Are you ready for IFRS?

The Benefits and Risks of conversion from U.S. GAAP to IFRS

The Securities and Exchange Commission (SEC) have issued a proposed move to support a single set of international accounting standards to be adhered to globally.

They have identified IFRS as the standards best placed to fill this role, meaning U.S. businesses who currently adhere to U.S. GAAP will have to re-evaluate their financial reporting processes. Despite an initial target of making a recommendation on the adoption of IFRS by 2011, no decisions have been forthcoming from the SEC.

In this publication we look at the issues that U.S. businesses may face with the proposed transition to IFRS, which due to the continued convergence projects, are relevant despite recent delays on a final decision by the SEC, and we explain how PKF can advise and support your business through this time of change.

Introduction

In February 2010, the Securities and Exchange Commission (SEC) published a statement of continued support for a single set of high quality global accounting standards and acknowledged that International Financial Reporting Standards (IFRS) is best positioned to serve that role. In May 2011, the SEC published a staff paper exploring one possible method to incorporate IFRS into the United States (U.S.) financial reporting system. The staff paper discussed a potential transition method, the role of the SEC and Financial Accounting Standards Board (FASB), and the perceived benefits and risks of the possible method. It did not discuss an option to voluntarily adopt full IFRS into the U.S. financial reporting system.

On July 13, 2012, the SEC released a final staff report providing a thorough discussion of the issues related to IFRS in the U.S., noting that a wholesale switch to IFRS would strain the resources of U.S. companies and that a stepped transition has more public support. The report purposely omits any recommended action plan. It is expected that the staff will, however, make a recommendation to the commission at some later, undetermined date. That means there's no timetable whatsoever on an SEC decision on IFRS. However, the continued convergence of IFRS and U.S. GAAP requires a state of readiness by companies to adopt standards that are increasingly similar to IFRS.

Currently, a number of new accounting standards are under development that will further the efforts of convergence of U.S. generally accepted accounting principles (U.S. GAAP) and IFRS. Convergence will have an effect on areas such as financial instruments, revenue and leasing.

The table below summarizes the IASB and FASB joint projects and expected time lines.

Joint Projects	H1 2012	H2 2012
Financial instruments – classification & measurement	Redeliberations	Final standard expected
Financial instruments - impairment	Redeliberations	Final standard expected
Financial instruments - hedging	Redeliberations	Redeliberations
Revenue recognition	Redeliberations	Final standard expected
Leases	Redeliberations	Final standard expected

In this publication we provide a high level overview of key differences between U.S. GAAP and IFRS. While this publication does not cover every difference between IFRS and U.S. GAAP, it focuses on those differences generally considered to be the most significant or most common.

In addition to providing an overview of key differences between U.S. GAAP and IFRS, this publication highlights some of the issues that U.S. companies will need to consider on convergence or adoption of IFRS and a suggested conversion methodology to help U.S. companies understand the processes that should be considered and to plan for convergence or adoption of IFRS.


BENEFIT
COST

contents

How will it affect your company?

We highlight some of the issues that companies will need to consider on convergence or adoption of IFRS

Business impact converting to IFRS

Group adoption

Many countries already require or permit IFRS for financial reporting purposes and many more are in the process of converging. As a result, many U.S. multinational companies are already dealing with IFRS in their foreign subsidiaries. Therefore, where IFRS is being adopted by U.S. foreign subsidiaries, the parent companies in the U.S. need to ensure they have input into the accounting policy elections under IFRS (upon adoption). Selection decisions usually cannot be undone for reporting purposes unless the change results in more relevant and reliable information and simplifies group reporting where there is consistency in policy throughout the group.

Cost savings

If IFRS is incorporated into the U.S. accounting framework, taking a centralized approach to IFRS reporting can potentially create significant cost savings for companies with many subsidiaries. For example, companies may want to think about shared service centres to consolidate back office functions such as financial reporting. It is also an ideal opportunity to streamline and enhance business processes, simplify policies and take advantage of changes in the IT environment.

Systems upgrade

As companies look to upgrade their systems infrastructure, they should carefully consider whether the new systems infrastructure can comply with measurement and disclosure requirements under the proposed convergence standards or under IFRS. Depending on the final method or process selected to incorporate IFRS into the U.S. accounting framework, companies may need the ability for their systems to handle dual reporting requirements during a transition period. Tax considerations may also require dual reporting. Identifying potential gaps in data will allow companies to design systems that deliver the necessary information in an efficient and timely manner. In additional, internal control (especially resulting from SoX requirements for public companies) is important. Companies need to ensure that appropriate internal controls over financial reporting are in place – "spreadsheet conversions" are not likely to comply.

Contracts

Converging to or adopting IFRS will have an impact on long term contracts and financial agreements.
For example, a company's debt covenants might specify a certain debt-equity ratio, which may change once the company applies new U.S. standards or adopts IFRS, therefore making it necessary for the company to renegotiate or seek modifications to its debt agreements.

What are the key differences between U.S. GAAP and IFRS?

We provide an overview of the most significant differences between U.S. GAAP and IFRS.

Financial Statement Presentation

Financial periods

IFRS	U.S. GAAP
One year of comparatives is required for all numerical information in the financial statements, with limited exceptions in disclosures. In limited note disclosures and the statement of equity, more than one year of comparative informationis required. A third balance sheet also is required for first time adopters of IFRS and in situations where a restatement or reclassification has occurred. Restatements or reclassifications in this context are in relation to a change in accounting policies or accounting estimates, errors or changes in presentation of previously issued financial statements. An entity in its financial statements should include the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office.	Comparative financial statements need not be presented. A single year may be presented and, in practice, a single year is often presented by private companies. Public companies must follow SEC rules, which typically require balance sheets for the two most recent years, while all other statements must cover the three-year period ended on the balance sheet date. An entity under U.S. GAAP is not required to disclose the registered office in its financial statements.

Income statement – presentation

IFRS	U.S. GAAP
IAS 1 *Presentation of Financial Statements:* does not give a standard layout but it does provide a list of minimum items that should be included. Entities may present all items of income and expense in either a single statement of comprehensive income or two statements (an income statement and a statement of comprehensive income). Expenses may be presented either by function or by nature. Additional disclosure of expenses by nature is required if functional presentation is used. Entities that disclose an operating result should include all items of an operating nature, including those that occur irregularly or infrequently or are unusual in amount, within that caption. Entities should not mix functional and nature classifications of expenses by excluding certain expenses from the functional classifications to which they relate.	No general requirement within U.S. GAAP to prepare the balance sheet and income statement in accordance with a specific layout. However, in practice, the income statement is presented either as: 1) A single step format, whereby all expenses are classified by function and then deducted from total income to arrive at income before tax, or 2) A multiple step format separating operating and non-operating activities before presenting income before tax.

Financial Statement Presentation (continued)

Income Statement – exceptional and extraordinary items	
IFRS	**U.S. GAAP**
The term 'exceptional items' is not used or defined. However, the separate disclosure is required (either on the face of the comprehensive/separate income statement or in the notes) of items of income and expense that are of such size, nature, or incidence that their separate disclosure is necessary to explain the performance of the entity for the period. 'Extraordinary items' are prohibited.	Although U.S. GAAP does not use the term 'exceptional items', significant unusual or infrequently occurring items are reported as components of income separate from continuing operations, either on the face of the statement of operations or in the notes to the financial statements. 'Extraordinary items' are defined as being both infrequent and unusual and are rare in practice. Entities may utilize one of three formats in their presentation of comprehensive income: • A single primary statement of income and comprehensive income • A two statement approach (a statement of income and a statement of comprehensive income) • A separate category highlighted within the primary statement of changes in shareholders equity.

Income statement – Other Comprehensive Income (OCI)	
IFRS	**U.S. GAAP**
In June 2011 the IASB issued amendments to IAS 1 *Presentation of Financial Statements* on the presentation of other comprehensive income (OCI).These amendments are effective for annual periods beginning on or after 1 July 2012. Upon adoption of the amendments, entities will still be permitted to present items of net income and other comprehensive income or in two separate but consecutive statements. The amendment will, however, require items included in other comprehensive income that may be recycled into profit or loss in future periods o be presented separately from those that will not be recycled.	In June 2011 the FASB issued ASU No 2011-05, *Presentation of Comprehensive Income.* These amendments are effective for Public entities for annual periods beginning on or after 15 December 2011 and for Non-Public entities' annual periods beginning on or after 15 December 2012. Upon adoption of the new standard, entities will present items of net income and other comprehensive income either in one single statement of comprehensive income or in two separate but consecutive statements. The option to present other comprehensive income and its components in the statement of changes in equity will be eliminated. In December 2011 the FASB issued an ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of items out of Accumulated Other Comprehensive Income.* ASU No. 2011-12 defers indefinitely the requirements for companies to present reclassification adjustments out of accumulated OCI by component in both the statement where net income is presented and the statement.

Financial Statement Presentation (continued)

<table>
<tr><th colspan="2">Balance sheet – offsetting assets and liabilities</th></tr>
<tr><th>IFRS</th><th>U.S. GAAP</th></tr>
<tr><td>A right of setoff is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. Two conditions must exist for an entity to offset a financial asset and a financial liability (and thus present the net amount on the balance sheet). The entity must both:
• Currently have a legally enforceable right to set off the recognized amounts
• Intend either to settle on a net basis or to realize the asset and settle the liability simultaneously.
In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor, provided that there is an agreement among the three parties that clearly establishes the debtor's right of setoff.
Master netting arrangements do not provide a basis for offsetting unless both of the criteria described earlier have been satisfied. If both criteria are met, offsetting is required.</td><td>It is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except where a right of offset exists. A right of offset is a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor. A debtor having a valid right of offset may offset the related asset and liability and report the net amount. A right of offset exists when all of the following conditions are met:
• Each of two parties owes the other determinable amounts
• The reporting party has the right to offset the amount owed with the amount owed by the other party
• The reporting party intends to offset
• The right of offset is enforceable by law.
Repurchase agreements and reverse-repurchase agreements that meet certain conditions are permitted, but not required, to be offset in the balance sheet.
There is an exception to the previously described intent condition for derivative instruments executed with the same counterparty under a master netting arrangement. An entity may offset:
1) Fair value amounts recognized for derivative instruments; and
2) Fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral arising from derivative instruments recognized at fair value. Entities must adopt an accounting policy to offset fair value amounts under this guidance and apply that policy consistently</td></tr>
</table>

Financial Statement Presentation (continued)

Balance sheet – classified balance sheets	
IFRS	**U.S. GAAP**
The presentation of a classified balance sheet is required, except when a liquidity presentation is more relevant.	The presentation of a classified balance sheet is required, with the exception of certain industries such as real estate.

Balance sheet classification – post balance sheet refinancing agreements	
IFRS	**U.S. GAAP**
If completed after the balance sheet date, neither an agreement to refinance or reschedule payments on a long term basis nor the negotiation of a debt covenant waiver would result in non-current classification of debt, even if executed before the financial statements are issued.	Entities may classify debt instruments due within the next 12 months as non-current at the balance sheet date provided that agreements to refinance or to reschedule payments on a long term basis are completed before the financial statements are issued. The reporting entity may be able to classify the obligation as long-term if a private entity is out of compliance with its debt covenants as at the end of its reporting period and the violation is waived/resolved by the creditor prior to the financial statements being issued or available to be issued.

Balance sheet classification – refinancing counterparty	
IFRS	**U.S. GAAP**
If an entity expects and has the discretion to refinance or roll an obligation for at least 12 months after the reporting period under an existing loan financing, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period.	A short term obligation may be excluded from current liabilities if the entity intends to refinance the obligation on a long term basis and the intent to refinance on a long term basis is supported by an ability to consummate the refinancing as demonstrated by meeting certain requirements.
The refinancing should be with the same counterparty.	The refinancing does not need to be with the same counterparty.

Statements of changes in equity	
IFRS	**U.S. GAAP**
A statement of changes in equity is presented as a primary statement for all entities.	Statement of changes in shareholders' equity are presented either as a primary statement or within the notes to the financial statements.

Interim Financial Reporting

Treatment of certain costs in interim periods	
IFRS	**U.S. GAAP**
Each interim period is viewed as a discrete reporting period. A cost that does not meet the definition of an asset at the end of an interim period is not deferred and a liability recognized at an interim reporting date must represent an existing obligation. For example, inventory cost variances that do not meet the definition of an asset cannot be deferred. However, income taxes are accounted for based on an annual effective tax rate (similar to U.S. GAAP).	Each interim period is viewed as an integral part of an annual period. As a result, certain costs that benefit more than one interim period may be allocated among those periods, resulting in deferral or accrual of certain costs. For example, certain inventory cost variances may be deferred on the basis that the interim statements are an integral part of an annual period.

Consolidations & Joint Venture Accounting

Consolidated financial statements	
IFRS	**U.S. GAAP**
These are generally required if criteria under IAS 27 are met and, from 1 January 2013, criteria under IFRS 10 will be required to be met. Parent entities prepare consolidated financial statements that include all subsidiaries. An exemption applies to a parent entity when all of the following conditions apply: • It is wholly owned or the owners of the minority interests have been informed about and do not object to the parent not presenting consolidated financial statements • The parent's debt or equity securities are not publicly traded and the parent is not in the process of issuing securities in public securities markets • The immediate or ultimate parent publishes consolidated financial statements that comply with IFRS.	The guidance applies to legal structures. Industry-specific guidance precludes consolidation of controlled entities by certain types of organizations such as registered investment companies or broker/dealers. Consolidated financial statements are presumed to be more meaningful and are required for SEC registrants. There are no exemptions for consolidating subsidiaries in general purpose financial statements.

Consolidation model	
IFRS	**U.S. GAAP**
This focuses on the concept of control in determining whether a parent-subsidiary relationship exists. Control is the parent's ability to govern the financial and operating policies of a subsidiary to obtain benefits. Control is presumed to exist when a parent owns, directly or indirectly, more than 50 per cent of an entity's voting power. Control also exists when a parent owns half or less of the voting power but has legal or contractual rights to control either the majority of the entity's voting power or the board of directors. Control may exist even in cases where an entity owns little or none of a special purpose entity's (SPE) equity. In each case, the application of the control concept requires judgement in the context of all relevant factors.	All consolidation decisions are evaluated first under the variable interest entities (VIE) model. This requires an entity with a variable interest in a VIE to qualitatively assess the determination of the primary beneficiary of the VIE. In applying the qualitative model, an entity is deemed to have a controlling financial interest if it meets both of the following criteria: • Power to direct activities of the VIE that most significantly affect the VIE's economic performance (power criterion • Obligation to absorb losses from or right to receive benefits of the VIE that could potentially be significant to the VIE (losses/benefits criterion).

Consolidations & Joint Venture Accounting (continued)

Consolidation model – continued	
IFRS	**U.S. GAAP**
When control of an SPE is not apparent, IFRS requires evaluation of the entity, based on the entity's characteristics as a whole, to determine the controlling party. The concept of having rights to the majority of the economic benefits and residual risks is just one part of the analysis. Other factors considered in the evaluation are whether the activities of the SPE are being conducted on behalf of the entity. If the entity has decision-making powers to obtain the majority of the SPE's benefits or has delegated its decision making, the substance of the arrangement would be considered in order to decide the controlling party for IFRS purposes. (The differences here do not incorporate the new standard IFRS 10 *Consolidated Financial Statements.)*	In assessing whether an enterprise has a controlling financial interest in an entity, it should consider the entity's purpose and design, including the risks that the entity was designed to create and pass through to its variable interest holders. Only one enterprise, if any, is expected to be identified as the primary beneficiary of a VIE. Although more than one enterprise could meet the losses/benefits criterion, only one enterprise, if any, will have the power to direct the activities of a VIE that most significantly affects the entity's economic performance.

Equity method investments	
IFRS	**U.S. GAAP**
IAS 28 *Investments in Associates* requires investors (other than venture capital organizations, mutual funds, unit trusts and similar entities) to use the equity method of accounting in the consolidated financial statements. For separate financial statements, investments in subsidiaries and associates can be accounted for either at cost or fair value.	ASC 825-10 *Financial Instruments* gives entities the option to account for equity-method investments at fair value. For equity-method investment which management does not use the fair value option, the equity method of accounting is required.

Business combinations

Measurement of non-controlling interest	
IFRS	**U.S. GAAP**
Non-controlling interest is measured either at fair value, including goodwill, or its proportionate share of the fair value of the acquiree's identifiable net assets, exclusive of goodwill.	Non-controlling interest is measured at fair value which includes the non-controlling interest's share of goodwill.

Assets and liabilities arising from contingencies	
IFRS	**U.S. GAAP**
Initial Recognition Contingent liabilities are recognized as of the acquisition date if there is a present obligation that arises from past events and its fair value can be measured reliably. Contingent assets are not recognized. *Subsequent Measurement* Contingent liabilities are subsequently easured at the higher of its acquisition date fair value less, if appropriate, cumulative amortization recognized in accordance with IAS 18, *Revenue*, or the amount that would be recognized if applying IAS 37, *Provisions, Contingent Liabilities and Contingent Assets.*	*Initial Recognition* Assets and liabilities arising from contingencies are recognized at fair value in accordance with ASC 820 *Fair Value Measurement and Disclosures* (formerly FAS 157) if the fair value can be determined during the measurement period. If the fair value of a contingent asset or liability cannot be determined during the measurement period, that asset or liability should be recognized at the acquisition date in accordance with ASC 450 *Contingencies* (formerly FAS 5 and FIN 14) if it meets the criteria for recognition in that guidance. *Contingent* assets and liabilities that do not meet the recognition criteria at the acquisition date are subsequently accounted for pursuant to other literature, including ASC 450. (See "Provisions and Contingencies" for differences between ASC 450 and IAS 37.) *Subsequent Measurement* If contingent assets and liabilities are initially recognized at fair value, an acquirer should develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies depending on their nature. If amounts are initially recognized and measured under the contingencies guidance in ASC 450, the subsequent accounting and measurement should be based on the same guidance.

Business combinations (continued)

Acquiree operating leases	
IFRS	**U.S. GAAP**
Separate recognition of an intangible asset or liability is required only if the acquiree is a lessee. If the acquiree is a lessor, the terms of lease are taken into account in estimating the fair value of the asset subject to the lease.	If the terms of an acquiree operating lease are favourable or unfavourable relative to market terms, the acquirer recognizes an intangible asset or liability, respectively, regardless of whether the acquiree is the lessor or the lessee.

Property, Plant & Equipment (PPE)

Revaluation of assets	
IFRS	**U.S. GAAP**
Revaluation is a permitted accounting policy election for an entire class of assets, requiring revaluation to fair value on a regular basis.	Revaluation is not permitted.

Depreciation of asset components	
IFRS	**U.S. GAAP**
Component depreciation is required if components of an asset have differing patterns of benefit, resulting in more disaggregation than under U.S. GAAP. The carrying amounts of components that are replaced are derecognized. Residual values and useful lives are reviewed at each balance sheet date.	Component depreciation is permitted but not commonly used. There is no explicit requirement for a review of residual values and useful lives, although a general requirement exists for assumptions and estimates to be considered.

Measurement of borrowing costs	
IFRS	**U.S. GAAP**
Eligible borrowing costs include exchange rate differences from foreign currency borrowings. Borrowing costs are offset by investment income earned on those borrowings. For borrowings associated with a specific qualifying asset, actual borrowing costs are capitalized.	Eligible borrowing costs do not include exchange rate differences. Interest earned on the investment of borrowed funds or for the construction of qualifying assets generally cannot offset interest costs incurred during the period. For borrowings associated with a specific qualifying asset, borrowing costs equal to the weighted average accumulated expenditures times the borrowing rate are capitalized.

Investment property	
IFRS	**U.S. GAAP**
Investment property is separately defined in IAS 40 *Investment Property* as an asset held to earn rent or for capital appreciation (or both) and may include property held by lessees under a finance/operating lease. Investment property may be accounted for on a historical cost basis or on a fair value basis as an accounting policy election. Capitalized operating lease classified as investment property must be accounted for using the fair value model.	Investment property is not separately defined and, therefore, is accounted for as held for use or held for sale.

Impairment of Property, Plant & Equipment (PPE), Goodwill and Intangible Assets

Method of determining impairment for PPE

IFRS	U.S. GAAP
One-step approach requires that impairment testing be performed if impairment indicators exist.	Two-step approach requires that a recoverability test be performed first (carrying amount of the asset is compared to the sum of future undiscounted cash flows generated through use and eventual disposition). If it is determined that the asset is not recoverable, impairment testing must be performed.

Impairment loss calculation for PPE

IFRS	U.S. GAAP
This is the amount by which the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is the higher of: (1) fair value less costs to sell, and (2) value in use (the present value of future cash flows in use including disposal value).	This is the amount by which the carrying amount of the asset exceeds its fair value, as calculated in accordance with ASC 820 (formerly FAS 157).

Allocation of goodwill

IFRS	U.S. GAAP
Goodwill is allocated to a cash-generating unit (CGU) or group of CGUs which represents the lowest level within the entity at which the goodwill is monitored for internal management purposes and cannot be larger than an operating segment as defined in IFRS 8 *Operating Segments.*	Goodwill is allocated to a reporting unit which is an operating segment or one level below an operating segment (component).

Impairment of Property, Plant & Equipment (PPE), Goodwill and Intangible Assets (continued)

Method of determining impairment for goodwill	
IFRS	**U.S. GAAP**
One-step approach requires that an impairment test be done at the CGU level by comparing the CGU's carrying amount, including goodwill, with its recoverable amount.	A reporting entity may first assess qualitative factors to determine if it is necessary to perform the two step impairment test (as detailed below). The two step test is necessary if it is likely that the fair value of the reporting unit is less than its carrying amount. The two-step approach requires a recoverability test to be performed first at the reporting unit level (carrying amount of the reporting unit is compared to the reporting unit fair value). If the carrying amount of the reporting unit exceeds its fair value, then impairment testing must be performed.

Impairment loss calculation for goodwill	
IFRS	**U.S. GAAP**
Impairment loss on the CGU (amount by which the CGU's carrying amount, including goodwill, exceeds its recoverable amount) is allocated first to reduce goodwill to zero. Then, subject to certain limitations, the carrying amount of other assets in the CGU are reduced pro rata, based on the carrying amount of each asset.	This is the amount by which the carrying amount of goodwill exceeds the implied fair value of the goodwill within its reporting unit.

Impairment loss calculation for indefinite lived intangible assets	
IFRS	**U.S. GAAP**
This is the amount by which the carrying value of the asset exceeds its recoverable amount.	This is the amount by which the carrying value of the asset exceeds its fair value.

Reversal of impairment loss	
IFRS	**U.S. GAAP**
This is prohibited for goodwill. PPE must be reviewed annually for reversal indicators. If appropriate, loss may be reversed up to the newly estimated recoverable amount, not to exceed the initial carrying amount adjusted for depreciation.	This is prohibited for all assets to be held and used.

Income taxes

Tax basis	
IFRS	**U.S. GAAP**
Tax basis is generally the amount deductible or taxable for tax purposes. The manner in which management intends to settle or recover the carrying amount affects the determination of tax basis.	Tax basis is a question of fact under the tax law. There is no dispute on this amount for most assets and liabilities but, when uncertainty exists, it is determined in accordance with ASC 740-10-25 (formerly FIN 48).

Uncertain tax positions	
IFRS	**U.S. GAAP**
IFRS does not include specific guidance. IAS 12 *Income Taxes* indicates that tax assets and liabilities should be measured at the amount expected to be paid. Some adopt a "one-step" approach which recognizes all uncertain tax positions at an expected value. Others adopt a "two-step" approach which recognizes only those uncertain tax positions that are considered more likely than not to result in a cash outflow. Practice varies regarding the consideration of detection risk in the analysis.	ASC 740-10-25 requires a two-step process, separating recognition from measurement. A benefit is recognized when it is "more likely than not" to be sustained based on the technical merits of the position. The amount of benefit to be recognized is based on the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement. Detection risk is precluded from being considered in the analysis.

Initial recognition exemption	
IFRS	**U.S. GAAP**
Deferred tax effects arising from the initial recognition of an asset or liability are not recognized when (1) the amounts did not arise from a business combination and (2) the transaction affects neither accounting nor taxable profit (for example, acquisition of non-deductible assets) upon occurrence.	This does not include an exemption like that under IFRS for non-recognition of deferred tax effects for certain assets or liabilities.

Recognition of deferred tax assets	
IFRS	**U.S. GAAP**
Amounts are recognized only to the extent it is probable (similar to "more likely than not" under U.S. GAAP) that they will be realized.	Recognized in full (except for certain outside basis differences) but valuation allowance reduces asset to the amount that is more likely than not to be realized.

Calculation of deferred tax asset or liability	
IFRS	**U.S. GAAP**
Enacted or "substantively enacted" tax rates as of the balance sheet date must be used.	Enacted tax rates must be used.

Intangible Assets

Development costs	
IFRS	**U.S. GAAP**
Development costs are capitalized when technical and economic feasibility of a project can be demonstrated if these fall under the criteria highlighted. Some of these criteria are to demonstrate technical feasibility, intention to complete the asset, and the ability to sell the asset at a future date.	Development costs are expensed as incurred unless these are addressed by another standard. Development costs related to computer software developed for external use are capitalized once technological feasibility is established in accordance with the criteria under ASC 985-20. In the case of software developed for internal use, only those costs incurred during the development stage as defined under ASC 350-40 *Internal Use Software* (formerly SOP 98-1) may be capitalized.

Advertising costs	
IFRS	**U.S. GAAP**
Advertising and promotional costs are expensed as incurred. A prepayment may be recognized as an asset only when payment for the goods or services is made in advance of the entity's having access to the goods or receiving the services.	Advertising and promotional costs are either expensed as incurred or expensed when the advertising takes place for the first time (policy choice). Direct response advertising may be capitalized if the specific criteria in ASC 340-20 *Capitalized Advertising Costs* (formerly SOP 93-7) are met.

Revaluation	
IFRS	**U.S. GAAP**
Revaluation to fair value of intangible assets other than goodwill is allowed.	Revaluation is not allowed.

Inventory

Costing methods	
IFRS	**U.S. GAAP**
LIFO is not allowed.	LIFO is allowed.
Measurement	
IFRS	**U.S. GAAP**
Inventory is carried at the lower of cost or net realizable value (best estimate of the net amounts inventories are expected to realize). This amount may or may not equal fair value.	Inventory is carried at the lower of cost or market. Market is defined as current replacement cost as long as market is not greater than net realizable value (estimated selling price less reasonable costs of completion and sale) and is not less than net realizable value reduced by a normal sales margin.
Reversal of inventory write-downs	
IFRS	**U.S. GAAP**
Previously recognized impairment losses are reversed up to the amount of the original impairment loss.	Write downs of inventory to the lower of cost or replacement cost will create a new cost basis that I cannot be reversed.

Leases

Lease of land and building	
IFRS	**U.S. GAAP**
The land and building elements of a lease are considered separately for purposes of evaluation of all indicators, unless the amount that would initially be recognized for the land element is immaterial, in which case they would be treated as a single unit for the purposes of lease classification. There is no 25% test to determine whether the land and a building should be considered separately for purposes of evaluating certain indicators.	A lease for land and buildings that transfers ownership to the lessee or contains a bargain purchase option would be classified as a capital lease by the lessee, regardless of the relative value of the land. Land and building elements are generally accounted for as single item, unless the land represents 25% or more of the total fair value of the leased property.

Recognition of a gain or loss on a sale and leaseback when the leaseback is an operating leaseback	
IFRS	**U.S. GAAP**
Gain or loss is recognized immediately, subject to adjustment, if the sale price differs from fair value.	If the seller does not relinquish more than a minor part of the right to use the asset, gain or loss is generally deferred and amortized over the lease term. If the seller relinquishes more than a minor part of the use of the asset, then part or all of a gain may be recognized depending on the amount relinquished. (Note: Does not apply if real estate is involved as the specialized rules are very restrictive with respect to the seller's continuing involvement and they may not allow for recognition of the sale.)

Recognition of gain or loss on a sale leaseback when the leaseback is a finance leaseback	
IFRS	**U.S. GAAP**
Gain or loss deferred and amortized over the lease term.	Generally, same as above for operating leaseback where the seller does not relinquish more than a minor part of the right to use the asset.

Financial Instruments (Under IAS 39 and not IFRS 9 - effective from 1 January 2015)

Fair value measurement

IFRS	U.S. GAAP
Various IFRS standards use slightly varying wording to define fair value. Generally fair value is neither an exit nor an entry price but represents the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.	One measurement model whenever fair value is used (with limited exceptions). Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is an exit price which may differ from the transaction (entry) price.

Day one profits

IFRS	U.S. GAAP
Day one gains are recognized only when all inputs to the measurement model are observable.	Entities are not precluded from recognizing day one gains and losses on financial instruments reported at fair value even when all inputs to the measurement model are not observable. For example, a day one gain or loss may occur when the transaction occurs in a market that differs from the reporting entity's exit market.

Debt vs. equity classification

IFRS	U.S. GAAP
Classification of certain instruments with characteristics of both debt and equity focuses on the contractual obligation to deliver cash, assets, or an entity's own shares. Economic compulsion does not constitute a contractual obligation. Contracts that are indexed to, and potentially settled in, a company's own stock are classified as equity when settled by delivering a fixed number of shares for a fixed amount of cash.	U.S. GAAP specifically identifies certain instruments with characteristics of both debt and equity that must be classified as liabilities. Certain other contracts that are indexed to, and potentially settled in, a company's own stock may be classified as equity if they: (1) require physical settlement or net-share settlement or (2) give the issuer a choice of net-cash settlement or settlement in its own shares.

Financial Instruments (Under IAS 39 and not IFRS 9 - effective from 1 January 2015) - (continued)

Compound (hybrid) financial instruments	
IFRS	**U.S. GAAP**
Compound (hybrid) financial instruments need to be split into debt and equity components and, if applicable, a derivative component. The derivative component may be subjected to fair value accounting.	Compound (hybrid) financial instruments (for example, convertible bonds) are not split into debt and equity components unless certain specific conditions are met but they may be bifurcated into debt and derivative components, with the derivative component subjected to fair value accounting.

Impairment recognition – Available-for-Sale (AFS) debt instrument	
IFRS	**U.S. GAAP**
Generally, only evidence of credit default results in the impairment of an AFS debt instrument. Impairment losses recognized through the income statement for available-for-sale equity securities cannot be reversed through the income statement for future recoveries. However, impairment losses for debt instruments classified as available-for-sale may be reversed through the income statement if the fair value of the asset increases in the subsequent period and the increase can be objectively related to an event occurring after the impairment loss was recognized.	Declines in fair value below cost may result in an impairment loss being recognized in the income statement on an AFS debt instrument due solely to a change in interest rates (risk-free or otherwise) if the entity has the intent to sell the debt instrument or it is more likely than not that it will be required to sell the debt instrument before its anticipated recovery. In this circumstance, the impairment loss is measured as the difference between the debt instrument's amortized cost basis and its fair value.

Hedge effectiveness – shortcut method for interest rate swaps	
IFRS	**U.S. GAAP**
Not permitted.	Permitted.

Financial Instruments (Under IAS 39 and not IFRS 9 - effective from 1 January 2015) - (continued)

Hedging a component of a risk in a financial instrument	
IFRS	**U.S. GAAP**
Allows entities to hedge risk components (portions) that give rise to changes in fair value.	The risk components that may be hedged are specifically defined by the literature with no additional flexibility.

Derecognition of financial assets	
IFRS	**U.S. GAAP**
Derecognition of financial assets is based on a mixed model that considers both transfer of risks and rewards and control.Transfer of control is considered only when the transfer of risks and rewards assessment is not conclusive. If the transferor has neither retained nor transferred substantially all of the risks and rewards, there is then an evaluation of the transfer of control. Control is considered to be surrendered if the transferee has the practical ability to unilaterally sell the transferred asset to a third party without restrictions. There is no legal isolation test.	Derecognition of financial assets (sales treatment) occurs when effective control has been surrendered over the financial asset. Control has been surrendered only when: • The transferred financial assets are legally isolated from the transferor • Each transferee (or, if the transferee is a securitization entity, each holder of its beneficial interests) has the right to pledge or exchange the transferred financial assets (or beneficial interests) • The transferor does not maintain effective control over the transferred financial assets or beneficial interests (eg, through a call option or repurchase agreement). The derecognition criteria may be applied to a portion of a financial asset only if it mirrors the characteristics of the original entire financial asset.

Foreign Currency

Translation/functional currency of foreign operations in a hyperinflationary economy	
IFRS	**U.S. GAAP**
Financial statements (current and prior periods) in local functional currency are indexed by using a general price index and then translated into the reporting currency at the current rate.	Local functional currency financial statements are re-measured as if the functional currency was the reporting currency (U.S. dollar in the case of a U.S. parent) with resulting exchange differences recognized in income.

Net investment denominated in currencies other than the functional currencies of the entities that are parties to the monetary items	
IFRS	**U.S. GAAP**
IFRS does not require monetary items to be denominated in functional currencies of the entities that are parties to the monetary item in order for it to be accounted for as a part of the reporting entity's net investment in those entities.	Foreign currency transactions between the entities within same group, for which settlement is neither planned nor likely to occur in the foreseeable future, may be considered a part of the net investment if the monetary items are denominated in the functional currencies of the entities that are parties to the monetary items.

Consolidation of foreign operations	
IFRS	**U.S. GAAP**
The method of consolidation is not specified and, as a result, either the "direct" or the "step-by-step" method is used. Under the "direct" method, each entity within the consolidated group is directly consolidated into the ultimate parent without regard to any intermediate parent. The choice of a method could affect the cumulative translation adjustments deferred within equity at intermediate levels and, therefore, the recycling of such exchange rate differences upon disposal of an intermediate foreign operation.	A "bottom-up" approach is required in order to reflect the appropriate foreign currency effects and hedges in place. As such, an entity should be consolidated by the enterprise that controls the entity. Therefore, the "step-by-step" method of consolidation is used whereby each entity is consolidated into its immediate parent until the ultimate parent has consolidated the financial statements of all the entities below it.

Revenue Recognition

Sale of goods	
IFRS	**U.S. GAAP**
Revenue is recognized only when risks and rewards of ownership have been transferred, the buyer has control of the goods, revenues can be measured reliably, and it is probable that the economic benefits will flow to the company.	Public companies must follow SAB 104. *Revenue Recognition* to determine when revenue is recognized. Under SAB 104, the guidelines are that revenue is generally realized or realizable and earned when all the following criteria are met: • Persuasive evidence of an arrangement exists • Delivery has occurred or services have been rendered • The sellers price to the buyer is fixed or determinable • Collectability is reasonably assured. Private companies generally also use the guidance under SAB 104 to help them determine when revenue should be recognized for a transaction where there is no other guidance in U.S. GAAP.
Rendering of services	
IFRS	**U.S. GAAP**
Revenue may be recognized in accordance with long-term contract accounting; including the consideration of the stage of completion, whenever revenues and costs can be measured reliably, and it is probable that economic benefits will flow to the company.	The risk components that may be hedged are specifically defined by the literature with no additional flexibility. All other service revenue should follow SAB Topic 13. Under SAB Topic 13 revenue should not be recognized until it is realized or realizable and earned. An entity's revenue earning activities involve delivering or producing goods, rendering services or other activities that constitute its ongoing major or central operations, and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. Application of long-term contract accounting ASC 605-35 *Construction-Type and Production-Type Contracts,* (formerly SOP 81-1) is only permitted for construction services.

Revenue Recognition (continued)

Multiple elements	
IFRS	**U.S. GAAP**
IAS 18 requires recognition of revenue on an element of a transaction if that element has commercial substance on its own. Otherwise, the separate elements must be linked and accounted for as a single transaction. IAS 18 does not provide specific criteria for making that determination.	Accounting Standard Update 2009-13 *Multiple-Deliverable Revenue Arrangements* revised the guidance around accounting for multiple elements in October 2009. The amendments eliminated the residual method of allocation and now require the arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. The relative selling price method allocates any discount in the arrangement proportionally to each deliverable on the basis of each deliverables selling price.

Deferred receipt of receivables	
IFRS	**U.S. GAAP**
This is considered to be a financing agreement. The value of the revenue to be recognized is determined by discounting all future receipts using an imputed rate of interest.	Discounting to present value is required only in limited situations

Share-based payments

Transactions with non-employees	
IFRS	**U.S. GAAP**
The fair value of a transaction should be based on the value of the goods or services received and only on the fair value of the equity instruments if the fair value of the goods and services cannot be reliably determined. The measurement date is the date on which the entity obtains the goods or the counterparty renders the services. There is no performance commitment concept.	Either the fair value of (1) the goods or services received, or (2) the equity instruments is used to value the transaction, whichever is more reliable. If using the fair value of the equity instruments, ASC 505-50 *Equity-Based Payments to Non-Employees* (formerly EITF 96-18), measurement is required at the earlier of (1) the date at which a “commitment for performance” by the counterparty is reached, or (2) the date at which the counterparty’s performance is complete.

Measurement and recognition of expense – awards with graded vesting features	
IFRS	**U.S. GAAP**
This must recognize compensation cost on an accelerated basis – each individual tranche must be separately measured.	Entities make an accounting policy election to recognize compensation cost for awards containing only service conditions either on a straight-line basis or on an accelerated basis, regardless of whether the fair value of the award is measured based on the award as a whole or for each individual tranche.

Equity repurchase features at an employee’s choice	
IFRS	**U.S. GAAP**
Liability classification is required (no six month consideration exists).	Does not require liability classification if employee bears risks and rewards of equity ownership for at least six months from the date the equity is issued or vests.

Subsequent Events

Date through which subsequent events must be evaluated	
IFRS	**U.S. GAAP**
Subsequent events are evaluated through the date that the financial statements are "authorized for issue." Depending on an entity's corporate governance structure and statutory requirements, authorization may come from management or a board of directors. Most U.S. entities do not have a similar requirement.	Subsequent events are evaluated through the date the financial statements are issued or available to be issued. Financial statements are considered issued when they are widely distributed to shareholders or other users in a form that complies with U.S. GAAP. For SEC registrants, financial statements are issued when the financial statements are filed with the SEC. Financial statements are considered available to be issued when they are in a form that complies with U.S. GAAP and all necessary approvals have been obtained. SEC registrants and conduit-bond obligors evaluate subsequent events through the date the financial statements are issued, while all other entities evaluate subsequent events through the date that the financial statements were available to be issued.

Stock dividends declared after balance sheet date	
IFRS	**U.S. GAAP**
Financial statements are not adjusted for a stock dividend declared after the balance sheet date.	Financial statements are adjusted for a stock dividend declared after the balance sheet date.

What action should be taken?

We outline PKFI's suggested conversion methodology to help companies plan for convergence

What action should be taken?

PKF International Limited's (PKFI) suggested IFRS conversion or convergence methodology for member firms is highlighted below and demonstrates how PKFI member firms can help you with the convergence or adoption of IFRS.

IFRS Conversion

Our methodology is split into four phases:

- Impact assessment
- Design and planning
- Implementation and embedding processes
- Training.

The illustration lists just some of the actions to be undertaken in each phase and, as illustrated, there is a certain amount of overlap between some of the phases. Also please note that some form of training will be required throughout each stage.

It is not all about finance

It is important to remember that, on convergence or adoption of IFRS, companies should not only focus on the finance teams for a successful transition but also involve the Tax, Systems (including business processes and systems), Regulatory, Human Resources and Training teams from the beginning of the project. A convergence or conversion project is the ideal opportunity to streamline the organizational structure by eliminating entities that are no longer needed, plan new tax efficient strategies and work with the systems teams to ensure that systems infrastructure is amended to cater for the production of information under the new requirements. You should also ensure that a plan is in place for staff to understand the new requirements under the new standards as illustrated in the diagram below.

Phase 1:

Impact Assessment

- High level assessment of the impact of IFRS on the financial statements, key issues and actions to consider
- High level assessment of potential impact on systems and financial reporting processes

Phase 2:

Design and planning

- Define project governance and infrastructure
- Develop communication and training strategy
- Design and finalise project plans
- Identify and train project teams
- Communicate project strategy
- Identify IFRS policy options
- Finalise selection of IFRS accounting policies and communicate this to management

Phase 3:

Implementation and embedding processes

- Identify solutions for accounting and reporting, tax, business, process, and systems changes associated with selected IFRS accounting policies
- IFRS conversion begins in phases
- Rollout of proposed solutions
- Continued training and knowledge sharing
- Calculate IFRS adjustments for each required period
- Complete the reporting packs for the required disclosures
- Consolidate IFRS results

Phase 4:

Training

- Resolve data gaps within the general ledgers and source systems
- Continued review of controls over IFRS financial reporting processes
- Post-implementation review of systems and financial reporting processes
- Develop policy guidance and on-going training programme

PKF International Limited (PKFI) is a network of legally independent member firms with around 245 member and correspondent firms located in around 125 countries throughout the world. PKFI is the 10th largest global accountancy network with $2.6 billion fee income and over 2,190 partners and 21,474 staff are employed by PKFI member firms.

PKFI member firms are leaders in assurance, tax, transaction and advisory services Worldwide,our people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

PKFI is a UK company that does not provide services to clients. For more information about our organization, please visit **www.pkf.com/IFRS**

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