

## IFRS Insights

### Achieving a global standard



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## Dialogue with Sir David Tweedie

### Q&A with the Chairman of the International Accounting Standards Board (IASB)

*The Deloitte IFRS Summit with Sir David Tweedie, the architect of IFRS, was held on December 11, 2008 at the Waldorf Astoria in NYC with nearly 150 finance executives from U.S. and European companies in attendance. Here are excerpts from the conversation with Sir David, as he discusses the movement towards IFRS and principles-based accounting.*

#### **Why has IFRS been so successful?**

The markets have driven it. If you want to invest in China or Australia, you want to be able to understand the results you get back. You want to know exactly what you're going to get. Countries have switched to IFRS as an inward investment — that's why IFRS has spread around the world.

When you [in the U.S] change, I think you won't find [IFRS to be] such a wrench — as perhaps many of you may be thinking. The IASB and FASB have locked into a program to converge U.S. GAAP and IFRS. By 2011, the two standards will pretty much get you the same answers.

#### **How do you see IFRS playing out in the U.S.?**

Had there not been the financial crisis, Christopher Cox (the SEC Commissioner), would have, by now, set IFRS on the train for the roadmap. The crisis obviously held him up and therefore it was felt that the new administration would make the final decisions.

The reconciliation requirement [for foreign private issuers using IFRS to reconcile with U.S. GAAP was eliminated] 18 months earlier than expected. And that could happen again [in terms of the IFRS roadmap and rule changes]. Why would the decision need to happen by 2011? It could very well happen earlier — in two years. The sooner the SEC sets a date, the sooner it will be easier for people to understand what's happening.

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IFRS Newsletter for  
U.S. Companies

# Dialogue with Sir David Tweedie (cont.)

Q&A with the Chairman of the IASB



## What do you see as the greatest difficulty ahead for the U.S. in its transition to IFRS?

One key thing is that people don't like change — nobody likes change. But there's going to be change anyway. With the convergence program, there will be joint change, so that we're actually moving together.

A lot of what you do under U.S. GAAP could continue because if you meet the principles, then no problem — carry on. You may find another way of doing it — as long as it's under the principles, it's okay.

Companies have found benefits in using the same accounting system throughout the organization. Apart from the obvious consolidation benefit — communication throughout the group is very easy if everyone is using the same accounting. Communication is therefore facilitated enormously.

The key question is the cost of capital. Everybody understands your accounting. Therefore, you can go anywhere to get [capital]. You open yourselves up to greater capital flows, [leading] to a reduction in the cost of capital for many companies. That's a key driver.

## Elaborate on principles-based versus rules-based accounting.

I don't think IFRS are any less stringent than U.S. GAAP. UK standards were short and weren't bad. When I started accounting, we didn't have any standards, so it was all judgment. We learned from our partners — learned what they did

and why. Gradually as time went on, the practice started to develop and practices were put in writing to establish them. Standards gradually came in — usually as a result of scandals.

Standards can be very short. If you have a special situation and you come to us and say, "What do I do in this situation?" Our answer will be: "You're best. Go ahead and think about it." We [the IASB] issued two interpretations last year for the whole world. How many interpretations were issued by IETF?

What we're trying to do is return accounting to the profession. Accounting is not rocket science. Principles-based standards are fairly straightforward, but you're going to have to use your judgment.

## What advice would you or have you given to the SEC as to what changes they need to make and how they would regulate under a principles-based approach for financial reporting?

Yes, we have spoken to the SEC because we know this can be wrecked if, in fact, they try to tell you what to do, or second guess you. In Europe when IFRS started, we were told that we would have an avalanche of queries coming from the regulators. But it never happened — we haven't had them.

## What lessons have been learned by the regulators in Europe as IFRS has been implemented? How have they changed their regulatory focus?

The regulatory body — the International Organization of Securities Commissions (IOSCO) — keeps record of how people are interpreting the principles. If some blatant abuse starts to appear — or some bizarre interpretation — then we would be told. But we hear but one or two a year, so it's gone pretty well.

## What are your views on the consistency of the application of IFRS?

The consistency of application is partly cultural. It'll affect you in the U.S. You'll still have U.S. GAAP in your minds and we'll start to notice a U.S. tendency. We may find something that's not what we intended and we'll clarify the standard. [The cultural aspect] will be there; it's natural.

In Europe, it went surprisingly well when you think about the [different models] — the UK, Scandinavia and the Netherlands were basically on an Anglo-American model; France was tax-based accounting; and Germany was creditor-protection accounting. There were massive changes. They only had the standards nine months before they had to use them. We were still rewriting them at that stage — it still went well. The second year was even better. It takes a while to get used to, but the application has been pretty good.

The regulators are watching [applicability] too — we don't want different applications worldwide, so it is an issue, but it will settle down and gradually the differences will get ironed out.

## Do you think there is a need for companies to have more detailed rules within the organization so that they're reporting consistently internally?

Within the organization, you'd set out your own policies and do what you like. What we're not going to do is do it for the companies — that's entirely up to them.



# Making It Happen: IFRS and State Taxes

## Uncharted territory

Many companies have already begun to assess the consequences that a conversion from U.S. GAAP to IFRS will have on their financial statements, accounting systems, compensation policies, and training programs. Those enterprises that have undertaken an assessment of the income tax issues associated with an IFRS conversion are likely beginning to understand the broader implications of a conversion on their provision for income taxes, tax accounting methods, and a variety of important global tax planning issues. Such enterprises also should begin to assess the potential impact on their state income taxes as well as on other state taxes.

### State income taxes

It is expected that a conversion to IFRS will impact a broad range of financial accounting methods. Thus, the financial accounting method changes in an IFRS conversion will require a thorough tax analysis to determine both the permissible and optimal tax accounting methods for both federal and state income tax purposes. To the extent federal taxable income changes in connection with an IFRS conversion, the corresponding change to state taxable income must also be considered. Such consideration will probably be undertaken not only by taxpayers, but also by state taxing authorities.

Each state tax jurisdiction will have to decide whether or not their tax regime will follow the federal approach to IFRS. Taxpayers who operate in states that do not adopt changes to federal tax accounting methods may be required to maintain certain legacy accounting systems. These legacy systems will allow them access to information needed to continue filing tax returns in accordance with historical tax accounting methods.

In addition to potential changes to state taxable income, companies may also see changes to their state apportionment percentages. State apportionment percentages are generally based on three factors: gross receipts, property, and payroll. These factors are weighted in accordance with each state's laws and regulations.

### Potential financial statement impact — interstate transactions

Upon conversion to IFRS, state income tax expense may be directly impacted by the fact that IAS 12, *Income Taxes*, requires recognition of both the current and deferred tax consequences related to the intercompany sale of assets remaining within a consolidated financial reporting group. Business enterprises assessing the impact of an IFRS conversion will need to evaluate the size and volume of intercompany transactions among their affiliated group members doing business in different state tax jurisdictions. If those transactions and the tax rate differential are material, they could give rise to volatility in the financial statement effective tax rate under IFRS. Those businesses will also face the challenge of establishing an accounting system to track the intercompany transactions as well as account for current and deferred income tax consequences by jurisdiction.

### Potential financial statement impact — deferred tax assets and liabilities

The state income tax rate used to record deferred tax assets and liabilities is generally calculated as the statutory state income tax rate multiplied by that state's apportionment factors. This state income tax rate could change as a result of an IFRS conversion. For many enterprises, a small change in the statutory state income tax rate can result in a substantial deferred tax adjustment. Thus, it will be important to evaluate carefully the impact an IFRS conversion may have on the overall state rate.

### Other state taxes

The state tax impact of a conversion to IFRS is not limited to state income tax. Other state taxes to consider include:

- **Franchise and net worth taxes.** Most states generally use financial statement balance sheet data prepared in accordance with U.S. GAAP as a starting point for calculating state franchise and net worth taxes. Such taxes are usually based on a company's reported equity with certain adjustments. A conversion to IFRS may also have an impact on these types of taxes. It's important to consider the impact a change to IFRS will have on the equity accounts used to compute net worth type taxes. Examples of accounting policies subject to change in an IFRS conversion that may impact equity accounts include: IAS 16, *Property, Plant, and Equipment*; IAS 2, *Inventories*; IAS 32, *Financial Instruments: Presentation*.
- **Property taxes.** A conversion to IFRS could result in a change in financial statement values for property, plant, and equipment (PP&E) as well as inventories. Although it remains to be seen how state tax authorities will react as more businesses adopt IFRS, those enterprises with substantial inventory and PP&E could experience a change in property taxes in jurisdictions that base property taxes on financial statement or book balances.

Each state has its own system of taxation, be it income tax, franchise tax, net worth tax, or some combination. There are almost as many ways to calculate state tax as there are states and, therefore, it is crucial that any IFRS assessment be executed on a state-by-state basis.

This article was adapted from the Deloitte Tax publication, "IFRSs and State Taxes: Uncharted Territory." [Access the full publication here.](#)

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# IFRS Pulse Survey Results

The IFRS Solution Center recently launched a survey series aimed at gathering relevant marketplace information to help keep companies current on the latest IFRS trends. Over 200 financial executives responded. Some of the results are highlighted here.<sup>1</sup> Respondents demonstrated an increased awareness of IFRS and conveyed that steps are being taken within their organizations to begin preparing for IFRS: 65% of respondents stated that their companies have assigned resources to begin planning for IFRS or intend to assign such resources within the next year. Complete survey results can be found at: [www.deloitte.com/us/ifrs/results2008](http://www.deloitte.com/us/ifrs/results2008).

## Have you assigned resources and responsibilities to evaluate and plan for IFRS implementation (e.g. created a program management office)?

We have assigned resources	30%
We plan to assign resources within one year	35%
We plan to assign resources after one year	35%

## How many full time personnel are (or would be) assigned to the evaluation and planning effort?

5 or Less	80%
6 to 10	9%
10 or More	11%

<sup>1</sup> The November Deloitte survey had over 200 respondents, which included financial professionals, CFOs and finance managers. The survey results presented herein are solely the thoughts and opinions of the survey participants and are not necessarily representative of the full population of companies. However, the results may provide valuable insight regarding the opinions and concerns of financial professionals in general. The goal of the November IFRS survey was to gauge relevant marketplace information on the latest IFRS trends.

## Technical Corner: IAS 36

### Impairment of Assets

As another year comes to a close — and a new year begins — companies are focused on their annual financial reporting process. A significant component of this, which will likely warrant additional focus this year due to the state of the economy and market prices, is impairment.

FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, FASB Statement No. 142, *Goodwill and other Intangible Assets*, and IAS 36, *Impairment of Assets* have similar requirements for when to test an asset for impairment. Periodically long-lived assets are to be reviewed for impairment indicators and if such exist (e.g. a significant decrease in the market price) an impairment test should be performed. Meanwhile, goodwill is required to be tested at least annually and more often if indicators exist. Despite these similarities, there are several key differences to take note of when comparing US GAAP and IFRS with regards to impairment.

- Analysis Level
  - Assets — if fair value amounts are not available for individual assets then, under US GAAP, they are tested by asset group whereas for IFRS they are tested at the cash-generating unit (CGU) level. CGU is the smallest identifiable group of assets that generates operating cash inflows which are independent from the inflows of other groups.
  - Goodwill — tested at the reporting unit level for US GAAP and for IFRS at the lowest level at which goodwill is monitored for internal management purposes, which cannot be larger than an operating segment.
- Calculation
  - Assets — rather than compare fair value to carrying amounts like US GAAP, IFRS compares the recoverable and carrying amounts. The recoverable amount is calculated as the higher of 1) fair value less costs to sell and 2) value in use.
  - Goodwill — US GAAP takes a two-step approach: 1) compare the fair value of a reporting unit to its carrying amount including goodwill and if fair value is less than carrying amount proceed to the second step; 2) compare the implied fair value of goodwill to its carrying amount. Under IFRS, the calculation involves a one-step approach that compares the recoverable and carrying amounts.
- Recording
  - Under US GAAP, impairment charges are recorded directly against the asset, thus creating a new cost basis. In contrast, IFRS requires impairment charges be recorded to a contra-asset account.
- Subsequent accounting
  - If certain criteria are met, IFRS requires the reversal of an impairment loss for all assets, except goodwill. US GAAP strictly prohibits the reversal of impairment losses for any asset.

Impairment is an area involving judgments and assumptions, especially those regarding the measurement of fair value. Therefore, it is important for companies to consider the accounting differences and think about improvements to accounting policy documentation that might be necessary when converting to IFRS.

# Upcoming IFRS Events

**IFRS and Internal Audit** — January 29, 2008: Deloitte and The Institute of Internal Auditors (IIA) are pleased to present this webinar on IFRS for Internal Audit — People, Process, Technology, Governance and Controls. Gather insight into key focus areas for internal audit, including people, process technology, governance & controls. Register now.

**IFRS Dbriefs Webcasts** — Gain practical knowledge of IFRS from leading Deloitte practitioners in these informative Webcasts. Learn more about the webcasts below and register at [www.deloitte.com/us/ifrs/dbriefs](http://www.deloitte.com/us/ifrs/dbriefs).

- **International Financial Reporting Standards: Why Private Companies Should Take Note** — January 28, 2:00 PM EST (19:00 GMT).
- **IFRS: New Year, New Updates** — February 17, 2:00 PM–3:30 PM EST (19:00 GMT).
- **IFRS: Is It More Complex Than Many Suspect?** — February 25, 1:00 PM EST (18:00 GMT).

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