



# IFRS SURVIVAL GUIDE

ADDRESSING THE CHALLENGES OF NEW STANDARDS

THE NEXT  
LEVEL OF  
SERVICE

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## ABOUT THIS GUIDE

This guide provides an introduction to IFRS, highlights important differences between IFRS and U.S. GAAP, and reviews the status of the FASB-IASB convergence project and the SEC's quest for global accounting standards. It also weighs the pros and cons of voluntary IFRS adoption by private companies (whether or not the SEC mandates its use by public companies). Finally, it outlines the next steps you should take, including assessing IFRS's effects on your company and developing a transition plan.

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# ARE YOU READY FOR IFRS?

In recent years, the movement toward a single set of high-quality global accounting standards has gained momentum. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) recently reaffirmed their commitment to “converge” U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). The Securities and Exchange Commission (SEC) continues to explore the possibility of requiring U.S. public companies to use IFRS beginning as early as 2015.

While the future of global accounting standards isn't entirely certain, one thing is: Whether IFRS becomes the international language of accounting or FASB and IASB simply continue to eliminate differences between their standards, companies of all sizes must understand the possible effects of such changes and begin to prepare for them now. The potential implementation date may seem years ahead, but adopting IFRS isn't just a matter of flipping a switch. It's an intensive process that requires several years of planning and preparation.

IFRS will almost certainly affect most — if not all — companies. Privately held companies currently aren't required to prepare their financial statements in accordance with GAAP (although many do so to satisfy lenders and other financial statement users). Like their public counterparts, however, private companies that adopt IFRS may potentially gain several benefits — including lower compliance costs and greater access to global markets.

Most private companies are now eligible for IFRS for small and medium-sized entities (SMEs). IFRS for SMEs eliminates topics that generally aren't relevant for private companies, simplifies the decision-making process, streamlines procedures and reduces the number of required disclosures. For some private companies, however, full IFRS offers greater flexibility to select accounting policies and make other choices that can have a positive impact on their financial results.

## WHAT IS IFRS?

The IASB is an independent, not-for-profit standards-setter based in London with 15 members from 10 countries, including the U.S. The IASB issued its first version of IFRS in 2001 to initiate the process toward developing uniform global accounting standards. Since 2001, IFRS has been accepted or adopted for public reporting purposes by more than 100 countries, including the members of the European Union.

Adoption of IFRS as a global standard offers several potential benefits, including:

**Enhanced comparability.** Uniform standards will aid investors in comparing global opportunities, making it easier for companies to raise capital across multiple jurisdictions.

**Reduced complexity.** IFRS is 2,700 pages, compared to approximately 17,000 pages for GAAP. IFRS for SMEs is only 230 pages.

**Greater transparency.** IFRS is principles-based, which breaks from GAAP's rules-based approach. Companies and their auditors focus on the economic substance of a transaction rather than strict compliance with detailed rules and “bright-line” tests. IFRS potentially produces a clearer picture of a company's financial position for investors, lenders, regulators and other financial statement users.

**Reduced costs.** For companies that do business in several countries, global adoption of IFRS will eliminate the costs associated with compliance with multiple accounting standards and maintenance of multiple sets of books.

**Protection of U.S. markets.** By aligning U.S. accounting standards with those of other developed countries, IFRS adoption will eliminate a significant cost barrier to operating in the U.S.





Adoption of IFRS in the U.S. also presents several challenges. For one thing, GAAP is well established and embedded in our business culture. Switching to a new set of accounting standards will require extensive education and training for accountants, auditors, bankers, brokers, lawyers, regulators and others.

Indeed, businesses that switch to IFRS will have to make significant investments to modify accounting processes and procedures; retool IT systems; and assess the impact of IFRS on everything from taxes and financing to compensation arrangements and contractual relationships.

## HOW DOES IFRS DIFFER FROM GAAP?

IFRS is principles-based, but it doesn't shun rules altogether. And GAAP, despite its many rules, is based on a set of principles. Rather than highlighting their differences, observers should consider both sets of standards as points on a continuum, with pure principles on one end and pure rules on the other.

Some even compare IFRS today to GAAP 50 years ago. GAAP started out as a set of principles, which have been refined and clarified over time. Whether IFRS moves closer to the rules end of the continuum as it ages remains to be seen. But its proponents believe that an emphasis on principles can lead to greater transparency and help avoid manipulation of financial statements.

This may seem counterintuitive. After all, a principles-based approach relies on professional judgment rather than adherence to a comprehensive set of rules. Doesn't this make it easier to "financially engineer" the desired outcome? Arguably, a principles-based approach makes financial statement manipulation *more difficult*.

Critics of U.S. GAAP's rules-based approach say that it invites abuse by allowing companies to focus on mere technical compliance at the expense of underlying principles or values. Complex rules coupled with scant explanation can make it difficult for financial statement users to understand the economic realities behind the numbers. IFRS, on the other hand, combines a principles-based approach with extensive disclosures that require companies to document the process that led to a particular accounting treatment and explain why its decision is consistent with underlying principles.

### GAAP VS. IFRS: HOW THEY COMPARE

GAAP	IFRS
Rules-based	Principles-based
Allows companies to focus on technical compliance, rather than underlying values	Requires companies to document the process that led to a particular accounting treatment
Mandates numerical "bright-line" tests	No specific numerical thresholds
Relies on complex rules	Relies on professional judgment
Noncontrolling interests always measured at fair value	Noncontrolling interests measured at fair value or the proportionate share of the acquiree's net assets
All assets and liabilities from contractual contingencies recognized	Contingent assets recognized; contingent liabilities recognized if fair value can be reliably measured
Defines the segment during goodwill impairment testing as the reporting unit	Defines the segment during goodwill impairment testing as the cash generating unit
Two-step impairment measurement model	One-step impairment measurement model

Take, for example, lease accounting. Both GAAP and IFRS distinguish between operating leases — which provide off-balance-sheet financing — and capital leases ("finance leases" in IFRS terminology). Under GAAP, a lease is classified as "capital" if it meets certain criteria, including 1) a lease term equal to 75% or more of the leased property's estimated economic life, and 2) minimum lease payments whose present value is at least 90% of the leased property's fair value (less certain investment credits retained by the lessor).

Although it calls for consideration of similar criteria, IFRS doesn't mandate specific numerical thresholds or bright-line tests. Instead, it focuses on the substance of the transaction and classifies a lease as "finance" (or in GAAP terminology, capital) if it "transfers substantially all of the risks and rewards incident to ownership" to the lessee. GAAP's rules make it possible for companies to design lease contracts so that they qualify as operating leases — something IFRS's principles make it much harder to do.

IFRS's standards aren't without drawbacks, though. Some observers fear that, while disclosures are more substantial, they rely on professional judgment that may lead to inconsistent practices and, therefore, reduced comparability. Others claim that dependence on judgment rather than bright-line rules will result in more frequent litigation. The table on Page 2 outlines several other major differences between IFRS and GAAP.

## WHERE DO WE STAND NOW?

Two separate movements are leading in the direction of global accounting standards:

**1. The FASB and IASB continue to work on the convergence project they began in 2002.** The project's goal is to eliminate major differences between GAAP and IFRS in critical areas. The two boards plan to finalize the convergence of several standards — including revenue recognition, fair value measurement, financial instruments, consolidation, leases and financial statement presentation — by 2011.

**2. The SEC continues to consider adoption of IFRS by U.S. public companies.** It already *allows* foreign issuers to file IFRS financial statements without reconciliation to GAAP. Recently, however, it pushed back the earliest *mandatory* date to 2015 and withdrew its proposal for early adoption. The Commission is assessing whether the change is in the best interest of U.S. investors and markets and may announce as early as 2011 whether IFRS will be mandatory. Its decision will be based on:

- ▶ Whether the standards are sufficiently developed and consistent in application,
- ▶ Whether the standards are set by an independent standard-setter and for the benefit of investors,

### 3 KEY IFRS DATES

- 1. Reporting.** The year end date of the company's first IFRS financial statements.
- 2. Adoption.** The opening balance date of the first IFRS reporting year.
- 3. Transition.** The opening balance date of the earliest year for which comparative IFRS information is required.

- ▶ The level of investor understanding and education,
- ▶ The impact on tax laws and other regulatory reporting,
- ▶ The impact on companies' accounting systems, contractual arrangements, corporate governance and litigation contingencies, and
- ▶ The readiness of financial statement preparers and auditors.



Finance personnel should monitor the activities of the FASB, IASB and SEC to determine appropriate next steps.

## MAKING THE TRANSITION

Adopting IFRS is a delicate balancing act that requires several years of planning and preparation. One of the advantages of uniform international accounting standards is that companies operating globally avoid the cost of compliance with multiple accounting standards. But making the transition from GAAP to IFRS generally involves a period of "dual reporting," during which companies must track their financial results under both standards.

IFRS 1 is the standard that governs the accounting and preparation of financial statements in the year a company adopts IFRS. Among other things, it requires first-time adopters to present at least one year of IFRS-compliant comparative financial information. (The SEC, however, may require two years of comparative information.) Companies also need to know some important dates. (See "3 Key IFRS Dates" above.)

Suppose, for example, that the SEC requires your company to switch to IFRS beginning in 2015 and to present two years of comparative information. If your company is on a calendar year, then the reporting date is Dec. 31, 2015, the adoption date is Jan. 1, 2015, and the transition date is Jan. 1, 2013.

## RETROSPECTIVE APPROACH

IFRS 1 assumes that a company preparing its first IFRS financial statements will apply all standards in effect on the reporting date *retrospectively*. In other words, your company should prepare its financial statements as if it had always used IFRS as its accounting framework (subject to certain exceptions and exemptions discussed below).

Although a complete discussion of the detailed guidance on making the transition to IFRS is beyond the scope of this publication, here are the basic steps:

- ▶ Prepare and present an opening IFRS statement of financial position (SFP) as of the *transition date*.
- ▶ Select IFRS accounting policies, which must be used in the opening SFP and throughout all periods presented in the company's first IFRS financial statements.
- ▶ In the opening SFP, recognize or derecognize assets and liabilities; remeasure recognized assets and liabilities; and reclassify assets, liabilities or equity components in accordance with IFRS standards in effect at the reporting date.
- ▶ Recognize adjustments resulting from first-time application of IFRS directly in retained earnings or another appropriate equity category (with exceptions).
- ▶ Ensure that IFRS estimates on the transition date are consistent with GAAP estimates made for the same date (with exceptions).

In addition to IFRS's general presentation and disclosure requirements, your company needs to prepare disclosures required for first-time adopters. These include reconciliations between GAAP and IFRS measures and other disclosures that explain how adopting IFRS affects your company's financial position, financial performance and cash flows.

Starting at the transition date, companies will need to track results using both GAAP and IFRS — continuing their current ledger and reporting process and establishing a second set of adjusting entries or ledgers based on the requirements of IFRS. Your company must maintain this dual reporting focus or system for two years so that on the adoption date you can present three statements of financial position and two statements of comprehensive income, cash flows, and changes in equity, along with related, comparative notes in accordance with IFRS.



## EXCEPTIONS AND EXEMPTIONS

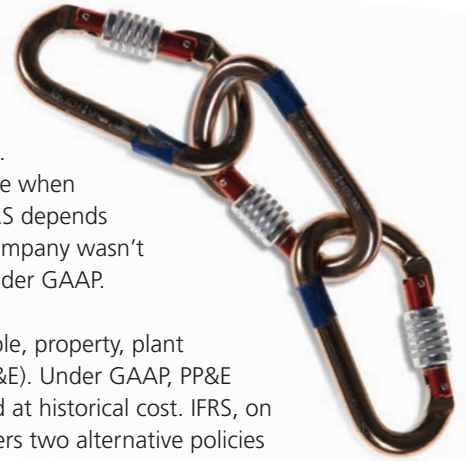
Retrospective application may be inappropriate under certain circumstances or may unduly burden a company. Accordingly, the IFRS has established four mandatory “exceptions” and 16 optional “exemptions.”

The mandatory exceptions apply when retrospective application would involve management judgment about past conditions after a transaction’s outcome is known and, therefore, would be unreliable or would invite abuse. So, for example, a company can’t adjust accounting estimates on transition to IFRS unless: 1) the adjustment is necessary to reflect changes in accounting policy, or 2) there’s objective evidence that previous GAAP estimates were in error. The other mandatory exceptions relate to derecognition of financial assets and liabilities, hedge accounting, and noncontrolling interests.

The optional exemptions involve situations in which the cost of applying IFRS retrospectively would likely outweigh

any potential benefits to financial statement users. This is often the case when compliance with IFRS depends on information a company wasn’t required to track under GAAP.

Consider, for example, property, plant and equipment (PP&E). Under GAAP, PP&E generally is reported at historical cost. IFRS, on the other hand, offers two alternative policies that a company must elect and apply consistently within each class of balance sheet items: 1) the cost model, which is similar (but not identical) to GAAP, and 2) the revaluation model, under which PP&E is reported at fair value, less accumulated depreciation and impairment losses. Companies that elect this second model must measure fair value periodically or when certain “triggering events” occur.



### LESSONS FROM EUROPE

From European companies that have already made the transition to IFRS, some key practices have emerged:

- ▶ Be an early adopter.
- ▶ Begin planning immediately.
- ▶ Establish a steering committee to oversee the process.
- ▶ Conduct an impact assessment to help contain costs and efficiently allocate resources.
- ▶ Draft a detailed plan that includes specific tasks and a realistic timeline.
- ▶ Determine how the transition will affect business processes.
- ▶ Engage the right in-house and external advisors.
- ▶ Enlist the support of everyone in the company.
- ▶ Upgrade your IT system to handle larger amounts of financial data.
- ▶ Develop a communication strategy to help ensure all stakeholders receive consistent messages.
- ▶ Make “big picture” goals for such areas as finance, IT, compensation and management structure.
- ▶ Keep current with IFRS developments as the IASB makes them public.

## HOW COMPANIES CAN BENEFIT FROM IFRS PREPARATION

Even if the SEC doesn't mandate the use of IFRS, conducting a readiness assessment and preparing for IFRS allow your company to:

- ▶ Review and fine-tune its accounting policies and procedures,
- ▶ Evaluate and enhance its internal controls,
- ▶ Ensure that it's making the most of its IT systems,
- ▶ Prepare for use of IFRS by a foreign subsidiary, and
- ▶ Get ready for future accounting changes brought about by the FASB-IASB convergence project.

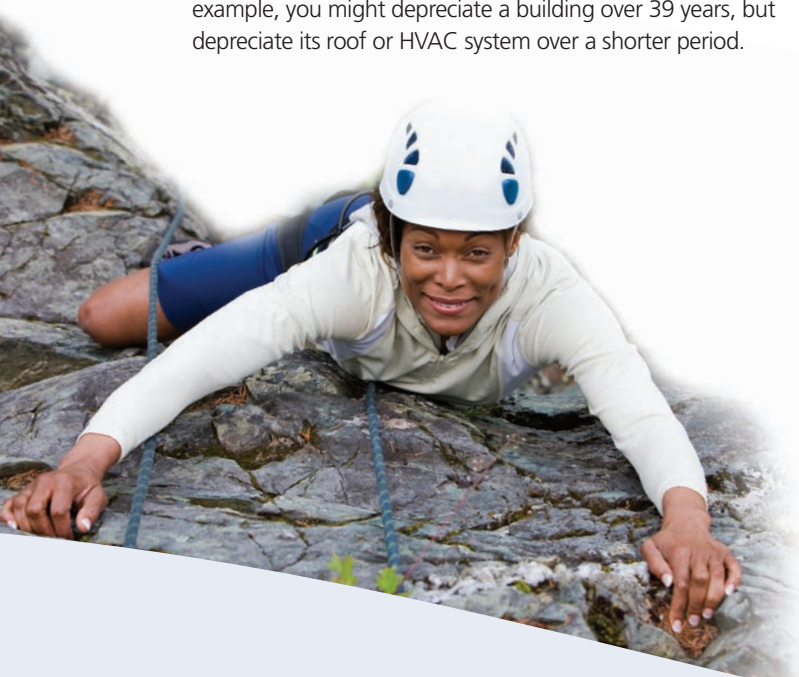
Here's where retrospective application gets tricky: IFRS also requires companies to "componentize" PP&E. In other words, if the cost of a fixed asset's component part is significant in relation to the asset's total cost, then the component should be depreciated separately over its individual useful life. So, for example, you might depreciate a building over 39 years, but depreciate its roof or HVAC system over a shorter period.

Companies currently following GAAP may not track component costs, and reconstructing those costs can be expensive and time-consuming. To relieve this burden, IFRS 1 permits a first-time adopter to set an asset's transition-date fair value as its deemed cost rather than apply IFRS retrospectively. The company uses this deemed cost going forward as the asset's cost basis for purposes of depreciation or impairment testing. Recognizing an asset at deemed cost doesn't affect the company's ability to choose the cost or revaluation model as a matter of accounting policy.



Other optional exemptions include business combinations, share-based payments, insurance contracts, leases and employee benefits. First-time adopters should project the impact of each exemption election on their future financial results and consider their choices carefully.

Going back to the PP&E example, electing the exemption can be beneficial. Setting an asset's fair value as its deemed cost avoids the burden of retrospective application. Also, higher asset values may boost a company's borrowing capacity and help ensure compliance with loan covenants. But there are also drawbacks to electing the exemption. It requires you to measure the fair value of assets on the transition date and may result in higher depreciation expense.



## PREPARING FOR CHANGE

Converting to IFRS is a significant challenge. Fortunately, U.S. companies have an advantage: Their peers in Europe and elsewhere have already gone through the process. From those companies' experience, several success factors and best practices have emerged:

**Start immediately.** Beginning the process too late probably is the most common mistake first-time adopters make. It takes time to select accounting policies, put the right technology in place, train personnel and arrange for funding — and these things need to be done before the transition date.

Even though it's uncertain whether the SEC will mandate adoption of IFRS or simply continue the convergence process, companies that take a "wait and see" approach may find themselves playing catch-up once a final determination is made. Plus, many of the steps in the process provide business benefits that go beyond financial reporting.

**Conduct an impact assessment.** This is critical to an effective, cost-efficient transition. Every company is different and will be affected by IFRS in different ways. An impact assessment helps ensure you allocate your resources effectively and that your transition plan focuses on the right things. As part of the assessment, ensure that your current policies and procedures are well documented. This can help you understand how IFRS will affect your company and lay the foundation for a smooth transition.

**Think strategically.** The transition to IFRS isn't just a compliance matter. It's also a unique opportunity for your company to re-evaluate its financial reporting framework. Each decision you make regarding accounting policies and exemption elections will have far-reaching consequences for your company's future financial results.



**Look beyond financial reporting.** Well-prepared companies know how the transition to IFRS will affect business processes throughout the organization and have a plan for addressing these issues. IFRS will have an impact on information technology, internal controls, risk management, budgeting, incentive compensation plans, loan covenants and a variety of contractual arrangements.



The transition to IFRS may also affect tax planning. For example, IFRS prohibits the use of LIFO (last in, first out inventory accounting). Unless Congress revises the federal tax code to permit companies to use different inventory accounting methods for financial reporting and tax purposes, many U.S. companies that switch to IFRS will find themselves with a significant tax liability.

**Involve everyone.** In addition to enlisting the support of your board and top management, ask people throughout the organization — at all levels and in all departments — to participate in the transition process.

**Put the right technology in place.** Converting to IFRS can place an enormous strain on your information technology systems. Under IFRS, your company will need to track new types and larger amounts of financial data, incorporate new processes, and satisfy new financial reporting requirements. Your IT systems and staff must be prepared for these changes.

**Provide training.** Converting to and operating under IFRS demands trained personnel throughout your organization, so ongoing training is critical. You also need to communicate with and educate investors and other external stakeholders about how IFRS will affect the company's earnings and other financial results.

**Be an early adopter.** Keep a close watch on the FASB-IASB convergence project. As the FASB issues new or amended standards that conform more closely to IFRS, consider early adoption if permitted. This will make the transition to IFRS that much easier when and if the time comes.

**Have a plan.** Like any major business initiative, a successful transition to IFRS requires a solid transition plan and a disciplined approach to project management.

**Monitor IASB activities.** Remember, your first set of IFRS financial statements and comparative information must comply with the standards in effect on the *reporting date*. Be sure to monitor IASB changes and proposals during the transition period and, if necessary, modify your systems or procedures to capture the information you need.

**Weigh potential benefits.** While private companies may not face regulatory requirements to use IFRS, the pressure to convert may increase for those with international operations, customers or financing needs. To determine whether they would benefit by adopting IFRS, private companies should conduct an impact assessment and weigh the potential benefits against the tax and other costs of converting.

## GET PROFESSIONAL HELP

Making the transition to IFRS is a complex process and this guide only scratches the surface. A successful transition requires the support of professionals with IFRS experience inside and outside your company. You will need to develop an understanding of IFRS so you can have informed discussions with your advisors and make the many strategic business decisions that adopting IFRS requires. ■

### IFRS, UHY LLP AND YOU

Making the transition to IFRS isn't easy for any company. But UHY LLP can help ease the transition process and increase efficiency. Our four cornerstones of service are:

**1. Expert team.** Our financial professionals deliver broad understanding and deep expertise in all industry sectors. We are "hands on" and collaborate well with clients.

**2. Commitment to a smooth transition and conversion.** We provide a full suite of services, including technical accounting, accounting policy, internal controls, tax and systems-related capabilities. UHY LLP works with management and trains employees to ensure a smooth process.

**3. Collaborative and proactive process.** To avoid surprises and ensure quality results, we provide collaborative and continual communication.

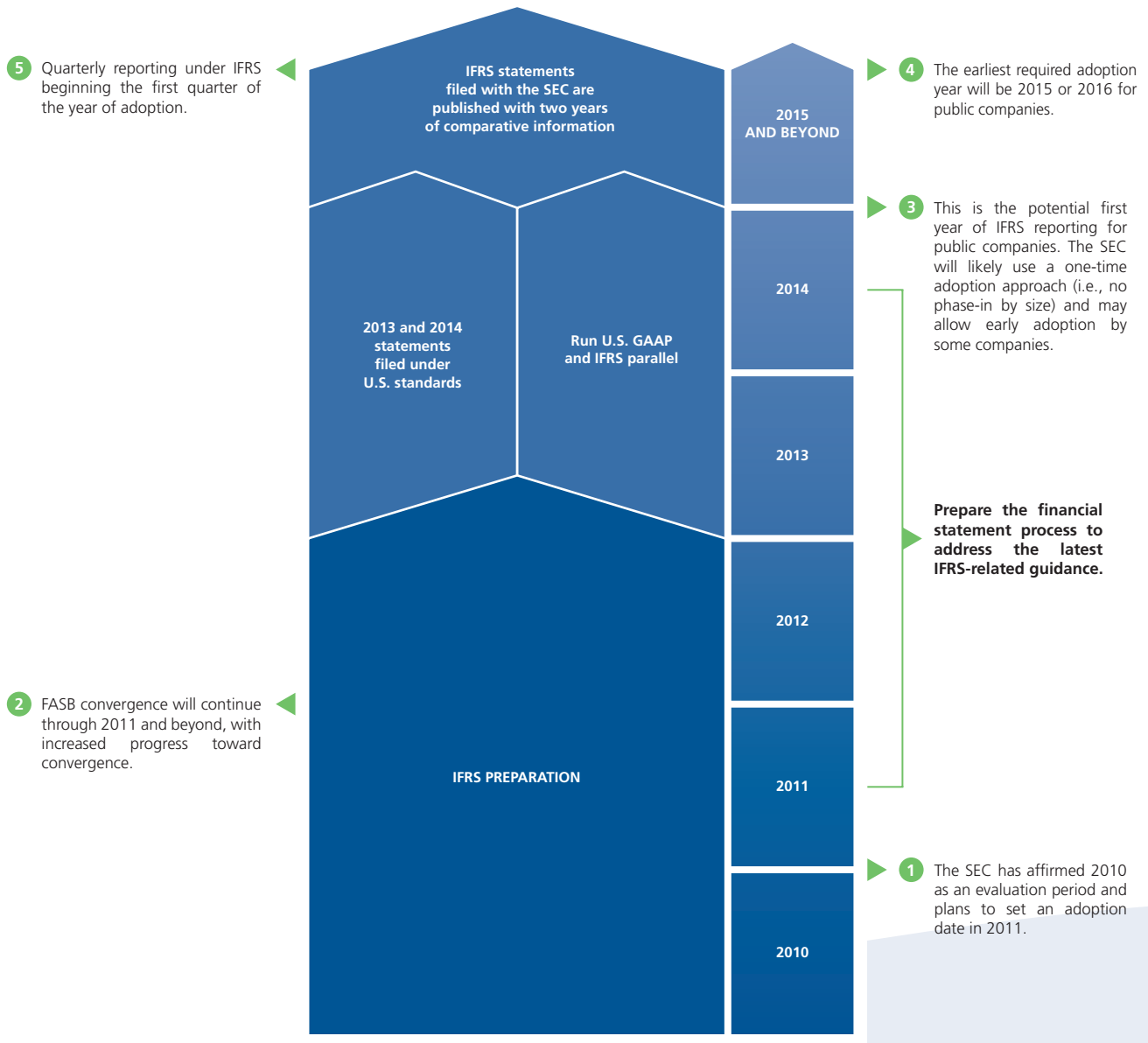
**4. Integrated approach.** We deliver a full suite of services and expertise through a continuum of client involvement. (See back cover.)



# IFRS SEC ROAD MAP

## Key milestones

The road to IFRS conversion may be a long one, and it's never too soon for public and even private companies to begin planning and preparing. Below is a general IFRS conversion timeline that may not apply to all companies. You should talk with your financial advisors to determine when your company needs to begin the process.



# UHY LLP'S INTEGRATED APPROACH FOR ADDRESSING IFRS



**Georgia**

Atlanta (678) 602-4470

**Michigan**

Southfield (248) 355-0280  
Sterling Heights (586) 254-8141

**New York**

Albany (518) 449-3171  
New York (212) 381-4800  
White Plains (914) 697-4966

**Maryland**

Columbia (410) 423-4800

**Missouri**

St. Louis (314) 615-1301

**Texas**

Dallas (214) 243-2900  
Houston (713) 561-6500

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