

# IFRS Conversion Practical Implications for US Companies

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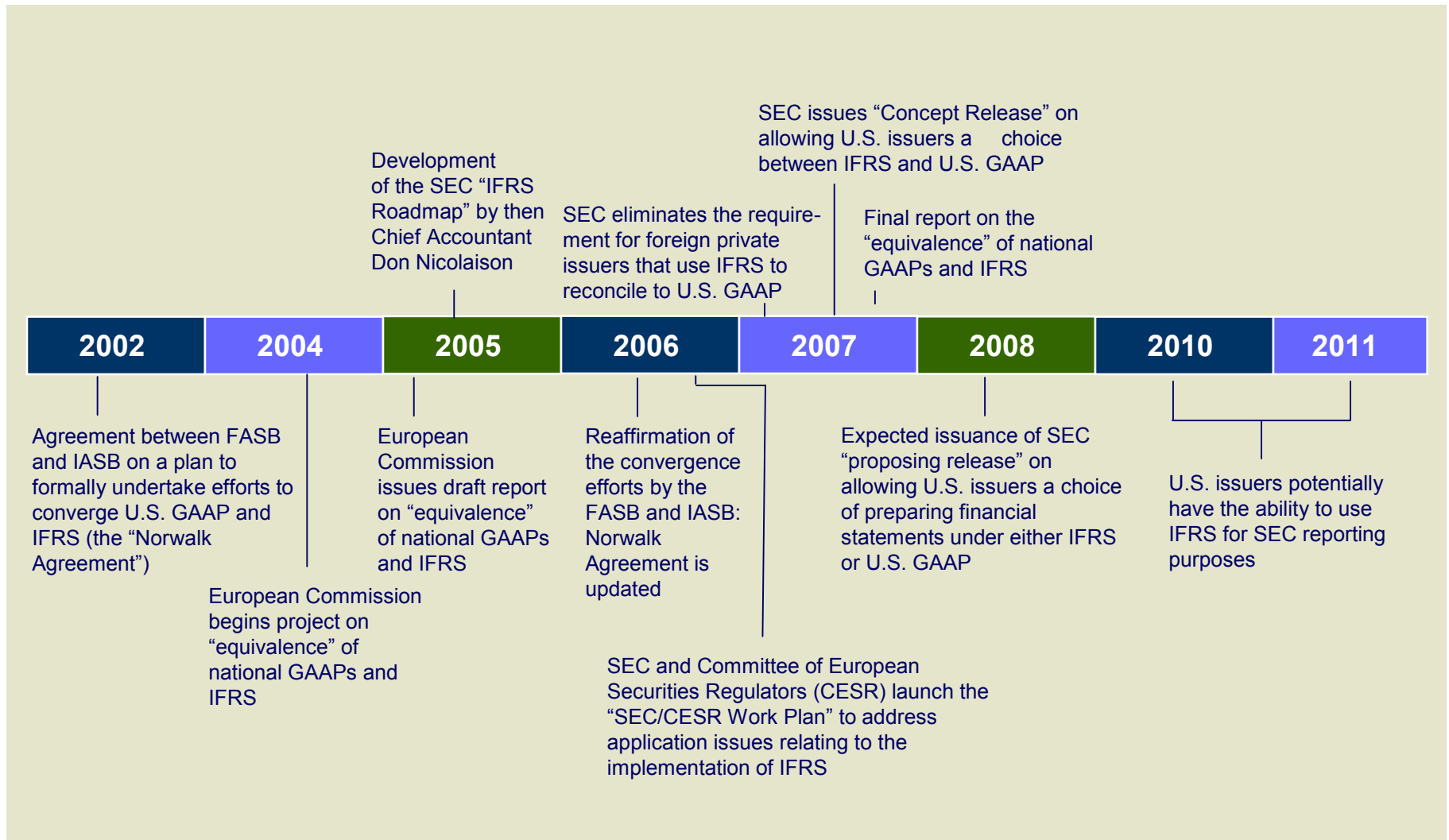
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# Agenda

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- IFRS today and tomorrow
- What should US companies do today?
- What does Conversion mean?
- Practical examples of IFRS differences
- Questions and answers

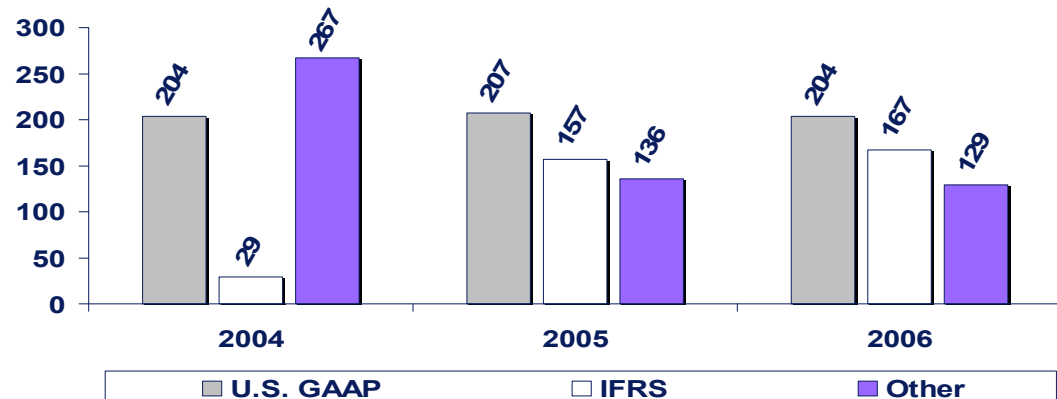
# The IFRS Timeline



# IFRS Today and Tomorrow

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- Today IFRS is used in over 100 countries:
  - Required across all EU countries, starting in 2005
  - Large countries like Brazil, Canada and India have announced mandated adoption
  - Approximately 40% of Global Fortune 500 currently use IFRS
- By 2011, it is expected that:
  - All major countries will have adopted IFRS to some extent
  - China and Japan will be substantially converged to IFRS
  - U.S. public companies will likely have the option of using either IFRS or U.S. GAAP
  - Substantial majority of Global Fortune 500 will report under IFRS



# Regulatory Developments

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- SEC rule change to eliminate the reconciliation to U.S. GAAP for foreign companies using IFRS
- SEC Concept Release on allowing U.S. issuers a choice between IFRS and U.S. GAAP
- Equivalence initiative for U.S. GAAP in the EU
- Greater cooperation between the SEC and international regulators on IFRS application issues
- Continuing convergence efforts between IASB and FASB
- Movement in the U.S. to simplify financial reporting

# SEC Concept Release

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- Asks questions on the impact of allowing U.S. issuers a choice of either IFRS or US GAAP
- Feedback from comment letter and roundtables held on December 13 and 17, 2007:
  - Significant support for use of IFRS in the US
  - Proposing release expected in first half of 2008
- Rule changes expected to allow IFRS adoption for US registrants by 2010 or 2011
- Proposing release sets the stage for possible mandatory adoption of IFRS in the U.S. at a later date

# IASB/FASB Convergence Efforts

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- Focus of convergence is on the process and on converging general principles
  - Less focus on converging details
  - Convergence will decrease but not eliminate differences
- Areas where IFRS and U.S. GAAP are not converged:
  - Consolidation policy, impairment, liabilities, intangibles
- Areas where there are differences in the “details”:
  - Revenues, income taxes, leases, pensions, business combinations, share-based payments

# What should US Companies do today?

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## Assess current IFRS impact within the Company

- What IFRS reporting requirements does the Company currently have for statutory or other purposes?
- How are these requirements and related risks currently managed?

## Evaluate future impact of IFRS

- In what countries is IFRS expected to apply in the future?
- Do competitors report under IFRS, or are they expected to convert in the near future?

## Evaluate opportunities and challenges of IFRS

- Is there a business case to implement IFRS, in order to reduce current reporting costs or risks?
- What are the pros and cons of implementing over a planned time horizon, vs. waiting for a possible mandated implementation?
- Consider that IFRS has an impact on more than financial reporting (i.e. systems, people, tax accounting, treasury and investor relations)

# Companies that are likely to start early?

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- Companies with some of the following characteristics are like to start conversion early:
  - international operations with statutory IFRS reporting
  - companies with JVs reporting under IFRS
  - competitors that have moved to IFRS
  - restrictive US GAAP accounting policies
  - long lead time to get ready for a mandatory conversion
- Companies with some or all of these characteristics:
  - Can benefit from IFRS conversion, and/or
  - May be exposed to risks if they do not start early

# What does Conversion mean?

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- A transformation of
  - How the Company will be measured internally and externally
  - How the Company will conduct its day to day business
  - How significant transactions will be entered into
  - Who will be included in the Company's peer group

# What does Conversion mean?

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*An Army of Accountants?*

# Overall Implementation Methodology

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## Assess readiness

- Determine global reporting requirements
- Assess the potential impact of IFRS on accounting and reporting environment
- Perform initial analysis of GAAP differences
- Identify IFRS required countries
- Preliminary assessment of IFRS in countries where it is optional
- Assess long-term strategy with respect to IFRS implementation

## Create a detailed plan for implementation

- Create a project plan
- Plan resources, and assign roles and responsibilities
- Identify Steering Committee and Advisory Group members
- Identify training needs
- Implement a web-based project management tool
- Set milestones and plan key meetings
- Assemble a project team

## Prepare and execute

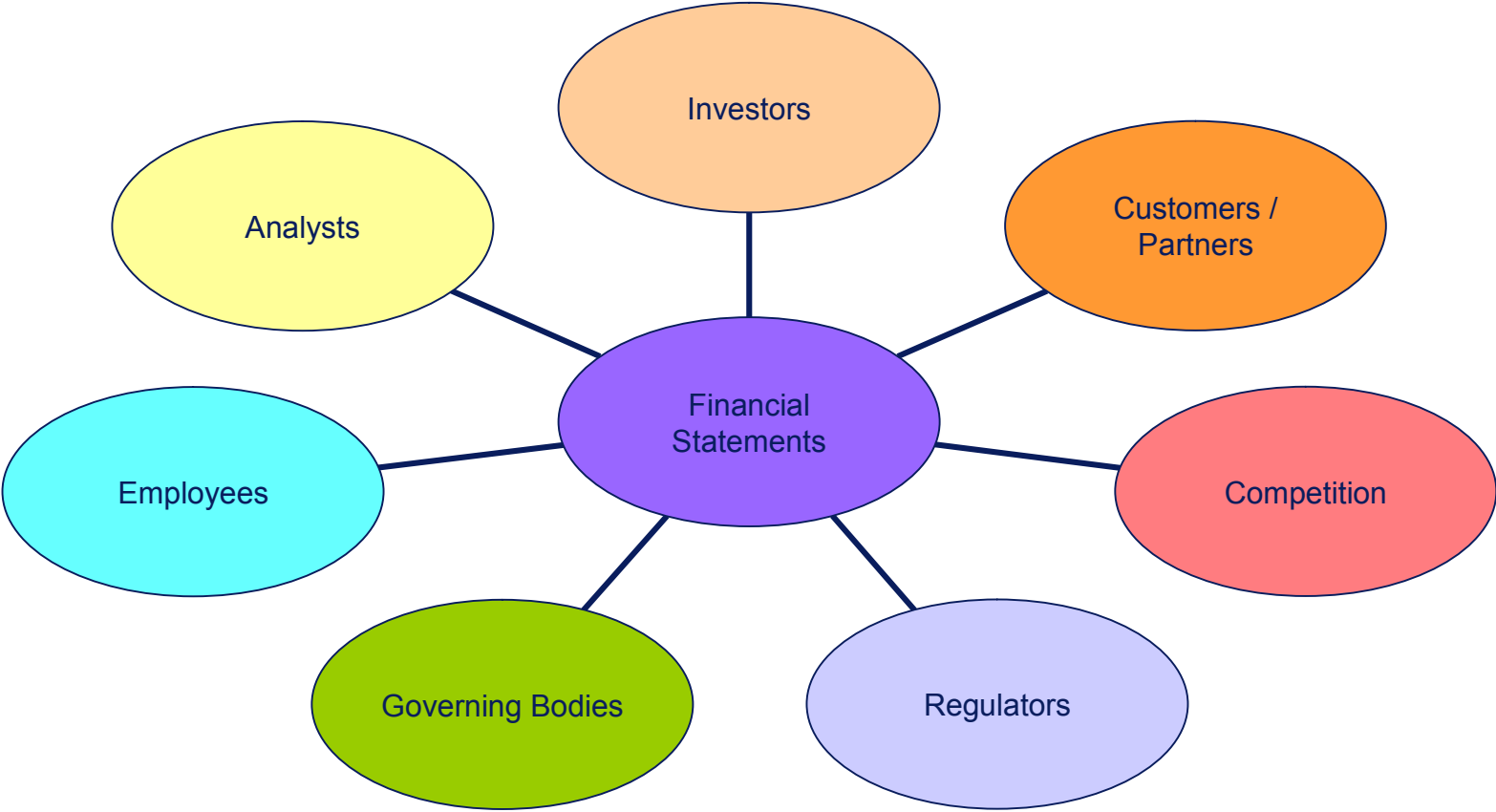
- Select and document global IFRS policies
- Conduct opportunities assessment
- Conduct detail analysis of GAAP differences
- Prepare IFRS compliant financial statements
- Develop tools for convergence and ongoing compliance
- Develop training materials and conduct training

## Develop a plan for sustainability

- Develop a sustainable “business as usual” IFRS accounting and reporting process
- Embed IFRS reporting in existing financial reporting systems
- Develop protocols and procedure for IFRS reporting
- Monitor compliance with ongoing reporting requirements

# Affected Parties

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# Assemble a Project Team

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- IFRS Conversion is a full time job.
- The Project Team should be diverse.
  - Different departments
  - Different geographies.
  - Corporate & Subsidiary

# IFRS Conversion Challenges & Success Factors

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- **Challenges**

- A Change in Mindset!
- Consistent Application
- The Conversion
- US GAAP errors?

- **Success Factors**

- Controlled implementation
- Stakeholders
- PMO Structure
- Controls & procedures
- External Advisors
- Auditor Involvement
- Consultation structure
- Training

# Change in Mindset

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**IFRS will be chaos.  
There are no rules!**

**Under US GAAP more time is  
spent finding loopholes  
around rules than reflecting  
the substance of transactions.**

# A Change in Mindset

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- Rules versus principles: “Where does it say that I cannot do this?”
- Example: Revenue Recognition/Multiple Elements
  - IFRS: “...However, in certain circumstance, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction...” and “...Conversely, the recognition criteria are applied to two or more transactions together when they linked in such a way that the commercial effect cannot be understood without reference to the series of transaction as a whole...”
  - US GAAP: EITF 00-21, SAB 104, SOP 97-2 etc
- Principles based approach put the burden on preparers and auditors to do the right thing!

# Consistent Application

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- Consistent inter- and intra-firm application of IFRS can be a challenge
- Will everybody within the organization have a consistent understanding and approach in the absence of bright line criteria.
- For example: Leasing
  - IFRS: “The lease is for the major part of the economic life of the asset”
  - US GAAP: “The lease term is equal to 75% or more of the estimated economic life....”
- How do other companies apply IFRS?

# The Conversion

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- Most Companies have reported between 5 and 10 differences between IFRS and US GAAP, however:
  - Many more differences have to be addressed;
  - Significant effort required to document areas that do not result in differences.
- The IFRS standards to be applied are a moving target as a result of IFRS 1 requirement to apply standards in effect as of the reporting date.
- Companies must maintain US GAAP and IFRS during transition and SEC may require related disclosures
- The impact on many other aspects of the organization is often underestimated.

# US GAAP Errors?

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- Implementation often represents an unprecedented evaluation of current accounting policies under US GAAP.
- The evaluation of the IFRS impact may shed new light on US GAAP conclusions
- Implementation of IFRS standards does not consider materiality
- Consider what to do with potential errors.
  - IFRS requires a reconciliation from US GAAP to IFRS in the first IFRS financial statements
  - Expectation that SEC will require a reconciliation from US GAAP to IFRS for a transition period

# Success Factors for Conversion

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- Develop a high level IFRS strategy for multiyear controlled conversion project
- Consider all internal and external stakeholders
  - Not limited to finance department
- Dedicated core implementation PMO with appropriate structure
  - Stakeholder involvement in PMO structure
- Central PMO with decentralized implementation
  - Central support with local execution
- Integration of IFRS in financial reporting controls and procedures

# Success Factors for Conversion (cont)

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- Match involvement of external advisor with internal resources
  - Don't let the conversion happen to you
- Involvement of independent auditor from an early stage
  - Avoid late surprises
- Develop consultation protocol with corporate and/or service centers
  - Critical for consistency
- Training at central and decentralized level
- Do not underestimate the effort!

# Identifying Differences

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- Identify all current policies under US GAAP
- Utilize existing publications to cross reference
- Identify all theoretical differences
- Identify all practical differences

# Adopting IFRS

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- Identify the first IFRS financial statements
- Comply with all of the version of IFRS effective at the reporting date
- Prepare an opening balance sheet at the date of transition to IFRS
- Select accounting policies and apply those policies retrospectively to all of the periods presented in the first IFRS financial statements
- Recognize all assets and liabilities in accordance with IFRS, and derecognize all assets and liabilities not in compliance with IFRS
- Recognize in equity in the opening balance sheet the effect of changes in accounting policies
- Consider whether to apply any of the 10 exemptions from retrospective application
- Apply the four mandatory exceptions from retrospective application
- Disclosures to explain the transition to IFRS from US GAAP

# Adopting IFRS (cont'd)

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- Key definitions:
  - **First IFRS financial statements:** The first annual financial statements in which an entity adopts IFRS by an explicit and unreserved statement of compliance with IFRS
  - **Date of transition:** The beginning of the earliest period for which an entity presents full comparative information under IFRS in its first IFRS financial statements
  - **Reporting date:** The end of the latest period covered by financial statements or by an interim financial report
- IFRS 1 principles require the full retrospective application of all IFRS standards at the closing balance sheet date for the first IFRS financial statements
- There are 10 optional exemptions that reduce the burden of retrospective application
- There are four mandatory exemptions where retrospective application is not permitted

# Adopting IFRS (cont'd)

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- **Exemptions from retrospective application:**

- Business combination and the scope of consolidation
- Fair value as deemed cost
- Employee benefits
- Cumulative translation differences
- Compound financial instruments
- Designation of financial assets and financial liabilities
- Share-based payments
- Insurance contracts
- Assets and liabilities of subsidiaries, associates and joint ventures

- **Mandatory exemptions from retrospective application**

- Estimates
- Assets held for sale and discontinued operations
- Derecognizing of financial assets and financial liabilities
- Hedge accounting

# Major Differences in Practice

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- IFRS 5 – Non-Current Assets Held for Sale and Discontinued Operations
- IAS 2 – Inventories
- IAS 12 - Income Taxes
- IAS 17 – Leases
- IAS 19 – Employee Benefits
- IAS 36 – Impairment of Assets
- IAS 37 – Provisions, Contingent Liabilities and Contingent Assets

# IFRS 1 – First time adoption of IFRS

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<b>Concept</b>	<b>IFRS</b>	<b>US GAAP</b>
Resetting of CTA	Most companies elect to reset their CTA	
Employee Benefits	Deferred Gains and losses can be released	
Business Combinations	Post-tax income/loss is required on the face of the income statement.	Pre and post-tax income/loss is required on the face of the income statement.

# IFRS 5 – Discontinued Operations

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<b>Concept</b>	<b>IFRS</b>	<b>US GAAP</b>
Definition of a discontinued operation	A reportable business or geographic segment or major component thereof.	A component which may be an operating segment, a reporting unit, a subsidiary or asset group.
Continuing involvement.	Not addressed.	Disposing entity should have no continuing cash flows representative of significant continuing involvement.
Presentation	Post-tax income/loss is required on the face of the income statement.	Pre and post-tax income/loss is required on the face of the income statement.

# IAS 2 - Inventories

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<b>Concept</b>	<b>IFRS</b>	<b>US GAAP</b>
Reversal of inventory write-downs.	Required, if certain criteria are met.	Prohibited.
Measurement.	LIFO is prohibited.	LIFO is permitted.

# IAS 12 – Income Taxes

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<b>Concept</b>	<b>IFRS</b>	<b>US GAAP</b>
Classification	Always presented as non-current.	Classified based on the related underlying asset or liability or on expected reversal of item.
Tax rate for measuring DTAs / DTLs	Use substantively enacted tax rate.	Use enacted tax rate.
Uncertain tax positions	Accounting for tax consequences reflects management's expectations.	Accounting is based on the sustainability of tax position.

# IAS 17 - Leases

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<b>Concept</b>	<b>IFRS</b>	<b>US GAAP</b>
Leases of land and buildings	Land and building elements are considered separately unless land element is not material.	Land and building elements are generally accounted for as a single unit, unless the land represents >25% of the total leased property.
Present Value of Minimum Lease Payments	Generally, the rate implicit in the lease is used to discount minimum lease payments.	The lessor must use the implicit rate while leasee should use the lower of the incremental or implicit rate.
Recognition of gain on an operating SLB.	Recognized immediately.	Amortized over the lease term.
Recognition of gain on a finance SLB.	Recognized over the lease term.	Recognized over the useful life of the asset.

# IAS 19 – Employee Benefits

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<b>Concept</b>	<b>IFRS</b>	<b>US GAAP</b>
One-time termination benefits	No distinction is made.	Minimum retention period.
Recognition of curtailment gains/losses	Recognized when entity is demonstrably committed and curtailment has been announced.	Curtailment loss is recognized when probable and estimable. Curtailment gain is recognized when employees are terminated, the plan is suspended or amendment is adopted.
Multi-employer plan that is a defined benefit plan.	Should be accounted for as a DB if the required information is available otherwise as a DC.	Account for the plan as a DC.

# IAS 36 - Impairment

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<b>Concept</b>	<b>IFRS</b>	<b>US GAAP</b>
Trigger for impairment	Impairment exists when carrying value exceeds FV less costs to sell or value in use.	Impairment exists when carrying value exceeds undiscounted cash flows.
Impairment test and measurement	One step approach.	Two step approach
Reversal of impairment	Required for all assets except for goodwill if certain criteria are met.	Prohibited.

# IAS 37 - Provisions

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<b>Concept</b>	<b>IFRS</b>	<b>US GAAP</b>
Measurement of Provisions	Accrue best estimate. Discounting is required where time value of money is material.	Accrue most probable outcome and discount only if fixed and determinable cash flows.
Decommissioning Provision	Use risk adjusted rate to discount upon initial recognition and adjust each reporting period.	Use the credit adjusted risk free rate upon initial recognition. Do not adjust the rate in future periods.
Restructuring	Recognize provision if detailed, formal plan announced or implementation has begun.	Recognize upon formal commitment, i.e. a detailed formal plan is not enough.

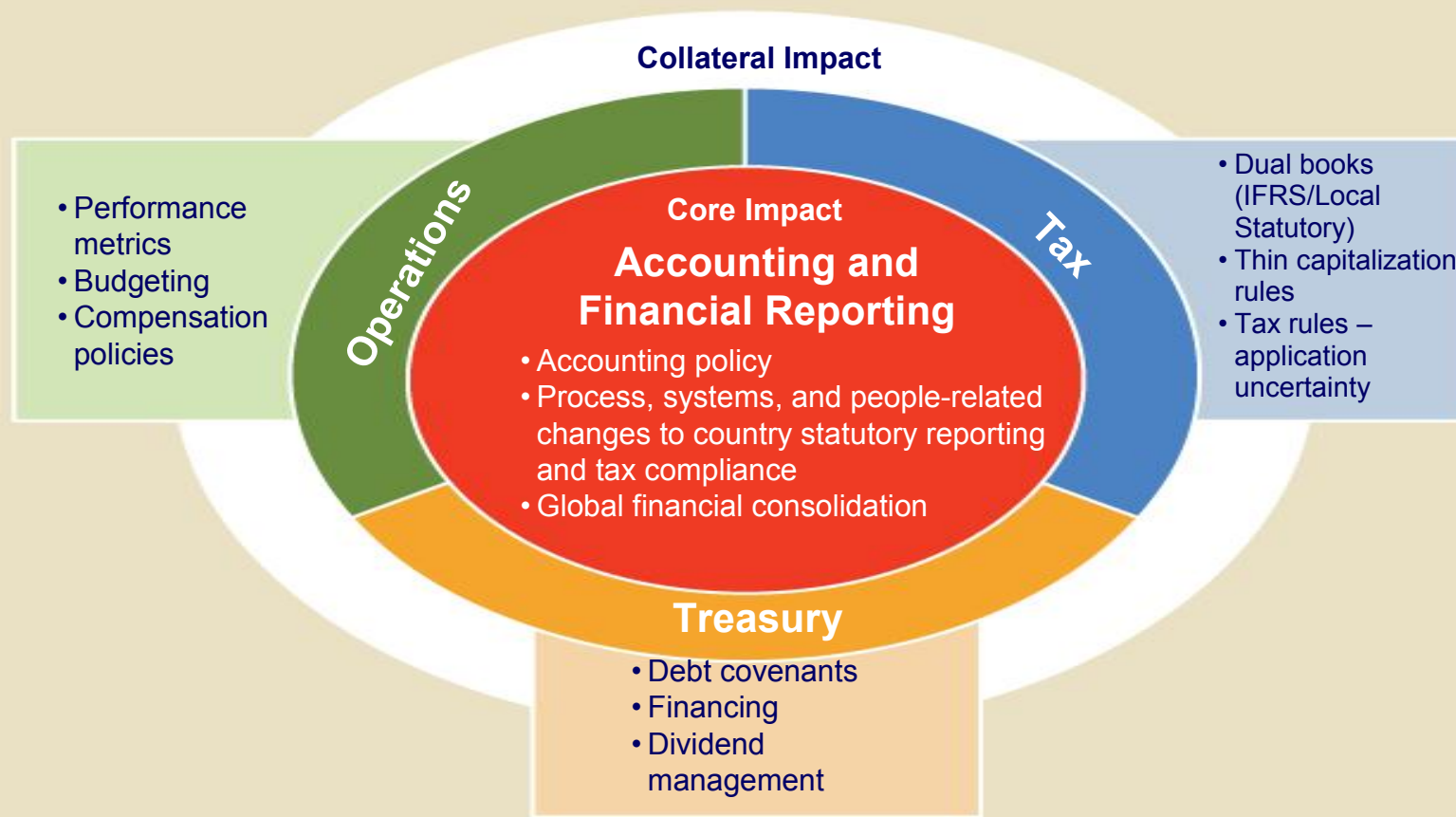
# Identifying Differences

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- Deloitte & Touche – “IFRS in your Pocket” published March 2007
- <http://www.iasplus.com/dttdpubs/0703ifrsusgaap.pdf>
- PWC – “Similarities and Differences” published October 2007
- [http://www.pwc.com/gx/eng/about/svcs/corporatereporting/SandD\\_07.pdf](http://www.pwc.com/gx/eng/about/svcs/corporatereporting/SandD_07.pdf)
- Ernst & Young -  
[http://www.ey.com/global/assets.nsf/International/IFRS\\_Towards\\_Convergence/\\$file/EY\\_IFRS-USGAAP\\_Towards\\_Convergence.pdf](http://www.ey.com/global/assets.nsf/International/IFRS_Towards_Convergence/$file/EY_IFRS-USGAAP_Towards_Convergence.pdf)

# IFRS Impact beyond external financial reporting?

Ultimately, every aspect of a company's business and operation is affected potentially.



# Cost of implementing IFRS

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- ICAEW study at the request of the EU:

Sales (Mln)		First Time Cost	Ongoing Cost
<EUR 500		0.31%	0.06%
EUR 500-5,000		0.05%	0.01%
>EUR 5,000		0.05%	0.008%

- Indicates that the cost of implementation exceed EUR million in most cases.
- May not be indicative for cost that are incurred by US companies.

# In Summary

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- IFRS has arrived and is here to stay!
- Start with an assessment of the impact today
- Planned implementation is a prospective multiyear project
- Consider the internal and external stakeholders
- Consider the multidisciplinary nature of IFRS conversion in structure of PMO
- Involve your advisors/auditors at an early stage
- Do not underestimate the effort!