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IFRS Insights
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Leveraging the IFRS Experience

A Look at Practical Lessons Learned

International Financial Reporting Standards (IFRS) are used in more than 100 countries worldwide, and although they are not currently mandated for U.S. public companies, statutory developments in countries such as the United Kingdom and Brazil, along with planned adoptions for countries such as Canada, South Korea and Mexico, present near-term challenges for companies with a global presence. Additional challenges are also arising from the convergence project between the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB).

While the first step typically faced when implementing IFRS is identifying and monitoring the accounting differences between IFRS and U.S. Generally Accepted Accounting Principles (U.S. GAAP), there are a number of other issues that can be more pervasive. To that end, based on our experience, below are some practical considerations for CFOs and their audit committees about planning for and implementing IFRS.

Identify the potential efficiencies

A conversion to IFRS provides an opportunity to use a "clean sheet" of paper. IFRS requires applying consistent accounting policies across a consolidated group, which presents companies with an opportunity to streamline their statutory reporting from potentially many GAAPs to only a few or even one. Thus, companies will be provided an opportunity to simplify their financial reporting systems and/or create a shared services center that may help improve operational efficiencies. Companies transitioning to IFRS from U.S. GAAP should consider streamlining operational adjustments, including systems, tax, people and process implications.

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Leveraging the IFRS Experience (continued)

Develop a roadmap

Although there is no "date certain" for mandatory IFRS adoption by U.S. public companies, the U.S. Securities and Exchange Commission (SEC) suggested as part of their work plan announcement that, for larger companies, this may be in 2015 or 2016. That might seem far away, but remember this: as currently proposed under the IFRS Roadmap, companies will need two years of comparative information, which equates to a transition date as early as January 1, 2013. For many companies, this means they should consider starting their efforts to collect necessary data and incorporate operational changes in current systems and processes soon. The most important point here is to develop a roadmap for the transition and to communicate that approach to stakeholders. Clarity around timing can serve as a guiding force for the planning effort.

Issue prioritization

In our experience, although the volume of U.S. GAAP/IFRS differences at companies might be in the dozens, there are typically five to ten issues that drive 70-80% of the work. It is therefore important to identify these priority issues at the outset of the project, so that granular implementation planning is done in these areas. In our experience, it is typically more cost effective to take a top-down, targeted approach to implementation rather than to build detailed plans regarding any and all differences. We typically find that differences which impact accounting sub-ledgers require the greatest implementation effort.

Managing convergence

For many companies, the requirement to implement many U.S. GAAP standards over the next several years may further complicate the IFRS conversion process. One step that companies can take to manage this complexity is to develop issue-based, comprehensive plans which assess the system, process, disclosure and tax implications of a specific issue (e.g., consolidations or leases) across both U.S. GAAP and IFRS. Conversion challenges expected over the next three to four years should also be included. Accounting changes should be viewed as a single effort, as opposed to multiple, separate projects.

Mind how you communicate

The differences between U.S. GAAP and IFRS and the downstream impacts can be difficult to comprehend, and project-related communications (both internal and external) are often under-scoped. Underscoping may lead to ad hoc questions and concerns about the ultimate impact of IFRS on a company's management reporting and key metrics. It is critical to develop a mechanism, such as an internal website, so that effective communication can be timely and frequent.

These are just a few of the potential issues that CFOs should consider when planning for IFRS. The bottom line: preparation, collaboration and communication are all important for a successful transition.

Making it Happen: IFRS and Statutory Reporting

Statutory Financial Reporting Developments

Many U.S.-based multi-national companies have already been dealing with the effects of IFRS as a result of their foreign subsidiaries. Many countries require or permit IFRS for statutory financial reporting purposes and many more countries have indicated they plan to follow suit in the foreseeable future.

Several countries have recently announced proposals to move to IFRS for statutory reporting purposes in the near future. For example, the United Kingdom and Ireland have proposals pending that would replace UK GAAP with IFRS and require reporting under either IFRS (as adopted by the European Union) or IFRS for Small and Medium-sized Entities (SMEs) as early as 2013 (based on recent indications from the UK Accounting Standards Board). A number of countries also continue to focus on converging local GAAP and IFRS, including Brazil, which has set 2010 as the target date for full convergence with IFRS.

Historically, statutory reporting has primarily been accomplished at international locations and has received less attention at a corporate level. However, in an IFRS environment, the potential for adoption of a consistent set of accounting standards at many locations causes a need for consistent application throughout the organization and creates an opportunity for standardizing and centralizing statutory reporting activities. In addition, the tax implications of statutory IFRS changes in certain jurisdictions can be greater than many executives expect.

What are U.S. companies doing now?

Some U.S. companies have begun to focus on developing multi-year plans in an effort to minimize the risks and maximize the benefits associated with an overall conversion to IFRS.

Potential Methods to Minimize Risks	Potential Methods to Maximize Benefits
• Ensure compliance with jurisdictional regulatory requirements • Avoid overlooking issues, including tax planning and cash tax implications, while working through a rushed conversion • Understand other cash implications of conversion (i.e., pension funding requirements) • Effectively manage communication between corporate and statutory locations	• Identify optimal conversion sequencing and timing • Ensure alignment with overall IFRS organizational objectives • Optimize resource use • Streamline statutory reporting process and reduce costs associated with maintaining multiple GAAPs • Simplify group reporting and consolidation procedures • Strengthen internal controls over financial reporting by standardizing processes • Leverage training and experience gained on earlier statutory conversions

Statutory transition strategy and conversion plan

For those U.S. multi-national companies that have not already done so, it is important in the near-term to consider developing a statutory transition strategy and conversion plan. Key steps should include:

- Conducting a detailed statutory reporting requirements analysis
- Assessing conversion impacts
- Developing a proposed timeline for conversion
- Developing a global IFRS accounting and conversion policy

Detailed statutory reporting requirements analysis

As a first step, consider completing an inventory of current IFRS reporting requirements and assess jurisdictional statutory reporting requirements. As part of this assessment, the company should determine the locations where it may already be reporting under IFRS or IFRS for SMEs, where it currently doesn't report under IFRS but IFRS is permissible, and where IFRS is not currently allowed but soon will be permissible.

For those locations currently reporting under IFRS, the focus during this stage should be on identifying accounting policies and elections made to determine if divergent policies exist throughout the organization. For those locations not yet reporting under IFRS, the focus should be on evaluating if, and when, conversion efforts should be conducted.

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Making it Happen: IFRS and Statutory Reporting (continued)

During this first step a company should also identify current resources and processes used either in-country or at shared service centers in order to comply with jurisdictional regulatory requirements. Following this analysis, a company should be able to identify professionals within the organization that have IFRS experience and could assist in the overall IFRS conversion effort in the future.

Implementation roadmap

Based on the statutory reporting assessment, an initial timeline for IFRS implementation is developed for locations where IFRS is either required or deemed advisable. The statutory conversion plan and timeline should be flexible and adaptable to both internal and external forces of change, including future legislative changes, legal entity structure changes, funding and budgeting changes and other corporate initiatives.

For those jurisdictions where IFRS is not permitted or there is little convergence between local GAAP and IFRS, future efforts should focus on monitoring these jurisdictions to determine whether modifications to the current plan and timeline will be required.

Global IFRS accounting and conversion policy

We recommend that companies develop a global IFRS accounting policy manual and conversion roadmap so that consistent accounting policies will be communicated and adopted globally. The manual and roadmap should provide guidance on how significant judgments in the application of IFRS accounting policies should be made, including addressing first-time adoption elections. Keep in mind that adoption elections that subsidiaries deem best for themselves might not necessarily be best for their U.S. parents, and, if the process is not centrally-controlled, those elections may vary widely among subsidiaries of a given company.

U.S. multi-nationals that actively participate in their subsidiaries' IFRS adoption can obtain significant cost savings because their participation may help reduce divergent policy elections, enabling them to maximize the advantages of being on one set of global accounting standards.

Technical Corner: Hedge Accounting

In November 2008, the IASB added the comprehensive financial instruments project to its agenda, which consists of three main phases: (click on each title below for additional information)

- Phase 1: **Classification and measurement**
- Phase 2: **Impairment methodology**
- Phase 3: **Hedge accounting**

As part of Phase 3, the IASB plans to conduct a comprehensive review of the current hedge accounting requirements. The IASB has tentatively decided to replace fair value hedge accounting with an approach similar to cash flow hedge accounting. The new approach would result in:

- the effective portion of the gain or loss on the hedging instrument being recognized outside profit or loss (i.e., in other comprehensive income), rather than as an adjustment to the carrying amount of the hedged item.
- the ineffective portion of the gain or loss on the hedging instruments being recognized in profit and loss, regardless of whether the ineffectiveness was caused by the fair value changes of the hedging instrument exceeding that of the hedged item or the fair value changes of the hedging instrument being less than that of the hedged item (i.e., the new approach for fair value hedge accounting will not contain a similar "lower of test" for cash flow hedge accounting).

The IASB has also tentatively agreed on:

- allowing derivatives, components of nominal amounts (i.e., proportions) and one-sided risks generally to qualify as eligible hedged items (subject to any limitations to hedge accounting on which the IASB may decide as this phase of the project progresses).
- exploring a new criterion for the purpose of determining risk components eligible for designation as hedged items.

The IASB continues to deliberate the hedge accounting model and expects to issue an exposure draft by the end of the third quarter of 2010 and a final standard by the end of the first quarter of 2011.

Industry Update

IFRS Considerations for the Oil & Gas Industry

The global movement towards IFRS represents a significant change for oil and gas (O&G) companies, and there are several key business and accounting factors driving the need for the industry to take notice of IFRS. A few examples include: mergers and acquisitions, extractive activities and leases.

Mergers and acquisitions (the business environment)

The energy industry is seeing a significant amount of activity in merger and acquisition transactions with indications that this will continue in the near-term. As a result, there are many transactions that could involve a target or buyer that utilizes IFRS for accounting purposes. This may create a challenge for the acquisition due diligence team, as it might be required to "translate" the accounting concepts and results while reviewing an entity for potential acquisition. This challenge could be magnified if a transaction closes and the purchased entity undergoing integration is required to convert because its new or former owner reports under IFRS.

Extractive activities (the accounting environment)

Of particular relevance to the upstream O&G sector is the IASB's April 2010 discussion paper (DP) on the topic of extractive activities. The purpose of the DP is to analyze the unique financial reporting issues applicable to mining and O&G companies. Four key areas relevant to the O&G industry are addressed in the discussion paper, including estimation and classification of discovered quantities, accounting for O&G properties, measurement of O&G properties and disclosures about extractive activities.

The DP proposes a common basis for defining "reserves and resources," which could lead to changes in existing accounting and disclosure practices given the varying definitions currently used. The DP also proposes that the accounting for O&G properties should be based on the legal rights to that property (i.e., exploration or extraction rights), which is consistent with the existing IFRS Framework, but not necessarily with local GAAP (particularly those jurisdictions that are focused on cost-deferral and phase-based recognition models).

Regarding measurement, the DP proposed that O&G properties should be measured at historical cost, supplemented with detailed disclosure about the entity's O&G properties. While historical cost is currently the dominant model, there are variations in practice which could change in converting to a single measurement basis.

Finally, the DP proposes to require disclosures on the value of O&G properties (e.g., quantities, current value measurement, assumptions and estimates), the contribution that O&G properties make to the entity's performance (e.g., revenues, expenses and capitalized costs) and the risks and uncertainties associated with O&G properties. The impact of these proposed disclosures may vary significantly given current diversity in practice.

Leases

Given the prevalence of leases in the O&G industry, lease accounting differences between IFRS and U.S. GAAP could pose a challenge to a company's IFRS implementation. U.S. GAAP and IFRS differentiate between operating leases and those that are recorded on the balance sheet (i.e., capital leases under U.S. GAAP and finance leases under IFRS). However, the general principle under IFRS results in finance lease treatment when substantially all risks/rewards incidental to ownership have been transferred, and does not provide the "bright line" numerical thresholds that exist under U.S.GAAP. As a result, there may be an increased use of professional judgment that could result in leases being classified differently under IFRS than under U.S. GAAP.

The FASB and the IASB (the Boards) are currently working on a joint project to bring to convergence U.S. GAAP and IFRS in this area. As to lessee accounting, the Boards are developing a new approach that would result in a lessee recognizing an asset representing its right to use the leased item for the lease term and a liability for its obligation to pay rentals. The new approach would therefore cause a lessee to recognize on its balance sheet contracts that it might have previously accounted for as operating leases (i.e., off-balance sheet).

As to lessor accounting, the Boards have had much debate on whether the new approach should treat the lessor's obligation to permit the lessee to use the leased item as a performance obligation (i.e., a liability) that the lessor would amortize into income over the lease term or treat essentially as a sale of all or part of the leased item.

Please join us for an educational program exploring the potential implications of IFRS to the O&G industry in Houston, TX on June 16-17. Please **click here** to register for the two-day IFRS training event.

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