

# Introduction to International Financial Reporting Standards

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# Goals for today

- Understand history of IFRS and players involved
- Understand difference between convergence efforts with US GAAP and conversion
- Highlights of some of the more significant differences in IFRS vs. US GAAP
- What to start thinking about today so you can be prepared should US companies have to implement IFRS

# Helpful Websites

- [www.iasb.org](http://www.iasb.org)
- [www.ifrs.com](http://www.ifrs.com)
- [www.sec.gov](http://www.sec.gov)

# Acronyms

- IAS – International Accounting Standards
- IASB – International Accounting Standards Board
- IFRS – International Financial Reporting Standards
- SIC – Standing Interpretation Committee
- IFRIC – International Financial Reporting Interpretations Committee

# What is IFRS?

- International Financial Reporting Standards (IFRS) are a set of accounting standards developed by the International Accounting Standards Board (IASB) that is becoming the global standard for the preparation of public company financial statements.



# IFRS Guidance

- IAS 1-41 (although many later eliminated)
- IFRS 1-8
- SIC 1-32 (most withdrawn or superseded)
- IFRIC 1-18 (1 withdrawn)

# Why IFRS?

- Demand for one set of common global reporting standards
- International companies desire to use one set of reporting standards throughout the world
- Growth in capital markets (IFRS enhances the ability of filers to raise capital outside their borders)
- Reducing cost of capital and reporting costs

# Top 10 Countries by GDP

1. US – US GAAP
2. Japan - IFRS roadmap proposed conversion by 2011
3. China – IFRS
4. Germany - IFRS
5. France - IFRS

# Top 10 continued

6. UK - IFRS

7. Italy - IFRS

8. Russia – Russian Accounting Principle – IFRS  
2011

9. Spain - IFRS

10. Brazil – Brazilian GAAP – IFRS in 2010

Other notable: Australia - IFRS, Canada-IFRS in  
2011, Mexico – IFRS 2012, Hong Kong - IFRS

# Current SEC Roadmap

- 2009 qualified companies can adopt early
- 2009-2011 convergence of existing guidance
- 2011 SEC to evaluate progress and success of early adopters and decide whether to convert

# Convergence

- In 2002, Norwalk Agreement formalized FASB and IASB commitment to convergence.
  - Make existing standard compatible
  - Coordinate future work so that compatibility is maintained.
- See [www.iasb.org](http://www.iasb.org) for full listing of convergence projects and expected issuance dates

# Major Differences

- IFRS is principle based vs. US GAAP is rule based
- IFRS guidance can fit into a book about 2 inches thick where US GAAP is about 17,000 pages of detailed rules and guidance.

# Financial Statement Presentation (IAS 1)

- IFRS requires comparative financial statements
- “Statement of Financial Position” vs. balance sheet title used
- Statement of OCI – can’t be displayed on statement of changes in stockholders’ equity
- Debt with covenant violations must be shown current unless waiver is obtained by the balance sheet date

# Inventory (IAS 2)

- Inventory is recognized at the lower of cost of net realizable value (selling price less costs to sell)
- If inventory previously written down to NRV can be written back up (but not above cost)
- Does not allow use of LIFO
- Costs excluded from cost such as abnormal amounts of wasted material or labor, storage costs, administrative overheads, selling costs

# Property, Plant & Equipment (IAS 16)

- IAS16 allows the use of cost method for valuation of PP&E or revaluation method – the method chosen applies to all assets within the same class of assets
- Each part of an asset that is significant in relation to the total cost should be depreciated separately
- Additional disclosure requirements

	Machinery and equipment	Computer and equipment	Vehicles	Buildings	Total
<b>Cost or valuation</b>					
At beginning of period.....					0
Reclassification between groups.....					0
Additions (historical cost) .....					0
Acquired on acquisition of subsidiary.....					0
Exchange differences.....					0
Disposed of on disposal of a subsidiary.					0
Disposals.....					0
Revaluation increase.....					0
Fully depreciated assets.....					0
At end of period.....	0	0	0	0	0
<b>Accumulated depreciation</b>					
At beginning of period.....					0
Reclassification between groups.....					0
Ordinary depreciation.....					0
Impairment loss.....					0
Exchange differences.....					0
Eliminated on disposals of subsidiary....					0
Eliminated on disposal.....					0
Fully depreciated assets.....					0
At end of period.....	0	0	0	0	0
Book value as at end of period.....	0	0	0	0	0
Book value as at beginning of period.....	0	0	0	0	0
Percent ordinary depreciation.....	0%	0%	0%	0%	
Taxation value as at end of period.....					0
<b>Disposals</b>					
Sales value.....					0
Book value.....					0
Gain (loss) on disposals.....	0	0	0	0	0

# Revaluation Method

- FV for real estate usually based on appraisal from qualified professional
- FV for equipment based on market values determined by appraisal
- If no market based evidence of FV, may need to use income approach or depreciated replacement cost approach
- Items in same class should be revalued simultaneously to avoid selective revaluing of assets, although does allow rolling basis if done within a short period of time

# Revaluation Method

- Revaluation of an asset resulting in increase should be recognized in Other Comprehensive Income (OCI) unless asset previously had a decrease as a result of previous revaluation that was adjusted through P&L in which case it goes through P&L
- Revaluation resulting in decrease goes through P&L unless there is previously recognized increases in OCI, in which case it would reduce OCI 1<sup>st</sup> and then P&L

# Component Depreciation

- Examples: Buildings (roof, HVAC system, parking lot, elevators), aircraft (engine, frame)
- Parts that have the same life can be grouped and depreciated together
- Remaining non-significant items grouped and depreciated together

# Disclosures for Revaluation Method

- Date of revaluation
- Whether an independent appraisal was done
- Methods and significant assumptions used
- What the assets would have been recorded at if the cost method was used
- Amount of revaluation surplus and change in revaluation surplus

# Revenue Recognition (IAS 11 & IAS 18)

Revenue Recognition criteria for goods

- (a) THE ENTITY HAS TRANSFERRED TO THE BUYER THE SIGNIFICANT RISKS AND REWARDS OF OWNERSHIP OF THE GOODS;
- (b) THE ENTITY RETAINS NEITHER CONTINUING MANAGERIAL INVOLVEMENT TO THE DEGREE USUALLY ASSOCIATED WITH OWNERSHIP NOR EFFECTIVE CONTROL OVER THE GOODS SOLD;
- (c) THE AMOUNT OF REVENUE CAN BE MEASURED RELIABLY;
- (d) IT IS PROBABLE THAT THE ECONOMIC BENEFITS ASSOCIATED WITH THE TRANSACTION WILL FLOW TO THE ENTITY; AND
- (e) THE COSTS INCURRED OR TO BE INCURRED IN RESPECT OF THE TRANSACTION CAN BE MEASURED RELIABLY.

# Significant Risks Not Transferred

- (a) when the entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions;
- (b) when the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the buyer from its sale of the goods;
- (c) when the goods are shipped subject to installation and the installation is a significant part of the contract which has not yet been completed by the entity; and
- (d) when the buyer has the right to rescind the purchase for a reason specified in the sales contract and the entity is uncertain about the probability of return

# Deferral of Costs

- IFRS - Revenue and expenses that relate to the same transaction or other event are recognised simultaneously; this process is commonly referred to as the matching of revenues and expenses
- US GAAP –FAS 91 & FTB 90-1

# Contractors

- Percentage of completion used when revenues and costs can be reasonably estimated.
- When reasonable costs can't be estimated but a determination is made that there will not be a loss revenue is recognized to the extent costs are recognized (zero margin).
- When the conditions that didn't allow you to recognize revenue because it wasn't reasonably estimated change, start using percentage completion
- Expected losses recognized immediately

# Revenue Recognition - Multiple Element Arrangement

- No IFRS guidance!
- IFRS tends to treat items more separately

Example of MEA. Facts: Contract prices below. Contract signed and software delivered on 10/1/08. PCS period starts upon delivery and is for 1 year. Services are 50% delivered as of 12/31/08. Case 1 & IFRS the PCS is optional and Case 2 the services are 100% complete and PCS is mandatory (if the customer does not pay PCS they have to stop using the software).

Element	Contract	US GAAP		IFRS
		Case 1	Case 2	
Software	\$ 1,000,000	\$ 1,000,000	\$ 250,000	\$ 1,000,000
Services	\$ 300,000	\$ 150,000	\$ 75,000	\$ 150,000
PCS	\$ 150,000	\$ 37,500	\$ 37,500	\$ 37,500
Total	\$ 1,450,000	\$ 1,187,500	\$ 362,500	\$ 1,187,500

# Revenue Recognition - Other Areas

- Layaway sales can be recognized when experience indicates the sale will be consummated if there is a significant deposit and goods are on hand, identified and ready to ship.
- Installation fees based on % of completion (no stand alone value needed)
- Service fees (i.e. maintenance contracts) that are separately identifiable are recognized over contract period (no VSOE needed but amount allocated needs to exceed the costs with reasonable profit margin)

# Revenue Recognition – Other Areas

- Membership/initiation fees can be recognized up-front if all other services will be paid for separately and collection is probable. If membership involves additional services such as publications or discounts not available to non-members, then revenue is recognized over membership period.

# Disclosures

- Policy
- Revenue derived by source (products, services, royalties, dividends, interest, non-cash barter)

# Leases (IAS17)

- No bright line criteria (“major portion” of economic life vs. 75%, “substantially all” vs. 90% of asset value)
- Gain can be recognized on sale-leaseback treated as an operating lease (payments at FV)
- Requires leases for land and building to be bifurcated and evaluated as separate leases

# Income Taxes (IAS 12)

- Deferred taxes are determined net (no disclosure of gross deferred assets and valuation allowance)
- “Substantially” enacted tax rates vs. enacted tax rates
- All deferred taxes are presented as non-current
- Share based payments – based on deduction not how much compensation was expensed
- Uncertain tax position
- Unrealized intragroup profits

# Share Based Payments (IFRS 2)

- Graded vesting required which significantly accelerates option expense. Below is example of graded vesting for an option grant that vest 25% per year.

Vesting	Traunch	Year 1	Year 2	Year 3	Year 4
25.00%	100.00%	25.00%			
25.00%	50.00%	12.50%	12.50%		
25.00%	33.33%	8.33%	8.33%	8.33%	
25.00%	25.00%	6.25%	6.25%	6.25%	6.25%
		52.08%	27.08%	14.58%	6.25%

# Example of stock compensation

<b>Assumptions</b>	
Issuance date	1/1/2008
Shares issued	1,000,000
FV of shares on 1/1/08	\$ 1.00
FV of shares 12/31/08	\$ 1.50
FV of shares 12/31/09	\$ 1.25
FV of shares 12/31/10	\$ 2.50
FV of shares 12/31/11	\$ 5.00
Tax rate	40%
Exercise price	\$ 1.00
Vesting term	4 years ratable
BS calculation of FV	\$ 400,000

# Example of stock compensation

<b>US GAAP</b>	<b>12/31/2008</b>	<b>12/31/2009</b>	<b>12/31/2010</b>	<b>12/31/2011</b>	<b>Totals</b>
Stock compensation expense	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 400,000
Tax benefit	\$ 40,000	\$ 40,000	\$ 40,000	\$ 40,000	\$ 160,000
Net expenses	\$ 60,000	\$ 60,000	\$ 60,000	\$ 60,000	\$ 240,000
DTA	40,000	80,000	120,000	160,000	\$ 160,000
<b>IFRS</b>	<b>12/31/2008</b>	<b>12/31/2009</b>	<b>12/31/2010</b>	<b>12/31/2011</b>	<b>Totals</b>
Stock compensation expense	\$ 208,333	\$ 108,333	\$ 58,333	\$ 25,000	\$ 400,000
Tax benefit	\$ 83,333	\$ 16,667	\$ 50,000	\$ 10,000	\$ 160,000
Net expenses	\$ 125,000	\$ 91,667	\$ 8,333	\$ 15,000	\$ 240,000
DTA	\$ 200,000	\$ 100,000	\$ 600,000	\$ 1,600,000	\$ 1,600,000
OCI	\$ 116,667	\$ -	\$ 450,000	\$ 1,440,000	\$ 1,440,000
Intrinsic value per share	\$ 0.50	\$ 0.25	\$ 1.50	\$ 4.00	
Total intrinsic value	\$ 500,000	\$ 250,000	\$ 1,500,000	\$ 4,000,000	
Tax on intrinsic value	\$ 200,000	\$ 100,000	\$ 600,000	\$ 1,600,000	
Tax on compensation recognized	\$ 83,333	\$ 43,333	\$ 23,333	\$ 10,000	
<b>IFRS</b>	<b>12/31/2008</b>	<b>12/31/2009</b>	<b>12/31/2010</b>	<b>12/31/2011</b>	<b>Totals</b>
Net income	(65,000)	(31,667)	51,667	45,000	-
DTA	(160,000)	(20,000)	(480,000)	(1,440,000)	(1,440,000)
OCI	116,667	-	450,000	1,440,000	1,440,000

# Provisions, Contingent Liabilities and Contingent Assets (IAS 37)

- When to record for IFRS (3 criteria)
- Definition of probable for IFRS is more likely than not which is greater than 50%
- Requires use of middle of range when each point in range is likely as any other vs. US GAAP the low end of the range is used
- Can record a contingent gain when realization is “virtually certain”

# Business Combinations (IFRS 3 and IAS27)

- For IFRS contingent liabilities are recognized separately at acquisition date provide fair values can be estimated. US GAAP they are recognized only if it meets the more likely than not criteria.
- Goodwill impairment test is 1 step approach vs. 2 step approach
- Non-controlling interests have the option of full fair value or proportionate share.

# First Time Adoption of IFRS (IFRS 1)

- Is considered the first financial statements in which the entity adopts IFRS by an explicit and unreserved statement in those financial statements that they are in compliance with IFRS.

# IFRS 1 – Financials to be Presented

- Comparative F/S
- Statement of position as of the opening period

For example, if you are issuing 12/31/09 F/S, you would issue comparative 12/31/08 F/S (SOFP, SOCI, SOCF, SOSE) in IFRS and present opening balance sheet as of 1/1/08

# IFRS 1 – Process of Conversion

- Recognize all assets and liabilities in accordance with IFRS as of opening balance sheet (any changes go to R/E)
- Determine which exemptions will be used
- Make sure mandatory exemptions are considered

# IFRS 1 – Optional Exemptions

- Business combinations
- Fair value or revaluation as deemed cost (PPE)
- Employee benefits
- Cumulative translation difference
- Compound financial instruments
- Assets and liabilities of subs, associates and JV
- Designation of previously recognised financial instruments

# IFRS 1 – Optional Exemptions Continued

- Share based payment transactions
- Insurance contracts
- Decommissioning liabilities included in the cost of PPE
- Leases
- FV measurement of financial assets or financial liabilities at initial recognition
- Financial asset or intangible
- Borrowing costs

# IFRS 1 – Prohibits Retro Application

- Derecognition of financial assets and financial liabilities
- Hedge accounting
- Estimates
- Assets classified as held for sale and discontinued operations
- Non-controlling interests

# IFRS 1 - Disclosures

- Explain how the transition from previous GAAP affected SOFP
- Reconciliation of equity reported under previous GAAP to IFRS

# What Planning Should You be Doing?

- Select a project leader
- Determine if additional resources are needed (do you need to hire someone with IFRS background?)
- Perform GAP analysis on US GAAP vs. IFRS
- Determine which optional conversion items to adopt
- Determine if there is any tax impact of conversion

# What Planning Should You be Doing?

- Select reporting system – new ERP needed?
- Redesign chart of accounts
- Is IFRS being considered in current negotiations of long-term contracts?
- Determine how conversion could affect bank covenants

# Planning/Budgeting for Cost of Implementation

- Accounting and tax processes (new ERP?)
- Cost of preparing dual F/S
- Employee training costs
- Investor/Analyst education
- Consolidating accounting departments

# Questions????

## For more information

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Thank you