence.htm.

³⁸ Available at http://eifrs.iasb.org/eifrs/files/88/iasbupdateoct08_186.pdf.

³⁹ See www.iasb.org/News/Press+Releases/Hans+Hoogervorst+and+Harvey+Goldschmid+to+co-chair+advisory+group+considering+financial+reporting+is.htm.

confidence in financial markets. During the roundtables, the IASB and FASB members asked participants to identify broader financial reporting issues arising from the global economic crisis. Issues identified during the roundtables were considered by the high-level financial crisis advisory group established to assist the boards in responding to the crisis in an internationally coordinated manner.

COMMON LONG-TERM SOLUTIONS

In addition to considering short-term responses to the credit crisis, the IASB and FASB have committed to developing common solutions aimed at providing greater transparency and reduced complexity in the accounting for financial instruments. As a starting point, the boards are using their joint discussion paper *Reducing Complexity in Reporting Financial Instruments*, comments received on the discussion paper, and the deliberations of the expert advisory group. The discussion paper represents the starting point for a replacement of IAS 39.

OCTOBER 27 EUROPEAN COMMISSION FOR MORE AMENDMENTS TO IAS 39

On October 27, the European Commission wrote the IASB requesting an amendment to, or interpretation of, IAS 39 to guarantee that 3 specific matters were addressed effective for year-end 2008 financial statements. These requested changes include the following:

- Financial assets presently classified as fair value through profit and loss using the fair value option can be classified into other categories and not measured at fair value, for the same reasons, and under the same conditions as the assets reclassified out of the held for trading category.
- Clarification on whether synthetic collateralized debt obligations include embedded credit derivatives. Currently, IAS 39 is interpreted as requiring separation and fair value measurement for such embedded credit derivatives,

whereas U.S. GAAP does not require an embedded derivative to be recognized separately.

- Adjustments to impairment rules applicable to available for sale interest bearing financial assets, so that available for sale would be treated the same way as loans and receivables and held to maturity debt instruments. The effect of such a change would be to keep a portion of the fair value decline on available for sale in equity rather than recognizing it in profit and loss as IAS 39 currently requires.⁴⁰

An annex requested a fourth change allowing reversal of impairment losses not only for debt securities but also for equity instruments.

The European Commission letter stated the following:

Recent developments raise broader issues related to the role of fair value accounting for financial instruments which we intend to explore further with all stakeholders as a matter of urgency. This issue should also be comprehensively addressed in the context of ongoing IASB projects. There may be a need to adjust the timetable of ongoing projects to reflect the immediate needs of the current crisis.

The European Commission's recommended changes would suspend paragraphs 9 and 50 of IAS 39 and allow companies using the IFRS to reclassify derivatives and avoid fair value accounting.

SUPPORT SURFACES FOR INDEPENDENT STANDARD SETTING AND DUE PROCESS

Key IASB constituents immediately voiced support for the board and independent standard setting. Hughes reported the following:

More interference from Brussels could kill off the dream of a single system of global accounting by threatening the credibility of the organisation that makes the rules, a broad group of UK investors and accountants has warned.⁴¹

Hughes further noted that in a letter to *Financial Times*, a group including the head of the U.K. Accounting Standards Board, representatives from each of the Big Four, and the head of the Association of British Insurers, which represents one-fifth of all

⁴⁰ See www.iasplus.com/crunch/crediterunch.htm#0810barroso.

⁴¹ Hughes, J. (2008). "IASB Warns Over Brussels Threat," *Financial Times* (November 13).

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U.K. investor power, called on the European Union to accept the IASB's decision as final.

In the November 12 letter, U.K. preparers, auditors, and users stated the following:

We have before us a situation that could threaten the independence of international standard setting, the use of proper due process and the future of global financial reporting standards.

...

Effective consultation with preparers and users of financial reports is an important element of the governance framework within which standard setters must operate. It is both a necessary constraint of the standard setter and an opportunity for comments from around the world to be gathered, considered and addressed as appropriate.

After the debate, the IASB must decide the issues on their merits. It must remain independent, even if it disagrees with the biggest user, the EU. Europe, for its part, should argue its case strongly, but in the end it must accept the decision of the independent standard setter.

The EU has the ability not to accept international standards for use in Europe, or to change them. We strongly believe that these powers should only be used in the most exceptional circumstances and that the present situation does not justify their use. We would not support another carve-out.

IFRS is becoming the world's global accounting standard, and the EU played a very important part in this convergence. If Europe in any way adopts its own version of IFRS, we not only lose the advantages of global comparability, we also risk detaching ourselves from this global movement and sacrificing our position of influence for one on the sidelines, just at a point when the global economy needs strong leadership in all areas, including accounting.⁴²

On November 15, 20 members of the National Standard Setters Group forwarded a communiqué to the IASB and IASCF trustees supporting the board's efforts to achieve true global financial reporting standards. The National Standard Setters Group members stated

we understand that . . . IASB has been put under considerable pressure by the current credit crisis being felt around the world. In particular we note that the IASB has

been receiving requests to review standards with some urgency. It acceded to the first such request in October and suspended due process to do so. It has now been asked to carry out a further review of standards and to complete its considerations in time for 31 December year end financial reporting.⁴³

The national standard setters continued with the following:

- It is important that the IASB follows appropriate due process.
- While appropriate due process should allow constituents ample time to consider and comment on any changes, it may be, in these extraordinary times, that due process will need to be shortened. Should this be the case we stand ready to assist the IASB to achieve the most effective due process possible. For instance we could stimulate debate among our national constituents, hold round tables on the technical issues involved and act as focal points for comments.
- We urge those adopting international financial reporting standards to accept the decisions of the IASB if they are made with adequate due process and deliberation, taking into account the impacts on markets and the economy.

Preceding a summit of the G20 heads of state, the International Corporate Governance Network stated

there must be no political interference in setting accounting standards. The fair value approach has been blamed for encouraging pro-cyclicality. Investors generally support fair value that delivers a picture of what is actually happening. There are some challenges to address, but abandoning this approach would damage confidence in financial reporting. It is important to recognise that there is a difference between fair value used for reporting and fair value used to measure the need for regulatory capital. Accounting standards also need to be clearer about when off-balance sheet business should be reported.⁴⁴

During December, the IASB responded to the requests of European Union. Actions taken are described in the section entitled, "December IASB Response to G20 Recommendations."

⁴² See www.ft.com/cms/s/0/6fef4ede-b123-11dd-8915-0000779fd18c.html.

⁴³ See www.aasb.com.au/admin/file/content9/c14/CommuniqueNSStoIASB.pdf.

⁴⁴ See www.iasplus.com/crunch/crediterunch.htm#0811iegn.

G20 CONCLUDE FAIR VALUE ACCOUNTING DID NOT CONTRIBUTE TO CRISIS

On November 15, the G20 heads of state and leaders of the World Bank, International Monetary Fund, United Nations, and Financial Stability Forum met to discuss the credit crisis. In a *Declaration of the Summit on Financial Markets and the World Economy*, the leaders announced immediate actions (to be completed by March 31, 2009) and medium-term actions that should be undertaken to strengthen the global economy, reform the world's financial markets, strengthen transparency, and improve accountability:

By March 31, 2009:

- The key global accounting standards bodies should work to enhance guidance for valuation of securities, also taking into account the valuation of complex, illiquid products, especially during times of stress.
- Accounting standard setters should significantly advance their work to address weaknesses in accounting and disclosure standards for off-balance sheet vehicles.
- Regulators and accounting standard setters should enhance the required disclosure of complex financial instruments by firms to market participants.
- With a view toward promoting financial stability, the governance of the international accounting standard setting body should be further enhanced, including undertaking a review of its membership, in particular in order to ensure transparency, accountability, and an appropriate relationship between this independent body and the relevant authorities.
- Private sector bodies that have already developed best practices for private pools of capital and/or hedge funds should bring forward proposals for a set of unified best practices. Finance Ministers should assess the adequacy of these proposals, drawing upon the analysis of

regulators, the expanded Financial Stability Forum, and other relevant bodies.⁴⁵

Medium-term actions:

- The key global accounting standards bodies should work intensively toward the objective of creating a single high-quality global standard.
- Regulators, supervisors, and accounting standard setters, as appropriate, should work with each other and the private sector on an ongoing basis to ensure consistent application and enforcement of high-quality accounting standards.
- Financial institutions should provide enhanced risk disclosures in their reporting and disclose all losses on an ongoing basis, consistent with international best practice, as appropriate. Regulators should work to ensure that a financial institution's financial statements include a complete, accurate, and timely picture of the firm's activities (including off-balance sheet activities) and are reported on a consistent and regular basis.

The G20 leaders also agreed to the importance of reinforcing international cooperation by, among other things, authorities, drawing especially on the work of regulators, collecting information on areas where convergence in regulatory practices such as accounting standards, auditing, and deposit insurance is making progress, is in need of accelerated progress, or where there may be potential for progress.

The G20 Finance Ministers concluded the main causes of the credit crisis include

- the search for higher yields without adequate appreciation of the risk and a failure of oversight,
- an abundance of "weak underwriting standards, unsound risk management practices, increasingly complex and opaque financial products, and consequent excessive leverage."
- policy-makers, regulators, and bank supervisors displaying a lack of appreciation of the build-up of risk, a lag in keeping pace with financial innovations, and an inability to foresee the effects of certain regulatory actions.⁴⁶

⁴⁵ Ibid.

⁴⁶ Katz, D.M. (2008). "G20 Verdict on Fair Value: Innocent," *CFO.com* (November 17).

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The G20 list did not include accounting and financial reporting.

Patrick Finnegan, director of the Financial Reporting Policy Group of the CFA Institute Center for Financial Market Integrity, responded to the G20 position stating, "There's tremendous consensus around the fact that [the crisis] has nothing to do with financial reporting. I don't think financial reporting could be held accountable for judgments of these large financial organizations that took these risks."⁴⁷ Finnegan additionally stated that he was pleased that the G20 finance ministers assigned blame on "excessive risk taking [and] poor judgments" and not on fair value financial reporting.

Strengthening Transparency and Accountability*

A comprehensive overview of measures undertaken by the IASC Foundation and the IASB responding to the conclusions reached by the G20 at their summit in Washington, DC, USA, 15 November 2008.

DECEMBER IASB RESPONSE TO G20 RECOMMENDATIONS

In December, the IASB undertook a series of steps to address recommendations made by the G20 leaders. Additionally, the board released a comprehensive overview of measures undertaken by the IASCF and IASB to date in response to the conclusions reached by the G20. The overview is reproduced in the figure entitled "Strengthening Transparency and Accountability."

Recommendation	By Date	Action Underway	Next Steps
The key global accounting standards bodies should work to enhance guidance for valuation for securities, also taking into account the valuation of complex, illiquid products, especially during times of stress	March 31, 2009	<ol style="list-style-type: none"> 1. SEC/FASB issued guidance. 2. On 31 October the IASB issued a staff summary and its expert advisory panel's report on fair value measurement when markets are no longer active. 3. On 15 October the IASB published proposals to improve the information available to investors and others about fair value measurements of financial instruments and liquidity risk. 4. IASB permits reclassifications in some instances. 5. In addition to those improvements, the IASB is developing a standard on fair value measurement 	<ol style="list-style-type: none"> 1. Ensure that any inconsistencies are addressed 2. Complete exposure draft on fair value measurement by second quarter 2009
Accounting standard-setters should significantly advance their work to address weaknesses in accounting and disclosure standards for off-balance sheet vehicles	March 31, 2009	<ol style="list-style-type: none"> 1. An exposure draft of the proposed IFRS <i>Consolidated Financial Statements</i>, which includes enhanced disclosures about off-balance sheet risk, was published on 18 December. 2. IASB staff have also been developing proposals to improve derecognition requirements, which should be published by the end of the first quarter of 2009. 	<ol style="list-style-type: none"> 1. Review in a timely manner comments on proposals on financial instrument disclosures 2. Derecognition exposure draft planned for the end of the first quarter 2009.

⁴⁷ See Katz, D.M. (2008). "G20 Verdict on Fair Value: Innocent" *CFO.com* (November 17).

Recommendation	By Date	Action Underway	Next Steps
		3. Three joint IASB / FASB round tables took place in November and December in London, Norwalk and Tokyo to identify further issues. The results of those meetings were presented to the Board at its meeting in December.	3. The IASB will address issues arising from the global financial crisis round-table meetings.
With a view toward promoting financial stability, the governance of the international accounting standard setting body should be further enhanced, including by undertaking a review of its membership, in particular in order to ensure transparency, accountability, and appropriate relationship between this independent body and the relevant authorities.	March 31, 2009	<ol style="list-style-type: none"> 1. Proposal on the Monitoring Board to be approved at the Trustees' meeting in Delhi in January, in addition to the accompanying MoU. 2. Approval of Constitutional proposal regarding the desirability of geographical diversity for IASB membership pending. 3. The second part of the Constitution Review on a broad range of constitutional issues launched with a discussion document on 8 December. 4. Ongoing discussions between the IASB and the Basel Committee. 	<ol style="list-style-type: none"> 1. Announcement of the Monitoring Board by the end of the year. 2. Amendments to the Constitutional Review in place for 2009. 3. The Trustees will be holding a series of round-table meetings to encourage further debate and comment from stakeholders around the world.
The key global accounting standard setting bodies should work intensively toward the objective of creating a single high-quality global standard	Medium term	<ol style="list-style-type: none"> 1. Convergence work underway with United States and Japan. 2. Memorandum of Understanding with the FASB sets out targets, including the development of a common financial instruments standard. 	Continue convergence work
Regulators, supervisors, and accounting standard-setters, as appropriate, should work with each other and the private sector on an ongoing basis to ensure consistent application and enforcement of high quality accounting standards.	Medium term	<ol style="list-style-type: none"> 1. Regular consultation and interpretations processes already in place. 2. Monitoring Board to establish a venue to raise a number of these issues. 3. Discussion about the need for intensified dialogue with Basel Committee and the banking industry. 	<ol style="list-style-type: none"> 1. Participate in FSF efforts on procyclicality. 2. Follow up on discussions with the Basel Committee.

(continued)

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Recommendation	By Date	Action Underway	Next Steps
Financial institutions should provide enhanced risk disclosures in their reporting and disclose all losses on an ongoing basis, consistent with international best practice, as appropriate. Regulators should work to ensure that a financial institution's financial statements include a complete, accurate, and timely picture of the firm's activities (including off balance sheet activities) and are reported on a consistent and regular basis.	Medium term	<ol style="list-style-type: none"> 1. On 15 October, the IASB released its proposals to improve financial instrument disclosures related to exposure to risk from off balance sheet items. 2. On 22 December the IASB released proposals clarifying the accounting for embedded derivatives. 3. On 23 December the IASB released proposals to improve the disclosures in relation to investments in debt instruments. 4. In addition to those improvements, the IASB is developing a standard on fair value measurement. 5. Major changes in disclosure of off balance sheet items proposed in consolidations exposure draft published on 18 December. 6. Issues of disclosure to be raised with the Financial Crisis Advisory Group. 7. Next steps on IAS 39 replacement under consideration. 8. Financial Crisis Advisory Group being created to report within 4-6 months. 	
Authorities, drawing especially on the work of regulators, should collect information on where convergence in regulatory practices such as accounting standards, auditing, and deposit insurance is making progress, is in need of accelerated progress, or where there may be potential for progress.	Medium term	<ol style="list-style-type: none"> 1. The Trustees will report to the Monitoring Body on the progress of the organisation's efforts. 2. The IASB will continue to inform the FSF secretariat on progress made related to its convergence programme. 	

This summary has been prepared by the staff of the IASC Foundation and the IASB.

* Source: www.iasb.org/NR/rdonlyres/3D0E315C-6C2F-46A2-80F3-1773F64AE0D7/0/G20Actionplan.pdf

December 2008 activities of the IASB included the following:

- *Improved accounting for off-balance sheet items.* As discussed previously, the board issued a consolidations exposure draft and continued work on derecognition.
- *New disclosure requirements related to impairment.* On December 23, the IASB issued an exposure draft to address the concerns of

roundtable participants regarding disclosures requirements for impairments. The proposals amend IFRS 7 and require additional disclosures on all investments in debt instruments, other than those classified in the fair value through profit category. Entities would be required to state in tabular form the fair value, amortized cost and amount at which the investments are actually carried. The amendments

also require disclosure of the effect on profit or loss if all debt instruments had been accounted for at fair value or at amortized cost. Comments were due January 15, 2009. The goal is to enable any possible change to take effect for 2008 year-end accounts.

- *Acceleration of efforts to address broader issues of impairment on a globally consistent basis.* Both the IASB and FASB instructed their staffs to jointly consider how existing requirements relating to reversals of impairment losses might be changed, and to report back in a month. The boards also plan to address the whole question of impairment as part of an urgent broader project in 2009. This topic will be reviewed by the Financial Crisis Advisory Group.
- *Ensuring consistent treatment of accounting for particular credit-linked investments between U.S. GAAP and the IFRS.* Stakeholders desire clarification of any possible difference in the accounting treatment between the IFRS and U.S. GAAP. FASB agreed to issue mandatory implementation guidance to ensure consistency between the IFRS and U.S. GAAP in practice.
- *Ensuring embedded derivatives assessed and separated if financial assets are reclassified.* Roundtable participants asked the IASB to act and prevent diversity in practice developing as a result of October amendments to IAS 39 to permit the reclassification of particular financial assets. On December 22, the IASB issued an exposure draft to clarify accounting for embedded derivatives. The proposals would require all embedded derivatives to be assessed and, if necessary, separately accounted for. Comments were due January 21, 2009. Announcing the exposure draft, IASB Chair Tweedie stated that “in response to exceptional circumstances, IASB amended accounting standards relating to the reclassification of financial instruments. Issuing that amendment without normal due process always carried the risk of unintended consequences, and these proposals seek to clarify the application of that amendment to embedded derivatives.”

- *Considering fully other issues related to financial instruments including the fair value option, raised at FASB and IASB roundtables.* Roundtable participants supported reconsideration of the fair value option concurrent with a broader reconsideration of the classifications categories. Almost all financial statement users indicated that allowing reclassification out of the fair value option now, without proper consideration of all the issues, would not improve financial reporting or enhance investor confidence. Reclassifications out of the fair value option would permit losses to be hidden. The IASB and FASB find these views compelling and believe any changes in the fair value option should be made only as part of a broader examination of accounting for financial instruments.

Indeed participants indicated an urgent need for a broader examination of the role of fair value measurement for financial instruments, including the issues of improving the impairment requirements, classification issues, the fair value option, and transfers between the categories. The IASB and FASB will fast track the urgent project and aim to complete their work in a matter of months.

Regarding the latter issue, in a December 17 letter to the European Commission, IASB Chair Tweedie further explained that both the IASB and FASB believe that the IFRS and U.S. GAAP standards on the fair value option already provide a level playing field. Any unilateral action would decrease comparability and create divergence. Such a move would be in direct contrast to the approach recommended by the G20.

Commenting on the exposure draft, Tweedie stated the following:

We continue to act swiftly in dealing with accounting issues that have arisen as a result of the crisis. Enhanced disclosures for investments in debt instruments will provide greater transparency and help to regain investors' confidence in the financial markets. In line with our commitment to seeking global solutions to a global crisis the FASB will also be issuing similar proposals.

Gavin Hinks reported that the IASB moved quickly to propose changes in areas “demanded” by the

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G20 as a way of tackling the credit crisis.⁴⁸ He concluded that the board met its Christmas deadline for moving on issues surrounding impairment, embedded derivatives, and differences in accounting for securities investments between the IFRS and U.S. GAAP. Hinks further highlighted that the IASB had not announced immediate changes as the board had in October for the reclassification of assets. The board alternatively opened proposals up for consultation through January 2009. Regarding the differences issue, the IASB only offered assurance that changes would soon be forthcoming from FASB that should resolve the issue.

Hinks explained that it is uncertain whether IASB proposals will satisfy key G20 members, including the French who pushed for sweeping changes in IAS 39 so that most financial assets would no longer be subject to fair value accounting. Hinks further explained the following:

There had been speculation that the IASB, working with the US standard setter FASB, would not be able to meet the Christmas deadline. Some sources had even suggested the IASB might be reluctant to comply because it felt it must reiterate its independence from heads of state.

Some regret exists at the IASB, especially with chairman Tweedie, that it felt compelled to make the reclassification changes to appease certain European states, notably the French. The reclassifications are regarded as poor accounting at the IASB.

CONCLUSION

IASB Chair Tweedie commented on the work completed by the board during December 2008 in response to the credit crisis, stating the following:

The IASB continues to move quickly to address financial reporting issues highlighted by the global economic crisis. G20 leaders have called for a globally coordinated response. We are committed to developing globally consistent approaches with our colleagues at the US FASB in order to serve the interests of investors and other users of financial information. We will act as speedily as possible, consistent with robust due process, to ensure the outcomes are themselves robust and well respected.

With the SEC roadmap proposing that U.S. registrants move from U.S. GAAP to the IFRS in the not so distant future, the credit crisis clearly illustrates the need for high quality global accounting standards and “a level playing field.” However, the crisis also illustrates the tremendous threat to independent standard setting associated with political inference from, among others, national presidents, EC, and US Congress. If a global standard is to be achieved the European Union and United States must participate in due process but accept each IFRS exactly as issued by the IASB. Forthcoming efforts of the IASB and its partner FASB to address the credit crisis will provide insight into whether this is feasible and if the time has come to reassign accounting standard setting for U.S. companies from FASB to the IASB.

⁴⁸ Hinks, G. (2008). “IASB moves on key G20 demands: Standard setter opens up consultation on embedded derivatives and impairment,” *Accountancy Age* (December 22).

From Here to Adoption? Considerations in the U.S. Adoption Decision

EDITOR'S COMMENTARY

In this chapter we have selected two articles summarizing the views of global accounting firm CEOs and accounting thought leaders on adoption of the International Financial Reporting Standards (IFRS) in the United States. The articles, “Global Accounting Firm CEOs on Challenges—Transitioning From GAAP to IFRS, and More” (from *Financial Executive*) and “Buckle Up” (prepared by Deloitte), reflect that CEOs of the large international auditing firms unanimously support a global accounting standard and a U.S. move to the IFRS. They also highlight the importance of thinking ahead in order to achieve a smooth transition to the IFRS. When asked to share their views on the proposed SEC roadmap for IFRS adoption, accounting thought leaders provide mixed responses. Although most of these leaders are, in general, supportive of the move to the IFRS, some advise caution, noting that the needs of, among others, investors and private entities should not be overlooked in a U.S. transition to the IFRS. Educational challenges are also highlighted.

The choice to include a discussion of undergraduate IFRS education in a book for practitioners and entities may seem odd. However, legitimate practical reasons exist that practitioners and entities with an interest in whether and when the United States adopts the IFRS should be concerned with what is (or is not) happening in the classroom. As noted previously, one of the key milestones in the SEC roadmap to IFRS adoption is ensuring that IFRS education is available to accounting students. The SEC will evaluate progress against this and other milestones in 2011, so the IFRS-readiness (or lack thereof) of the class of 2011 accounting program graduates could have a real and direct impact on the timing of a United States move to the IFRS. The class of 2011 is comprised of third year accounting majors for the 2008-2009 academic year in progress at the time this book goes to press. Our observation is that at this time, despite the tremendous efforts of the large accounting firms, AICPA, International Association for Accounting Education and Research, American Accounting Association, and others to provide IFRS training materials and promote IFRS education, many students enrolled in upper level accounting courses at U.S. universities have minimal, if any, exposure to IFRS.

Even if the United States does not adopt IFRS in the near-term, those entering the accounting profession need to be IFRS-ready. For example, many U.S.-based accountants presently work for, or audit, U.S.-based subsidiaries of IFRS parents. U.S. accounting graduates need to know the global norm. Cognizant of the importance of IFRS knowledge for entry-level accountants, the AICPA Board of Examiners is assessing strategies to incorporate the IFRS into the Uniform CPA Examination.

According to AICPA Senior Vice President Arlene Thomas,

the CPA Exam includes content designed to test the knowledge and skills that need to be demonstrated by entry-level CPAs for the protection of the public interest. Many entry-level CPAs are using IFRS right now, and its use is growing in the profession; so the CPA Exam will include IFRS. Plans are currently underway to determine the proper timeline for integrating IFRS into the exam in phases over the next few years.

The exam includes content designed to test the knowledge and skills that need to be demonstrated by entry-level CPAs for the protection of the public interest. Key factors considered in making this determination include the relevance and importance of the IFRS to the work of entry-level CPAs, as well as the frequency with which entry-level CPAs will be required to use IFRS knowledge.

Many entry-level CPAs are using the IFRS right now, and growth in the acceptance of the IFRS in the professional and regulatory environment will necessitate that CPAs have knowledge of the IFRS and the ability to apply it in practice. Given this growth in the use of the IFRS, the CPA exam will eventually include questions about the IFRS.

The AICPA staff has begun a comprehensive study to fully assess the required changes to exam content specifications to reflect IFRS content and terminology. Because the new content will be gradually integrated into the exam, work is also underway to identify those integration phases and their corresponding timelines.

The SEC roadmap and the Financial Accounting Standards Board and International Accounting Standards Board convergence activities will significantly contribute to the timeline in which the IFRS will be integrated into the CPA exam. Although use of the IFRS is expected to grow, U.S. GAAP will continue to be used for some time, with the likely result that entry-level CPAs will need to be “bilingual” with respect to these accounting standards. This will require careful planning to ensure that appropriate proportions of IFRS and U.S. GAAP content appear in the exam, and that the proportions change over time as use of the IFRS continues to grow in the profession.

The chapter concludes with Deloitte’s “Buckle Up,” which contends that every company will eventually have to navigate the road to the IFRS and the only relevant questions are when and how to adopt. “Buckle Up” encourages companies to prepare now for a “smooth ride” on the road to IFRS. Otherwise companies risk having a “roller coaster” or “train wreck” experience. We particularly encourage readers to consider the “Buckle Up” section on “Where the Rubber Meets the Road.” Here Deloitte highlights seven areas where important differences between the IFRS and U.S. GAAP can “trigger far reaching changes” for U.S. companies converting to the IFRS.

Global Accounting Firm CEOs on Challenges—Transitioning From GAAP to IFRS, and More

By Ellen M. Heffes, Financial Executive

May, 2008

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CEOs of major accounting firms (alphabetically) respond to this question: *What major challenges do you envision within the next 3 to 5 years—for both your clients and your firm—related to financial reporting, auditing and likely moving from U.S. generally accepted accounting principles (U.S. GAAP) to International Financial Reporting Standards (IFRS)? How can these challenges be overcome?*

TIMOTHY P. FLYNN, CHAIRMAN, KPMG INTERNATIONAL

The question about whether the world is going to operate under global standards is no longer “if,” but “when.”

U.S. multinational companies must think about converting to IFRS from two perspectives. First, from a regulatory perspective, by ensuring they are prepared to respond to any regulatory mandate to adopt IFRS. Second, from a competitive perspective, with the global IFRS conversion already underway, U.S. companies must consider whether to convert earlier than required to ensure comparability and competitiveness with peer global companies using IFRS. Thus, IFRS adoption, by at least some U.S. companies, appears equally certain.

Conversion from U.S. GAAP to IFRS will be much more than an accounting exercise—it will be a massive undertaking. Accountants will need to be trained to understand the implications of the new reporting standards and how they affect the preparation of their financial statements. Academia will need to adapt its curricula to reflect the move to IFRS. Most importantly, investors must be able to comprehend the new financial reporting product that will result.

Moving to IFRS will impact more than accounting and reporting; it will affect a company’s business, systems and processes and people. Companies will need to assess business implications such as contractual terms, risk management practices, treasury operations and even management compensation metrics. Systems and processes related to data collection and

financial reporting controls must be evaluated and revised so that IFRS becomes ingrained in companies’ processes.

The availability of IFRS-trained professionals will be a critical success factor. Companies will need to train employees in the finance function regarding new accounting policies and procedures, and prepare them to operate in an environment where there will be less detailed application guidance and fewer “bright lines.” In many cases, hiring will be necessary to bring in additional employees with the requisite skills and temporary workers and service providers may be needed to help complete the conversion.

Audit firms similarly will be challenged to develop IFRS-related skills to help ensure both compliance and transparency. At KPMG, we have developed a strong cadre of experienced audit, tax and advisory professionals who have assisted our global clients with their conversions to IFRS and have audited their IFRS financial statements. We are leveraging their skills to help educate and support our U.S.-based clients, and to train other professionals within our firm. We’re also committed to educating the auditors and CFOs of tomorrow, and recently held a webcast to familiarize business and accounting professors with IFRS and the issues around conversion.

Finally, communications to key stakeholders will be fundamental to a company’s successful conversion—including employees, board and audit committee members, investors, analysts, creditors, customers and suppliers. And, throughout the process, there needs to be ongoing communication with the external auditor.

Global Accounting Firm CEOs on Challenges—Transitioning From GAAP to IFRS, and More

Conversion from U.S. GAAP to IFRS will be a complex endeavor, but one that I believe will be worthwhile for both companies and investors. At KPMG, we look forward to playing a major role in working with the profession to ensure a well-managed transition.

DENNIS NALLY, CHAIRMAN AND SENIOR PARTNER, PRICEWATERHOUSECOOPERS, LLP

IFRS is fast becoming the de facto reporting standard around the world. Already, 100 countries allow—or even require—that companies use IFRS in preparing financial statements. The U.S. must quickly follow suit. Doing so will ensure that U.S. issuers will be better able to compete for capital with non-U.S. companies in capital markets around the world.

There are other benefits as well. Embracing a single set of global accounting standards will contribute to a higher degree of investor understanding and confidence than currently exists. Costs will also drop, as companies will not need to prepare two sets of financial statements—one for the U.S. and one for other capital markets—or continually reconcile and explain the differences between reporting the same economic performance under two standards.

For companies, complexity is reduced by having a single set of standards that can be applied from one situation to another, either domestically or internationally. Yet, with all its many appealing features, IFRS won't be successful if we don't take steps to make it work the same way in the U.S. as it works in the rest of the world.

That means embracing the most critical feature of IFRS—its focus on principles instead of on detailed rules. With fewer rules to follow, IFRS lets accountants and auditors do what they are hired to do: exercise professional judgment in accordance with principles. For this to work, the legal and regulatory authorities in the U.S. must allow auditors to exercise reasonable professional judgments that are not subject to excessive second-guessing or, even worse, to litigation.

If the rules and requirements of the U.S. financial reporting system are not changed to respect making reasonable professional judgments around principles,

it will undermine a core foundation of IFRS, and financial reporting in the U.S. will be out of step with the rest of the world. That is hardly an ideal position for the U.S. to be in if it wishes to lead on changes that will come, as international standards converge in other areas.

American businesses, regulators and policy-makers can no longer decide on their own what international standards will be. Rather, we must collaborate to meaningfully influence the development of international standards, rules and principles. In doing so, we will not only be helping to select the criteria that will define business success; we will also be proving to the world that the outlook of American business is truly international.

EDWARD E. NUSBAUM, CEO, GRANT THORNTON LLP

The first and most significant challenge that companies are dealing with, and will be dealing with in the future, is the current volatility in the U.S. economy. Over the last several years, companies have been operating in a favorable economy. Now, as we are on the cusp of a recession, companies will have to learn how to operate in difficult economic times. Management may be faced with the possibility of lower earnings and asset values, as well as tight credit. Consequently, fair value measurements will become more relevant. Our firm and clients will have to be well versed in fair value accounting, including valuation techniques. Financial statement users will look closely at fair value measurement disclosures to assess the reliability of those measurements. Our firm, as well as others, will be more focused on auditing fair value measurements.

The second major challenge will be the training involved with IFRS adoption. As businesses and the financial markets become more globalized, there will be a need for a single set of global accounting standards. With more than 100 countries using IFRS and a more favorable view of IFRS by the SEC, it is inevitable that IFRS will be accepted globally. The implications of the worldwide use of IFRS are momentous: nearly every accountant, foreign and domestic, will have to be retrained on the differences between local GAAP and IFRS—accountants in all

global companies, accountants in our client companies, every auditor in our firm and all firms.

Generally, we have not seen IFRS training and its implications included in accounting curricula. Our firm, as well as others, should work with accounting professors to develop training for students and employees. Certainly, Grant Thornton is training our people on IFRS, but we face the same challenges as all firms do; namely, creating appropriate training and providing real-world experience with implementation. I believe we will see marked improvement in this area if the profession and the academics can collaborate to produce training and teaching materials.

A third very important challenge is the detection and deterrence of fraud. Due to the current investor climate, the expectation has grown that auditors will do more relative to the detection of fraud. Answering the question of how auditors can assist in reducing and minimizing the likelihood of fraud, while also increasing the likelihood of detecting it (through both internal controls and external audits), will take time, research and field experience. Firms will not only need to invest in research and training, but they will also have to participate actively with academics to move fraud detection into the basic curricula for accounting students.

All of these challenges are major, and I believe we are moving in the right direction.

BARRY SALZBERG, CEO, DELOITTE LLP

The movement toward IFRS represents a significant trend that will require both our clients and our professionals to prepare for a comprehensive change that is not solely about accounting and financial reporting.

A global accounting language has been a goal for many years. Associated benefits of a global standard include: better comparability of financial information globally across industries; greater transparency of financial information for investors; enhanced market efficiencies with improved access to foreign markets; and reduced cost and complexity in reporting.

Right now, IFRS is having a significant impact: over 100 countries already require IFRS for publicly listed companies. By 2011, we expect that most countries, including the U.S., will permit or require IFRS.

Before long, every company around the globe will have to develop proficiency in IFRS. In the U.S., finance professionals will need training to adapt to an accounting framework that focuses less on brightline rules and more on objectives, principles and judgment. This will require a major shift in mindset for companies and the financial reporting community.

IFRS may present different opportunities and challenges for companies, based on their size, industry and degree of complexity. Companies will need to assess the impact of IFRS to determine the most appropriate approach and timeline for transition, and should explore opportunities to simplify their reporting processes around the world. To help ensure that IFRS is applied in a globally-consistent manner, most multinational companies will need to modify their accounting policies, processes and systems. In many cases, U.S.-based companies are already dealing with IFRS reporting obligations at the subsidiary level, but may not realize the extent of their exposure—or the potential risks and opportunities therein.

As a global organization, Deloitte is ensuring that practitioners have all they need to help clients face this evolving reality. We have developed training programs to equip our professionals and clients with essential tools and capabilities. This effort not only demands technical accounting capability, but also the necessary tax knowledge, valuation skill and ability to evaluate processes and systems. Using a comprehensive IFRS methodology based on a holistic viewpoint, we are conducting assessments for clients to help determine what IFRS may mean for them in both the short- and long-term.

Education, including certifications that are relevant to IFRS reporting, presents another significant challenge. Deloitte is collaborating with academic institutions to develop programs that teach IFRS and address principles-based accounting for current and future finance professionals.

The adoption of IFRS is inevitable and challenging. Through timely and careful preparation, companies and the accounting profession can successfully adapt to this important standard and help facilitate benefits for investors, the capital markets and financial reporting in general.

Global Accounting Firm CEOs on Challenges—Transitioning From GAAP to IFRS, and More

**JAMES S. TURLEY, CHAIRMAN AND CEO,
ERNST & YOUNG LLP**

We believe that the world needs to adopt a single set of high-quality global accounting and financial reporting standards. By lining up behind a single set of standards—and we believe that IFRS should serve as that set of standards—the SEC would help companies achieve greater efficiency with fewer different reporting requirements across multiple jurisdictions and bring a new level of comparability for investors.

Change is never easy. We recognize that conversion from U.S. GAAP to IFRS would create challenges. Establishing a conversion date for U.S. companies would encourage companies, regulators, the accounting profession and educators to start the planning process and confront the significant legal, regulatory and other changes that would come with conversion.

There are legitimate concerns about the degree to which reasonable, good-faith judgments by preparers and auditors regarding the application of the international standards would be respected by regulators and the courts. IFRS provides fewer bright lines, as well as less interpretative and less industry-specific guidance than U.S. GAAP. In order for IFRS to be implemented successfully in the U.S., our regulatory and legal environments would need to better support professional judgments made by companies and auditors. We are encouraged by the recommen-

dations of the SEC Advisory Committee on Improvements to Financial Reporting with respect to professional judgment.

Education and training are critical. The sooner companies focus on preparing their people, the easier it will be to convert. Fortunately, tax and accounting professionals know that ongoing training and education come with the territory. That said, there is no amount of classroom learning that can make up for on-the-job training and practical experience once conversion becomes reality.

The differences between U.S. GAAP and IFRS should not be underestimated. Although the two standard-setters have pursued a convergence agenda for several years—and progress has been made to narrow differences—many remain. Some differences are well known and significant, while others are less obvious but may nonetheless have a significant financial statement effect, given a company's particular circumstances. When conversion becomes reality—and we believe it will—companies will need to plan carefully.

While there will be challenges presented by a conversion to IFRS, they are outweighed by the benefits. In today's global market, differing accounting standards exact a price. Common standards provide a foundation for capital market activity that promotes investment and strengthens economies. As global markets increasingly affect one another, the need for consistent global standards is more and more clear.

Buckle Up: On the Road to IFRS

By Deloitte

September, 2008

HERE WE GO. AGAIN.

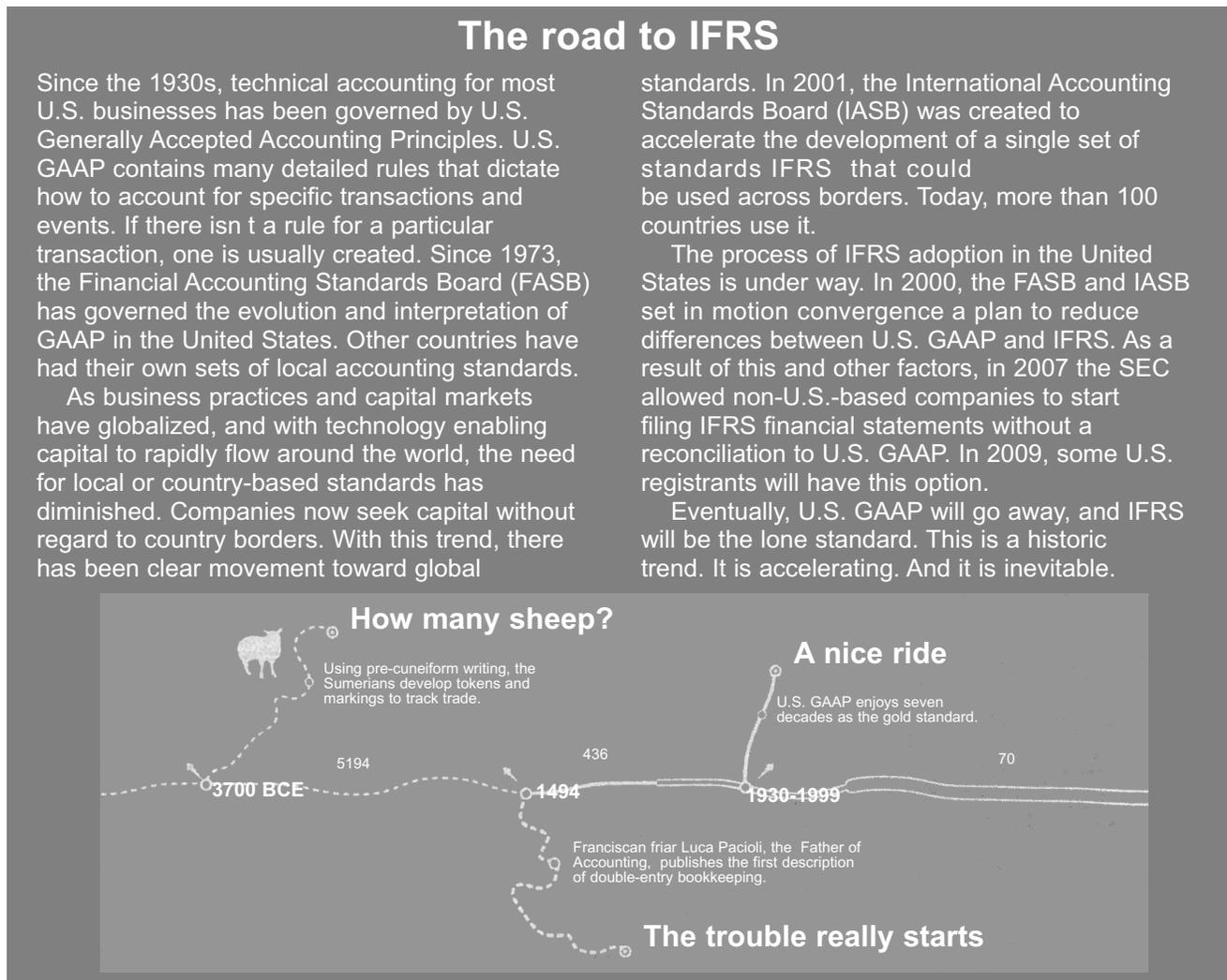
In case you haven't noticed, finance and accounting are about to get a makeover. This time it's International Financial Reporting Standards (IFRS). And it's a big deal.

More than 100 countries, including those in the European Union and parts of Asia and Latin America, have already adopted IFRS. More than 7,000 companies are on board in Europe alone. By 2009, some

public companies in the United States will have the option of IFRS reporting. Mandatory use of IFRS is likely to begin in 2014.

For many U.S. companies, early conversion to IFRS has appeal. Simplified reporting. Reduced operating costs. Greater transparency and comparability for investors. Improved access to capital. Plus some companies see their competitors already embracing IFRS. That's why momentum toward IFRS adoption has been steadily building, even before it's required.

FIGURE 21-1



Buckle Up: On the Road to IFRS

Today's decisions will determine the direction and speed of your transition. You can make it a smooth ride, a roller coaster, or a train wreck. The choice is yours.

TO ADOPT OR NOT TO ADOPT? THAT IS NOT THE QUESTION.

Converting to IFRS is one decision you won't have to make. Every company will eventually be going on this ride. The questions are when and how.

This might feel eerily familiar. Over the past decade, many companies have traveled the Y2K and Sarbanes-Oxley roads. Those experiences offer lessons you'll be able to use with IFRS, but there are important differences, too. For one thing, IFRS is

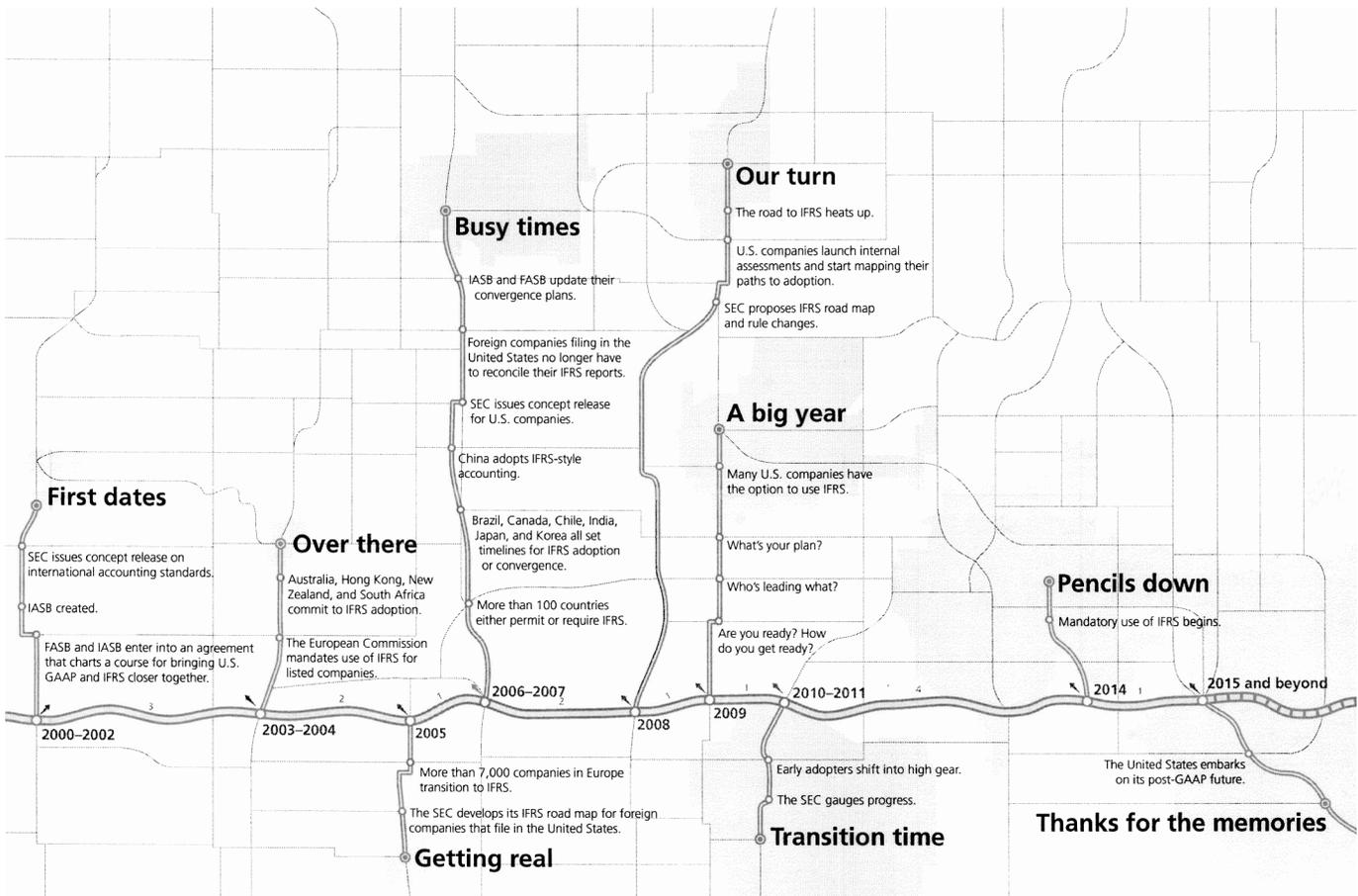
being driven by the globalization of capital markets. Not just by government policy.

This is a unique challenge. If you act as though you've done it all before, you'll run the risk of underplanning and missing opportunities. And if you think convergence will solve this problem, think again.

Important decision points are coming up faster than you may think. Do you want to get ahead of the crunch and ensure a smooth, orderly process? Do you want to move among the early adopters to realize potential benefits before your competitors?

Every business will have a different outlook on IFRS, but no matter what your approach, know this: The full transition will take a well planned effort, requiring leadership and vision. For many companies, it will take at least three years.

FIGURE 21-2



WHAT HAS TO CHANGE?

Taking your organization from U.S. GAAP to IFRS will require managing change in multiple areas: technical accounting and tax, internal controls and processes, management and statutory reporting, technology infrastructure, and organizational issues. They're all interconnected, which makes things a bit more complicated than you might imagine.

Your finance organization may become IFRS Central for a while, as others tap into your team's expertise, but this change is bigger than accounting. In fact, IFRS will expand your finance team's communication, coordination, and relationships. That makes it both an opportunity—and a potential headache.

Compared to U.S. GAAP, IFRS relies more on general principles than detailed rules and bright lines. This means your finance people will end up working much more closely with others in the organization to make judgments about accounting based on the underlying economics of transactions.

A flurry of operational changes could be triggered by IFRS as well. You may have to reexamine contracts and debt agreements, treasury policies, employee benefits, education and training, and communications. You may also have opportunities to centralize statutory accounting functions into shared service centers. You may even need to revisit decisions about offshoring, outsourcing, and tax planning.

IFRS will also stretch the CFO's job description with new kinds of decisions, new ways of thinking, and plenty of outreach. There's a good chance your colleagues (and board members) don't know a lot about IFRS. You'll have to inform them—and cultivate their support to make it work.

WHERE THE RUBBER MEETS THE ROAD

IFRS isn't completely different from U.S. GAAP. After all, it's still accounting. But a lot of important things are different, and each can trigger far-reaching changes. Here are some of the key things to look out for—and what CFOs need to do about them.

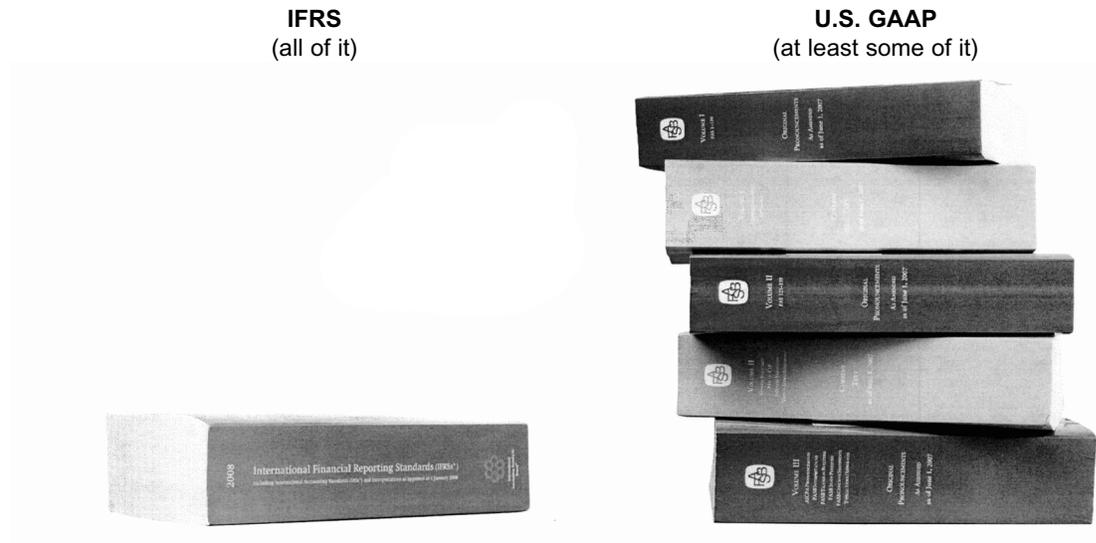
The topic	The change	The implication
Meet that long-lost relative	Consolidation policy. Entities are consolidated based on assessing risks and rewards, as well as governance and decision-making activities.	More entities may be consolidated. Entities that may need to be assessed for consolidation include those where there is a significant equity investment, such as joint ventures, special purpose entities, and franchisees.
Are you afraid of commitment?	Provisions. Under IFRS, a liability is recognized when an entity has a demonstrable commitment—a different standard from under U.S. GAAP.	Liabilities will be recognized and measured differently. Examples include restructuring charges, onerous contracts, uncertain tax provisions, litigation, and asset retirement obligations.
Recognizing the unrecognizable	R&D. Internal costs to develop a product must now be capitalized.	Development costs will be deferred and amortized. Entities will need to identify and track costs that should be capitalized as assets, assign useful lives, amortize the assets, and evaluate them for impairment.

(continued)

Buckle Up: On the Road to IFRS

The topic	The change	The implication
Is the price right?	Asset impairment. Impairments are recognized based on an asset's recoverable amount—the higher of its fair value and value-in-use.	Impairment charges will be recognized earlier and measured differently. They are also required to be reversed if the conditions that led to the impairment no longer exist.
Is the value fair?	Financial instruments. Fair value measurements may be different and are not always based on exit value. Assets are derecognized based primarily on an assessment of risks and rewards. The debt and equity components of contracts are required to be separated.	Financial assets and liabilities will be measured differently. It will be more difficult to derecognize financial assets because qualified special purpose entities no longer matter. Instruments with debt and equity elements will be accounted for differently.
Depreciation isn't simple anymore	Property. Assets are depreciated on a component basis, and an asset's residual value is revalued each period. There is also an option to revalue property.	The computation of depreciation will be more complicated. Also, the measurement of an asset may be different.
What is 2 + 2?	Less guidance. IFRS is less reliant on bright lines and detailed rules than U.S. GAAP.	CFOs will need to focus more on the economics underlying transactions and events. This will eliminate accounting arbitrage and result in more judgment in applying standards. Examples of areas where more judgment is required include financial statement presentation, property, leases, revenue recognition, consolidation policy, provisions, intangibles, and financial instruments.

FIGURE 21-3



PUTTING PRINCIPLES INTO ACTION

This won't be easy. Implementing IFRS calls for more complex decisions—and you'll need clear processes for managing them. That will require a judgment framework.

In 2008, the SEC's Committee on Improvements to Financial Reporting (CIFR) issued its final recommendations, including the need for a framework for making financial reporting judgments under IFRS.

Does that mean more work for you? Probably. Different work? Definitely. You'll still focus on areas like transaction analysis, accounting research, and decision making—but you'll find that each area demands a different allocation of your time.

Consider creating a project management office to begin developing your own framework for how judg-

ments will be made. Start with good guidelines. Identify the people who will be responsible for applying them. Then educate your professionals on the company's approach. That will make it easier to understand and trust the judgments made when it's time to sign your name.

Before you go

- Get clear about how IFRS and U.S. GAAP differ. Determine the level of effort required to address the differences.
- Evaluate the impact on accounting policy. Some areas of accounting will require new policies due to clear differences in standards. In other areas, there may or may not be differences, depending on the choices you make.

Buckle Up: On the Road to IFRS

FIGURE 21-4

The judgments you'll make

Judgment area	What it means for you
Transaction analysis CIFR recommended analyzing the business purpose and substance of transactions, and considering all available material facts.	<ul style="list-style-type: none"> ¥ New need to document processes ¥ Economic substance is paramount and often involves considerations beyond accounting ¥ Documentation should be contemporaneous
Accounting research CIFR recommended that all relevant accounting research be identified and alternatives be considered based upon investor needs.	<ul style="list-style-type: none"> ¥ White papers will be needed to document the assessment ¥ Increased sensitive to diversity in practice
Decision making CIFR recommended seeking input from multiple individuals with expertise and emphasized the importance of consistent application of accounting judgments based upon reliable assumptions and estimates.	<ul style="list-style-type: none"> ¥ The review process should include non-accounting professionals ¥ Increased emphasis on the appropriateness of assumptions ¥ Increased emphasis on disclosure

The time you'll take

U.S. GAAP		
Transaction analysis	Accounting research	Decision making
IFRS		
Transaction analysis	Accounting research	Decision making

WHAT ABOUT TAX?

When it comes to planning for IFRS, the long-term benefits should be balanced with near-term risk mitigation. Understanding the conversion issues affecting income tax accounting, such as the impact on the effective tax rate and cash taxes, is critical. Do it right, and you could fund your transition.

Differences in accounting for income taxes in areas such as share-based compensation, currency fluctuations for foreign subsidiaries, and intercompany sales could influence your effective tax rate. And just when you thought you had a handle on accounting for income tax uncertainties under U.S. GAAP, accounting under IFRS may result in adjustments to reserve balances that could affect your bottom line.

It may seem that differences in accounting for goodwill, consolidation requirements, or debt/equity classification (for starters) have little to do with accounting for income taxes. Yet they may affect your tax rate and repatriation plans. Planning now for the global tax impact of IFRS will likely put your organization in a more favorable tax position in the future.

You may be thinking: "Surely a change in book reporting won't affect my taxable income as determined by local law." It depends. Some countries rely mostly on book income as the tax base. Others, such as the United States, have more complex rules and offer many alternative tax accounting methods. Regardless, beware of the potential to pay more tax should profits increase under IFRS. Avoid over-

paying by adopting the most advantageous tax accounting methods.

And don't forget tax returns. Different countries are moving to IFRS at different times. Even with IFRS in place, many jurisdictions will require a local version of GAAP for tax compliance. The challenge of dealing with myriad global tax regimes isn't going away soon.

Before you go

- Make sure you understand the changing tax issues and how you can capitalize on them. Be prepared for scenario planning and modeling.
- Keep an eye on the long term—but don't neglect near-term risk. Errors can be costly.
- Include the Chief Tax Officer as part of the transition team.

THE BLACK BOX

Many of the benefits of IFRS center on statutory reporting. That means you could soon have a chance to streamline, simplify, and centralize an often cumbersome process.

Statutory reporting isn't a very transparent process in most companies. It's often performed remotely, once a year, in an operational black box. And because it's not done consistently across the globe, it can be harder than you think to know all the resources and standards that are used. IFRS provides an opportunity to shine a light into that black box and make it more efficient.

Your statutory reports are a great place to begin working IFRS into your system. Many companies already report under IFRS for various statutory locations—some because they have to, and some because they can. Monitoring and expanding this practice to bring your statutory reports in line with IFRS, where possible, can increase your readiness and help iron out reporting problems before you take on a consolidated conversion down the road. It also avoids potential issues with subsidiaries that are already reporting under IFRS but aren't applying it consistently.

Consider establishing regional centers for IFRS reporting. In the past, shared service centers focused

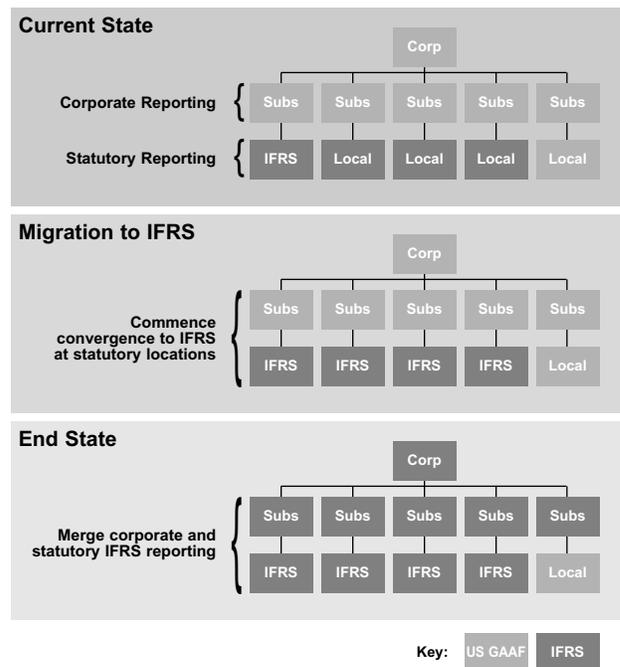
more on transaction processing because statutory reporting varied so widely from country to country. But with IFRS, you should be able to use shared service centers to consolidate operations, drive cost savings, and improve controls.

Before you go

- Inventory your current IFRS reporting requirements and locations.
- Identify resources within your organization to assist in the IFRS effort.
- Assess how consistently IFRS accounting policies are applied at all IFRS reporting locations.

FIGURE 21-5

The connection between statutory reporting and consolidated reporting under IFRS



Today your statutory locations may use a variety of standards either IFRS or the GAAPs of local jurisdictions. If you align these locations with IFRS first, they can be valuable test beds for using the new standard. The end-state vision is a consistent basis of reporting for consolidated and statutory purposes.

Buckle Up: On the Road to IFRS**WATCH YOUR STEP**

Many companies that adopted IFRS in Europe learned systems lessons the hard way. They chose to put a basic IFRS framework in place without thinking through transaction-level details. Now they're paying the price. Their systems can't deliver the detailed information required by regulators. They are trapped in a swirl of spreadsheet workarounds to deliver information that should have been automated.

A more effective approach anticipates the need for transaction details while building out high-level systems. That doesn't mean you take on a gigantic enterprise program all at once. Begin instead with an impact assessment and a piloted rollout.

IFRS could require adjustments to financial reporting systems, existing interfaces, and underlying databases to incorporate specific data to support IFRS reporting. Here are the big impacts:

- *Upstream systems.* Additional reporting requirements in areas such as taxes, financial instruments, and fixed assets.
- *General ledger.* Changes to the chart of accounts. During transition, general ledger reporting will likely need to accommodate ledgers for both U.S. GAAP and IFRS.
- *Reporting data warehouse.* Changes in data models, such as valuation systems and actuarial models.
- *Downstream reporting.* Changes to the number of consolidated entities, mapping structures, and financial statement reporting formats.

Plan on needing several years to work through the issues. If you take shortcuts, your ability to maximize value and mitigate risk could be compromised—and you probably won't end up with a sustainable solution.

Before you go

- Assess the impact of IFRS on your technical infrastructure. Front-end systems, general ledgers, sub-ledgers, and reporting applications may need to be evaluated.
- Identify the impact on current system projects. As new projects are planned, take time to align requirements with the likely impact of IFRS.

THE MORE THINGS CHANGE

One of the trickiest things about adopting IFRS is the way changes in one area can affect work in other areas.

Let's say you're in the middle of a new systems implementation that will take several years to complete. If you don't plan ahead, you may find yourself with a system that's not configured for IFRS adoption. That's likely to be true for any business transformation project.

The same can be said of big organizational changes. Companies are constantly fine-tuning their structures. Factoring IFRS into your improvement plans is important to prepare for the future of finance. Even new contracts, such as debt agreements and leases, should be evaluated in light of IFRS.

There will be new processes required, too, as well as solid controls. For example, you'll need to manage the reversal of impairment reserves and the segregation and capitalization of development costs. Your planning, forecasting, and budgeting systems will need to reflect IFRS reporting. If you have regulatory reporting requirements, those may change too.

You can't and shouldn't stop everything to get your IFRS house in order. But if you have large initiatives in progress that will be affected by the conversion to IFRS, try to get things aligned sooner rather than later. That's one of the big lessons learned during the European IFRS experience. Understanding the systems interactions and dependencies helps all the moving parts work together better.

DRIVERS AND PASSENGERS

The conversion to IFRS could knock some of your people out of their comfort zones. That's not something you should leave to chance.

For CFOs, the challenge is two-fold. You have to realign your talent and organization to suit the new reality, and you have to keep people happy along the way. The first part requires that you ask the right questions. The second part will take good answers.

The right questions include: Do your people have the technical knowledge they need on IFRS? Do they have the skills and mindset to operate using

principles instead of rules? How can you retrain the ones who don't—and get the most from the ones who do? Will IFRS affect how your employees are compensated? If so, how?

Begin a formal assessment of—not a casual look at—the finance talent with IFRS skills already under your roof. Invest in training to position your people to excel as IFRS becomes a reality.

It's natural for people to be apprehensive about what IFRS is and what it will mean for them personally. To keep emotions in check, communicate early with colleagues above, alongside, and below you so they know what's happening. Help them remember that IFRS is not only a challenge, but also an opportunity for career enhancement. If they're informed, included, and prepared, they will feel ownership—and their personal commitment to success just might be contagious.

Your financial reporting function is going to depend more than ever on the judgment of individuals. That's something you can't easily teach. But you can foster, recognize, and reward it.

Before you go

- Identify stakeholder groups affected by IFRS. Assess their current level of understanding of what's ahead.
- Create a plan to address the training and communication requirements for each stakeholder group. Keep people informed through the entire journey. Take time to celebrate success.

SIGN HERE

Your IFRS journey will eventually lead to a certification on your desk—and a pen in your hand. It's all going to happen sooner than you think—and that means it's time to get going.

Begin your transition by fixing your starting point with a thorough assessment. Find out which IFRS or local GAAP requirements currently apply in the different jurisdictions where you report. Understand which specific differences between U.S. GAAP and IFRS will bring the most change—and risk—to your company.

Then develop an internal structure to manage the changes ahead. Involve senior executives who repre-

sent the functions that are most affected by IFRS, such as tax, IT, HR, and treasury. Be sure you're taking responsibility for educating your board and audit committee members. You might start by sharing this book with them.

With a structure and plan in place, you can begin to focus on the operational details of your conversion. If you've identified risks, how will you address them? How will your communication plan evolve from simply alerting people to preparing them for change?

Create an IFRS timeline that specifies when you'll begin organization-wide transition to IFRS reporting, when you'll actually file under IFRS, and all the stops along the way.

Targeted implementations in statutory locations can be a smart way to road-test the technology, process, and accounting policy changes that will come with IFRS. From there, you can move on to pilot conversions of whole subsidiaries in areas where IFRS is permitted or will soon be required.

You'll need plenty of runway. You'll have to provide comparative financials during conversion—and deal with all the systems, process, and organizational issues surrounding the transition. It will take time. And it will ultimately require your signature.

ARE WE THERE YET?

For many companies, IFRS is here today. For others, it's on the near horizon. It's coming—there's no question about that. And CFOs must decide how to get on top of the new requirements.

Before you do anything else, develop a road map of your IFRS opportunities and risks. That's a good way to lay a foundation for the transition plan you'll need going forward.

Then take a closer look at the changes IFRS implementation is going to require. Think ahead about how you'll engineer each of the changes, and what roadblocks you might encounter.

For you, IFRS is both a challenge and an opportunity—one that will take leadership, vision, and ambition.

For your organization, it's going to be an exciting ride. You're in the driver's seat. Make sure you know where you're going—and how you're going to get there.

Buckle Up: On the Road to IFRS

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Glossary

The following is a brief listing of terms and acronyms with a specific definition or relevance in the context of International Financial Reporting Standards (IFRS). This list is not comprehensive and does not attempt to fully address accounting terms generally applicable outside the context the IFRS.

adoption In this context, refers to the transition by a jurisdiction from another set of accounting standards to the IFRS.

conceptual framework A theoretical structure that underlies the standard setting process and use of technical rules in accounting. The International Accounting Standards Board's (IASB's) framework was published in 1989 and draws on the U.S. framework prepared by the Financial Accounting Standards Board (FASB) in the 1970s. Currently the IASB and FASB are working on the development of revised joint framework.

convergence Term used to refer to the process by which standard setters from different jurisdictions work to bring their respective standards into alignment. Most commonly used in the United States to refer to the ongoing convergence project between the U.S. FASB and the IASB.

date of transition In the context of first-time adoption of the IFRS, the beginning of the first period for which full comparative information is presented. For example, if first adoption is for the calendar year ending December 31, 2013 and the company normally presents one prior year of full comparative information, the date of transition is January 1, 2012.

E.U.-endorsed IFRS Those standards and interpretations of the IASB that have been approved by the European Union and therefore are required for the preparation of the consolidated statements of E.U. listed companies.

Financial Accounting Standards Board (FASB) A U.S. entity charged with accounting standards setting for U.S. publicly listed companies.

FASB Accounting Standards Codification (ASC) At the time of publication, FASB is at work on a project to codify U.S. generally accepted accounting principles (GAAP) and certain relevant content issued by the Securities and Exchange Commission (SEC) into a single source. FASB ASC is currently scheduled to become the single authoritative source of U.S. accounting and reporting standards, other than guidance issued by the SEC, for nongovernmental entities on July 1, 2009.

first-time adoption In this context, refers to the first complete use by an entity of the IFRS for the presentation of its annual financial statements.

International Accounting Standards (IAS) The standards originally issued by the International Accounting Standards Committee. In some cases these standards have been updated by the IASB as part of the continuing development of the IFRS.

International Accounting Standards Board (IASB) The standard setting board of the International Accounting Standards Committee Foundation. The board has 12 full-time and 2 part-time members. It began work in 2001.

International Accounting Standards Committee (IASC) An organization, formed in 1973, whose purpose was to devise and promulgate IAS in order to reduce the variation of practices in financial reporting throughout the world. From 1973 to 2000, the IASC was controlled by the world's accountancy bodies. However, in 2001 an independent structure comprised of trustees and a board was established. See **International Accounting Standards Board (IASB)**.

International Accounting Standards Committee Foundation (IASCF) A trust set up in 2000 in order to take over standard setting from the IASC. The IASCF is legally registered in the United States. It is led by trustees; originally, there were 19 trustees, but, in 2005, the number of trustees was increased to 22. The IASCF's main operations are run by the IASB.

International Financial Reporting Interpretations Committee (IFRIC) A body set up by the IASB to issue interpretations of international standards. IFRIC replaced the Standing Interpretations Committee (SIC).

International Financial Reporting Standards (IFRS) Standards issued by the IASB. Former standards (IAS) issued by the IASC are still in force until withdrawn. The acronym IFRS when used in the plural includes all the applicable IFRS, IFRICs, IAS, and SIC interpretations.

memorandum of understanding (MOU) In the context of U.S. efforts to converge with the IFRS, the term generally refers to the 2002 agreement (updated in 2006 and 2008) between the U.S. FASB and the IASB. The 2002 version, frequently referred to as the Norwalk Agreement, formalized the commitment of FASB and the IASB to work jointly to minimize differences between, or converge, existing standards. Updated versions, respond to the SEC's indication that its decision on whether to require adoption of the IFRS will be influenced by FASB and the IASB working jointly to improve (as opposed to converging) standards where both boards' present standard is viewed as problematic. In other words, the MOU was evolved from a commitment to eliminate differences (that is, converge existing standards) to focus more strongly on joint improvements.

U.S. generally accepted accounting principles (GAAP) A technical accounting term that encompasses the conventions, rules, and procedures necessary to define accepted accounting practice in the United States at a particular time. It includes not only broad guidelines of general application, but also detailed practices and procedures. Those conventions, rules, and procedures provide a standard by which to measure financial presentations.

Note: At the time of publication, FASB is at work on a project to codify U.S. GAAP and certain relevant content issued by the SEC into a single source to be known as FASB ASC, which is currently scheduled to become the single authoritative source of U.S. accounting and reporting standards, other than guidance issued by the SEC, for nongovernmental entities on July 1, 2009.

Additional Resources

For more information on International Financial Reporting Standards (IFRS) visit these sites:

www.ifrs.com

IFRS related tools, information, and resources from the AICPA, with links to other sites and information; continuously updated.

www.iasplus.com

Developed by the accounting professionals at Deloitte, this site contains a wealth of IFRS information and tools.

www.fasb.org

The official Web site of the U.S. Financial Accounting Standards Board.

www.iasb.org

The official site of the International Accounting Standards Board (IASB). Contains downloadable summaries of the IFRS, exposure drafts, white papers, and extensive other resources; the official source for ordering IASB publications.

www.sec.gov

The official site of the U.S. Securities and Exchange Commission (SEC). Contains detailed information on the SEC roadmap and other SEC sanctioned convergence activity.

www.deloitte.com/ddt/section_node/0,1042,sid%253D177677,00.html

Information, tools and resources from the U.S. IFRS professionals at Deloitte.

[www.ey.com/global/content.nsf/us/aabs - Assurance - IFRS in U.S. - Overview](http://www.ey.com/global/content.nsf/us/aabs_-_Assurance_-_IFRS_in_U.S._-_Overview)

Information, tools and resources from the U.S. IFRS professionals at Ernst & Young

www.kpmgifrsinstitute.com

Information, education, tools, and resources from the IFRS professionals at KPMG.

www.pwc.com/ifrs

Information, tools, and resources from the IFRS professionals at PricewaterhouseCoopers.

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