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IFRS Insights

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An IFRS Newsletter for U.S. Companies

Convergence or Adoption?

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.

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Convergence or Adoption? (cont.)

A look at convergence efforts

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.

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.

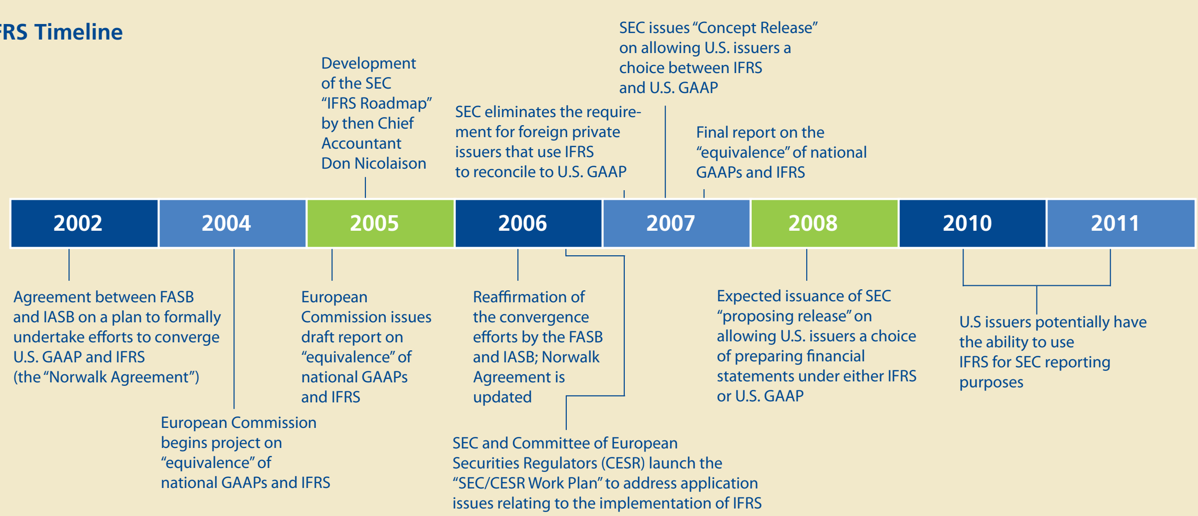
The SEC also confirmed that it was moving forward with its plans to release an IFRS implementation "roadmap," in the near future.

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.

IFRS Timeline



Making it happen: Today's Systems Considerations

For tomorrow's financial reporting

IFRS may be a familiar issue in finance circles, but it has yet to be fully absorbed by the IT world. Yet, factoring in the technology and systems implications associated with IFRS adoption will require prompt attention from IT leaders. As companies undergo or plan enterprise IT or systems projects, such as installing ERP or upgrading legacy systems, it is critical to consider IFRS in their implementation plans.

Organizations that do not effectively consider IFRS from a systems perspective may find that IT investments made today do not align with key IFRS reporting needs in the next three to five years. Also, without considering the systems implications of IFRS, companies may unintentionally forgo important opportunities, such as improving the efficiency of their statutory and global financial reporting. Involving IT leaders in IFRS planning early can not only help avoid potential rework down the road, but can also help determine the timing and cost of an IFRS transition for the organization.

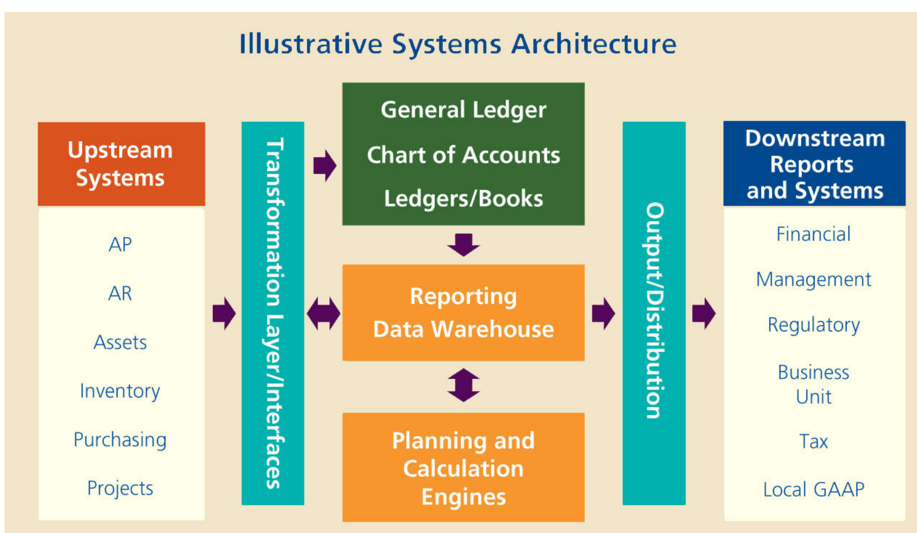
Currently, many systems are not configured to manage the additional ledgers that a transition to IFRS may require. And data needed to support IFRS may not be captured in existing processes and systems. Under IFRS, systems for recording, calculating, and tracking transactions will need to be modified as companies prepare to change over. While some systems issues are industry specific (such as the calculations of derivatives for companies in financial services), others apply broadly to all global organizations. Understanding the state of the organization's existing financial systems and what modifications may be necessary to prepare for changes in accounting standards can help inform the scope and timing of an IFRS transition.

As illustrated in the systems architecture (see figure 1), key technology and systems areas to consider in developing an IFRS strategy include:

- **General ledger –** Based upon differences between IFRS and local GAAP, companies should assess high-level changes to the chart of accounts and analyze reconciliation processes between sub-ledgers and the general ledger. Assessing accounting, reporting, close consolidation, and reconciliation processes enables the development of a workable and comprehensive systems plan. Journal entry methods, templates, expense allocation methods and calculation routines should also be assessed to determine whether rules need to be adjusted.
- **Upstream systems –** In planning, companies should identify and document internal and external data sources that would be migrated. Take note of missing data elements due to differences in the accounting treatment between current accounting standards and IFRS. Recognizing the upstream dimension is an important aspect in planning, scoping, and timing the transition. Capturing development costs for capitalization in certain instances is an example of such data requirements.
- **Reporting data warehouse –** Current systems may not have the functionality to handle all IFRS reporting requirements, so changes in financial information requirements due to IFRS should be identified – and the impact of these requirements on the existing data models should be assessed. Valuation systems and actuarial models will also need to be evaluated to accommodate IFRS changes.
- **Downstream reporting –** Companies should anticipate changes in reporting features related to complying with IFRS. For example, external reporting templates may need to be revised to reflect IFRS requirements, or ad hoc query capabilities may need to be enabled to support the need for increased or different disclosure. IT and business intelligence environments should also be assessed for IFRS-readiness.

To effectively position the company to achieve benefits associated with IFRS, companies must assess the potential impact of IFRS on systems and technology when developing an IFRS plan. Addressing the technology issues can help bring about needed improvements in financial systems and boost the performance of finance operations.

Figure 1. Systems Architecture for illustrative purposes



Q&A

Q: What has the transition to IFRS been like for the European Union (EU)?

A: Approximately 8,000 EU companies transitioned to IFRS in 2005. Conversion projects initiated in 2003 had the goal of producing financial information under IFRS in early 2005. Enterprise-wide projects that involved several functions throughout the organization entailed significant project management issues. Some of the lessons from the EU transition to IFRS include:

- The effort was often underestimated.
- The late start frequently resulted in the escalation of costs, especially after the transition date.
- Many companies did not achieve a "business as usual" state for IFRS reporting.
- Often there was a lack of a holistic approach that took collateral effects into consideration. IFRS transition is more than a technical accounting exercise.
- Many companies discovered that it was hard to get it right the first time.
- Some companies are only now starting to explore the benefits of an IFRS implementation.

Technical Corner: IAS 16

Reviewing Property, Plant and Equipment

In this issue, we focus on International Accounting Standard (IAS) 16 to briefly summarize: the standard, the key differences with U.S. Generally Accepted Accounting Principles (U.S. GAAP), and how these accounting differences may impact your organization.

When adopting IFRS for the first-time, companies have the opportunity to revalue their long-lived assets and establish a new "deemed cost" for purposes of the opening balance sheet. This question, among others, will need to be addressed and is made independent of the company's ongoing policy on measuring fixed assets.

IAS 16, Property, Plant and Equipment, prescribes the principles for initial recognition and subsequent accounting for property, plant and equipment as they are recognized as long-lived assets. Although assets are initially recognized at cost, there are some significant differences between IAS 16 and U.S. GAAP.

IAS 16 allows a choice in accounting model:

- **Cost model:** The asset is carried at cost less accumulated depreciation and impairment; or
- **Revaluation model:** The asset is carried at fair value.

Under the revaluation model, revaluations, which are prohibited by U.S. GAAP, are performed regularly so an asset's carrying value and fair value are not materially different at the balance sheet date. Additionally, if an item is revalued, the entire class of assets to which it belongs should be revalued.

Furthermore, IAS 16 requires components of an asset with different benefit patterns to be depreciated separately. For example, an airplane has separate components such as an airframe, engines, interiors, and in-flight electronic equipment that have different useful lives. IFRS requires the cost to be allocated to these separate components and depreciated over their respective useful lives.

Moreover, when calculating the depreciable amount the residual value is measured differently under IFRS than U.S. GAAP. The residual value under IFRS is the current net selling price, assuming the asset was already of the age and condition expected at the end of its useful life. For U.S. GAAP, the residual value is generally the discounted present value of expected proceeds on future disposal. Additionally, the residual value for IFRS may be adjusted upwards or downwards whereas under U.S. GAAP it may only be adjusted downwards.

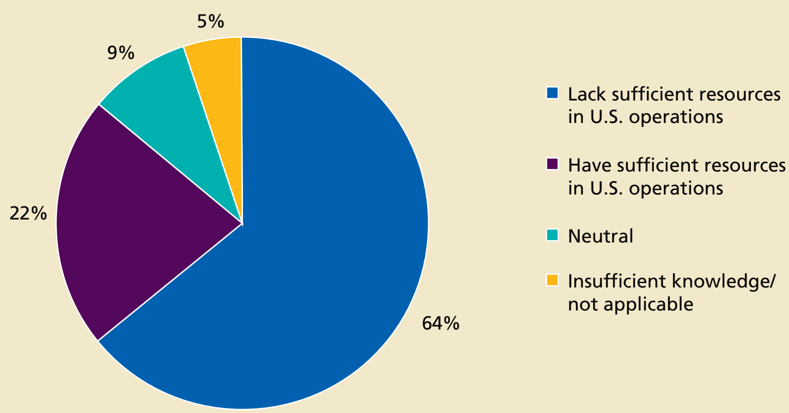
The accounting differences and choices provided by IAS 16 can have a significant impact on the balance sheet and on operational results. Therefore the guidance under IAS 16 should be thoroughly examined when considering IFRS adoption.

Featured Statistic

In a recent 2008 Deloitte Survey, senior finance executives were asked whether their company has an adequate number of personnel in U.S. operations that collectively have a level of IFRS knowledge that is sufficient to convert to and maintain IFRS financial statements.

Of the U.S. companies that would consider adopting IFRS, if given the choice, 64 percent say they lack skilled resources in their U.S. operations. These results indicate that more training in IFRS is needed.

Adequacy of Resources in U.S. Operations



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

Deloitte offers a two-day IFRS executive training program to learn about key accounting issues and practical considerations related to IFRS implementation. Upcoming sessions include:

Dallas (August 19–20, 2008)
New York (September 16-17, 2008)
Atlanta (September 24-25, 2008)
Chicago (October 2-3, 2008)

To register or obtain more information please visit deloitte.com at:
www.deloitte.com/us/ifrs/training

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