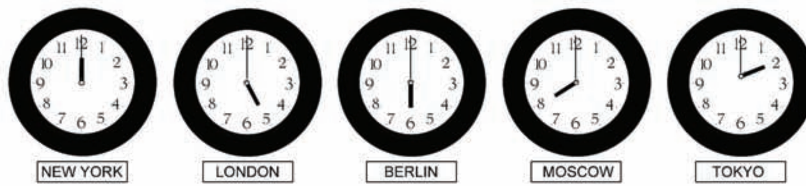
Deloitte.

IFRS: What should boards and audit committees be considering now?



Contents

3 Foreword by Jim Quigley

4 Where are we now?

5 What are U.S. companies doing today?

6 What should boards and audit committees be considering?
- Set the tone
- Focus on the process
- Understand the risks

9 Conclusion

10 Appendix - Issues Guide

This publication contains general information only, and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte and its affiliates and related entities shall not be responsible for any loss sustained by any person who relies on this publication.

Foreword by Jim Quigley

Audit committee members play a critical role in the effective functioning of the capital markets. Their oversight and experience assists company management teams to navigate rough waters, capitalize on opportunities, operate efficiently, and, of course, provide timely, reliable financial information to investors.

In an effort to support these important audit committee activities, and to help directors stay current, this publication provides guidance on an important emerging topic for audit committees: IFRS — International Financial Reporting Standards. This publication has two sections: (1) an overview of IFRS with considerations for the board and audit committee; and (2) an "issues guide" in the appendix, a tool that outlines a number of the technical accounting differences between U.S. Generally Accepted Accounting Principles (GAAP) and IFRS and provides some key questions to use in meetings with management.

Since 2005, when the European Union required European companies to use IFRS for financial reporting, the global trend has been towards adoption of IFRS and away from U.S. GAAP. Today, more than 40 percent of Global Fortune 500 companies use IFRS and by 2011 a clear majority will likely do so. The goal of a single set of high quality accounting standards has been envisioned for many years. The growing acceptance of IFRS brings that vision closer to reality. The Securities and Exchange Commission (SEC) has solicited comments on a proposed road map to adopt IFRS in the U.S. for all filers, but the SEC has not yet committed to a date certain for adoption. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) recently announced their continued commitment to convergence of U.S. GAAP and IFRS.

The benefits of global adoption of IFRS are significant for investors. Global adoption will create a common denominator from which regulators and supervisors can assess the operations of the entities and markets they oversee. It will permit investors to compare the financial position of companies across borders, potentially allowing investors to more efficiently allocate capital on a global basis. And for many global companies, global adoption will likely eliminate the need to keep multiple sets of books in order to comply with divergent accounting regimes and thus improve the quality of financial statements by reducing the risk of translation errors between different accounting standards.

Although converting to IFRS will present challenges, we believe it will be worth the effort. Capital markets do not function effectively without a solid foundation of trust and confidence. Comparable, transparent, and reliable financial reporting provides a fundamental pillar of trust that enables global markets to function more effectively, facilitating international investment, and stimulating the investments necessary for economic recovery.

We hope you find this compilation useful. Feel free to distribute it to your colleagues; if you need additional copies, contact your Deloitte professional, who would be happy to provide them.

As always, we value and welcome your comments and feedback.

Jim Quigley
Chief Executive Officer, Deloitte Touche Tohmatsu

IFRS: What should boards and audit committees be considering now?

Over the last several years, the world's capital markets have undergone tremendous expansion, diversification, and integration. Accompanying these changes has been a movement away from local financial reporting standards toward global standards.

Where are we now?

In 2002, the twenty-five member states of the European Union (EU) met and decided to require EU companies listed on EU exchanges to report under International Financial Reporting Standards (IFRS) beginning in 2005. Today, IFRS is used for public reporting in over 100 countries throughout the world. Other countries, namely Argentina, Brazil, Canada, Chile, India, Korea, and Mexico, will be following over the next couple of years. Japan also is weighing mandatory use in 2015. In addition, now or in the near future, many of these countries will permit or require the use of IFRS for local statutory purposes.

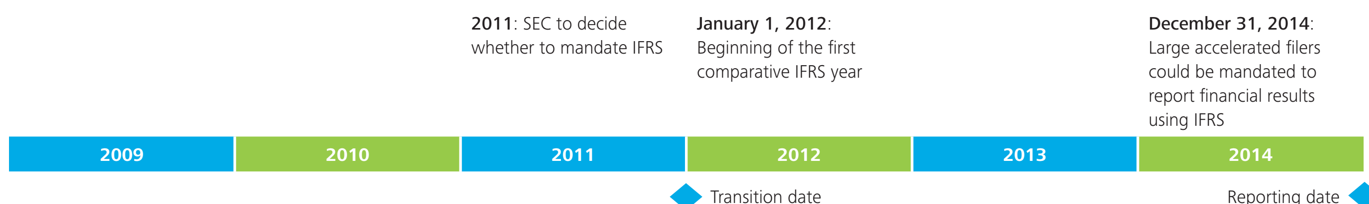
The movement toward IFRS has challenged regulators to revisit current public reporting requirements and the information needs of investors. In 2007, the U.S. Securities and Exchange Commission (SEC) began allowing foreign companies the ability to file IFRS financial statements in order to fulfill U.S. public reporting requirements. As a result, those foreign companies that file IFRS financial statements are no longer required to include a reconciliation to U.S. GAAP.

The discussion has now turned to the U.S. domestic environment. Last year the SEC issued for comment its "IFRS Roadmap," proposing an eventual adoption of IFRS beginning in 2014 for U.S. public companies. The IFRS Roadmap also included a proposal to permit certain U.S. issuers the option of using IFRS early.

The issuance of the SEC's IFRS Roadmap comes at a time when national governments are addressing issues relating to the global financial crisis. The leaders of the "Group of Twenty" countries (G-20) recently reiterated their desire for a single set of global standards in response to the current financial crisis.

In determining how to move forward with the proposed IFRS Roadmap, the SEC will likely consider recent developments related to the financial crisis, including the loss of confidence in the U.S. capital markets, the development of capital market alternatives outside the United States, and the impact on global competitiveness.

Representative U.S. Timeline, as proposed*



* Representative timeline of proposed SEC Roadmap for large accelerated filers (as proposed, IFRS required for accelerated filers in 2015 and non-accelerated filers in 2016)

The increasing use of IFRS around the world—and the likelihood that IFRS will eventually be required in the U.S.—is driving a growing number of U.S. companies to develop an IFRS transition strategy.

As U.S. executives await the SEC's next steps to follow up on the proposed IFRS Roadmap, many are preparing their organizations for change and mobilizing around IFRS planning and transition activities. Boards and audit committees have the important roles of overseeing the development of a comprehensive transition plan; helping to ensure that the potential risks surrounding conversion are being addressed; and helping to set the tone for an effective IFRS conversion.

What are U.S. companies doing today?

Many companies have undertaken assessment activities to identify areas of significant impact. According to a recent Deloitte survey,[1] 80% of financial executive respondents indicated that their companies are involved with an IFRS assessment: 40% are performing or have performed a high-level IFRS assessment, while another 40% plan to perform one. Survey results also indicate that 60% of companies that are performing or have performed a high-level IFRS assessment sought or are seeking external assistance. Approximately 40% are taking on the task themselves.

Given the broader implications that IFRS may have, company executives are finding the need to take a more holistic approach to those assessments. For example: tax structures may be affected as a result of IFRS being used by subsidiaries for statutory reporting purposes; changes in information technology infrastructure may be needed to address such areas as parallel reporting during the transition period; and agreements such as loans and leases may require revisions.

A high-level IFRS assessment generally includes the following activities:

- **Identifying the key impacts of IFRS throughout the organization** – This involves comprehensively analyzing the potential impacts of IFRS throughout the organization, focusing not only on accounting and systems impacts, but also on impacts in such areas as income taxes, sales contracts, loan agreements and employee compensation arrangements. Companies with global operations are already getting a taste of IFRS in countries in which their subsidiaries file IFRS financial statements for statutory purposes. For such companies, the assessment process should include determining which countries require IFRS for statutory reporting purposes, and assessing that the application of IFRS by subsidiaries in those countries is appropriate.

- **Determining project interdependencies and lead-times** – This involves mapping the necessary implementation actions and evaluating the time needed to complete such actions, considering the interrelationship among activities, both related and unrelated to IFRS. This also includes factoring IFRS into current or upcoming systems implementation projects.

- **Estimating resource needs** — Based on the outcome of the previous steps, an estimate of the time and resources needed to complete the implementation is developed.

The product of a well-executed IFRS assessment is typically a company-specific roadmap designed to enable an orderly migration to IFRS, while anticipating and mitigating risk, and facilitating greater value for the organization.

[1] "IFRS Survey Results 2009: Update on views and activities," Deloitte Development LLC, September 2009. Survey participants were self-selected, and responded through a web-based survey. Survey results are solely the thoughts and opinions of survey participants and are not necessarily representative of the total population of finance professionals.

What should boards and audit committees be considering?

Early and comprehensive oversight by the board and audit committee in the development of an IFRS implementation program can help ensure the program has the appropriate level of management's attention. It is essential that the board and its committees, along with management, begin to form the company's perspective on IFRS and begin discussions on the potential risks and benefits of IFRS. Through insightful discussion, members of the board and its committees (e.g., the audit committee and the compensation committee) can begin to coordinate themselves – become aligned with management – and determine the company's IFRS direction and strategy.

To begin to set expectations for the organization, the board and audit committee should consider the following:

- **Set the tone.** The board and audit committee may play leading roles in the prioritization of IFRS for the organization.

  Raising the following key questions with management now can help establish the proper "tone at the top":

  - **Has management aligned key stakeholders?** Establishing a steering committee of high-level executives representing the functional groups most affected by IFRS, who are empowered to allocate resources as needed, is an important element of achieving buy-in throughout the organization.
  - **What is management doing about communications?** Open and regular communication with internal and external constituents regarding the changes around IFRS may contribute positively to the perception of a company. Investors and analysts appreciate being kept informed.

– **What steps are being taken to educate the organization?** Generally, training that is timely and specific to individual needs yields the greatest benefit. If training is too general and too early, information learned may not be retained. Timely education for the board and its committees is also important. Building IFRS proficiency will enhance board members' ability to lead productive dialog and provide useful insights in IFRS planning discussions.

- **Focus on the process.** Both the board and audit committee members should focus early on in overseeing the company's approach, timeline, and budget for transition. The amount of time companies have to prepare may be less than many would expect, and a thoughtful approach to conversion can help to control costs. Encourage management to consider short- and long-term planning issues in determining what the company needs to do now versus later. Be mindful of opportunities in the IFRS conversion process that could translate into longer-term benefits.

  Key questions to consider raising with management include:

  – **Has a PMO been established?** A dedicated project management office provides a single point of coordination that can help companies adhere to a unified plan by: establishing milestones and monitoring performance against them; facilitating a globally consistent application of IFRS; fostering the creation of and deploying standard templates; and coordinating training activities.

  – **Is management taking a fresh look at policies?** IFRS provides an opportunity to refresh accounting policy implementation, with a focus on achieving greater transparency and more timely financial reporting. (See Appendix, "Issues Guide," for a more detailed view of key IFRS/U.S. GAAP differences.)

  – **Is the company monitoring evolving standards?** The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are working toward convergence of their standards.

There are currently several active projects, some of which may result in significant impacts. While a goal of the projects is to achieve full convergence, some differences may remain upon their completion. When a company adopts a new U.S. GAAP standard, it should also be considering the related IFRS standard, and addressing the impact of the differences that remain between the two standards. Management should also consider anticipated changes related to the convergence agenda—and incorporate those into any long-term plan.

  – **Will the company be ready by the transition date?** Under the SEC's proposed Roadmap, large accelerated filers would be required to file their 2014 financial statements using IFRS, along with comparative financial statements for 2013 and 2012. For such companies, this would mean an *adoption* date of December 31, 2014, with a *transition* date of January 1, 2012. To efficiently and properly transition to IFRS, it is advisable to run parallel IFRS and U.S. GAAP reporting, and this would mean finalizing the beginning balance sheet by the transition date.

  – **Is the independent auditor involved?** The early and continued involvement of the independent auditor can prevent future surprises and can provide management with a well-informed source of assistance that has a deep knowledge of the company.

Lessons from the European experience
U.S. companies have the advantage of learning from companies in countries, such as those in the European Union, that have already transitioned to IFRS. Consider these cautionary lessons (based on the observations and experiences of Deloitte professionals in the field) in an attempt to avoid common pitfalls and overcome challenges.

- **The effort was often underestimated** – The original misconception that conversion was solely an accounting issue was replaced with a growing realization that the initiative was larger and more complex.
- **Projects often lacked a holistic approach** – Because of the limited view cited above, companies frequently did not take the collateral effects into consideration, such as the impacts on information technology, human resources, and tax.
- **A late start often resulted in escalation of costs** – Those few companies that anticipated conversion and took steps to prepare for it were often in much better shape than those that did not. Companies that delayed their response often paid a price, in terms of higher costs and greater diversion of resources.
- **Many companies did not achieve "business as usual" state for IFRS reporting** – The highest quality financial data is obtained when companies fully integrate IFRS into their systems and processes. The compressed timeframes often precluded this possibility; instead, first-year financials were in many cases produced using extraordinary, labor intensive, and unsustainable measures.
- **Several companies are only now starting to explore benefits from IFRS implementation** – Due to multiple constraints, the first-year effort in the EU was focused more on "getting it done." Potential benefits in terms of reducing complexity, increasing efficiency, decreasing costs, and improving transparency had to be deferred.

- **Understand the risks –** Work with management to be aware of potential risks up front, including understanding the risk of waiting too long to develop a plan. Also, IFRS contains less detailed guidance than U.S. GAAP and therefore requires the use of more professional judgment. How will the board and audit committee address the risk that IFRS is applied consistently throughout the organization?

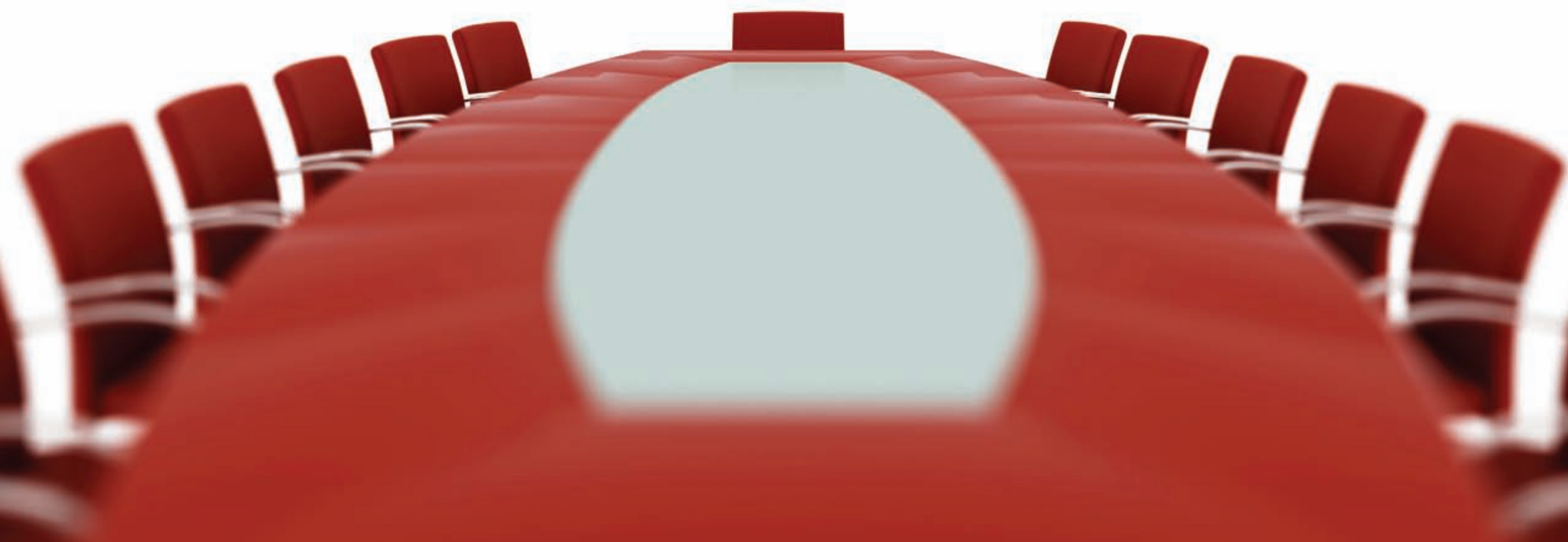
  Key questions to consider raising with management include:

  – **Is management preparing for an increased use of judgment?** In contrast with U.S. GAAP, IFRS has fewer bright-line rules, resulting in the need for the increased application of judgment. Depending on such factors as complexity and level of decentralization, a company may need to develop a framework for how judgments will be made, focusing on transaction analysis, accounting research, and decision making. With the increased use of judgment, it is also expected that the level of disclosure will increase. As IFRS policies are considered for adoption, it is important to understand whether management's policy selections may be overly aggressive or conservative, and how such selections stack up against peers in the industry.
  – **What is the company doing about statutory conversions?** Centrally managed IFRS implementations by subsidiaries should be considered to potentially avoid inefficiencies and inconsistencies when IFRS is adopted for consolidated reporting in the U.S.; to identify shared service opportunities; and to develop individuals whose IFRS experience can be leveraged in future conversion activities.
  – **What are the Sarbanes-Oxley (SOX) implications?** To guard against falling out of Sarbanes-Oxley compliance during the IFRS conversion process, as process changes are designed, it makes sense to consider the effects of such changes on existing internal controls.

Conclusion

With IFRS so clearly on the horizon, boards and audit committees should consider asking the key questions and engaging management now. Establishing processes for frequent updates and communications can help drive a sustainable plan going forward. Underestimating the planning involved—and the time required—for a change from U.S. GAAP to IFRS could prove risky. The board and audit committee can serve as a guiding force in positioning a company to achieve strategic, operational, and economic benefits from a transition to IFRS.

In the appendix, an "Issues Guide" is provided, outlining some of the key potential accounting differences between IFRS and U.S. GAAP, along with the related broader impacts of those differences, and presenting questions that board and audit committee members should consider asking as they help to guide their companies down the path of IFRS implementation.



Appendix – Issues Guide

11 **Inventory**

11 **Consolidation Policy**

12 **Financial Statement Presentation**

12 **Revenue**

13 **Business Combinations**

13 **Investments in Associates & Joint Ventures**

14 **Long-lived Assets**

14 **Asset Impairment**

15 **Intangible Assets**

15 **Leasing**

16 **Provisions and Contingencies**

16 **Income Taxes**

17 **Employee Benefits**

17 **Share-based Payments**

18 **Financial Instruments Presentation and Disclosure**

18 **Financial Instruments Recognition**

Inventory

General Requirements

- Primary standard – IAS 2
- Guidance addresses the recognition and measurement of inventory
- Alternatives for measuring the cost of inventory include FIFO and weighted average cost; "retail method" also is allowed if it approximates cost
- The same cost formula must be used for all inventory having a similar nature and use
- The subsequent measurement of inventory is based on the lower of cost or "net realizable value"
- NRV is the estimated selling price of the inventory in the ordinary course of business less the estimated costs of completion and of making the sale

Potential Differences from U.S. GAAP

- Use of LIFO as a measurement basis for inventory is prohibited under IFRS
- Inventory is required to be measured at the lower of cost or NRV, which may not be the same as a "market value"
- Same cost formula must be used for inventory of a similar nature
- Costs related to asset retirement obligations may be included as part of inventory cost basis, rather than property, plant and equipment (PP&E)
- Impairment charges on inventory are required to be reversed, if certain criteria are met

Implementation Considerations

- Data capture may be more or less detailed leading to possible inventory system changes
- Cost formulas for inventories whose nature and use are similar may need to be aligned throughout the entity
- NRV will need to be calculated and tracked
- Processes and controls will need to be developed for monitoring whether inventory impairment should be subsequently reversed
- Changes in the measurement basis of inventory may affect income taxes, particularly if LIFO currently is used as a measurement basis
- **Changes pending:** None

Key Questions to Ask

- Will the basis of inventory measurement change?
- What processes are in place to monitor the reversal of inventory impairment?
- Have tax implications been assessed relating to potential changes in accounting for inventory?
- Has the cost formula been adjusted to include capitalized inventory costs, such as those associated with asset retirement obligations?

Consolidation Policy

General Requirements

- Primary standard – IAS 27
- Key issue is determining whether "control" exists
- All controlled entities are required to be consolidated, with limited exceptions for certain nonpublic entities
- Control is the power to govern the financial and operating policies of an entity so as to obtain benefit from its activities
- Guidance provides a number of control "indicators" that focus on governance and decision-making activities, as well as economic factors such as benefits and risks
- Potential voting rights must be considered when assessing whether control exists
- Entities holding less than majority of voting rights may still consolidate under "de facto" control
- Guidance also included on the presentation of the parent's separate financial statements

Potential Differences from U.S. GAAP

- Overall consolidation approach is based on whether an entity controls another; applies to all types of entities regardless of legal structure
- There is no exception from consolidation for "investment companies"
- The accounting policies of all subsidiaries must be conformed to those used in consolidation
- The reporting dates of all subsidiaries must be conformed

Implementation Considerations

- Determining whether entities should be consolidated will require increased judgment
- Processes and controls will need to be developed for monitoring potential voting rights and whether they are currently exercisable or convertible
- Processes for the capture of financial data related to all controlled entities will need to be developed, and accounting policies and reporting dates will need to be conformed
- Changes in the reporting entity as a result of more or fewer entities consolidated may affect income taxes
- **Changes pending:** The IASB is currently working on a new consolidation standard, as part of a joint project with the FASB, which will revise the definition of control, include more application guidance, and require enhanced disclosures. In addition, the FASB issued guidance (Statement 167) in June 2009 to improve the financial reporting for variable interest entities.

Key Questions to Ask

- Will more or fewer entities be consolidated, and how will that affect existing transactions between or among entities within the consolidated group?
- What processes are in place for making judgments about consolidation policy?
- Do the reporting dates or accounting policies of any entities within the consolidated group differ?
- Are the current information systems capable of capturing the information needed to reflect changes in the reporting entity?

Financial Statement Presentation

General Requirements

- Primary standards – IAS 1, IAS 7, IAS 8, IAS 10, IAS 24, IAS 33, IAS 34, IFRS 5, IFRS 8
- Guidance addresses the basic form and content of financial statements and includes general considerations such as fair presentation, going concern, accrual accounting, consistency of presentation, materiality and offsetting
- Financial statement components include a statement of financial position, statement of comprehensive income, statement of changes in equity, statement of cash flows, and notes to the financial statements
- May have a "condensed" presentation for interim reporting
- Certain disclosures are required for public companies (e.g., EPS, segments)
- No specific industry guidance

Potential Differences from U.S. GAAP

- Format and structure of the financial statements; may present alternative performance measures; no "extraordinary items" in the statement of comprehensive income; classification of expenses may be based on function or nature
- Cash-flow classification of interest, dividends, income taxes and bank overdrafts; disclosure of discontinued operations by category
- Level and nature of disclosure in the notes to the financial statements; more of a focus on judgments made and assumptions used
- Events occurring after the reporting period do not affect classifications as of the end of the reporting period (i.e., refinancing of bank loans or debt covenant waivers)
- Narrower definition of a discontinued operation

Implementation Considerations

- Data capture may be more or less detailed, which could lead to changes in the chart of accounts
- The process around monitoring debt covenants or calculating EPS may need to be revisited
- Disposals may result in more or less discontinued operations
- Management reporting may change as a result of different financial statement formats and the use of alternative performance measures
- Communication with investors may be affected as financial statement formats; questions may be asked about accounting differences and how general principles were applied
- **Changes pending:** There is an IASB/FASB joint project to develop a comprehensive standard for the organization and presentation of information in the financial statements with an emphasis on presentation of a cohesive picture of an entity's operations and enhanced cash flow information to assess liquidity and financial flexibility. An exposure draft is expected in early 2010 with a final standard in 2011. The boards also have a joint project to develop a comment definition of a discontinued operation, which is expected to be finalized by early 2010.

Key Questions to Ask

- How would the presentation format change?
- What is the potential impact on EPS?
- What are the key performance measures and how will they change?
- How do the presentation formats compare with those of others in the industry?
- Is a communication strategy in place to address reporting under IFRS?

Revenue

General Requirements

- Primary standards – IAS 11, IAS 18
- Guidance addresses general principles related to revenue from the sale of goods and services; little detailed guidance; also addresses revenue from interest, royalties and dividends
- A key issue is understanding the "unit of account" (i.e., combining and segmenting contracts, multiple element arrangements)
- Principles relating to the sale of goods focus on the transfer of "risks and rewards" and "control" over the goods
- Revenue from the sale of services is recognized based on the "percentage of completion"
- Emphasis on fair-value measurement of the consideration received

Potential Differences from U.S. GAAP

- Overall level of guidance is much less; limited detailed guidance resulting in more judgment in determining revenue recognition policies
- Variances in applying judgment may result in differences in the revenue recognition related to arrangements with multiple elements and those involving upfront fees; as well as in real estate sales and other industry issues
- Contract accounting – when the stage of completion cannot be estimated reliably, revenue is recognized to the extent that recoverable expenses have been incurred

Implementation Considerations

- The selection of revenue recognition policies will require increased judgment; an overall approach to revenue recognition will need to be developed that focuses on a judgment framework
- Data capture may be more or less detailed, which could lead to information systems changes
- Contract designs may be affected
- Changes in the timing of revenue recognition may affect income taxes
- **Changes pending:** There is an IASB/FASB joint project to develop a single contract-based model for revenue recognition upon completion of performance obligations that can be applied consistently across industries and geographies. An exposure draft is expected in 2010 with a final standard in 2011.

Key Questions to Ask

- What is the overall approach to revenue recognition and how does it compare to others in the industry?
- What processes are in place for decision-making regarding revenue recognition, and are the appropriate resources involved?
- Are revenue policy disclosures sufficient?

Business Combinations

General Requirements

- Primary standard – IFRS 3
- Based on the "control" notion
- Guidance addresses the accounting by the acquirer; requires use of the acquisition method for the recognition and measurement of assets acquired, liabilities assumed and any noncontrolling interests in the acquired entity
- Restructuring provisions are generally prohibited from recognition as acquired liabilities
- Transaction costs are expensed
- Guidance addresses the accounting for goodwill; annual impairment test is required; no amortization, and the deferral of "negative goodwill" is prohibited
- Scope includes transactions involving mutual entities and control by contract; does not address common control transactions

Potential Differences from U.S. GAAP

- May account for noncontrolling interests at either full fair value or the fair value of the proportionate share of the net assets acquired; accounting policy choice on a transaction-by-transaction basis
- Acquisition of noncontractual liabilities are initially recognized at fair value; subsequent measurement may be different
- Accounting for common control transactions are not addressed
- Related pro forma financial information is required for all entities (public and nonpublic)

Implementation Considerations

- Processes for the capture of financial information related to business combinations will need to be developed, particularly for fair-value information related to contingent liabilities
- Changes in the amount of certain items acquired or assumed in a business combination and the related goodwill may affect income taxes
- **Changes pending:** None

Key Questions to Ask

- How will the terms and structuring of future business combination transactions be affected?
- What will be the effect of any changes in the valuation of assets acquired and liabilities assumed?
- How will any future exit strategies or other restructuring plans related to acquired businesses be affected?

Investments in Associates & Joint Ventures

General Requirements

- Primary standards – IAS 28 and 31
- Key issue is determining whether "significant influence"/"joint control" exists
- Significant influence is the power to participate in financial and operating policy decisions of the entity Entities where significant influence exists are considered to be "associates" and are accounted for using the "equity method"
- Investment in an associate is initially recognized at cost; subsequent carrying amount is increased or decreased based on investor's share of profit/loss of associate; distributions reduce the carrying amount
- There are scope exceptions for "investment" companies and investments "held for sale"
- Joint control exists when the financial and operating policy decisions require the consent of all venturers through the contractual sharing of control
- Investments in jointly controlled entities may be accounted for under either the equity method of accounting or the "proportionate consolidation" method. The proportionate consolidation method is expected to be eliminated

Potential Differences from U.S. GAAP

- Exception from equity accounting for associates / joint ventures held for sale
- Potential voting rights must be considered when assessing whether significant influence / joint control exists
- The accounting policies of all associates / joint ventures must be conformed
- The reporting dates of all associates / joint ventures must be conformed
- If losses exceed the interest in associate, discontinue recognition unless a legal obligation exists
- Impairment testing not based on an "other than temporary" notion
- Proportionate consolidation, used in some industries (e.g., oil and gas, real estate) under U.S. GAAP, to be discontinued as a policy option under IFRS

Implementation Considerations

- Determining whether entities should be considered associates or jointly controlled entities will require increased judgment
- Processes and controls will need to be developed for monitoring potential voting rights and whether they are currently exercisable or convertible
- Processes for the capture of financial data for all entities being accounted for as associates or jointly controlled entities will need to be developed, and accounting policies and reporting dates will need to be conformed
- Changes in the reporting entity as a result of more or fewer entities being accounted for as associates or jointly controlled entities may affect income taxes
- **Changes pending:** The IASB's ED for the Joint Ventures project (ED 9, Joint Arrangements) proposed the elimination of the proportionate consolidation accounting policy option. The IASB is currently in the process of finalizing the new Joint Arrangements standard.

Key Questions to Ask

- Will more or fewer entities be accounted for under the equity method of accounting?
- Will more or fewer entities be considered joint ventures?
- What changes will need to be made to the joint venture arrangements?
- What processes are in place relating to making judgments related to the accounting for associates or joint ventures?
- Do the reporting dates or accounting policies of any investments in associates or jointly controlled entities differ?
- Are the current information systems capable of capturing the information needed to account for investments in associates and joint ventures?

Long-lived Assets

General Requirements

- Primary standards – IAS 16, 23, 40, 41
- Long-lived assets are initially recognized at cost, includes all costs directly attributable to preparing the asset for use; borrowing costs are capitalized
- Depreciation is based on the "components" approach
- Subsequent measurement of property, plant and equipment or investment property may be at fair value
- Investment property is land or a building (or part of a building) held to earn rentals or for capital appreciation or both
- Biological assets and agricultural products at the point of harvest must be measured at fair value; fair value changes of biological assets in profit or loss; agricultural products at the point of harvest under IAS 2
- Asset exchanges are recognized at fair value, if they have "commercial substance"

Potential Differences from U.S. GAAP

- Components approach to depreciation is required; major overhaul costs are generally included as a separate component
- Residual values are required to be adjusted to fair value (upwards or downwards)
- Subsequent measurement of asset retirement obligations may be different
- Property, plant and equipment may be measured at cost or fair value using the "revaluation model"
- Investment property may be accounted for using the cost or fair value model; property held as an operating lease may be considered an investment property
- Biological assets must be fair valued

Implementation Considerations

- Asset valuation and depreciation will require increased judgment
- Process and controls may need to be developed for determining the fair value of certain assets if the fair value option is selected
- Data capture for asset componentization may be detailed; which could lead to information system challenges
- Residual value changes will need to be tracked
- Changes in the measurement basis of long-lived assets and depreciation may affect income taxes
- **Changes pending:** The IASB issued an ED of an IFRS on fair value measurement which is generally consistent to the fair value guidance under U.S. GAAP. A final standard is expected in the second half of 2010.

Key Questions to Ask

- What will be the measurement basis of long-lived assets?
- Would the revaluation model be considered and is it possible to determine fair values of certain assets?
- Will depreciation amounts change as a result of the components approach?
- Are the current information systems able to capture the information necessary for asset componentization?
- Do any properties under operating leases qualify as investment properties?

Asset Impairment

General Requirements

- Primary standard – IAS 36
- A single approach to impairment
- Focus on the asset's "recoverable amount," which is the higher of fair value less costs to sell and value in use
- Value in use is the present value of estimated future cash flows expected to arise from use of the asset and its disposal
- Level of testing is based on the "cash-generating unit" (CGU) (i.e., smallest identifiable group of assets that generates cash inflows independently of other assets)
- For goodwill, testing may aggregate CGUs; must at least allocate to an operating segment
- Impairment losses, except on goodwill, are required to be reversed, if certain criteria are met

Potential Differences from U.S. GAAP

- Impairment losses may be recognized in an earlier period given differences in the impairment "trigger"
- The level of impairment testing may be different depending on the CGU
- Amount of impairment may be different based on the recoverable amount of the asset
- Any impairment charges on property, plant and equipment, investment property (where the cost model is used), and intangibles (except goodwill) are required to be reversed, if certain criteria are met

Implementation Considerations

- Determining the level at which assets are tested for impairment will require increased judgment Processes and controls for the reversal of impairment charges will need to be developed
- Data capture for an asset's recoverable amount may be detailed, which could lead to information system changes
- Changes in the timing and amount of impairment charges may affect income taxes
- **Changes pending:** None

Key Questions to Ask

- How will potential changes to asset impairment recognition affect the timing of impairments?
- What are the tax consequences of potential changes in impairment?
- Are the current information systems able to capture the information needed for impairment testing and any subsequent reversals?
- Are the current information systems capable of capturing the information necessary for impairment testing?

Intangible Assets

General Requirements

- Primary standard – IAS 38
- Guidance addresses the accounting for intangible assets acquired separately or in a business combination and those generated internally
- Requires acquired intangible assets, including development costs, to be recognized, if certain criteria are met
- Must classify costs of internally generated intangible assets into a research phase and a development phase
- Requires all research expenditures to be expensed
- Development expenditures are required to be capitalized, if certain criteria are met
- Intangible assets may be revalued, if certain criteria are met

Potential Differences from U.S. GAAP

- Capitalization of development costs is required; criteria to be met include:
  – Ability to demonstrate technical feasibility,
  – Intention to complete the asset and use or sell
  – Ability to use or sell the asset
  – How the intangible asset will generate probable future economic benefits
  – Availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset
  – Ability to reliably measure the expenditure during development
- Intangible assets may be measured at cost or fair value using the "revaluation model"
- Advertising and promotional costs are generally expensed as incurred

Implementation Considerations

- Determining when intangible assets should be capitalized will require increased judgment
- Processes and controls for determining fair value of certain intangible assets may need to be developed if the revaluation model is used
- Processes and controls for the capitalization of development costs will need to be developed
- Data capture for the capitalized development costs may be more detailed, which could lead to information system changes
- Capitalization of development costs may affect income taxes
- **Changes pending:** None

Key Questions to Ask

- Should the revaluation model be considered, and are the fair values of certain intangible assets able to be determined?
- What amount of development costs will need to be capitalized?
- What are the tax consequences of capitalizing development costs?
- Are the current information systems able to capture the information needed for capitalizing development costs?
- Will capitalized advertising and promotional costs need to be expensed?

Leasing

General Requirements

- Primary standard – IAS 17
- Guidance addresses the accounting for both lessees and lessors
- Scope includes leases of property, plant and equipment, as well as of intangible assets; concessionary arrangements accounted for under IFRIC 12
- Accounting for a lease depends on its classification as either an operating or finance (i.e., capital) lease; operating leases are "off balance sheet" while finance leases are "on balance sheet"
- If a lease transfers "substantially all" the risks and rewards of ownership, it is classified as a finance lease
- Operating lease payments are usually recognized on a straight-line basis

Potential Differences from U.S. GAAP

- Utilizes a principle-based framework for lease classification that focuses on the substance of the arrangement
- Generally the implicit rate in the lease is used to discount the minimum lease payments, which may affect classification
- Leases involving land and buildings are required to be accounted for separately, if material. No special accounting for "leveraged leases"
- Sale and leaseback transactions are accounted for based on their substance

Implementation Considerations

- Determining the classification of leases will require increased judgment because there are no strict classification criteria
- Processes and controls for classifying leases may need to be enhanced
- Data capture for leases may be more detailed, which could lead to information system changes
- Changes in lease classification may affect income taxes or financing ratios (i.e., debt to equity)
- **Changes pending:** There is an IASB/FASB joint project to develop a common leasing standard which will require recognition of lease related assets (i.e., right to use) and liabilities on the statement of financial position. A joint discussion paper was issued in March 2009. An exposure draft is expected in the second quarter of 2010 with a final standard in 2011.

Key Questions to Ask

- Will there be changes to lease classification and, if so, what is the potential financial statement impact?
- Will debt covenants be affected?
- What is the effect on how lease arrangements are structured?
- What are the potential tax consequences?
- Are the current information systems able to capture any additional information needed to account for leases?

Provisions and Contingencies

General Requirements

- Primary standard – IAS 37
- Guidance addresses the accounting for "provisions" and "contingent" assets and liabilities
- Provisions are liabilities of uncertain timing or amount; are "probable" (i.e., more likely than not) of occurring and resulting in an outflow of resources to settle the obligation (may be either legal or constructive)
- "Contingent" assets or liabilities are not recognized as their likelihood of occurring is not "probable"
- Provisions are measured using a settlement notion; use of the "best estimate" or mid-point of range if all possible outcomes equally likely
- Discounting of provisions is required, if material
- Several disclosures are required, although "prejudicial" items are not required to be disclosed

Potential Differences from U.S. GAAP

- Recognition threshold for provisions based on "more likely than not;" result is that liabilities may be recognized earlier
- Provisions are measured based on the "expected-value" method or at the mid-point of a range of equally likely possible outcomes
- Provisions must be discounted, if material
- Provisions relating to "onerous" operating lease contracts are recorded when there is a commitment (i.e., communication to a landlord)
- Areas where there may be differences in the timing and measurement include litigation provisions, restructuring charges, decommissioning liabilities, and uncertain tax provisions
- "Prejudicial" items are not required to be disclosed

Implementation Considerations

- Determining liability recognition and corresponding disclosures will require increased judgment
- The legal department and outside counsel will need to be educated on the threshold for recognition of provisions
- Processes and data capture for provisions may be more detailed, which could lead to information system changes
- Changes in the timing and measurement of provisions may affect income taxes
- **Changes pending:** The IASB is currently in the process of finalizing amendments to IAS 37 as part of the Liabilities project to converge guidance for restructuring provisions and termination benefits under IAS 19 with U.S. GAAP and improve the overall recognition and measurement of provisions.

Key Questions to Ask

- Have all obligations been assessed for potential recognition as provisions?
- What is the effect on the timing of restructuring provisions and provisions relating to onerous contracts?
- Have the implications of changes in recognition of provisions been discussed with the company's legal advisers?
- Do any disclosures consist of prejudicial information?

Income Taxes

General Requirements

- Primary standard – IAS 12
- Guidance is based on the "temporary difference" approach; deferred tax items are recognized for differences between the carrying amount of an asset or liability in the statement of financial position and its tax base, and for operating loss and tax credit carryforwards
- Deferred taxes not recognized on the initial recognition of an asset or liability that is not related to a business combination or that does not affect book or tax profit
- Deferred tax assets are recognized when they are "probable" of realization (i.e., more-likely-than-not)
- Deferred tax items are measured based on the applicable tax rates that are enacted or "substantively" enacted
- Deferred tax items are considered to be noncurrent

Potential Differences from U.S. GAAP

- Initial recognition exemption; other items may have a tax effect that are scoped out under U.S. GAAP
- Tax rates used to measure deferred tax items
- Must use rate applicable to undistributed profits to measure deferred tax on undistributed earnings of a subsidiary
- Deferred tax items are considered noncurrent for classification on the statement of financial position
- Allocation of tax to equity components – "backward tracing"
- Particular areas with a different tax treatment include share-based payments, leveraged leases, and uncertain tax provisions

Implementation Considerations

- The tax department should be educated on the different tax accounting requirements and their effect on tax planning
- Processes and data capture for deferred tax items may be more detailed, which could lead to information system changes
- **Changes pending:** The IASB issued an ED to clarify and improve the accounting for income taxes as well as reduce differences with U.S. GAAP. The IASB is currently in the process of analyzing the comments received on the ED and is expected to determine the direction of the project after this consideration process.

Key Questions to Ask

- Have the deferred tax effects of other changes in accounting under IFRS been assessed?
- What is the overall effect on current tax structures and reporting?
- What is the effect on future tax planning?

Employee Benefits

General Requirements

- Primary standard – IAS 19
- Guidance addresses all forms of employee benefits, including short-term benefits; post-employment benefits, (i.e., pensions); other long-term benefits (i.e., bonuses); and termination benefits
- Accounting for post-employment benefits depends on the type of plan (defined contribution, defined benefit or a multi-employer plan)
- Defined contribution plans involve payment of fixed amounts that are expensed as the employee provides services
- For defined benefit plans, a benefit obligation is recognized using an actuarial valuation method, net of plan assets held
- Termination benefits are recognized when "demonstrably committed"

Potential Differences from U.S. GAAP

- Multiemployer plans are accounted for based on their economic substance as either a defined benefit or defined contribution plan
- Policy choice regarding recognition of actuarial gains and losses; recognized in income either using the "corridor" method or accelerated method, or permanently in equity
- Prior service costs are recognized immediately, if vested
- Measurement of expected rate of return on plan assets is based solely on fair value
- Recognition of a defined benefit asset is subject to a "ceiling"
- Liability must be recognized for minimum funding requirements when obligation arises
- Termination benefits and curtailments are recognized when "demonstrably committed"

Implementation Considerations

- Current plans will need to be evaluated to ensure they are accounted for under the appropriate type of plan
- Determining actuarial gains and losses requires judgment
- Processes and controls for the asset ceiling test will need to be developed
- Data capture may be more detailed, which could lead to information system changes
- Changes in the timing and amount of pension cost may affect on income taxes
- **Changes pending:** The IASB has a project to significantly improve IAS 19 over the next couple of years and has divided the project into three phases in addition to a later more fundamental review in conjunction with the FASB of accounting for employee benefits: (1) discount rate; (2) recognition and presentation of changes in defined benefit obligation and plan assets and disclosures; and (3) contribution-based commitments. An ED was issued regarding the discount rate for employee benefits and the IASB will determine the timing of the other phases in conjunction with the financial statement presentation project.

Key Questions to Ask

- How will the current accounting for employee benefits be affected?
- Will the employee benefit plan funding requirements be affected?
- Will future benefit plan structures be affected?

Share-based Payments

General Requirements

- Primary standard – IFRS 2
- Applies to transactions where goods and services have been exchanged for share-based payments
- Transactions generally measured based on a "grant date" approach
- Accounting for grant depends on how transaction will be settled; cash settlement is a liability; equity settled is equity; may have elements of both
- Compensation expense recognized on the basis of grant-date fair value over the period in which the shares vest Awards with "graded vesting" features are measured as multiple awards
- No specific valuation model is required to determine share value; guidance requires inclusion of several inputs

Potential Differences from U.S. GAAP

- Scope is broader; includes employee stock ownership plans
- Compensation expense is recognized on an accelerated basis for grants with "graded vesting" provisions
- Compensation expense related to certain types of award modifications is based on the higher of the modified award fair value or the original grant date fair value
- Measurement of compensation expense for grants to non-employees is based on the fair value of the goods or services when provided
- Classification of grant is based on how the transaction will be settled
- Income tax treatment
- Requirements are the same for public and nonpublic entities

Implementation Considerations

- Processes and controls need to be developed for identifying all transactions that should be accounted for as share-based payments
- Awards need to be evaluated for appropriate classification as a liability or equity
- Judgment will be required in the measurement of share-based payments at fair value
- Data capture may be more detailed, particularly regarding graded vesting, which could lead to information system changes
- Income tax implications of share-based payments need to be understood
- **Changes pending:** None

Key Questions to Ask

- Should compensation structures be changed?
- How does accounting for existing share-based payment arrangements potentially change under IFRS?
- What fair-value techniques are being used and how will they change?
- Are the current information systems able to capture the information needed to account for share-based payments?

Financial Instruments Presentation and Disclosure

General Requirements

- Primary standards – IAS 32, IFRS 7
- Financial instruments are classified as either financial assets, financial liabilities, or equity depending on the substance of the underlying contractual arrangement
- Instruments with liability and equity elements are generally accounted for separately – "split accounting"
- Issued equity securities redeemable at the option of the holder or upon a contingent event are usually classified as liabilities
- Financial assets and liabilities may be offset, if certain criteria are met
- Several disclosures required related to risks related to financial instruments held

Potential U.S. GAAP Differences

- There is no mezzanine equity classification under IFRS; must classify as either liabilities or equity
- "Split accounting" is required for instruments with liability and equity components; allocate the individual components based on fair value using the "with-and-without" method
- Offsetting of financial assets and liabilities is more intent based rather than just legal right of offset
- Additional disclosures are required

Implementation Considerations

- Processes will need to be developed for the capture of data for additional disclosures, differing offsetting, and "split accounting."
- Different classification of financial instruments may affect income taxes
- **Changes pending:** The IASB and FASB have a joint project to better distinguish between debt and equity classification of financial instruments and converge the two sets of standards. An ED is expected in 2010 related to this project. The IASB also has a project on derecognition with a goal of clarifying the guidance, eliminating differences with U.S. GAAP and requiring further disclosure on exposure to risks. The IASB is expected to finalize the deconsolidation guidance in the second half of 2010 – the FASB is monitoring this project to determine what standard-setting might be required.

Key Questions to Ask

- Are the appropriate processes available for the use of "split accounting"?
- Should debt covenants that are linked to the amount of liabilities and equity reported in the financial statements be renegotiated?
- What additional disclosures will be required related to financial instruments held?

Financial Instruments Recognition

General Requirements

- Primary standard – IAS 39
- Financial instruments are recognized and measured based on their classification as either financial assets, financial liabilities, or equity
- Derecognition of financial assets is based primarily on whether "risks and rewards" have been transferred
- Financial liabilities are derecognized when extinguished
- Focus on the use of "fair value" as a measurement basis – subsequent measurement depends on classification of financial instrument; use of the fair-value option is allowed in certain instances
- "Hedge accounting" is allowed if certain criteria are met and are sufficiently documented

Potential U.S. GAAP Differences

- Fair value not limited to an "exit-value" notion
- Impairment testing not based on an "other-than-temporary" notion; reversal of impairments for some items, if certain criteria are met
- Derecognition of financial assets
- Definition of a derivative is broader - a notional, payment provision and net settlement are not required
- Fewer restrictions on the types of risks that can be hedged; the "shortcut method" is not permitted for hedge accounting; all hedges must be assessed for effectiveness and documented
- May adjust the basis of certain assets or liabilities for the effects of "cash-flow hedges"

Implementation Considerations

- Valuation techniques used to determine fair value may need adjustment
- Processes will need to be developed for the capture of data for impairments (including reversals), interest recognition, and derecognition requirements will need to be developed
- Hedge documentation may need adjustment, and hedge effectiveness testing may require additional documentation
- Different recognition and amounts of financial instruments may affect income taxes
- **Changes pending:** As part of a joint project, the IASB and FASB are amending the accounting for financial instruments with a goal of simplifying the classification and measurement requirements. The project will replace IAS 39 and is being conducted in three phases and expected to be finalized in 2010 by the IASB (1) classification and measurement, (2) impairment, and (3) hedge accounting. The IASB issued IFRS 9 on November 12, 2009 addressing phase one. While this is a joint project, the boards currently are discussing proposals that could result in significant differences.

Key Questions to Ask

- What "off-balance-sheet" transactions exist, and will they now be "on balance sheet"?
- What fair value measurement techniques are being used and will they change?
- Will the hedging strategy be affected?
- What fair-value techniques are being used and will they change?
- Will our hedging strategy be impacted?

#9126

About Deloitte
Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu and its member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

Copyright ©2009 Deloitte Development LLC. All rights reserved.
Member of Deloitte Touche Tohmatsu