

IFRS Insights

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An IFRS Newsletter for
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Timing Is Everything

The U.S. Journey Toward IFRS

Riding two horses, traveling two train tracks, pedaling two bicycles. There are a variety of analogies to use in describing the Financial Accounting Standards Board's (FASB) dual commitment to maintaining U.S. GAAP while continuing to work on convergence projects with the International Accounting Standards Board (IASB). At the recent June 16th FASB forum, *High-Quality Global Accounting Standards: Issues and Implications for U.S. Financial Reporting*, at Baruch College, Bob Herz, the chairman of the FASB, used the "two horses" analogy to signify the current challenges faced by the FASB today. Efforts by the FASB to update the Memorandum of Understanding ("MOU") with the IASB – providing a plan for future convergence projects – are in motion, underscoring the commitment to strengthen International Financial Reporting Standards (IFRS) for eventual adoption in the U.S.

The FASB forum consisted of a panel discussion between FASB board members and invited guests, including financial statement users, representatives from small and large private and public companies, auditors, and regulators. The message from the forum participants was quite clear: *timing is everything*. And the SEC is under pressure to provide a definitive mandatory transition date so that the financial reporting community knows how to proceed to ensure an orderly transition to IFRS.

Financial professionals still await signs from both the FASB and the SEC on when – and how – a transition to IFRS could play out in the U.S. Anticipated Senate confirmation of the nominated SEC Commissioners may facilitate SEC action around the standards in the next several months.

Dates, Timelines, and Milestones

Over the past year, the SEC has made significant strides in moving toward IFRS. Not only did the SEC eliminate the requirement for foreign private issuers to reconcile IFRS financials with US GAAP, but it also issued a Concept Release soliciting input on whether U.S. companies should have the option to use IFRS, as global competitors do.

There has been much discussion in the financial community and in SEC circles about future SEC rulemaking for U.S. issuers. At the FASB forum, Conrad Hewitt,

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Timing Is Everything (cont.)

The U.S. Journey Toward IFRS

Chief Accountant at the SEC, stated, "I think we should be focused on implementation of switching to IFRS." SEC representatives indicated a communication would be issued later this summer. Although the specifics of the communication are uncertain, it will most likely include an updated SEC transition roadmap and possibly a "Proposing Release" allowing some U.S. issuers to use of IFRS. The roadmap might also include milestones that must be achieved before the SEC would require a mandatory adoption of IFRS.

Effective dates of such rulemaking are not known, but at the forum, SEC representatives commented that certain regulatory and educational benchmarks must be reached before requiring

mandatory adoption of IFRS. Notably, there was a consensus among forum participants that adoption of IFRS by public companies would be feasible within five years.

Much debate exists around adoption approaches to be taken by the regulators (i.e. an option to report under IFRS followed by a mandate or simply one mandatory date). One increasingly likely scenario includes having a short optionality period (from 2011-2013) with a mandatory adoption date (2013).

In addition, the SEC may consider having staggered mandatory adoption dates with larger issuers being required to adopt first, followed by smaller issuers. This would be similar to the implementation of the SOX 404 requirements.

Regardless of the method advocated, the overriding message is clear: IFRS awareness is building, especially among larger public companies — some of which are already taking steps to better understand the practicalities and benefits of an IFRS transition.

For private companies, IFRS is also an important issue, although the specific approaches and questions around adoption may differ. At the June FASB forum, Judy O'Dell, President of the Private Companies Financial Reporting Committee ("PCFRC"), discussed several options for private company financial reporting ranging from staying with U.S. GAAP, to full IFRS, to some version of IFRS specific to private companies.

Technical Corner: IAS 27

Preparing consolidated IFRS financial statements

A frequent question raised in IFRS discussions is: What are the differences between IFRS and U.S. GAAP? For good reason: Understanding and addressing these differences is central to the company's financial reporting. In the next several issues, we will review some of these differences, including consolidation policy, share based payments, property and impairment, and revenue recognition, to name a few. First up in this edition: Consolidation under IFRS.

A fundamental consideration in preparing consolidated IFRS financial statements is determining which entities to include in the IFRS consolidation. The consolidation model under IFRS is different from the U.S. GAAP model. Although the consolidation models under IFRS and U.S. GAAP are both premised on whether or not one entity controls another, the approaches are very different. IFRS has a single model that incorporates both the notion of governance and risks and rewards into the consolidation analysis. However, U.S. GAAP has two distinct models: a risk and rewards model under FIN 46(R) and a voting control model under ARB 51.

As a general rule in IAS 27, control is presumed to exist when an investor owns, directly or indirectly, more than 50 percent of the voting power of an entity. Control also exists when the parent owns half or less of the voting power of an entity when there is:

- power over more than half of the voting rights by virtue of an agreement with other investors;
- power to govern the financial and operating policies of the entity under a statute or an agreement;
- power to appoint or remove the majority of the members of the board of directors or equivalent governing body where control of the entity is by that board or body;
- power to cast the majority of votes at meetings of the board of directors or equivalent governing body where control of the entity is by that board or body.

In determining whether control exists under IFRS, the above points look to the existence of power and not intent or actual exercise of that power. For example, currently exercisable or convertible potential voting rights held by an investor are considered in determining whether it controls an entity. Also, an investor's retention of risk and ability to obtain benefits in an entity should not be ignored in the IFRS consolidation analysis.

Since entities may experience changes in the affiliates that are consolidated under IFRS, as compared to the determinations reached under US GAAP, it is important for companies to be aware of these differences.

Making It Happen: Spotlight on Tax

Assessing the tax implications of IFRS

Increasing pressure to reduce costs, boost efficiency, create value, and achieve greater transparency are just a few challenges facing corporate finance and tax leaders today. Another issue looming on the horizon is how to effectively address the interaction between the evolving International Financial Reporting Standards (IFRS) and tax. IFRS adoption will require careful consideration of a number of tax issues to achieve sustainable benefits and minimize risk.

Key areas for CFOs and their tax counterparts to focus on today include:

- **Conversion to IAS12 (including interim convergence)** – The effort between the International Accounting Standards Board (IASB) and the FASB to converge the income tax accounting standard is nearing completion. Soon the FASB is expected to decide whether to issue an exposure draft revising Statement of Financial Accounting Standards No. 109 (FAS 109), *Accounting for Income Taxes*, to become more similar to the converged version of International Accounting Standard No. 12, *Income Taxes* (IAS 12). A revised standard of accounting for income taxes applicable to both public and private US companies could potentially be applied as early as 2010.
- **Tax compliance processes** – From the perspective of income tax filings, key differences between U.S. GAAP and IFRS must be assessed (see figure 1 for significant differences between U.S. GAAP and IFRS that may require considerable tax analysis). Because taxable income in most jurisdictions is based on financial statement earnings, the underlying methodology to determine taxable income will change. In other words, when the accounting standards change, so will the tax calculations. This will require a careful evaluation of existing tax compliance processes, and revisions to them, to accommodate the determination of financial statement income under IFRS.

- **Tax accounting methods** – Changes in accounting methods used to determine net income will also have an effect on the tax accounting methods used in determining taxable income. These changes in U.S. tax accounting methods will need to be evaluated. The following issues are implicit in the adoption of IFRS, for example, and will likely require careful tax analysis:

- Is the new financial reporting standard a permissible tax accounting method?
- Is the new book method advisable for tax reporting purposes?
- Is it necessary to file multiple requests for changes in methods of accounting?
- Will there be modifications in the computation of permanent and temporary differences?
- How will reporting in accordance with IFRS impact the computation of taxable earnings and profits, foreign source income and investments in subsidiaries?

- **Global tax planning matters** - Global tax planning will need to be updated to capitalize on changes (e.g. operational, financial, etc) associated with IFRS adoption to help bring about efficiencies. Planning may involve an analysis of whether to implement a certain tax strategy either before or after adoption. Also, to the extent a tax result depends on the pre-tax statutory books, consideration should be given to whether there are additional tax benefits to be obtained under one standard over the other.

Evaluating opportunities to maximize after-tax cash flow and reduce the organization's overall corporate effective tax rate are important aspects of developing a comprehensive IFRS strategy. Many of the sustainable tax benefits of an IFRS conversion can be connected to international tax, including opportunities to: implement a shared service center; simplify the legal entity

structure; and optimize cash repatriation planning and transfer pricing policies. For example, a common standard for global financial reporting may make it possible to operate a financial reporting shared services center that could potentially shift income to lower tax rate jurisdictions and reduce the overall global tax rate. These advantages may help build a compelling business case for mobilizing around IFRS sooner rather than later – especially if global competitors are currently enjoying similar benefits.

Tax considerations are an essential part of an IFRS strategy. If the tax accounting and reporting components are overlooked or not properly brought into the fold, a company could run into significant risk. Exploring and analyzing the tax consequences early – including the impact on systems and processes – can help inform and determine the optimal path toward a successful IFRS conversion.

Figure 1. Significant differences that may require considerable tax analysis include:

- Revenue recognition principles
- Revaluation of property, plant and equipment
- Component depreciation
- Inventory valuation
- Sale and leaseback transactions
- Pension liabilities and assets
- Business combinations
- Share-based compensation

For more information about the tax implications of IFRS, read the recent Deloitte Tax publication, [“IFRS for U.S. Companies: Tax implications of an accelerating global trend.”](#)

Q&A

Q: Does an XBRL taxonomy exist for IFRS?

A: Yes. The IASB recently announced the release of the "XBRL Taxonomy 2008", following its publication of a near final version in March 2008 for a 60-day comment period. The Taxonomy is a complete translation of IFRS as published in the IFRS Bound Volume 2008. The IFRS Taxonomy 2008 is published in the same languages as IFRS. National XBRL jurisdictions are translating the taxonomy in their local language and extending the taxonomy to reflect their particular local implementation of IFRS. Taxonomies will thus be available to enable those reporting under IFRS in different countries to use XBRL, enhancing efficiency and comparability as adoption of IFRS expands around the world. The taxonomy can be accessed at <http://www.iasb.org/xbrl/taxo.asp>.

The SEC proposed rule on XBRL includes requirements for the use of XBRL by companies using IFRS (as published by the IASB). Under the proposal, foreign private issuers that use IFRS will be required to submit XBRL exhibits with their filings for periods ending on or after December 15, 2010.

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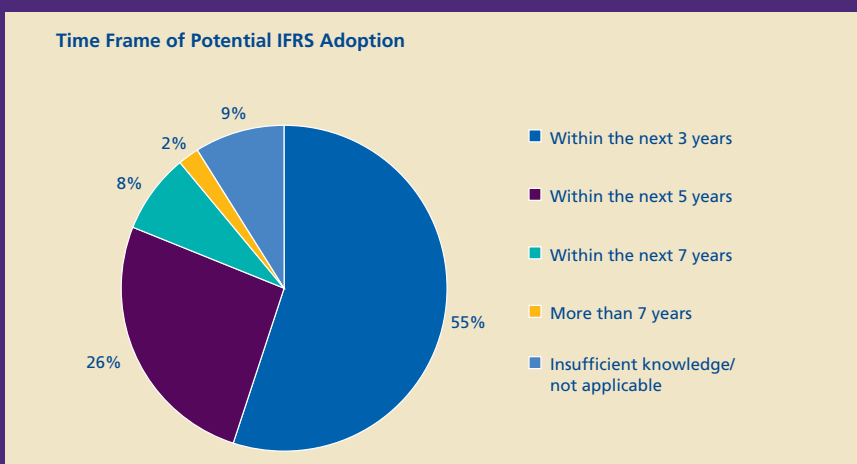
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Featured Statistic

In a recent 2008 Deloitte Survey, senior finance executives were asked:

Within what timeframe would your company consider adopting IFRS, if given a choice?

Of the U.S. companies that would consider adopting IFRSs, if given the choice, 55 percent indicated they would adopt within three years. The three to five year timeframe set forth below for a majority of the respondents is consistent with the SEC's expected timing of allowing certain U.S. issuers to use IFRSs.



Source: 2008 IFRS Survey, *Where Are We Today?*, May 2008. See www.deloitte.com/us/ifrs/2008survey for more information.