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IFRS Newsletter for U.S. Companies

IFRS Conversion: Some Important Lessons Learned

Insights from those companies transitioning to IFRS now

Lessons around IFRS conversion began to accumulate when Europe and Australia required IFRS for public companies in 2005. Now, as some global companies based in the U.S. embark on their own IFRS efforts, the inventory of insights is growing—and becoming more essential for executives to know.

U.S. companies are presented with a unique opportunity to reconsider their existing financial reporting in addressing IFRS. And they have the advantage of learning from companies that have already adopted IFRS. While some U.S. companies are making enhancements and adjustments to their accounting policies and operations, others may just be learning about the importance of IFRS. But no matter what the stage, executives can benefit from knowing what works and what doesn't.

Here are some insights and practical considerations from companies implementing IFRS today that can be factored into IFRS planning going forward.

Begin with accounting changes, but don't stop there. While understanding the accounting changes associated with a transition from U.S. GAAP to IFRS is an obvious starting point, companies should also consider focusing on operational adjustments, including systems, tax, people, and process implications. Consider how an accounting change such as revenue recognition might impact the configuration of your ERP system. Once identified and understood, it may take several months of lead time to make those system modifications. You'll also want to consider developing IFRS budgets and forecasts in advance of the year the company officially converts in an attempt to avoid rework or "apples to oranges" comparisons. The sooner you know *what* aspects may need changing, the better, in terms of planning, for *how* to effectively make those changes.

Be aware of financial statement presentation and disclosure differences — and what they mean for the enterprise. The differences between U.S. GAAP and IFRS for financial presentation and disclosure requirements can drive changes in systems, processes, and controls. For example, new or more detailed data may be required, which may drive system and process changes — as in collecting more detailed fixed asset information or developing additional ERP query capabilities.

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IFRS Conversion: Some Important Lessons Learned (continued)

Select the right project sponsor. It's important to identify a leader — perhaps the Chief Accounting Officer or other c-suite executive — who is well positioned within the organization to help usher through IFRS changes that require the help of the larger organization. A project sponsor with widespread influence and organizational clout can help connect to other business functions when there are IFRS-related changes required. This becomes especially important for a company that may have a dozen different IFRS work streams that span across accounting, tax, systems, and controls.

Involve your external auditor. Because IFRS is principles-based accounting — and not rules-based like U.S. GAAP — there is a need for more professional judgment. It's important, therefore, that the conclusions by the company and external auditor are aligned — especially before any implementation changes are made in the organization. Make sure you're on the same page with your external auditor in accounting conclusions — to help avoid potential misunderstandings or rework.

Decide on the "go-live" date. Much of a company's IFRS planning will likely be determined around the date to officially "go live" with IFRS. Once this date is set (or generally agreed upon), preparation efforts can be defined and paced. Given the timing outlined in the SEC's proposed IFRS roadmap, most large U.S. companies would adopt IFRS by 2014. In order to be ready, two years of historical data will need to be provided. Companies that know when they'll switch to IFRS then have the opportunity to begin collecting necessary data and incorporating operational changes in current systems and processes in advance. For companies undergoing ERP systems changes in the near term, they'll have the opportunity to factor in IFRS changes now – and consider whether setting up a dual reporting capability for U.S. GAAP and IFRS would be beneficial or necessary. Clarity around timing can serve as a guiding force for the planning effort.

Establish a project management office. As a central point of coordination, a project management office can help facilitate the consistent application of accounting policy and changes across a global enterprise. Providing streamlined support, one office can assist with issuing consistent instructions, deploying standard templates, and adhering to one company roadmap. For issues — such as leasing — that require a significant amount of judgment, it's important that the established policy is broadly communicated throughout the organization so it can be applied consistently. Having one office may help drive consistent messaging about key information and policies to the larger organization.

Learn from those companies that have already converted to IFRS. U.S. companies have the advantage of learning from companies in countries, such as those in Europe, that have already converted to IFRS. Consider these cautionary tales in an attempt to avoid common pitfalls and overcome challenges. An example: In Europe, some companies opted to record top-sided conversion adjustments – often relying on manual changes and spreadsheets– which, in turn, led to errors, costly rework, and other unintended consequences.

Communication is king. Companies should not underestimate the need for communicating with internal and external constituents regarding the changes around IFRS. Developing internal and external communication strategies, such as websites, blogs, and road shows, can help educate employees, avoid confusion, and engage the larger organization in the effort. Proactively and responsibly informing investors and analysts may help prevent misinterpretation and could contribute to the perception that the company is forward thinking.

Notice opportunities for improvements. While IFRS conversion can involve a significant amount of work, there may be a unique opportunity to make needed improvements in your financial reporting and accounting operations, systems, tax accounting and processes. As an organization undertakes this type of change, it may be worthwhile to make overdue upgrades or enhancements that could significantly improve overall finance operations.

Top 5-10 differences generate 90% of the work. Among the many issues considered in planning an IFRS transition, there are often five to ten accounting and process issues that drive much of the effort. Development cost, fixed asset componentization, share-based payments, and dual reporting are some examples of these key items. Determine which issues will be big for your company to address. Once you identify the issues that may require the most attention, plan for the necessary lead time so the organization can adequately prepare.

Among the lessons learned from the European experience were the following:

- 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 IT, HR, 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 for it, 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 time frames often precluded this possibility; instead, first-year financials were often 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.

Source: Deloitte's IFRS Industry series, providing resources that examine industry-specific issues related to IFRS.

Making It Happen: Teaming with the Audit Committee

IFRS considerations for audit committees

Chief Financial Officers have a central role to play in helping audit committee members prepare for and oversee an IFRS transition. This role includes explaining the potential enterprise-wide costs and benefits associated with a transition to IFRS, discussing the financial statement impact associated with a transition to IFRS, and working with the audit committee in determining accounting policies under IFRS. It also involves collaborating with independent auditors and working with management teams (e.g., tax, IT, human resource leaders) to address any issues that could possibly undermine — or boost — the success of the IFRS effort.

Active involvement from CFOs also includes establishing appropriate buy-in from audit committee members and helping set the right tone at the top — as well as setting a timeline and budget for transition. CFOs can start now by discussing key questions with the audit committee, which may ultimately determine the organization's adoption approach. For example, some key questions about processes, information systems and income tax considerations include:

Process and control implications: What processes or controls will need to be changed or enhanced to comply with IFRS requirements?

Consider certain issues regarding the accounting for *Asset Impairments*. Under U.S. GAAP, subsequent reversals of impairment losses for all assets are prohibited. Under IFRS, impairment of all assets (other than goodwill) must be subsequently reversed if certain criteria are met. Companies will need to develop processes and controls to monitor whether or not subsequent changes have occurred in the underlying value of a previously impaired asset which meet the impairment reversal criteria. Furthermore, data capture for an asset's recoverable amount may be detailed, which could lead to potential information systems changes.

Other examples of accounting issues that potentially surface process and control changes include *Consolidation, Investments in Associates, and Investments in Joint Ventures*. The underlying basis for consolidation differs between U.S. GAAP and IFRS. U.S. GAAP provides two consolidation models depending on the type of entity involved (variable interest entity or voting interest entity) whereas IFRS has a single consolidation model based on control. In addition, under U.S. GAAP, entities would generally not consider potential voting rights when determining whether control, significant influence or joint control is present. Under IFRS, companies must consider potential voting rights, such as put or call options, when assessing whether control, significant influence or joint control exists if such voting rights are currently exercisable or convertible and do not lack economic substance. Companies will need to develop processes and controls to assess whether or not an entity is consolidated and to monitor potential voting rights and whether or not they are currently exercisable or convertible.

Systems issues: Are the current information systems capable of capturing the information needed to comply with IFRS requirements?

Take *Property Plant & Equipment* as an example that raises system questions. Under IFRS, depreciation is based on the "components approach," meaning that each part of an asset that is significant in relation to the total value and that has a differing pattern of benefits or useful life is depreciated separately. This may require enhancements to the current fixed asset system in place to capture additional levels of detail — if the components approach was not used under U.S. GAAP.

Another example: *Intangible Assets*. Under IFRS, expenditures related to the development phase of an internally generated intangible asset are capitalized as an intangible asset if specified criteria are met. This may require enhancements to the current information systems to capture the information needed for tracking development costs for potential capitalization.

Tax considerations: What are the potential tax implications of a conversion to IFRS?

An obvious accounting example that raises tax questions is *Income taxes*. The several accounting differences between IFRS and U.S. GAAP will likely impact the starting point for the accounting of deferred income taxes as well as potentially the current tax structure as a whole. Companies may also need to reconsider their global tax planning strategies to best capture the benefits of a conversion to IFRS.

These are just a few of the key issues CFOs and audit committees will need to think through carefully in conducting their IFRS assessments and planning. Collaboration and preparation will be essential. For more detailed information in preparing for meetings on IFRS, access the Deloitte & Touche LLP publication, "IFRS Considerations for Audit Committees."

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Preview of IFRS Pulse Survey Results

The IFRS Solution Center recently conducted a survey of financial executives to help keep companies current on the latest IFRS trends. Over 150 financial executives responded. The sample of survey respondents includes companies from various industries including financial services; health services and government; consumer and industrial products; energy and resources; and technology, media, and telecommunications.

Here we highlight some of the results.[1]

- Seventy-five percent (75%) of respondents supported or strongly supported a movement toward a single set of high quality accounting standards, such as IFRS. This show of support is noteworthy—as current views toward IFRS evolve and financial executives consider the SEC's proposed IFRS roadmap and timeline.
- Sixty-two percent (62%) of respondents agreed or strongly agreed that the SEC should establish a date (the so-called "date certain") for requiring U.S. companies to use IFRS. The data may suggest an emerging desire to diminish uncertainty surrounding the timing for the acceptance of IFRS in the U.S.
- Over half (56%) of financial executives surveyed indicated that the SEC should extend the option for early use of IFRS to a broader group of U.S. companies than outlined in the current SEC roadmap.
- Sixty-one percent (61%) responded that that the SEC's proposed requirement that would entail having companies maintain U.S. GAAP books on an ongoing basis until 2011, would decrease the likelihood of companies electing the option of early conversion.
- Forty-three percent (43%) of financial executives described the proposed SEC timeline to be "about right"; while 13% indicated it wasn't sufficiently aggressive.
- Sixty-four percent (64%) of respondents stated that no budget has yet been allocated for IFRS conversion, in contrast to the quarter (25%) who have budgeted for assessment, readiness and other aspects of conversion.

Coming soon: The report with survey results will be issued soon on www.deloitte.com/us/ifrs/library.

Technical Corner: IAS 38

Accounting for Intangible Assets

Competing in an increasingly globalized market necessitates that companies continuously innovate their products, services, and/or operations. Accounting for research and development activities that support innovation can have a significant impact on an entity's financial statements. Although the general requirements of amortizing an intangible asset with a finite life over its useful life and annually reviewing an intangible asset with an infinite life for impairment are similar, there are several key differences between U.S. GAAP (SFAS 142, "Goodwill and Other Intangible Assets") and IFRS (IAS 38, "Intangible Assets"), including:

- **Development Costs** — U.S. GAAP in SFAS 2 "Accounting for Research and Development Costs" requires research and development activities to be expensed with the exception of certain costs associated with developing internal use software. IAS 38 is similar to U.S. GAAP in that it requires research activities to be expensed. However, an intangible asset should be recognized if both of the following criteria are met:

  - It is probable that the expected future economic benefits that are attributable to the asset will flow to the entity.
  - The cost of the asset can be measured reliably.

  In other words, the entity should capitalize development costs if it can demonstrate all of the following:

  - Technical feasibility
  - Intent to complete the intangible asset
  - Ability to use or sell the intangible asset
  - Future economic benefits
  - Availability of adequate technical, financial, and other resources to complete development
  - Ability to reliably measure the costs.

- **Revaluation of Intangible Assets** – U.S. GAAP prohibits the revaluing of intangible assets thereby requiring the cost model. Under IFRS, if there is an active market for an intangible asset, the revaluation model may be used. While specific revaluation dates or periods are not required, a revaluation must be kept sufficiently up to date so that the carrying amount of the asset does not differ materially from the fair value. Intangible assets continue to be amortized and tested for impairment. Increases in an asset's value are credited directly to equity ("revaluation surplus"); however, to the extent that the upward revaluation reverses a revaluation decrease for the same asset previously recognized as an expense, the increase is recognized in the income statement. A revaluation decrease is charged directly against any related revaluation surplus for the same asset. Any excess is recognized as an expense.

It is important for entities to be aware of IAS 38 requirements when contemplating an IFRS conversion. Implementation guidance within IFRS 1, "First-time Adoption of International Financial Reporting Standards" prohibits using hindsight to conclude recognition criteria have been met. Therefore, in order to capitalize development costs at the "as of date" the company needs to conclude 1) that future economic benefits from the asset will flow to the entity and 2) it has a reliable system for accumulating costs of internally generated intangible assets. As a result, diligent planning is necessary during first time adoption to recognize development costs at the opening balance sheet date. Generally, the entity will need to document its conclusions as to the future economic benefit and its ability to strictly and reliably measure development costs well in advance of the transition date. A lack of planning could lead to exclusion of development costs from the opening balance sheet, which could have a significant impact on earnings in the year of adoption and subsequent years.

[1] The Deloitte survey had over 150 respondents, which included financial professionals, CFOs and finance managers. Survey participants were self-selected, and responded through a web-based survey. The survey results are solely the thoughts and opinions of the survey participants and are not necessary representative of the full population of companies.

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IFRS Contacts

Joel Osnoss — New York
Deloitte & Touche LLP
+1 212 436 3352
josnoss@deloitte.com

D.J. Gannon — Washington DC
Deloitte & Touche LLP
+1 202 220 2110
dgannon@deloitte.com

Alfred Popken — New York
Deloitte & Touche LLP
+1 212 436 3693
apopken@deloitte.com

Tom Omberg — New York
Deloitte & Touche LLP
+1 212 436 4126
tomberg@deloitte.com

Sam Doolittle — San Francisco
Deloitte & Touche LLP
+1 415 783 4343
sdoolittle@deloitte.com

Nick Difazio — Detroit
Deloitte & Touche LLP
+1 313 396 3208
ndifazio@deloitte.com

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