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International Financial Reporting Standards for U.S. Companies:

Implications of an accelerating global trend

The movement toward International Financial Reporting Standards (IFRS) as a single set of globally accepted accounting standards is quickly gathering momentum. IFRS is rapidly gaining acceptance around the world, spurring U.S. companies to assess the potential implications of adopting the standard. Among recent developments that have heightened interest among U.S. companies are the following:

- The Securities and Exchange Commission (SEC) issued a "concept release" in August 2007 that solicits input on whether U.S. issuers should be permitted to prepare their financial statements using IFRS or U.S. GAAP for SEC reporting purposes. The majority of comments received on the concept release expressed support for U.S. issuers using IFRS. Subsequently, the SEC will consider whether to issue a "proposing release" (formally proposing the rule), which could come during 2008. It is expected that U.S. companies will have the option of using IFRS by 2010 or 2011.
- The SEC approved a final rule in November 2007 that eliminated the requirement for foreign private issuers using IFRS to reconcile to U.S. GAAP; the rule is effective for periods ending after November 15, 2007.
- IFRS is now used for public reporting purposes in over 100 countries, ranging from Australia to the United Kingdom. Others countries are expected to follow in the next few years, including Israel (2008), Chile (2009), Korea (2009), Brazil (2010), and Canada (2011).

The bottom line: By 2011, almost every country around the world could be using IFRS to some extent, including the United States.

What is IFRS?

IFRS is a set of accounting principles that is rapidly gaining acceptance on a worldwide basis. These standards are:

- published by the London-based International Accounting Standards Board (IASB)
- more focused on objectives and principles and less reliant on detailed rules than U.S. GAAP

Since 2002, efforts have been under way to converge IFRS and U.S. GAAP.

IFRS Timeline

2002
- Agreement between FASB and IASB on a plan to formally undertake efforts to converge U.S. GAAP and IFRS (the "Norwalk Agreement")

2004
- European Commission begins project on "equivalence" of national GAAPs and IFRS

2005
- Development of the SEC "IFRS Roadmap" by then Chief Accountant Don Nicolaison
- European Commission issues draft report on "equivalence" of national GAAPs and IFRS

2006
- Reaffirmation of the convergence efforts by the FASB and IASB; Norwalk Agreement is updated
- SEC and Committee of European Securities Regulators (CESR) launch the "SEC/CESR Work Plan" to address application issues relating to the implementation of IFRS

2007
- SEC eliminates the requirement for foreign private issuers that use IFRS to reconcile to U.S. GAAP
- SEC issues "Concept Release" on allowing U.S. issuers a choice between IFRS and U.S. GAAP
- Final report on the "equivalence" of national GAAPs and IFRS

2008
- Expected issuance of SEC "proposing release" on allowing U.S. issuers a choice of preparing financial statements under either IFRS or U.S. GAAP

2010 / 2011
- U.S issuers potentially have the ability to use IFRS for SEC reporting purposes

Why are many companies considering IFRS?

Currently, U.S. companies that raise capital or operate in foreign countries often have to prepare multiple sets of financial statements to comply with the local GAAP of various countries. This is no easy task and can create a significant burden. For global companies, it requires staying on top of an array of accounting guidance and preparing different sets of financial statements—efforts that often involve significant cost and resources.

The recent SEC developments have served as a wake-up call for many U.S. executives—especially those at multinational companies. IFRS is no longer a topic reserved mostly for foreign private issuers filing statements with the SEC. With the opportunity to file financial statements according to IFRS within reach, more U.S. companies have greater interest in understanding (and mobilizing around) IFRS and the associated benefits.

In time, it is highly probable that every company will need to address IFRS in some manner. Therefore, companies would benefit from developing a rational response to the inevitable.

For global organizations, IFRS may represent a significant cost savings opportunity, as it affords the following advantages:

- ***Standardized and improved accounting and financial reporting policies*** – IFRS allows for the development of a consistent set of accounting and financial reporting policies for *both* local statutory and consolidated reporting, which improves the comparability of financial information and tax planning. This directly benefits shareholders and analysts looking for consistent, high-quality information to assess companies across borders.
- ***More efficient use and availability of resources*** – IFRS provides an opportunity for developing centralized accounting processes through a shared-services approach, allowing for the efficient use of resources. It also facilitates the development of standardized training programs, eliminates divergent accounting systems, and could reduce third-party fees related to local statutory reporting. Furthermore, having a single set of accounting standards enhances the ability to train and develop accounting personnel throughout the globe.
- ***Improved controls*** – IFRS allows for more control over statutory reporting, thereby reducing risks related to penalties and compliance problems at the local level. Many local statutory reports are prepared through a manual conversion from U.S. GAAP. Often there is no worldwide "owner" for statutory reporting.
- ***Better cash management*** – Dividends that can be paid from subsidiaries are based on local financial statements. A change from local GAAP to IFRS can have significant effects on cash dividends, allowing a consistent standard across countries that can improve cash flow planning.

Key benefits of IFRS

Reduced complexity, greater transparency, increased comparability, and improved efficiency are all potential benefits of IFRS:

Investors –The investment community is increasingly looking for high-quality financial information. Investors, in increasing numbers, perceive IFRS as an opportunity to compare companies across global industries. Companies that do not provide this information now may soon need to, as shareholders and analysts may expect (or demand) it. The more that demand for IFRS financial information grows, the more even the playing field becomes, thus allowing investors to have an "apples-to-apples" perspective when comparing financial results.

Capital markets – With IFRS, greater market efficiencies can be realized. A single, global set of accounting standards can encourage both companies and investors to more easily access multiple or foreign markets. In effect, this can help stimulate investment and enable cross-border capital flows.

Companies – Streamlining financial reporting processes throughout a global operation can eliminate divergent accounting systems and enable greater consistency in reporting, thereby reducing costs, increasing operational effectiveness, and decreasing the likelihood of potential errors resulting from the misapplication of standards. Many of the elements of IFRS application can be standardized and performed centrally.

Many companies have IFRS on their radar. According to a recent survey by Deloitte & Touche LLP[1], approximately 20 percent of respondents would consider adopting IFRS, if given a choice. And almost two-thirds of those companies would consider adopting IFRS within the next three years. As more companies become familiar with IFRS, we believe that interest will continue to grow.

Many Global Fortune 500 companies have already jumped on the IFRS bandwagon. Within the Global Fortune 500 companies, approximately 40 percent currently follow IFRS, with another 40 percent currently using U.S. GAAP. The remaining 20 percent use local GAAP; however, many of these companies are located in countries that will be transitioning to IFRS in the near term, such as Canada and Brazil.[2]

The correlation between the increasing use of IFRS and the declining use of local GAAP illustrates a powerful global trend—one that more U.S. companies are noticing. It is likely that by 2011, a clear majority of the largest global companies could be using IFRS.

[1] The "Global Financial Survey," conducted by Deloitte & Touche LLP, received responses from senior financial executives from approximately 300 U.S. companies.
[2] *Ibid.*

Global acceptance of IFRS is not without its challenges

The movement toward IFRS as a single set of globally accepted accounting and financial reporting standards will entail challenges. For companies and the greater financial reporting community, perhaps the biggest challenge is a cultural one. Bringing together accounting standards may be relatively easy compared to coordinating the variety of cultural differences and perspectives involved in interpreting and applying IFRS; this also involves considering the legal and financial consequences of alleged departures from the standards.

For a multinational company, ensuring that IFRS is applied in a globally consistent manner instead of as an amalgam of local versions may involve significant efforts around the creation of policies, the modifications of systems, and the training of personnel. With the use of IFRS, companies, auditors, regulators, and users will need to adapt to an accounting and financial reporting framework that requires more judgment and less reliance on detailed rules and bright lines. Companies will be required to understand base principles and objectives, how judgments are made, and how they are applied. Such an approach to accounting requires a change in mindset.

What should U.S. companies do?

Given the heightened interest and activity around IFRS, U.S. companies would be well served by taking action now to develop a greater understanding of IFRS. This involves assessing the implications of current and potential SEC developments on their organizations, and determining an appropriate course of action for responding to a shift toward IFRS.

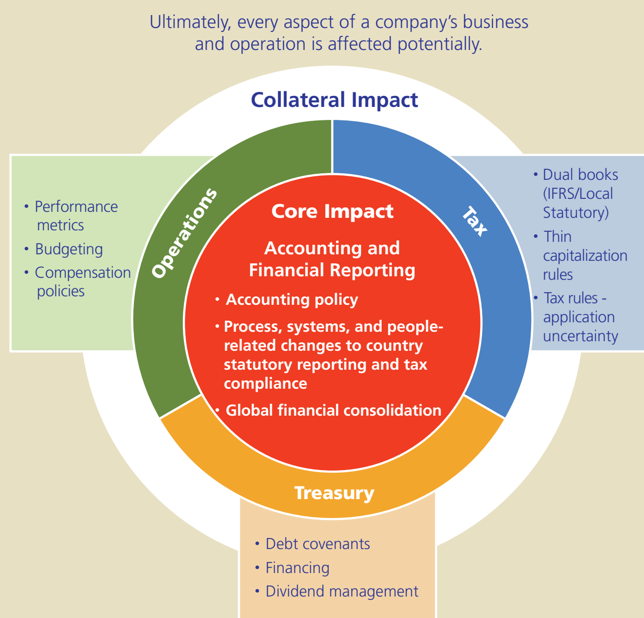
We believe that CFOs, CEOs, audit committees, and boards of directors should consider the following in an effort to understand the impact of IFRS on their company:

1. Assess how the organization is currently exposed to IFRS. U.S. companies with the following characteristics may have more incentives than most to consider adoption of IFRS:
   - A parent company outside the U.S. that now reports under IFRS. This can include investors of the parent as well.
   - Investors (including those involved in joint venture arrangements) outside the U.S. that now report under IFRS.
   - Foreign subsidiaries that have local or statutory IFRS reporting requirements.
   - Companies with complex cross-border structures and whether there are IFRS requirements resulting from such structures.
   - Companies operating in industries which have major players using IFRS for financial reporting purposes.

   Key questions to consider: Does the organization currently have IFRS reporting obligations for statutory or other purposes? How is the organization dealing with these reporting obligations? What is the organization's current risk exposure under existing IFRS reporting requirements?
2. Evaluate how IFRS reporting will impact the organization in the future. Take a holistic approach and assess the impact on aspects such as culture, tax, and financial reporting metrics. Consider whether new IFRS reporting obligations are surfacing for the organization around the world, and whether competitors are moving to IFRS.
3. Analyze the cost and benefits of IFRS adoption. Does IFRS help the organization increase the efficiency of its financial reporting procedures? What are the costs of implementing IFRS? How long would it take the organization to adopt IFRS in a controlled manner? Will the organization be ready if IFRS becomes mandatory at a certain date?
4. Consider developing an IFRS implementation plan for an effective and efficient conversion. Assess reasonable timelines; and evaluate potential approaches to implementation, such as an early adoption plan (with a phased implementation), or an expedited plan in case of an IFRS mandate. Assess what type of approach would be appropriate to meet the unique needs of the company.

Transitioning to IFRS is not just about changing accounting policies. Adoption impacts all aspects of a company, including financial reporting systems, internal controls, taxes, treasury, cash management, and legal, among others. (See illustration in figure 1.) Converting to IFRS requires a transformation that involves employees, processes, and systems. Planned and managed properly, the conversion can bring about substantial improvements in the performance of the finance function as well as better controls, and reduced costs.

Figure 1. The adoption of IFRS affects more than a company's accounting policies, processes, and people.



Moving Forward

Market forces, regulatory activity, the promise of efficiencies, and other factors are pushing IFRS into the headlines and to the top of senior executives' agendas across corporate America. The movement toward IFRS is real. Companies must ask themselves: Can we afford not to investigate the impact of IFRS?

Resources & Contacts

Deloitte & Touche LLP has extensive experience in International Financial Reporting Standards (IFRS). With thousands of IFRS-experienced professionals in our global network, we provide a comprehensive array of services related to IFRS. As a multidisciplinary organization, we can help companies address a wide range of IFRS issues. We offer companies assistance with:

- Evaluating the potential impacts of IFRS
- Assessing readiness for IFRS conversions
- Implementing IFRS conversions, providing support with technical research, project management, and training
- Addressing the implications of IFRS in such areas as tax, finance operations, technology, and valuation

For more information, please contact:

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