

IFRS Insights

Achieving a global standard

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New Year

Updates on SEC activity and FASB/IASB convergence efforts

In late December, Securities & Exchange Commission (SEC) representatives, including SEC Chief Accountant James L. Kroeker, indicated that the SEC would take further action regarding its proposed IFRS roadmap in early 2010. As January comes to a close, many constituents are anticipating actions of the Commission on IFRS, including a date for U.S. public companies to convert to IFRS.

In remarks at the 2009 AICPA National Conference, Kroeker noted, "An important area highlighted by the financial crisis is the potential for arbitrage or mischief that can result from differential regulatory standards when you cross national borders. The crisis has shown that accounting standards are not immune to this issue. Thus, the crisis has highlighted the importance of developing, implementing and enforcing high-quality and consistent accounting standards around the world."

Other SEC staff members along with SEC Commissioner Elisse B. Walter noted during the conference that although feedback on the proposed roadmap indicated widespread support for a single set of high-quality global accounting standards, views differed on what approach should be taken. Commissioner Elisse B. Walter stated, "We should move forward with further incorporating IFRS into the U.S. capital markets if, and only if, it is the right thing to do for U.S. investors."

While the SEC continues to evaluate the appropriate way forward, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) have been working on several standard-setting projects focused on jointly improving and converging accounting standards. At a recent joint IASB/FASB meeting, both boards reaffirmed commitment to convergence of IFRS and U.S. GAAP and agreed to "intensify efforts" for completing major joint projects in the Memorandum of Understanding (MOU). The agreed upon milestones for each major project are summarized in Figure 1. The two boards are scheduled to meet monthly to discuss the technical accounting aspects of the major projects and progress towards achieving the established milestones.

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New Year (Continued)

Impact on companies

Does the reinigorated effort on convergence change what a company should be doing in relation to IFRS? Companies may want to pay close attention to convergence efforts, as potential changes to current U.S. GAAP may shift more towards principles rather than rules—requiring a change in thinking among financial executives. Companies may also need to plan for and implement “convergence-driven” changes to U.S. GAAP, which may require significant effort.

An eventual shift to IFRS may involve less work—with the two sets of standards being

more similar or converged. However, experience in other projects has shown that convergence doesn't necessarily result in “identical” standards. For example, the accounting for stock options is similar in principle under U.S. GAAP and IFRS as both require the fair value of options to be expensed through the income statement, however, differences in the underlying details could impact the recognition and measurement of the expense (e.g. using straight-line or the accelerated method when recognizing expense). Furthermore, the first-time adoption of IFRS by U.S. companies will likely have significant impacts to accounting, tax, people, process and systems.

Figure 1. Overview of Main Convergence Projects

Project	Date	Milestone
Financial Instruments		
	Nov 2009	<ul style="list-style-type: none"> The IASB published an Exposure Draft on impairment of financial assets, proposing a model based on expected cash flows. The IASB completed its first phase to replace IAS 39, <i>Financial Instruments: Recognition and Measurement</i> with the issuance of IFRS 9, <i>Financial Instruments</i> which addresses the classification and measurement of financial assets. See the “Technical Corner” article for more information on IFRS 9.
	Q1 2010	<ul style="list-style-type: none"> The IASB will publish its initial proposals on hedging of financial assets and liabilities with comments due by the end of June 2010. The IASB will publish any changes to its initial proposals on the classification and measurement of financial liabilities with comments due by the end of June 2010. (The IASB published proposals for the classification and measurement of financial liabilities in July 2009 but decided not to include financial liabilities within the scope of the first phase of the financial instruments project). The FASB will publish its comprehensive exposure draft covering classification and measurement, impairment and hedging with comments due by the end of June 2010. As part of that proposal, the FASB will solicit views on the IASB’s proposals for recognition and measurement (of both assets and liabilities), impairment, and hedging. The IASB also will publish a request for views on the FASB’s comprehensive Exposure Draft.
	Q2 2010	<ul style="list-style-type: none"> The IASB will review the application of its requirements for classification and measurement of financial assets by those entities early adopting the requirements.
	Q4 2010	<ul style="list-style-type: none"> The boards expect to publish their final standards.
Consolidations		
	Q2 2010	<ul style="list-style-type: none"> The FASB expects to publish an Exposure Draft on consolidations. The IASB will make available a staff draft of its proposed final standard and will also publish a request for views on the FASB proposals.
	Q3 2010	<ul style="list-style-type: none"> The IASB is aiming to publish a final, converged standard on consolidation covering all entity types.
	Q4 2010	<ul style="list-style-type: none"> The FASB is aiming to publish a final, converged standard on consolidation covering all entity types.
Derecognition		
	Q2 2010	<ul style="list-style-type: none"> The IASB and the FASB will assess the differences between U.S. GAAP and IFRS, based on the application of the modified U.S. GAAP requirements. The IASB and FASB will consider together the suitability of a control based derecognition model, which the IASB will have developed over the preceding quarter.
Fair Value Measurement		
	Q1 2010	<ul style="list-style-type: none"> The boards will consider together comments received on the IASB Exposure Draft. In addition, the FASB will decide whether it will need to propose any amendments to U.S. GAAP to improve its requirements for <i>Fair Value Measurement</i> and to also ensure that the requirements are in harmony with the proposed IFRS. If an exposure draft is necessary, the FASB expects to issue it in Q2 2010.
	Q3 2010	<ul style="list-style-type: none"> After the close of the public comment period for the FASB Exposure Draft (if necessary), the boards will deliberate issues jointly. The IASB expects to publish its final standard on <i>Fair Value Measurement</i> and the FASB is expected to finalize any related amendments to U.S. GAAP, if required.

Figure 1. Overview of Main Convergence Projects (Continued)

Project	Date	Milestone
Revenue Recognition		
	Q2 2010	• The IASB and FASB expect to publish an Exposure Draft on Revenue Recognition.
	Q2 2011	• The IASB and FASB are aiming to publish final standards on Revenue Recognition.
Leases		
	Q2 2010	• The IASB and FASB will publish together Exposure Drafts proposing the accounting for leases, from the perspective of the lessor and the lessee.
	Q2 2011	• The IASB and FASB plan to publish together their final standards on accounting for Leases.
Financial Instruments with the Characteristics of Equity		
	Q2 2010	• The boards plan to issue Exposure Drafts.
	2011	• The boards plan to complete the project by mid 2011, issuing a final IFRS in 2011.
Financial Statement Presentation		
	Q1 2010	• The IASB and FASB expect to publish Exposure Drafts proposing a standalone statement of comprehensive income, thereby eliminating the current options for presentation of other comprehensive income.
	Q2 2010	• The FASB expects to publish a proposal to adopt the IFRS definition of a discontinued operation. • The IASB and FASB both expect to publish an Exposure Draft on <i>Financial Statement Presentation</i> .
	Q3 2010	• The FASB plans to finalize the amendments to adopt the IFRS definition of a discontinued operation. • The IASB and FASB plan to finalize the amendments to require entities to present comprehensive income in one statement.
	2011	• The IASB and FASB plan to publish final standards on <i>Financial Statement Presentation</i> by June 2011.

Making It Happen: Share-based Payments and IFRS

Accounting differences between U.S. GAAP and IFRS

Differences between U.S. GAAP and IFRS — even in areas where there has been substantial convergence — could present challenges that span across accounting, tax, systems, and operations for U.S. companies, if not carefully evaluated. A closer look at how U.S. GAAP and IFRS differ for share-based payment plans reveals important issues that companies may need to focus on as they develop an IFRS transition strategy.

Some notable differences that can have significant impact are summarized here:

- **Classification of share-based payments** — determining whether a share-based payment award is classified as a liability or an equity instrument.

Under U.S. GAAP, there are classification rules that permit equity treatment for certain share-based payment awards, which may be settled in cash. Equity treatment of these awards may be desirable from an earnings standpoint, as there is less potential volatility in the income statement.

Under IFRS, some of these bright-line classification exceptions don't exist. Therefore, awards that qualify for equity classification under U.S. GAAP today may be classified as liabilities under IFRS, which would require re-measurement at each reporting period, resulting in potential earnings volatility.

As part of IFRS transition planning, companies may want to examine their existing plans and evaluate whether changes are necessary in an effort to preserve equity classification.

- **Recognition and measurement** — analyzing the effects of graded vesting on the measurement and recognition of share-based payment expense.

Unlike U.S. GAAP, IFRS does not provide the option to recognize and measure an award with graded-vesting (i.e., an option award that vests in tranches over a number of years) as a single award. Therefore, companies with graded vesting awards will need to calculate fair value and record compensation expense for each individual tranche of an option award. This will often lead to an acceleration of share-based payment expense causing potential differences in pretax earnings when compared to U.S. GAAP

- **Effective tax rate** — understanding the effects of stock price volatility on the calculation of deferred tax assets (DTAs) and the effective tax rate.

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Making It Happen: Share-based Payments and IFRS (Continued)

A company will likely need to consider the interplay among share price volatility, the resulting accounting impact on deferred taxes, and the effective tax rate. For the IFRS model, share price fluctuations can cause effective tax rate volatility. Under IFRS, the deferred tax asset calculation is based on the estimated tax deduction at the end of each reporting period, and it is remeasured each reporting period to reflect the change in the current share price. Under U.S. GAAP, the DTA is estimated based upon book compensation expense and then measured when the option is exercised and the deduction is claimed. As a result, there could be fluctuations in the DTA and thus earnings, under IFRS that would not occur under U.S. GAAP.

- **Information systems** — assessing system capabilities and requirements to track share-based payment reporting at different levels.

Information systems that support share-based payment award administration range from in-house manual spreadsheets, vendor packages, and outsourcing to plan record keepers. Each system has its own benefits and challenges. However, with the added complexity involved in measuring and recognizing IFRS compensation expense as mentioned above, companies may need to reconsider their approach — and systems — to these calculations. While major software providers have the ability to track graded vesting tranches, one significant software challenge may reside in the need to perform a parallel analysis of each award under both U.S. GAAP and IFRS during the IFRS transition period.

By gaining a better understanding of the nuances of IFRS and what it may mean for share-based payment plans and administration, companies can develop a more effective IFRS transition plan that considers challenges and potential solutions in advance.

For more information on share-based payments and IFRS, access the publication, “A closer look at share-based payment plans and IFRS: Accounting differences that matter.”

Technical Corner: IFRS 9 Financial Instruments

On November 12, 2009, the IASB issued IFRS 9, which replaces the existing classification and measurement requirements in IAS 39 for financial assets. IFRS 9 is mandatory for annual periods beginning on or after January 1, 2013, with early application permitted. The issuance of IFRS 9 represents the completion of the first phase of the IASB’s project to replace IAS 39. The IASB expects to replace some or all of the remaining portions of IAS 39 during 2010.

The key provisions of IFRS 9 are summarized below:

- **Scope:** IFRS 9 applies to all financial assets within the scope of IAS 39
- **Classification:** IFRS 9 requires classification into one of three categories for measurement and income recognition:
 - o Amortized cost
 - o Fair value through profit and loss (FVTPL); or
 - o Fair value through other comprehensive income (FVTOCI)
- **Classification criteria:** An entity is required to use two classification criteria in determining the measurement attribute for financial assets, (a) business model test — determine if an entity’s business model is to hold the assets to collect its contractual cash flows, and (b) cash flow characteristics test — determine if the contractual cash flows represent payment of principal and interest only.
- **Measurement:** Financial assets that satisfies the above two criteria are typically measured at amortized cost except when an entity irrevocably elects to designate the financial asset as FVTPL at initial recognition. Financial assets that do not meet the criteria are measured at fair value.
- **Equity Investments:** All equity investments, including unquoted equity investments, are classified as FVTPL except when an entity irrevocably designates an equity instrument at FVTOCI at initial recognition.
- **Recognition of gains and losses for FVTOCI:** All gains and losses on financial assets designated as FVTOCI, except dividend income, which is recognized in profit and loss, are recorded in OCI. Amounts in OCI are permanently deferred in equity (no recycling).
- **Embedded derivatives:** Contractual cash flows of hybrid financial assets are assessed in their entirety and are required to be classified as FVTPL in their entirety if cash flow characteristics test is not met.
- **Reclassification:** Reclassification between FVTPL and amortized cost is required under certain situations but is expected to be infrequent.

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Technical Corner: IFRS 9 (Continued)

The table below compares the key provisions of IFRS 9 and the FASB's tentative decisions reached through November 16, 2010¹ on the project to replace the current classification and measurement accounting requirements for financial instruments under U.S. GAAP.

Subject	IFRS 9	FASB's Tentative Decisions
Categories of financial instruments	Provides three categories for financial assets .	Also provides three categories for financial instruments . All financial assets and liabilities within the project scope would be measured at fair value with the exception for certain types of entity's own debt, which may be recorded at amortized cost if certain criteria are met.
Criteria for amortized cost measurement	Provides two criteria; the business model test and the cash flow characteristics test. A financial asset must be carried at amortized cost if the criteria are met.	Provides an entity the option to elect to carry certain types of its own debt at amortized cost if it meets the criteria for classification as FVTOCI and such designation addresses an accounting mismatch.
Criterion for FVTOCI classification	Upon initial recognition, an entity has the option to irrevocably elect to classify an equity investment as FVTOCI.	An entity has the option to classify a financial asset or financial liability as FVTOCI if its business strategy is to hold a debt instrument with principal amount for collection or payment of contractual cash flows rather than sell or settle the debt instrument.
Reclassification of amounts in OCI	Amounts in OCI are permanently deferred in equity.	Amounts in accumulated OCI are recycled to net income upon sale, settlement, or impairment.
Equity investments	All, including unquoted equity instruments, are measured at fair value.	All, including nonmarketable equity securities, are measured at fair value through earnings.
Embedded derivatives in financial hybrid contracts	Hybrid financial assets with embedded derivatives typically would not meet the cash flow characteristics test and would therefore be required to be classified in as FVTPL in their entirety.	Hybrid financial contracts with an embedded derivative that requires bifurcation under ASC 815 will be classified in its entirety as fair value through earnings. Hybrid financial contracts with an embedded derivative that does not require bifurcation under ASC 815 and meets FVTOCI classification criteria are permitted to be classified as FVTOCI.
Fair value option	Retained for financial assets when fair value designation eliminates accounting mismatch; irrevocable election at initial recognition.	No explicit fair value option.
Reclassification	Required for financial assets that meet the cash flow characteristics test if the business model changes; changes are expected to be infrequent.	Not permitted.

For more information on IFRS 9, access Deloitte's publication, "Heads Up: IASB Issues IFRS on Classification and Measurement of Financial Assets."

¹ As noted in our first article, Financial Instruments is one of the major convergence projects and the FASB plans to issue a comprehensive Exposure Draft in the first quarter of 2010 and has not made any final decisions.

² Accounting Standards Codification (ASC) Topic 815 — *Derivatives and Hedging*.

IFRS Survey Stats

A look at the numbers

A Deloitte survey,* with over 150 financial executives participating, was conducted in September 2009 to gather data and information on the latest IFRS trends, views, and assessment activities. Highlights include:

- Seventy percent (70%) of respondents indicated approval for the SEC's proposed roadmap: 51% responded that the SEC should approve the proposed roadmap, but consider pushing back the mandatory deadline a year; and 19% responded that the SEC should approve its proposed roadmap "as is."
- Forty-five percent (45%) of respondents selected "delay in the finalization of the SEC's roadmap" in characterizing the reason why their companies' IFRS assessment plans have been delayed. Only 9% of respondents identified "economic challenges or constraints" as the reason for delaying an IFRS assessment.
- Thirty-four percent (34%) of survey participants indicated IFRS adoption would make the U.S. more competitive in the global marketplace, while 38% responded that IFRS adoption would not.

For the complete survey report, access "[IFRS Survey Results 2009: Current issues.](#)"

* Survey was conducted by Deloitte & Touche LLP. Survey participants were self-selected, and responded through a web-based survey. Polling results are solely the thoughts and opinions of survey participants and not necessarily representative of the total population of financial professionals.

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