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Volume 15, March/April 2010

IFRS Insights
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SEC Publishes Work Plan for Moving Forward With IFRS

A look at the SEC's statement in support of convergence and global accounting standards

Ever since the end of the comment period for the Securities and Exchange Commission's (SEC) proposed IFRS Roadmap, which occurred in April of last year, many companies have been waiting for the SEC to announce next steps on IFRS. The anticipated announcement came on February 24 when the SEC issued a formal statement supporting convergence and the development of a single-set of global accounting standards. The statement provides an overview of the SEC's IFRS activities to date, summarizes certain aspects of the input received on the IFRS Roadmap, and presents an approach going forward for IFRS in the U.S. Perhaps most important, the SEC has directed its staff to execute a Work Plan, the completion of which, combined with the completion of ongoing convergence efforts, will allow it to decide on a mandate next year. This is consistent with the timing outlined in the proposed IFRS Roadmap.

The SEC statement is significant as it puts this Commission on record for supporting the movement to IFRS.

SEC Staff's Work Plan

The Work Plan outlines a detailed set of activities that the SEC staff will undertake to provide the SEC with the information it needs to make a determination of whether, when, and how to incorporate IFRS into the U.S. financial reporting system. The Work Plan addresses the following six areas of concern that were highlighted in comments on the SEC's proposed IFRS Roadmap:[1]

1. Sufficient development and application of IFRS for the U.S. domestic reporting system. Before the SEC decides whether to incorporate IFRS into the U.S. financial reporting system, it will first determine whether the standards are sufficiently developed and applied. To help make this determination, the SEC staff will analyze whether the standards are comprehensive, auditable, and enforceable, and allow financial statement comparability within and across jurisdictions.

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[1] For more detailed information about the SEC's statement, see Deloitte's *Heads Up* publication, "The Road to IFRSs is under Construction: SEC Publishes Work Plan for Moving Forward with IFRSs for U.S. Issuers."

SEC Publishes Work Plan for Moving Forward With IFRS (continued)

2. The independence of standard setting for the benefit of investors. The SEC staff will evaluate whether the International Accounting Standards Board (IASB) is sufficiently independent for the benefit of investors. Specifically, the staff will analyze whether the IASB's funding and governance structure supports an independent standard-setting process. Of particular concern is whether the IASB can develop high-quality accounting standards that benefit investors while demonstrating independence from commercial and political pressures and maintaining accountability to investors through appropriate due process.

3. Investor understanding and education regarding IFRS. Because of the differences between U.S. GAAP and IFRS, the SEC staff will consider investors' current understanding and familiarity with IFRS and how they become further educated. The extent to which investors will need further education will affect the scope and timing of transition to IFRS.

4. Examination of the U.S. regulatory environment that would be affected by a change in accounting standards. The SEC staff will consider the impact not only on the manner in which the SEC fulfills its mission, but also on other areas of the regulatory environment such as regulatory filings with industry regulators, tax issues (e.g., use of the last-in-first-out (LIFO) method of accounting for inventory), statutory dividend and stock repurchase restrictions linked to financial reporting, the need to align audit regulation and audit standard setting with IFRS, and potential exemptions for broker-dealer and investment company reporting. The SEC staff will also examine the effect on adoption of IFRS for private companies.

5. The impact on issuers, both large and small, including changes to accounting systems, changes to contractual arrangements, corporate governance considerations, and litigation contingencies. The SEC staff will assess the magnitude and logistics of the changes that issuers would need to undertake with respect to accounting systems, controls, and procedures; contractual arrangements; and corporate governance. The SEC will also assess legal issues associated with the lower threshold for recognition of litigation-related loss contingencies under IFRS.

6. Human capital readiness. The SEC staff will explore readiness considerations related to education and training for issuers, including audit committees, investor relations departments, specialists, attorneys, external auditors, regulators (e.g., SEC staff, PCAOB staff), state licensing bodies, professional associations, industry groups, and educators. The SEC staff will also explore the impact of adoption of IFRS on the availability of external audit services and audit quality.

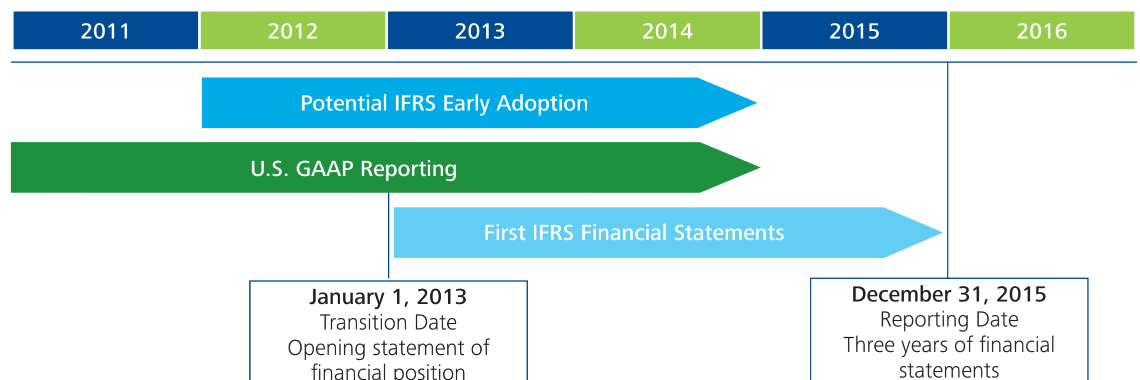
The first two areas above focus on information that is relevant to the SEC's determination of whether to incorporate IFRS into the U.S. financial reporting system, while the last four focus on the when and how (timing and scope) of potential adoption. The Work Plan is subject to further adjustments for new information or developments, and the SEC staff will provide public progress reports beginning no later than October 2010, continuing until the Work Plan is completed.

While the SEC did not define a date certain for IFRS adoption, the statement acknowledges that the first-time U.S. companies could be required to report under IFRS would be approximately 2015 or 2016 (See Figure 1).

What activities are some companies currently pursuing? While some multinational companies are looking to better understand the statutory reporting environment to identify potential areas to streamline and consolidate reporting, other companies have assessments already underway to further understand the potential impact of IFRS on accounting systems, processes, controls, and taxes. Analyzing the implications of convergence efforts between U.S. GAAP and IFRS is also an area that some companies are diving into. Developing IFRS proficiency through training employees is an area of focus for many companies as a way to prepare for the future.

Figure 1.

The SEC anticipates providing four to five years for IFRS adoption.



Making It Happen: IFRS and Repatriation Planning

Considering the opportunities and challenges in statutory reporting

The tax and treasury departments of many U.S. multinational companies have already begun dealing with changes in their repatriation transactions as a result of the movement toward IFRS for local statutory reporting purposes in countries outside the U.S. It's important to note that although many companies focus on upcoming mandatory IFRS requirements in countries such as India and Brazil, there are many other countries that permit the use of IFRS for statutory reporting purposes.

Importance of Repatriation Transactions

There is a natural tension between the tax and treasury functions of U.S. multinational corporations when considering cash repatriation. Tax planning can be done so that earnings of the enterprise are taxed in an efficient manner, which is often easier to accomplish if those earnings do not cross borders with the resulting taxes paid in multiple jurisdictions. The treasury department, on the other hand, is concerned with getting cash where it needs to be, either to grow the business or share the profits with its shareholders. In order to facilitate both objectives, companies may use various types of repatriation transactions that facilitate the movement of cash in a tax-efficient manner.

Converting financial statements from local standards to IFRS results in an adjustment to retained earnings on adoption for the differences between the two standards.

A common element in many of these transactions is the payment of dividends from subsidiaries. Such distributions generally require that the subsidiary have sufficient distributable reserves to satisfy corporate law obligations. Converting financial statements from local standards to IFRS results in an adjustment to retained earnings on adoption for the differences between the two standards. The net effect of these adjustments could increase or decrease total distributable reserves, and in some cases could result in eliminating distributable reserves all together. A closer examination of the impact of conversion on global tax and treasury planning may be warranted, particularly in those jurisdictions where IFRS is optional or soon to become mandatory.

Opportunities and Challenges

There are an increasing number of jurisdictions in which the use of IFRS is optional (or early adoption is possible) for subsidiary or standalone statutory reporting, including Italy, Japan, Poland and the United Kingdom. When determining whether to adopt IFRS in these jurisdictions, companies should consider evaluating the potential impact of a conversion on distributable reserves and any related opportunities and challenges for repatriation transactions.

Following are just two examples of repatriation transactions that rely on the existence of distributable reserves:

- One annual repatriation transaction involves the distribution of earnings that were previously subject to U.S. tax as a result of subpart F income ("previously taxed income" or PTI). Companies with substantial PTI balances should consider the legal ability of the subsidiary to make a distribution and determine whether a distribution prior to conversion is warranted based on the expected impact of conversion on retained earnings. Conversely, subsidiaries with trapped PTI may benefit from an increase in retained earnings upon conversion.
- Another transaction involves a nontaxable return of capital from a subsidiary for U.S. tax purposes. To the extent there is tax basis in the subsidiary, any incremental distributable reserves arising from conversion to IFRS may be able to be repatriated free of U.S. tax.

Cash that is effectively stranded in a particular jurisdiction due to unfavorable tax consequences is not a new phenomenon. Companies that are already dealing with this may consider one-time transactions that provide the opportunity to repatriate large sums of cash based on unique facts or law changes. Being able to choose the timing of a conversion from local GAAP to IFRS may provide additional repatriation opportunities or prevent unwanted consequences such as trapped earnings.

Next Steps

So how should a U.S. multinational evaluate the impact of IFRS on its global tax and treasury planning? Start by addressing a few important questions:

- In which jurisdictions has repatriation planning been limited due to insufficient distributable reserves?
- Which jurisdictions have excess cash but no distributable reserves?
- Which jurisdictions are integral to the company's ability to move cash around the group?
- Will IFRS soon be mandatory or is the company considering an optional conversion in any jurisdictions? If so, what is the likely impact on retained earnings/distributable reserves?
- Are there situational repatriation transactions that could be leveraged to access an increase in retained earnings post-conversion or to avoid trapped earnings as a result of conversion?

Addressing these questions, coupled with a careful treasury and tax analysis, are important considerations in an overall IFRS assessment process and can help organizations integrate their global conversion to IFRS with their fundamental tax and treasury objectives.

Technical Corner: Financial Instruments

In November 2009, the IASB issued an exposure draft (ED), Financial Instruments: Amortized Cost and Impairment, which proposes a fundamentally new approach to accounting for credit losses to replace the existing "incurred-loss" model. The proposed approach, which affects the recognition of both net interest revenue and credit impairment, is designed to result in earlier loss recognition by taking into account future credit losses expected over the life of loans or other financial assets (an "expected-loss" approach). The expected-loss approach would apply to all financial assets measured at amortized cost, such as loan assets, investments in debt securities, and trade receivables that meet the IASB's criteria of amortized cost measurement.

Under this approach, an allowance for expected future losses is estimated upon initial recognition and gradually built over the life of a financial asset by deducting a margin for future credit losses from gross interest revenue, even if no losses have yet been incurred. This is achieved by adjusting the initial effective interest income (EIR). Expected cash flows reflecting expected losses would be discounted at the initial EIR and continually updated to measure the revised carrying amount. Amounts representing impairment would be recognized in profit or loss, with subsequent impairment recognized continuously through re-estimation of expected cash flows. Impairment would be reversed by adjusting the expected cash flows (no trigger is required).

Comments on the ED are due by June 30, 2010. The IASB expects to finalize the new requirements in 2010, and to make them effective for 2013 or later.

Industry Update for Rate-regulated Activities

Update on the IASB Exposure Draft, Rate-regulated Activities

For regulated industries, such as the power and utilities sector, many companies have been tuning into developments around the IASB's exposure draft ED/2009/8, *Rate-regulated Activities*. Here's a quick overview and update on where things stand, following the IASB's meeting in February:

- The comment period ended November 20, 2009. The IASB received 156 comment letters, with diverse views in support of and against the proposed standard. Views of respondents outside the utilities sector were evenly balanced for and against the proposal, while those from the utilities sector, particularly from North America, were strongly supportive of the ED.
- At the February 2010 IASB meeting, no technical decisions were made, but significant scheduling issues were addressed and it is now unlikely that the original timetable for re-deliberation and approval of an IFRS can be sustained. Since many of the routes open to the Board would involve re-exposure of the proposals, the earliest that an IFRS could be issued, according to the IASB project calendar, is the latter part of 2011. The IASB staff noted that they would require at least two months for an additional analysis. As a result, re-deliberations of the ED may not begin until late Q2 2010. So, more news to come.

For more information on the specifics of the meeting, see the IASPlus Web site.

Featured Stats

In a recent 2010 Deloitte Dbriefs webcast poll,[2] financial executives were asked the following questions about IFRS:

How do you view the movement toward a single set of high-quality globally accepted accounting standards?	
Votes Received: 3,387	
Support	57.5%
Strongly support	23.4%
Oppose	7.9%
Strongly oppose	2.6%
Don't know	6.5%
Not applicable	2.1%

Which IFRS development and application consideration concerns your company the most?	
Votes Received: 3,543	
Comprehensiveness	25.4%
Auditability and enforceability	26.5%
Comparability within and across jurisdictions	25.0%
Don't know	17.5%
Not applicable	5.6%

What level of knowledge and experience does your financial reporting personnel have for reporting under IFRSs?	
Votes Received: 3,387	
No IFRS knowledge or experience in-house	31.9%
Some in-house knowledge and experience	42.5%
Sufficient knowledge and experience in-house	9.0%
Don't know	11.5%
Not applicable	5.1%

[2] The Financial Reporting Dbriefs webcast, "International Financial Reporting Standards: SEC's Plans for Moving Forward," was held on March 9, 2010. The poll results presented herein are solely the thoughts and opinions of the poll participants and are not necessarily representative of the full population of financial executives.

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