

# IFRS Insights

## Achieving a global standard

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### Making it happen:

#### Why a project management office may be necessary for coordinating IFRS efforts

International Financial Reporting Standards (IFRS) projects are typically multi-dimensional — impacting people, processes, systems, and strategy across programs or business areas — and coordinating the related efforts can be challenging. Because there are often a diverse set of internal stakeholders who have varying degrees of knowledge about the transformation and how they may be impacted, it is important to have a change management approach which imparts the proper level of knowledge, commitment, and involvement to the dispersed stakeholders.

#### One approach to consider

As a consequence, it is often advisable to have a project management office (PMO) which serves as a single point of coordination. IFRS-related projects can have a high impact on core operations and financial reporting performance, and the PMO can help to improve efficiencies and reduce risk.

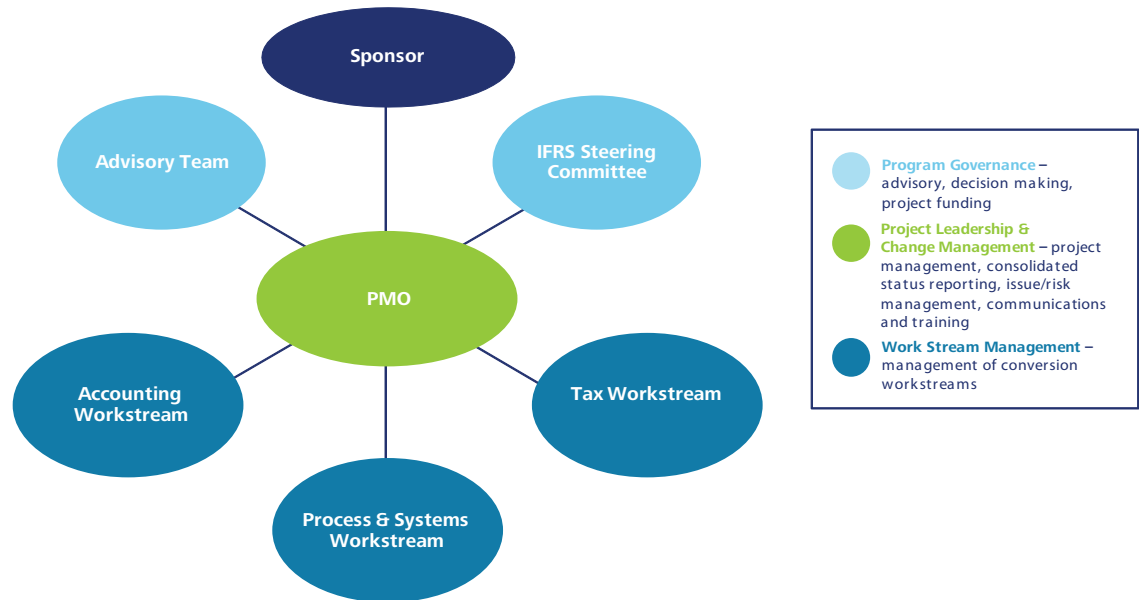
A typical IFRS project consists of independently-managed workstreams, comprising specific issues in such areas as accounting, tax, and systems, process and controls. The PMO can provide the framework, processes, and tools which help create consistency across these workstreams and can facilitate communications and coordination of project-related activities. Project transparency is important, and can be facilitated by common reporting. The PMO typically establishes its linkage to leadership and workstream management by centralizing project control, but the depth of its responsibilities and breadth of authority depends upon how it is positioned within the project structure.

There is no one-size-fits-all approach to positioning the PMO within the project structure; however, two common approaches are the centralized model and the regional model. Regardless of the model, because of its strategic position at the center of the project structure, the PMO can be an important link between the workstreams and leadership to help ensure that successes, critical issues, and risks are rapidly communicated and/or resolved.

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### Centralized PMO

Illustrative example: In this model, the PMO is actively involved in all aspects of the project.



**Responsibilities** — In the centralized model, the PMO typically performs most or all of the key PMO responsibilities and is staffed with a team of project managers who have specific competencies that span from solid communications planning to project delivery. Broadly, the ranges of their responsibilities help:

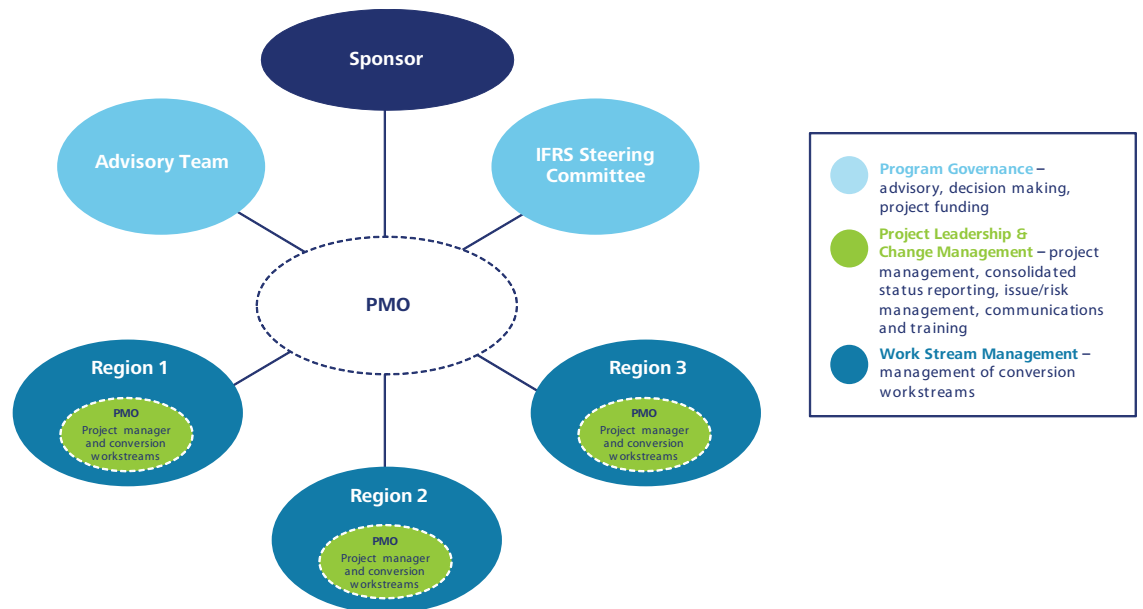
- **Establish communication structure and protocols** — proactively manage communications needs for internal and external stakeholders
- **Establish milestones and develop the overall project plan** — structure project plans to account for key dependencies, milestones, barriers, and timelines
- **Prioritize initiatives and resources** — address changing needs and ensure timely achievement of project deliverables
- **Foster creation and deployment of standard templates** — facilitate a globally-consistent application of IFRS and standardize conversion activities
- **Manage project tracking and reporting** — develop processes to monitor progress against milestones
- **Conduct issue resolution** — anticipate and proactively identify issues and risks and facilitate resolution

- **Monitor the budget** — ensure costs are kept under control
- **Report to the steering committee** — provide updates on a regularly-scheduled basis
- **Coordinate training activities** — develop training on new processes and technical accounting requirements as necessary

**Decision-making** — In this model, most budget, staffing, issue resolution, and risk management decisions are made in the centralized PMO. Critical issues, risks, or decisions are escalated to the steering committee for final resolution.

### Regional PMO

Illustrative example: In this model, there is typically a small centralized PMO that has delegated responsibility and authority out to PMOs located in geographical regions or business units.



**Responsibilities** — The role of the central group is typically advisory and serves as a consolidator of the project information (i.e., status, budget, risks) managed and gathered from the distributed or regional groups.

**Decision-making** — Distributed groups may develop and run their own PMO, but they may use the advisory services of the central group. In addition, distributed groups may get funding from individual business units rather than the central group.

A well structured and operated PMO, regardless of the model used, can provide significant benefits. With its ability to help reduce risk by increasing transparency into workstream planning and execution efforts, contain costs by assisting in the timely completion of project milestones, streamline issue resolution, improve leadership ability to make informed decisions, and drive change to facilitate the adoption of new processes, the PMO can play a vital key role in the success of IFRS projects.

In our experience, the regional model is typically used when:

- Each region or subsidiary is authorized to make its own decisions
- There is limited budget or there are limited resources to devote full-time to PMO responsibilities
- The responsibilities of the central PMO group are limited and focused mostly on consolidated reporting

## Technical corner:

### Transfer pricing and IFRS: Planning is essential

With the global move toward International Financial Reporting Standards (IFRS), companies should be considering whether a change to their transfer pricing is, or will be, warranted. This consideration is important, as transfer pricing plays an important role in a company's overall tax posture. To determine whether a company's transfer pricing is "arm's length," comparisons are made to other unrelated party transactions or to the profitability levels of independent third parties. As the accounting standards used may affect these unrelated transactions or profitability levels, the transfer pricing of some multinational corporations may change during the IFRS conversion period.

We consider three transfer pricing methods here:

#### **Comparable uncontrolled transaction method**

The comparable uncontrolled transaction method compares transactions between related parties to transactions of unrelated parties. For example, Entity A may pay related Entity B a royalty for the use of a trademarked brand name owned by Entity B. In this case, a comparison to similar royalty agreements, based on revenues, between third parties might be made to determine whether the royalty paid between the related parties is arm's length. To the extent that revenues are accounted for differently under U.S. generally accepted accounting principles (U.S. GAAP) and IFRS, the total amount of royalty paid may differ, both for the comparable transactions and for Entity A.

#### **Comparable profits method**

Under the comparable profits method, an entity with related party transactions, referred to as the "tested party," can determine if its profitability is arm's length by comparing it to the profitability levels of comparable companies. Profitability is determined by looking at ratios of profitability measures, referred to as Profit Level Indicators (PLIs), often on a multiple-year basis.

##### **Common PLIs include:<sup>1</sup>**

- Operating Margin = Operating Profits / Sales
- Gross Margin = Gross Profits / Sales
- Net Cost Plus = Operating Profits / (COGS + Operating Expenses)
- Berry Ratio = Gross Profits / Operating Expenses
- Return on Operating Assets = Operating Profits / Operating Assets

<sup>1</sup> As described in Internal Revenue Code §1.482

Each of these PLIs uses financial statement line items. For U.S. companies, the financial data is typically taken from audited financial statements that are filed with the U.S. Securities and Exchange Commission using U.S. GAAP or IFRS. To the extent that the relevant line items differ under IFRS when compared to U.S. GAAP, the profit levels of the tested party or the profit levels of the comparable companies may change. Thus, even with no change to the economics of the company, the company's transfer pricing may no longer be supported as arm's length.

#### **Profit split methods**

Profit split methods are frequently used to allocate profits when two members of the same multinational group own valuable intangible property.

- The first step is to calculate the total profit attributable to the transaction being analyzed. These profits may differ under U.S. GAAP and IFRS.
- The second step, when appropriate, is to allocate an arm's length return to entities that perform routine functions. These arm's length returns are typically derived from a set of comparable companies. As previously discussed, this return has the potential to differ between U.S. GAAP and IFRS.
- The third step is to split the remaining profit using an allocation key. The allocation key is often a financial statement line item, such as sales or R&D expenses, or items such as salaries and bonuses.

In this example, if the bonuses mentioned in the third step include some form of financial instruments or stock-based compensation that is accounted for differently under IFRS than under U.S. GAAP, there may be further differences in the amount of income that would be allocated to each of the entities when a different accounting standard is used.

#### **The importance of transfer pricing planning**

Some corporations' transfer pricing will shift the profitability of the company or will no longer support the underlying transactions as arm's length as a result of the conversion to IFRS of either the tested entity or its comparables. A first step should be to consider what is contained in the intercompany contracts. Can an intercompany contract be altered? Is an accounting standard listed in the contract?

Companies should consider when the accounting standard changes whether the transfer pricing method used still reflects the appropriate arm's length profitability for companies with functions and risks similar to those of the parties involved in the intercompany transactions. Corporations may need to update their transfer pricing documentation. For consistency in accounting methods when testing, it may be appropriate to change the period over which a company's profitability is tested against the profitability of the comparable companies. If the arm's length range of profitability changes under IFRS, it is prudent to properly document why this change occurred, which may also be helpful to both the company's external auditors and the tax authorities' auditors.

Companies may also consider renewing or initiating an advanced pricing agreement (APA) to confirm that their transfer pricing is compliant during the IFRS conversion process. APAs are binding agreements negotiated between one or more taxing authorities and are a viable way for companies to determine that they will not be subject to transfer pricing adjustments upon examination during the period where the APA is binding. If a corporation has been subjected to a transfer pricing adjustment by a tax authority and a conversion in accounting standards has taken place, competent authority proceedings might be considered to mitigate double taxation.

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## Revenue recognition exposure draft

On June 24, 2010, the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) (the Boards) published a joint exposure draft (ED) on revenue recognition. The Boards embarked upon a joint project in 2002 to comprehensively address revenue recognition and this ED (Revenue from Contracts with Customers) is their next step in developing an entirely new revenue recognition standard for both U.S. generally accepted accounting principles (U.S. GAAP) and International Financial Reporting Standards (IFRS).

The ED provides entities with a single comprehensive model to use in reporting information about the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers to provide goods or services. Under the proposed model, revenue is recognized when control of goods and/or services is transferred to the customer.

Under the proposed model, an entity would:

- Identify the contract(s) with a customer
- Identify the separate performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the separate performance obligations
- Recognize the allocated revenue when the entity satisfies each performance obligation

(See next page for further details.)

The proposed model would apply to all contracts with customers except for leasing contracts, insurance contracts, financial instrument contracts, and nonmonetary exchanges.

The proposed standard would also require entities to disclose more information about revenue. Entities would be required to disclose both qualitative and quantitative information about contracts with customers and significant judgments (and changes in judgment) made in applying the proposed standard (including a summary of information about contracts extending beyond one year).

### Effective date and transition

Many companies are beginning to evaluate the implications of these accounting changes. It will be important for them to consider the implications of the ED's provisions on their current revenue recognition accounting policies and whether their systems are capable of capturing the necessary information to comply with the proposed disclosures.

Comments on the ED are due by October 22, 2010. The Boards have not decided on an effective date for the proposed standard, however, according to the revised convergence schedule released recently the final standard is expected to be issued in the second quarter of 2011. When effective, the ED proposes full retrospective application of the model to all contracts.

The IASB and the FASB have also recently issued EDs on insurance contracts and leases. We will provide an overview of these topics in future issues of *IFRS Insights*.

## Steps in applying the revenue recognition model

### Identify the contract(s) with a customer

- A contract is an agreement between two or more parties that creates enforceable rights and obligations. While an entity would most likely apply the provisions of the proposed model to a single contract, there may be situations when an entity would combine two or more contracts (when pricing of contracts is considered interdependent) or would segment a single contract (when goods or services within the contract are priced independently of others).

### Identify the separate performance obligations

- Under the ED, an entity evaluates all goods and/or services promised in the contract to determine whether there are separate performance obligations. The proposals would require an entity to account separately for a good or service if it is distinct, meaning that the good or service is sold separately or could be sold separately because it has a distinct function and profit margin. The proposed guidance may result in more units of accounting in multiple element revenue arrangements than under current guidance.

### Determine the transaction price

- The transaction price is the amount of consideration an entity expects to receive from the customer in exchange for transferring goods or services. That price can be variable because of discounts, rebates, refunds, incentives, performance bonuses/penalties, contingencies, price concessions, or other similar items. If the price is variable, an entity is required to use an estimated transaction price based on the probability weighted amount of consideration expected to be received if it can be reasonably estimated. The proposed model also requires an entity to consider the effects of collectability and the time value of money.
- Entities may recognize revenue earlier than they currently do under existing standards. In addition, because the proposed model requires entities to update the estimated transaction price each reporting period, entities will have to adjust estimated revenue periodically resulting in increased volatility. Some entities may find updating such probability-weighted calculations to be quite time consuming and complex.

### Allocate the transaction price

- The ED requires that the transaction price be allocated between distinct goods or services in proportion to their stand-alone selling price. The observable price of a good or service that is sold separately is the best evidence of a stand-alone selling price. However, in situations where the goods and services are not sold separately, the selling price would be estimated. Any discount to the aggregate of stand-alone selling prices is allocated to all goods or services in proportion to the stand-alone selling price of each.

### Recognize the allocated revenue

- Revenue would be recognized when the customer obtains control of the goods or services. The transfer of control of a product or service can be at a point in time or continuous.
- An entity must also evaluate each individual performance obligation to determine whether it is onerous. A performance obligation is considered onerous if the expected direct cost (probability weighted) to satisfy the obligation are greater than the allocated transaction price. If so, a liability for the onerous obligation is recognized. Currently under IFRS, an entity evaluates the contract as a whole to determine whether it is onerous. Some entities choose to sell items at a loss to generate future profitable business. Under the proposed guidance, an arrangement that includes such items will result in the recognition of an onerous performance obligation once it's considered a contract (as defined in the ED), even if those items are bundled with other profitable items so that the contract as a whole is profitable.

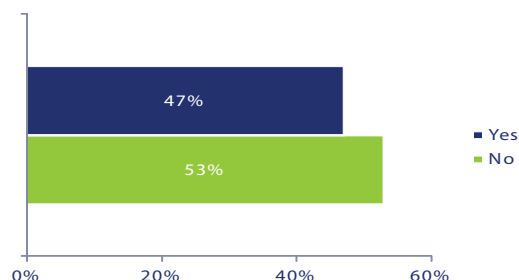
## Industry update:

### Insights from Deloitte's 2010 Oil & Gas IFRS Conference

In late June, Deloitte hosted 65 representatives from 37 companies at its 2010 Oil & Gas (O&G) IFRS Conference. The attendees — including many CFOs, controllers, and accounting directors — heard from keynote speaker Glenn Brady, a member of the International Accounting Standards Board (IASB) working group that is focused on writing a discussion paper about extractive industries. They also had the opportunity to learn about some of the impactful accounting areas for O&G companies, including: extractive activities, full cost, revenue recognition, asset retirement obligations, impairment, joint ventures, inventory, rate-regulated activities, joint ventures, tax, financial instruments, business combinations, and property, plant, and equipment.

At the conference we surveyed the audience on several topics related to International Financial Reporting Standards (IFRS) and IFRS conversions. A sampling of the results are illustrated below and provide some insight into the actions being taken by O&G companies<sup>1</sup>.

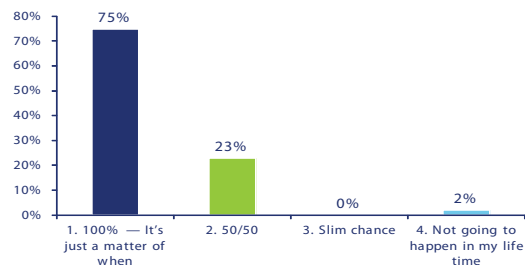
**Question 1:** If your company has foreign subsidiaries, will those subsidiaries be required to report under IFRS within the next two years?



47% responded Yes. This is not too surprising, given the fact that companies in Brazil, Canada, and Mexico will be converting to IFRS within the next two years.

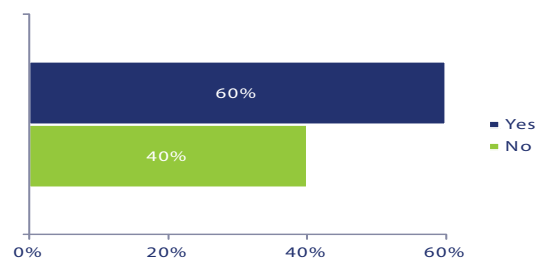
**Question 2:** Using the following scale, how would you rate your company's current view on the potential for IFRS conversion becoming mandatory?

1. 100% — It's just a matter of when
2. 50/50
3. Slim chance
4. Not going to happen in my life time



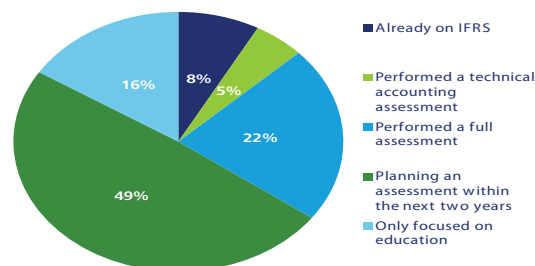
75% percent of the respondents indicated they believe it is just a matter of time. This suggests that the U.S. Securities and Exchange Commission's (SEC) comments over the past five to six months are convincing companies that IFRS conversion will be coming. The remaining questions seem to be, "when will it happen?" and "how much effort will it take to convert?"

**Question 3:** Has your company designated an individual to be responsible for IFRS?



60% of respondents said Yes. This indicates the desire of companies (management and audit committees) to start analyzing what the impact of IFRS could be on the company, both in terms of resources and financial statement accounts.

**Question 4:** How ready is your company for IFRS?



Almost half of the respondents indicated they are planning to do an assessment within the next two years, and 27% have done some sort of assessment already. At the other end of the spectrum, 16% indicated they were not planning to do anything other than provide education on IFRS at this point.

<sup>1</sup> This document contains the results of an informal survey conducted by Deloitte. These survey results are provided for informational purposes only. These results were taken from the participants "as is" and were not validated or audited by Deloitte.

## IFRS resources

We have two upcoming training events planned if you're looking to learn more about IFRS through courses that offer CPE credit:

- Join us for two days of IFRS executive training in Houston on September 28–29. [Check our website for more details and registration information.](#)
- Attend our one-day IFRS Boot Camp, presented by Deloitte and Financial Executives International (FEI), in New York City on November 17. [Go to FEI's website for additional information.](#) Make sure to enter "Deloitte" in the source code box when you register to receive a discounted rate of \$895.

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