

# ATTITUDES TO IFRS v2.0

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# ▶ 1. FOREWORD

In our 2007 report, *Attitudes to IFRS*, we shared information from in-depth interviews with 19 CFOs of UK-based entities about their experience of IFRS conversion. All had public debt or equity listed on an EU regulated market and were required to convert from UK GAAP to IFRS in 2005.

Since 2005, the adoption of IFRS by public markets in many territories has accelerated significantly. This acceleration has been heightened by the recent financial crisis and the perceived need for a single-set of high quality global accounting standards. Over 110 countries now require or have permitted IFRS for public reporting purposes. In addition to here in Canada others including Argentina, India, Japan, Malaysia, Mexico, South Korea and Taiwan, have already committed to require, or voluntarily permit, adoption of IFRS for public, or publicly accountable, entities in 2011 or 2012. This leaves one major economy that has not yet committed to the full adoption of IFRS: the United States of America. While at the time of publication, the Securities and Exchange Commission has not yet provided a definitive roadmap on its consideration of IFRS replacing US GAAP, the general consensus in the US is that it is a matter of "when" and not "if."

IFRS adoption has therefore become a matter of significant interest to many companies around the world. This interest has now gathered pace for subsidiary companies too, with the issuance of IFRS for SMEs by the IASB and decisions to be made across multinational groups about IFRS adoption. Consequently, we have updated our original report, and in this publication we speak with CFOs of entities who have more recently adopted IFRS, many of whom did so as a consequence of the London-based AIM's mandatory adoption of IFRS in 2007.

As local GAAP requirements may differ from those used by our respondents this report is not intended to provide a detailed account of specific differences between local GAAP and IFRS. Rather, it aims to provide those interested with a better understanding of IFRS adoption by sharing in the experiences of other CFOs and their thoughts and attitudes towards adoption.

We hope this report will help strengthen your understanding of key issues to be considered in adoption of IFRS.

May 2010



**GARY DRENNAN**



**CARLO MARIGLIA**

## ▶ 2. EXECUTIVE SUMMARY

- 2.1** With the continued expansion of International Financial Reporting Standards (IFRS) across the globe, including introduction in a number of major territories within the next two years including here in Canada, and anticipated changes in private company reporting globally in the next few years, we have updated and expanded our 2007 report, Attitudes to IFRS.
- 2.2** This report, Attitudes to IFRS v2.0, is a result of in-depth analysis and interviews with the Chief Financial Officers (CFOs) of 22 companies who have converted to IFRS much more recently.

The key findings identified are:

- **Focus on timing.**  
All respondents said that they should have started their IFRS conversion much sooner.
- **Take time in identifying the right solution.**  
A number of respondents commented that they would have taken the opportunity to revisit their accounting policies applied under local generally accepted accounting principles (GAAP) had they started IFRS conversion earlier enough. Starting late meant missing opportunities to choose the most appropriate accounting policies for their business.
- **Invest in staff and training during and after the move to IFRS.**  
CFOs continue to invest significant resources, both internal and external, in IFRS conversion, educating and training their own staff, preparing transition balance sheets and issuing their first IFRS financial statements during an intense period of change.
- **Effectively manage behavioral change.**  
Respondents noted that being proactive in foreseeing changes in company behavior through adoption was important, especially in areas such as sales-force incentivization programs, mergers and acquisitions (M&A) activity and employee share plan arrangements.
- **Use the materials available.**  
The majority of companies took advantage of publicly available IFRS financial statements to use as examples as well as benefitting from the later adoption of accounting standards that are now more fully embedded and interpreted than they were for our 2007 respondents.
- **Early involvement of auditors and external advisers.**  
Greater practical experience with the standards than existed for our 2007 respondents has helped IFRS conversion run more smoothly. However a number of respondents reported problems with the speed at which auditors cleared complex issues and financial statements, albeit at a lower level than in 2007. Early dialogue was seen as a possible way to improve this.
- **Effectively communicate with analysts.**  
Some respondents noted the need to keep analysts up-to-speed and avoid surprises. However, there was not a great deal of consistency in analysts' relative interest in IFRS, with some companies reporting that non-GAAP measures appeared to be more critical to analysts than the new IFRS numbers.
- **Consider embedding IFRS in monthly reporting.**  
Companies have mixed views on whether to use IFRS, local GAAP or adjusted IFRS non-GAAP measures to report and evaluate performance internally. But with many jurisdictions expected to permit adoption of IFRS for SMEs for local GAAP reporting purposes, extended use of local GAAP is expected to diminish significantly.
- **IFRS standard setters need to remain focused.**  
Some respondents are highly critical of the evolution of IFRS adopted in the European Union and are concerned that political interference could derail global adoption and the achievement of a single-set of high quality global accounting standards.

- 2.3** For companies who are considering conversion in the near-term, including those considering adopting IFRS for Small and Medium-sized Entities (IFRS for SMEs) in countries excluding Canada, or through conversion of multinational subsidiaries, there is much work to be done. Changing the historic results of the business to IFRS can be a significant project. Additionally, many significant IASB projects are due for completion in the next few years.
- 2.4** Although it is anticipated that these IASB projects will not be required to be adopted immediately, they may be available for early adoption. Companies that are due to adopt IFRS in 2011 or 2012 will need to assess the requirements of these new standards and consider whether initially to adopt the existing standards and then move to the new standards, or to adopt the new standards early to avoid a second change in the near-term.
- 2.5** The move to a common accounting model will have many benefits, including greater consistency and comparability between entities, across countries and in similar industries. This should lead to more efficient markets and a lower cost of capital. Companies adopting IFRS may obtain competitive advantage as the quality, clarity and credibility of disclosures become a commercial as well as a compliance issue. However, in the short-term, IFRS conversion remains a challenge that all respondents agreed required forward planning and significant focus by many parties.



## ▶ 3. INTRODUCTION

### PUBLIC COMPANY DEVELOPMENTS

**3.1** Since 2005, when a number of territories around the globe, including the European Union (EU)<sup>1</sup>, introduced mandatory adoption of IFRS by public entities, there has been a dramatic shift in accounting by public companies in many territories around the world:

- **Over 110 countries now require or permit the use of IFRS for public company reporting.**
- **Major economies such as Argentina, Canada, India, Japan, Malaysia, Mexico, South Korea and Taiwan are now also set to adopt IFRS, either mandatorily or voluntarily, in 2011 or 2012.**
- **The Securities and Exchange Commission (SEC), responsible for overseeing public securities in the United States, has since 2007 accepted financial statements from foreign issuers with registered securities in the United States that are prepared under IFRS without a reconciliation of net income and shareholders' equity to generally accepted accounting principles in the United States (US GAAP). The SEC has also issued a proposed roadmap<sup>2</sup> for the potential introduction of IFRS by all domestic issuers in the United States, which continues to be reviewed and considered by the SEC.**

**3.2** To accelerate IFRS adoption, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) agreed in 2006 to a Memorandum of Understanding (MoU) that described a program to achieve improvements in accounting standards, and substantial convergence between IFRS and US GAAP. This MoU was updated in 2008, and in November 2009 the two boards issued a further statement outlining steps for completing their convergence work by 2011.

**3.3** This level of change in accounting is unparalleled in global terms. It has significant support from the G-20 Leaders, who at their September 2009 meeting in Pittsburgh, reaffirmed their commitment to global convergence in accounting standards, and called on accounting bodies to focus on achieving a single set of high-quality, global accounting standards within the context of their independent standard-setting process, and complete the MoU project by June 2011.

**3.4** This continued adoption of IFRS will see fully listed multinational companies in these territories spending considerable time and effort dealing with conversion of their Groups to IFRS as well as significant changes in accounting and disclosure requirements between now and 2012.

### PRIVATE COMPANY DEVELOPMENTS

**3.5** Although standard setters in many individual jurisdictions now permit IFRS as an alternative to national accounting standards for private as well as public companies, in territories such as the United Kingdom, the vast majority of private entities have continued to use local GAAP. However, in addition to IFRS for public companies, the IASB in July 2009 issued IFRS for SMEs, a self-contained standard that contains a simplified version of a number of the full IFRS principles for recognizing and measuring assets, liabilities, income and expenses, and a significantly reduced number of required disclosures.

**3.6** It is widely anticipated that many national accounting standard setters in countries excluding Canada may consider allowing the adoption of IFRS for SMEs to replace existing national accounting standards for companies that are not publicly accountable<sup>3</sup>. An example of this is in the United Kingdom, where the Accounting Standards Board (UK ASB) in August 2009 proposed replacing UK GAAP with a choice of IFRS, or IFRS for SMEs. Adoption in the UK of either IFRS, or IFRS for SMEs could begin as soon as fiscal years beginning on, or after, January 1, 2012, if the proposal obtains approval.

<sup>1</sup> In the European Union, public entities incorporated in a European Union Member State are required to prepare financial statements in accordance with IFRS as adopted by the European Union, which differs from the standards as issued by the International Accounting Standards Board.

<sup>2</sup> Source: 'Roadmap for the Potential Use of Financial Statements Prepared in Accordance With International Financial Reporting Standards by US Issuers' issued by the SEC in November 2008.

<sup>3</sup> This term as it is used by the International Accounting Standards Board is wider than simply companies with debt or equity securities, as it also includes entities who hold assets in a fiduciary capacity for a broad group of outsiders, such as Banks and credit unions.

- 3.7** Given this rapidly changing landscape, we felt it appropriate to provide an insight to the views of CFOs who have been through adoption more recently than those in our 2007 report. In our 2007 report, we conducted a series of in-depth interviews with the CFOs of 19 fully listed UK companies who had converted to IFRS in 2005 and shared their thoughts, attitudes and experiences both in dealing with IFRS conversion and living with IFRS thereafter. In order to provide further insight these were face-to-face discussions, rather than questionnaires.
- 3.8** For this publication, we spoke to the CFOs of 22 European Union-based companies, many of whom were listed on the Alternative Investment Market (AIM), the London Stock Exchange's international market for growing companies, where mandatory adoption of IFRS only occurred in accounting periods beginning on or after January 1, 2007, for companies incorporated in the European Union. The interviews mainly took place between April and September 2009 and took the form of open-ended conversations about the whole experience of the respondents (2009 respondents) to adopting and reporting under IFRS. Many of these companies had just completed their second year of reporting under IFRS, and were able to reflect on both their initial conversion and ongoing reporting requirements under the new IFRS standards.
- 3.9** As a number of the interviews occurred before the issuance of IFRS for SMEs by the IASB we chose not to discuss the anticipated effects on reporting for some of the subsidiaries of these companies and whether they had considered adopting IFRS for SMEs in future periods in their subsidiaries. We have though commented in Section 7 of this report on a number of factors for companies to consider around the possible adoption of IFRS for SMEs as this may affect foreign subsidiaries of Canadian companies.



## ▶ 4. MAKING IFRS CONVERSION WORK

**4.1** One of the key items identified in 2007 was that the IFRS conversion process required considerable input from existing accounting and finance staff. This meant that in many cases existing staff were diverted from other activities. This was the case even in circumstances where respondents had chosen to either hire external accounting firms or additional staff with appropriate experience in supporting their conversion to IFRS.

### HOW DID WE APPROACH AND PLAN FOR IFRS CONVERSION?

**4.2** Almost all respondents were critical of their own performance in planning for IFRS with a recurring theme of wishing they had started the conversion project much earlier. Many freely admitted that they had underestimated both the time involved and the disruption to their business.

“Conversion to IFRS did take a very long time. We simply didn't plan correctly for this and did not have sufficient capable in-house experience in IFRS.”

**4.3** This late start for many generally led to a big-bang approach to IFRS conversion, with much of the work being performed in the year of adoption. Many respondents suggested that better planning would have yielded greater efficiency. Resource constraints also played a part, and many respondents underestimated how much groundwork would be required by their staff to acquaint themselves with the new standards. A number of the respondents who started late in their IFRS conversion bemoaned the lost opportunity to take a fresh look at their accounting under local GAAP. Time constraints meant they had to focus on keeping the new accounting treatments as close as possible to existing local GAAP, but within the new parameters of IFRS.

**4.4** For those few companies who did plan well in advance, and carried out their own identification of potential areas of GAAP difference the year before adoption, there was a marked difference in their feedback on both how well the process went and the quality of accounting standards adopted on IFRS conversion.

**4.5** Many of the respondents looked initially to their auditors for pointers and the best feedback went to those auditors who participated in the process. A number of respondents used external accountants to assist in their IFRS conversion and the most positive feedback given to those external accounting firms arose from their ability to provide much more hands-on advice than the auditors could due to independence constraints.

**4.6** Most of the companies were pleased that they had completed IFRS conversion on time, but almost all respondents wished they had started work earlier. Companies considering IFRS conversion would do well to heed this advice. Earlier implementation of a detailed plan will generally lead to a better solution and avoid adding long and stressful hours to many people's day jobs.

### HOW DID WE USE RESOURCES ON IFRS CONVERSION?

**4.7** Many respondents with more complex businesses used a mix of staff and external accountants to complete work on the IFRS conversion process. Most of these companies emphasized the need for senior management to be involved in the process — from all sections of their business.

**4.8** Additional external specialists were brought in by many respondents to assist with certain specific pieces of work, such as fair valuations of assets and liabilities in business combinations, as well as with valuation of share options where these were more than “plain vanilla” option plans.



- 4.9** Those who monitored it estimated that the process from initial planning through to final issuance of financial statements took around three months of internal staff time, with one company identifying a process that took up six months of internal staff time.

**“With having a small accounting department we seriously underestimated the disruption to our daily business routines.”**

- 4.10** Respondents who were significantly involved in the IFRS conversion process registered their surprise at both the time required for training to get up to speed on the nuances of IFRS as well as at the time taken to complete the first full set of IFRS financial statements.
- 4.11** Respondents were surprised both at the volume of additional disclosures required in IFRS compared to existing local GAAP as well as at the work required to identify missing data required for these additional disclosures, some of which meant going back over a number of years. In the vast majority of cases, resources to complete the process did not increase in line with the additional disclosures required.

**4.12** The level and depth of resources required will depend upon the complexity of the business and the composition of group structures. Complex businesses will need to consider how best to fill these needs with a likely mix of internal and external resources, and possibly through hiring additional staff. In territories where IFRS has not been in place previously, companies will not have the luxury of hiring ready-made specialists and will need to plan ahead to consider how best to fill that void. This may involve secondments of finance staff from their subsidiaries who have already adopted IFRS or through their relationships with external accounting firms with international resources and prior experiences in IFRS.

## HOW INVOLVED WERE THE AUDITORS?

- 4.13** Most of the respondents involved their auditors in consultation and review of their IFRS topic areas at some point in IFRS conversion. A number of respondents commented that their auditors had taken a very strict inflexible line on independence, which at times left them feeling exposed and forced to turn to other external providers. More effective advice and direction from auditors, while maintaining clear lines of independence, could have led to a much more cost effective solution, suggested some respondents.
- 4.14** Consequently, these respondents were to varying degrees critical of their auditors, with at least two firms changing their auditor owing to either a deemed lack of in-depth understanding of the IFRS issues facing their business or slow response times to queries.
- 4.15** All respondents highlighted the need to try to clear issues with their auditors early in their IFRS conversion process, noting varying degrees of success.
- 4.16** Since the 2007 report, the general level of criticism aimed at auditors has dropped. This is probably because knowledge is now much more embedded within accounting firms in these territories than it was in 2007. While isolated pockets of criticism remained, it seems that auditors have improved considerably in their response times and interpretations of GAAP.
- 4.17** As accountants become more proficient with the practical application of IFRS they can react more quickly to clients' complex accounting issues under IFRS than in 2005. There is a danger however that other jurisdictions will go through similar learning curves as their audit firms and their respective technical departments familiarize themselves with IFRS. In light of this, companies should consider challenging their auditors early in the process about their proposed approach.

**“The City [London Markets] does not like surprises so if you have unusual results from your new accounting then inform analysts of this as early as possible otherwise it may have a damaging effect on share price.”**

## HOW MUCH WERE THE COSTS OF IFRS CONVERSION?

**4.18** External costs varied considerably, driven by companies' abilities to retain or hire relevant IFRS experienced individuals to assist with conversion or for those with more complex businesses the need to hire external accounting firms to manage the process and the technical outputs of conversion.

**4.19** The time spent by internal staff appeared much more consistent. Many of the respondents estimated that it took around three months to complete the IFRS conversion process, with a further two months spent on preparation of the first set of IFRS financial statements.

**4.20** Respondents in 2009 generally did not have as many quantifiable differences between local GAAP and IFRS upon adoption as 2007 respondents. These less complex and smaller businesses required much less work to embed IFRS or map identifiable GAAP differences into their existing accounting systems. Only a handful of respondents had to (or elected to) change their accounting systems through adoption of IFRS. The general process of managing GAAP adjustments once identified seemed much less complex than for the larger respondents from 2007.

**4.21** Figure 1 shows an indication of the typical cost (in Euros €) of preparing the first IFRS consolidated financial statements of publicly traded companies, which was carried out in a survey in 2007 by the Institute of Chartered Accountants in England and Wales (ICAEW)<sup>4</sup> commissioned by the EU. One key element in controlling project costs is the creation of a detailed project plan from the outset with a clear timetable and scope, which companies should consider instigating as early as possible.

Figure 1

Typical costs of first IFRS financial statements <sup>4</sup> :	
Companies with revenue below €500m	0.31% of revenue
Companies with revenue from €500m to €5,000m	0.05% of revenue
Companies with revenue above €5,000m	0.05% of revenue
Typical costs of recurring IFRS financial statements:	
Companies with revenue below €500m	0.06% of revenue
Companies with revenue from €500m to €5,000m	0.01% of revenue
Companies with revenue above €5,000m	0.008% of revenue

**4.22** In their report, the ICAEW stated that “the smallest companies bore the proportionally greatest cost” and that “small companies appear to have been unable or unwilling to utilize internal resources and relied upon external advice and support to a greater extent.” Additionally, the ICAEW also stated that the largest companies were more likely to embed IFRS into their reporting leading to reduced recurring costs.

**4.23** For companies listed in the EU, audits were also only required to be completed on the first year of reporting only. Comparative periods re-stated to IFRS did not require re-auditing. In other jurisdictions auditors will be required to audit comparative periods, which is likely to increase the overall costs of compliance in the first year of reporting under IFRS.

**4.24** As a number of our respondents were listed on AIM, a market focused on growing companies, costs of IFRS conversion will inevitably have been lower in absolute terms than for our respondents in 2007. Users of this report should take heed of the comments made by the ICAEW, particularly around embedding of IFRS into reporting, which may lead to reduced recurring costs.

<sup>4</sup> Source: ICAEW report “EU Implementation of IFRS and the Fair Value Directive,” October 2007.



## WHAT CONSULTATION DID WE HAVE WITH OTHER COMPANIES IN OUR SECTOR?

- 4.25** While only a handful of respondents discussed IFRS conversion issues with other CFOs or financial controllers in their sector, those that did were very positive in their feedback of this approach and felt such peer group interaction helped them quickly assimilate key issues for their business.
- 4.26** Many respondents appeared reticent to reach out to other CFOs or financial controllers owing to the sensitivity of some of the information being presented. Instead they chose to turn to either their auditors or their external accounting advisors for relevant industry experience and background.
- 4.27** The majority of respondents did take advantage of the wide array of IFRS financial statements publicly available since 2005 in their sectors to review for appropriate trends and techniques, including in areas such as the required IFRS transition disclosures.
- 4.28** **The wide range of information available today places companies adopting IFRS for the first-time in 2011 and 2012 and beyond at a significant advantage to those earlier adopters dating back to 2005. Although IFRS continues to develop and improve, and many new projects are due to be completed in 2011 and 2012, new adopters of IFRS will be in a much better position to take advantage of the wider exposure to IFRS than even our 2009 respondents.**
- 4.30** There was little if any comment made by analysts on the transition from local GAAP to IFRS. It may be that IFRS has been around for long enough now to raise analysts' understanding and expectations around its adoption.
- 4.31** Where comments were made by analysts they tended to focus on complex valuation areas such as share-option charges and financial instrument valuations. However, there was some diversity in these responses as in some instances respondents mentioned that the analysts would add-back certain specific GAAP items to get a non-GAAP measure to compare to other similar entities. In a number of other instances analysts made no adjustments for items that had material affects on the current year's numbers caused by the adoption of IFRS, such as amortization of intangibles and fair-valuation of derivatives.
- 4.32** The small number of respondents who received questions from analysts on their accounting, stated that there was a real need to manage the flow of information to analysts and to be able to give clear and timely explanations of the anticipated impacts on financial statements.
- 4.33** Most of the companies broadly agreed that analysts continued to focus on preliminary results statements and summary financial information rather than the main body of the financial statements. Consequently, many questioned the need for the level of disclosures in IFRS financial statements when there was such a gap between the information reviewed by analysts and that actually prepared and included in a full set of IFRS financial statements.
- 4.34** **While analysts' interest in IFRS numbers tends to vary, it is important that companies consider the results of the business from more than simply a commercial perspective. CFOs need to have a sufficient understanding of the IFRS balances to be able to explain differences. To maintain credibility with the markets, communication of those results needs to be planned thoroughly as it's seen as being very important to avoid surprises.**
- 4.35** **This might be best achieved by providing regular updates to analysts on progression of IFRS adoption, and ongoing discussion of identified areas of GAAP difference throughout the process. This will lead to better understanding and affirmation with analysts when the process completes.**

## HOW DID WE COMMUNICATE IFRS INFORMATION TO OUR INVESTORS AND ANALYSTS?

- 4.29** In 2007, respondents described the reaction of analysts and investors to their first IFRS financial information as somewhat muted, a message that is relatively consistent with that made by respondents in 2009.

## ▶ 5. EXTENDING THE USE OF IFRS

**5.1** In 2007, companies were mixed about how significantly they had extended the use of IFRS from the consolidated financial statements to both individual financials for the parent (if required by local practice) and their respective subsidiaries, as well as IFRSs effects on other parts of the business. With our 2009 respondents, that lack of a clear consensus continues. There are potentially significant benefits in using IFRS for the parent company and subsidiaries but there are also areas that companies need to address, including IFRSs fewer concessions or exemptions for the parent and subsidiaries than under previous local GAAP reporting and more extensive disclosure requirements. Companies need to think carefully before using IFRS in the statutory financial statements of the parent company (standalone basis) and subsidiaries.

**5.2** In addition to reporting consolidated financial statements under IFRS, Figure 1 shows that 47 percent of respondents chose to adopt IFRS in the standalone financial statements of the parent company, which must be disclosed separately in some jurisdictions, such as in the UK. The remaining 53 percent chose to continue to adopt local GAAP in the parents' standalone financial statements.

**5.3** All but one of the respondents had trading subsidiaries. Of those, 84 percent had UK-based subsidiaries with 16 percent also having subsidiaries in other territories. IFRS could not be adopted in all these other territories owing to local reporting requirements.

**5.4** Of the remaining 84 percent, in absolute terms 61 percent of respondents chose to continue to adopt local GAAP in the standalone financial statements of each of their subsidiaries, with the other 23 percent fully-adopting IFRS across the whole group structure. While a number of reasons were cited for continuing with local GAAP, a consistent comment concerned possible reductions in distributable profits of the parent company. Here the possibility arose that the remittance of profits from the subsidiary to parent could have resulted in a reduction in the carrying amount of the investment rather than income in the standalone financial statements of the parent. Since January 1, 2009, any dividend received from a subsidiary is included in the income statement of the parent company and no longer has a potential effect on distributable reserves, unless the carrying amount of the investment in the subsidiary becomes impaired.

**5.5** As respondents adopted IFRS prior to this change in January 2009, this approach may have been taken to conserve distributable reserves of the parent company. Others simply did not feel that it was necessary to adopt IFRS across the group and that the costs of the significant additional disclosures required for a subsidiary compared with local GAAP outweighed the benefits. Some of these respondents also continue to run much of their business from an internal focus based on local GAAP, and that as such, top-side adjustments to comply with IFRS were made at external reporting periods only.

### PARENT COMPANY REPORTING

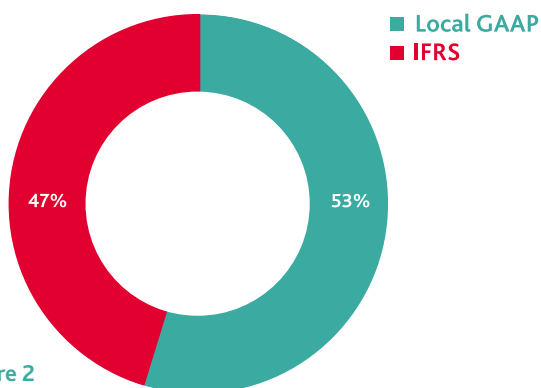


Figure 2



“At the time of initial adoption of IFRS, issues around distributable reserves existed, which meant that we could not adopt IFRS across the Group. However, even after this issue has been resolved, we remain unable to fully adopt IFRS because national accounting standard setters haven’t moved quickly enough to allow us to do so. It’s incredibly frustrating.”

- 5.6** The lack of global adoption of IFRS in all jurisdictions makes it very difficult for entities fully to adopt IFRS. Until IFRS is accepted in all major territories for all companies, including for tax purposes, entities will continue to have to deal with parallel accounting, reconciliations and the resulting inefficiencies.
- 5.7** We chose not to discuss the exposure draft on IFRS for SMEs, which was issued as a standard in July 2009, as respondents had not had time to digest the final exposure drafts or the new standard adequately, and to consider whether they would choose voluntarily to adopt IFRS for SMEs at subsidiary level. This topic is discussed in Section 7 of this report. Companies adopting IFRS will have to consider very carefully a number of factors around the wider group, including local tax legislation regarding preparation of financial statements, national accounting standard setters’ requirements, and the cost/benefit analysis of converting individual group companies to IFRS.
- 5.8** Many larger groups will be keen to take advantage of the benefits of IFRS adoption across as many companies in their multinational groups as possible. But they will need to consider many factors, including the progress being made by national accounting standard setters.

## INTERNAL MONTHLY REPORTING

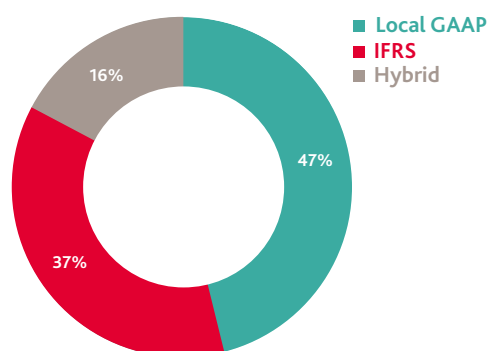


Figure 3

- 5.9** Figure 3 above shows that 47 percent of our respondents also chose to show internal monthly reporting management accounts information on an IFRS basis, the same proportion as had chosen to adopt IFRS in the parent company’s separate financial statements. This appears to be purely coincidental, as a number of the companies whose parent had not adopted IFRS report on monthly consolidated management accounts on an IFRS basis, and of the 53 percent remaining who chose not to report monthly IFRS consolidated management accounts, 37 percent continue to report management accounts monthly on the previous local GAAP basis. Of the remaining 16 percent, all report partially on an IFRS basis with only certain IFRS adjustments posted at external public reporting periods. Adjustments not made monthly by these companies included accounting for lease incentives, accounting for financial instruments at fair value, deferred taxes, share option charges and related employee benefit costs.

**"While we understand conceptually the reasons why IFRS has chosen to look at cash flows on a discounted basis, our management believe that such discounting is worthless, and for decision-making purposes we look at the actual cash costs to our business. So the significant amounts of time spent on working out discounted cash flows are adjusted back to their previous GAAP equivalent."**

**5.10** One of the main reasons for not fully adopting IFRS on a monthly reporting basis was that many of the companies had large trading subsidiaries that continued to report under local GAAP and this continued to be used by management to assess operating performance.

**5.11** One company did mention that its bank covenants had been maintained on a local GAAP basis, and therefore as a key driver in the business this was used by management to ensure strict monthly adherence. A number of respondents also disagreed with the IFRS treatment in particular areas, and felt that the performance of the business was better assessed by excluding those items, such as share option charges.

**5.12** With no consistent basis being used by analysts to evaluate company performance externally, some making little comment on IFRS numbers in the year of adoption and others adding back specific non-cash items, it is no surprise that companies have differing views on whether to use IFRS, local GAAP or adjusted IFRS non-GAAP measures to report and evaluate performance. What is clear, though, is that whether this non-adoption of IFRS for monthly reporting is for purely historic reasons, or to consider external covenants or even to be consistent with what analysts look at, it is likely to change.

**5.13** Many jurisdictions are expected to adopt the provisions of IFRS for SMEs to replace local GAAP reporting, so the extended use of local GAAP for internal reporting purposes is expected to diminish in the foreseeable future. In addition, the replacement of IAS 14 "Segment Reporting" by IFRS 8 "Operating Segments" in 2009 may also start the process of eliminating local GAAP reporting for internal purposes due to the required disclosure of measures regularly provided to chief operating decision makers to corresponding amounts in the financial statements, as public disclosure will require CFOs and CEOs to become more familiar with reconciliations to IFRS.

**5.14** It is clear that new adopters will have to be focused on their debt covenants and consider them early when converting to IFRS. Companies that are presently negotiating new debt agreements should be mindful of the future consequences of IFRS adoption when negotiating any covenants with lenders. These companies will also have to consider how they will assess performance on an ongoing basis. Those with quarterly reporting requirements are much less likely to use previous local GAAP on a monthly basis as reconciliation from local GAAP to IFRS will be required at regular intervals on an external basis. Those with less frequent reporting requirements will need to consider whether the benefits of maintaining local GAAP reporting for internal purposes outweigh the disadvantages of reconciling to IFRS at reporting periods only. They will also need to consider the message that maintaining old GAAP to evaluate performance will send to the market place as market participants become more sophisticated in their understanding of IFRS.

## IMPACT OF IFRS ON BUSINESS DECISIONS

**5.15** While the general consensus is rightly that accounting should not be the primary factor in business decisions, the accounting change does seem to be becoming more important.

**5.16** The adoption of IFRS on a group-wide basis was discussed by a number of our respondents as one of the areas that could impact them favorably if national accounting standard setters would agree a consistent approach to IFRS adoption. Respondents appeared keen on this but bemoaned the lack of consistency in this area.

- 5.17** A number of respondents also commented on the new business combination standard and emphasized that M&A activity would be an area which they felt would affect both them and any target's management in negotiations of new deals, including how companies will go about structuring employee compensation in business combination arrangements. The negotiation of financing arrangements to fund such M&A activity, and the related financial and debt covenants, were seen as areas to be mindful of.
- 5.18** Few companies, in discussing impacted areas, commented on areas such as employee compensation arrangements, including whether they had considered changing from the issuance of performance-related share option plans to restricted share awards or how sales staff are remunerated on their variable-pay structures. Only one respondent commented on changes they had made to their share option plans as a consequence of adopting IFRS.
- 5.19** Companies are becoming acutely aware of the need to be mindful of and focus on the effects of accounting on future results and performance. In jurisdictions like the United States, where M&A activity is traditionally voluminous in bull markets, the changes to the US business combinations accounting standard (part of the MoU and convergence of acquisition accounting between IFRS and US GAAP) should be seen as a standard which may change behaviors in structuring transactions.
- 5.20** In territories such as the United States, where sales-force variable compensation is invariably linked to revenue recognized under US GAAP, changes in revenue recognition rules may have a direct impact on those employees' overall remuneration. Consequently, revisions may be required to existing employment agreements, and possibly to the way companies conclude contractual arrangements with customers.



## ▶ 6. IMPACT OF IFRS ON FINANCIAL STATEMENTS

- 6.1** There is no real consensus about the exemptions taken in the first-time adoption of IFRS or in the types of GAAP differences quantified by companies. What is clear, however, is that IFRS has had a significant impact on the first IFRS financial statements prepared by the respondents. Many identified a volume increase of 20-30 pages in their annual reports as a consequence of the adoption of IFRS. However, such disclosure increases were not the only significant areas of impact on the IFRS financial statements.

### HOW DID TRANSITION TO IFRS AFFECT COMPANIES?

#### IFRS 1 TRANSITION EXEMPTIONS

- 6.2** One of the critical areas of IFRS 1 is that it provides a practical solution on initial adoption of IFRS by offering exemptions (some mandatory) from fully applying IFRS in a number of areas including now: retrospective application of business combinations; identification of cumulative translation since inception; applying fair-valuation to share-based compensation arrangements which vested before the date of transition, use of the deemed cost for oil and gas assets and the retrospective designation of hedges.
- 6.3** Some of our respondents with previous experience in converting to US GAAP were very positive about these practical exemptions that simply do not exist in US GAAP, which were considered to be very time consuming and expensive due to the need retrospectively to apply standards existing at the time.

#### IFRS 1 EXEMPTIONS CHOSEN

2009 respondents	2007 respondents
IAS 21 – The effects of changes in foreign exchange rates	IAS 16 – Property, plant and equipment
IAS 32 – Financial instruments: presentation	IAS 19 – Employee benefits
IAS 39 – Financial Instruments: recognition and measurement	IAS 21 – The effects of changes in foreign exchange rates
IFRS 2 – Share-based payment	IAS 27 – Consolidated and separate financial statements (2003)
IFRS 3 – Business combinations (2004)	IAS 32 – Financial instruments: presentation
	IAS 39 – Financial Instruments: recognition and measurement
	IFRS 2 – Share-based payment
	IFRS 3 – Business combinations (2004)

Figure 4

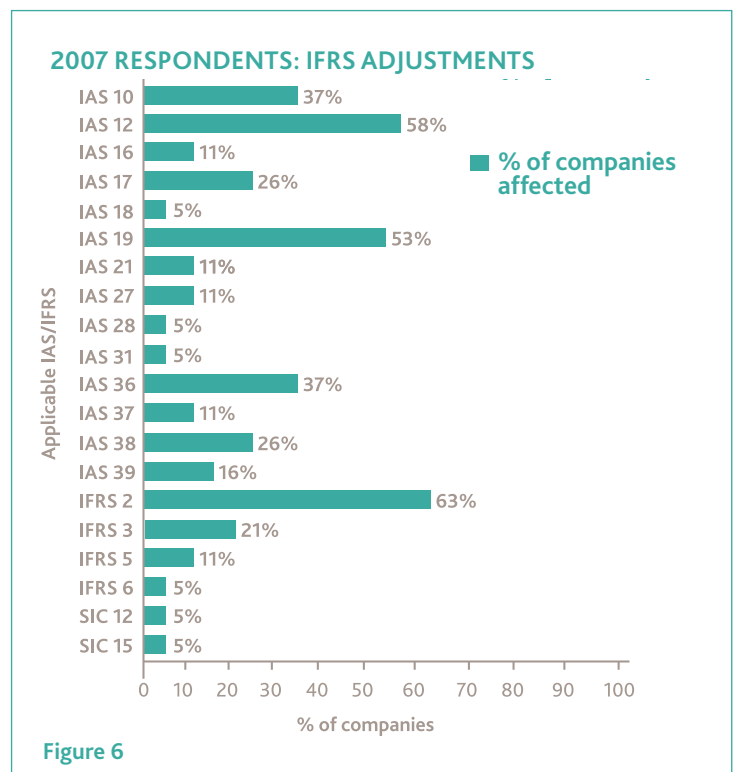
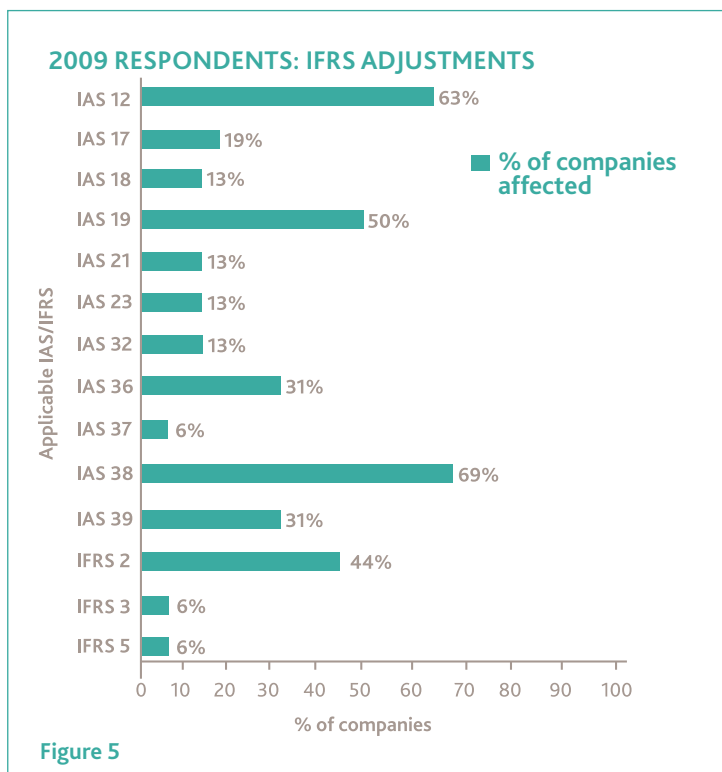
- 6.4** What is evident in reviewing Figure 4 is that, IFRS 1 exemptions are available, some of the exemptions are being used consistently by respondents. In our discussions, few chose to ignore relevant exemptions. As an example, respondents consistently commented favorably on areas such as the exemption from the normal requirement to separately identify cumulative translation since inception, showing at a deemed value of zero at the date of transition to IFRS.
- 6.5** One key area where the IFRS 1 exemptions were applied in almost all instances, where applicable, is the business combinations exemption. Of the 22 respondents in 2007 and 2009 combined who could have taken the exemption from retrospectively applying IFRS 3 "Business Combinations" to all historic business combinations, all but one company chose to do so.



**6.6** This respondent chose retrospectively to apply business combination accounting under IFRS due to one specific acquisition made three years previously as management wished to separate significant definite-lived intangible assets that had been subsumed into goodwill under local GAAP. This was because they wished to amortize those intangibles over their useful economic lives. However, they also chose not to go back and apply to all prior period business combinations, only from that specified acquisition date. The respondent was also required to apply IFRS 3 to seven other acquisitions that had occurred during the year of adoption, as a consequence of choosing to adopt accounting under IFRS 3 for an earlier acquisition. This respondent noted that they had significantly underestimated the workload involved in applying IFRS 3 to these acquisitions.

**6.7** Our respondents have clearly focused on the exemptions available to them, and many have concluded that the costs involved in retrospectively applying current IFRS to historic periods are simply too great, outweighing the benefits of restating all historic transactions on a consistent basis. Companies converting to IFRS should identify each of the exemptions available to them and consider the effects on their results alongside the sometimes significant costs involved in retrospectively applying current IFRS. This is an issue that new adopters of IFRS should look at early in IFRS conversion. It should be noted that our respondent above highlighted the significant level of work required in retrospectively applying this one standard and it is important to remain conscious of the cost/benefit decision when making IFRS 1 exemption elections.

**IDENTIFIED GAAP DIFFERENCES**





- 6.8** Figures 5 and 6 identify the areas of quantified difference between local GAAP and IFRS by our respondents in their IFRS 1 transition disclosures in the first reported IFRS financial statements.
- 6.9** In comparison to our 2007 respondents fewer items are included as areas of difference. This will be due to a number of factors, notably that the 2009 respondents may have less complex businesses than 2007 respondents. But it is also due to the convergence of local GAAPs with IFRS since 2007. Areas such as IFRS 2 and IAS 39 have been subsumed into some respondents' local GAAPs, and this is likely to be a path other jurisdictions will follow.
- 6.10** In territories like the United States, the MoU has identified a number of joint projects for convergence in areas such as revenue recognition and leases, it is likely that we will continue to see a reduction in identifiable GAAP differences because of embedding of standards consistent with IFRS into local GAAP. This is also expected to be the case in territories like Japan. One of the key areas that will require analysis by companies applying IFRS in future periods will be how new standards are applied locally. So while technically standards will end up being the same, interpretation may still end up identifying application differences at the time of adoption of IFRS.
- 6.11** A few areas of GAAP difference have not occurred as frequently as users of this report may expect, one example of this being revenue recognition. Only 13 percent of our respondents had made adjustments to revenue recognition as a consequence of adopting IFRS, even in sectors such as technology, which is slightly higher than in our 2007 respondents when only 5 percent identified a difference between local GAAP and IFRS.
- 6.12** This is not perhaps as surprising as it may initially seem as the revenue recognition standard, IAS 18, will be replaced as part of the MoU, as a consequence of the perceived need for improvement in the existing standard. Indeed, as commented previously, it is one of the standards that companies that adopt IFRS in a few years will have to consider as the new revenue recognition standard is slated for completion by June 2011. This may lead to new adopters having more differences than our respondents.
- 6.13** In our 2007 report, we speculated that the following areas were likely to be significant differences between local GAAP and IFRS:
- Accounting for operating lease incentives (IAS 17).
  - The capitalization of internally developed intangible assets (IAS 38).
  - The separate identification of intangible assets acquired in business combinations (IFRS 3).
  - The replacement of the amortization of goodwill with annual impairment tests for that goodwill (IAS 36).
  - Limited, but potentially significant, differences on deferred taxes (IAS 12).
  - The presentation of the IFRS income statement (IAS 1).
  - The nature and volume of IFRS disclosures (IAS 1).
- 6.14** Reviewing responses shows that those items did turn out to be many of the significant areas of difference. In addition, other differences arose such as the capitalization of borrowing costs (IAS 23), accounting for holiday pay (IAS 19) and accounting for financial instruments (IAS 39). The list was not meant to be exhaustive, but indicative of issues likely to occur. What is clear, though, is that the variety and complexity of issues to be addressed between local GAAP and IFRS during both 2007 and 2009 is significant.
- 6.15** It is important to note that the quantified differences listed above represent only some of the number of areas that respondents looked at when they started preparing their identification and evaluation of GAAP differences. Many respondents commented that the reconciliation was not representative of the number of areas that companies actually examined. Users of this report should be mindful of this when considering their own adoption of IFRS.
- 6.16** It is clear that listed companies in the EU and other territories have borne the brunt – and the cost – of the current version of IFRS and its related learning curve. Fully-listed EU companies faced uncertainty over the final content of some standards and delays in reaching agreement with their auditors on the interpretation of IFRS. Much of this was embedded knowledge by the time the 2009 respondents converted, and therefore was seen as less of an issue.

**“We are on the verge of a breakthrough [in global IFRS adoption]; please don't let the politicians bring that down.”**

**6.17** While much of this will now be embedded knowledge within larger accounting firms with international accounting networks there are still likely to be issues with different interpretations of IFRS for local accounting firms in the new jurisdictions.

**6.18** There is no substitute for real-life application of those standards. Furthermore, in jurisdictions planning to adopt in 2011 or 2012, by the time many complete IFRS conversion there will be many new IFRS standards being issued, meaning both companies and auditors will be addressing significant new issues for the first-time. This will likely again lead to a significant learning curve for all, and possibly lengthy delays in agreeing positions with new adopters' auditors.

## COMPANY SENTIMENT ABOUT IFRS

**6.19** In general terms, our respondents were accepting of IFRS, although opinion varied considerably about whether or not it was an improvement on local GAAP. Much of this raw feeling will arise from having recently completed IFRS conversion with the considerable time and effort that went into that project fresh in the mind. This will also have been compounded by the tepid response from many analysts and investors.

**6.20** At a macro level however, respondents were very much in favor of IFRS, its principles-based approach and its suggested eventual global adoption that will allow the markets to compare companies irrespective of national boundaries. Some respondents expressed relief that we appear now to be moving towards global adoption of IFRS, after so many years where US GAAP had been the frontrunner. Those respondents commented positively on the more principles-based approach to accounting under IFRS as opposed to the perceived form-driven, rules-based approach of US GAAP.

**6.21** Political involvement was a key issue for many. CFOs commented unfavorably on what they described as political interference from the EU. They bemoaned the need to use IFRS as adopted by the EU, which may for some companies, particularly in the financial services sector, create differences with IFRS.

**6.22** In addition to this parallel accounting they also commented on EU rights to veto standards of which EU politicians disapprove. Comments were also made around the delay in approving standards as issued by the IASB within the EU. Respondents were clearly looking for a level playing field with other users of IFRS and the ability to adopt IFRS standards at the same time as other companies outside of the EU on the date of issuance.

**6.23** One respondent speculated that the expected new IFRS standard on classification and measurement of financial assets, out at the time as an exposure draft<sup>5</sup>, during a number of our interviews, would likely be available for early adopters under IFRS as issued by the IASB, but not by those public entities based in the EU as generally new standards do not get endorsed quickly enough. We would note that at the date of publication the issued standard, IFRS 9 Financial Instruments has not yet been endorsed by the EU, and in other territories, public companies are already permitted to adopt IFRS 9.

**6.24** There was much concern raised by our respondents about whether or not this deemed political interference would end up stalling or possibly derailing the global adoption of IFRS. What is quite clear though, and has been a topic of fierce debate over the past 12 months or so, is that the politicization of accounting standards has undermined confidence in the markets.

<sup>5</sup> Issued in November 2009 by the IASB as IFRS 9 “Financial Instruments.”

"IFRS 7 disclosure was a major challenge for us. We had a significant quantity of acquisitions and existing legacy systems in place and collation of the data took us considerably more time than we would have imagined. On top of that, we had asked our advisers and auditors for disclosure examples as an aide memoire and those received were so radically different that we didn't even know where to start."

"We chose to issue share options to our employees, but if we had chosen variable cash bonus awards instead, then simply put, in our most current year we wouldn't have paid a bonus. As the options are out-of-the-money, we struggle with the concept of taking a large charge through income when the likelihood of take-up is so considerably low."

## BIGGEST CONCERNS ABOUT THE ADOPTION OF IFRS

### DISCLOSURE IN IFRS FINANCIAL STATEMENTS

- 6.25** Many of our respondents identified disclosure as being one of the biggest surprises for them in converting from local GAAP to IFRS, and this was prior to the issuance of IFRS 8 "Operating Segments" (IFRS 8) which may provide substantial incremental disclosures from 2009. During conversion, many rightly focused their efforts on the analysis and quantification of their GAAP differences, on identification of IFRS exemptions, as well as in preparing IFRS 1 transition disclosures.
- 6.26** However, many respondents left the drafting of the first IFRS annual financial statements until very late in the process and were caught unawares by the nature and volume of IFRS disclosures. Although response times from auditors have generally improved since 2007, where many complained of audit firms raising disclosure issues late in the reporting process, there were a number of instances where companies continued to be highly critical of the late completion of reviews of financial statements, even when companies had provided that information to their auditors well in advance. With the benefit of hindsight, many companies said that they should have started work much sooner and been much more aggressive in trying to obtain earlier approval from their auditors.
- 6.27** Respondents were in the main highly critical of the additional disclosures required by IFRS in areas such as IFRS 7 "Financial Instruments: Disclosure" even when entities did not have sophisticated financial instruments. They commented negatively on the need to increase the content and length of annual reports by, in some cases, more than 100 percent. That is not to say that there was not approval for some of the additional areas of disclosure, such as in IAS 1 on sources of uncertainty and judgment which was seen as one significant area of improvement, as is IFRS 8, but there was some alarm at the volume of increase.
- 6.28** Many challenged whether or not such additional disclosures would receive sufficient scrutiny from the analyst community and investors to merit the incremental work involved. Although many understood the need for improved quality of disclosures

in banking and other regulated sectors, citing problems in the financial crisis, many queried the usefulness of such disclosures if analysts simply ignore the financial statements and focus directly on the preliminary results statement.

### SHARE-BASED PAYMENTS

- 6.29** The respondents who had issued option awards to their employees made varying comments regarding share-option charges. Generally, many respondents agreed in principle with IFRS 2 in terms of expensing costs for services rendered. However, in light of current market conditions and significant decreases in share prices for many companies, they found it hard to understand the concept of continuing to recognize large charges in their income statements over the vesting period even when the options were significantly out-of-the-money, and in some instances would be expected to remain so for the foreseeable future.
- 6.30** Further, a number of respondents found the concept of using statistical models to calculate fair value of option awards difficult, and felt that accounting was becoming so complex that even the accountants were finding it difficult to understand the basis of valuations. This was an area where a number of respondents used external specialists to value and calculate annual charges for share-based payments.
- 6.31** For some, the work involved in identifying, evaluating and continually calculating these charges was difficult to justify when analysts frequently add back the charges to obtain performance-based non-GAAP measures.

### BUSINESS COMBINATIONS

- 6.32** The respondents in our 2007 report had been fairly critical of some of the principles in the existing business combinations standard under IFRS at the time; i.e. IFRS 3 "Business Combinations." Most notably, they questioned the need separately to identify additional intangible assets and the valuation involved in that identification. Deferred tax consequences in relation to business combinations, most notably in the areas of providing deferred tax on the uplift between the pre-acquisition carrying amounts and the fair values, and deferred taxes on definite-lived intangibles were also mentioned as areas of concern.

**"Accounting is simply getting too complex. We have a team of well-qualified experienced accountants here and they struggle with some of the standards. If this is the case at that level, how is a layman expected to be able to analyse and interpret such data? We really need to focus on making accounting simple."**

- 6.33** This message continued in discussions with our 2009 respondents. Whilst respondents accepted the need to use fair value measures properly and on a consistent basis in practice to determine values of consideration and values of assets and liabilities assumed, the transition from local GAAP (which for many respondents allowed them to subsume other intangible assets into goodwill upon acquisition) has been difficult.
- 6.34** Related to this, and in light of the significant global economic changes, some respondents also expressed concerns about the complexity of the impairment model in relation to the valuation of goodwill which would come under close scrutiny in the 2009 year-end. A number bemoaned the change from a model in which goodwill had been amortized to a non-amortization model.

**6.35** Many of the concerns about business combination accounting have arisen because of the significant changes for many respondents from local GAAP to IFRS, where local GAAP has a much less sophisticated model of accounting. Many users of this report will already have a model which is either similar to or almost identical to IFRS. As an example, the revised US accounting standard on business combinations that was issued in December 2007, FASB Statement No. 141 (Revised) "Business Combinations"<sup>6</sup> was the first joint project completed by the FASB and IASB under the MoU, with the IASB issuing IFRS 3 (Revised) "Business Combinations" in January 2008.

## OTHER EXISTING AREAS OF CONCERN IN IFRS

- 6.36** Our 2009 respondents also commented on other areas of IFRS that have either caused problems through complexity of the standard, consumption of time, or alternatively that they simply felt added little or no incremental benefit. These included capitalization of development costs, which was a consistent adjustment for companies in the technology sector, ongoing tracking of cumulative translation adjustment for subsidiaries (after adoption) and discounting of long-term deposits and payments.
- 6.37** One issue that was mentioned frequently in our 2007 report as an area of concern was accounting for financial instruments at fair value. In 2009 this topic was rarely mentioned. Reasons for this may be that many of the respondents were not the types of businesses who entered into a significant number and value of complex instruments and trading positions, nor had material embedded derivatives within their existing contracts with suppliers and customers. In addition, even for those companies who did have such transactions, local GAAP had already subsumed IAS 39 into existing standards, whereas in 2005 many companies were addressing this area for the first-time.



<sup>6</sup> In July 2009, the FASB revised US GAAP references to reflect citations in its new Accounting Standards Codification, which is now the single source of authoritative US GAAP literature. FASB Statement 141 (Revised) "Business Combinations" is now referred to as ASC 805, Business Combinations (ASC 805).

**“The drive towards standardization is welcomed but the proliferation of disclosures is not so good, although this aspect is recognized not to be a unique problem of IFRS.”**

## FUTURE AREAS OF CONCERN IN IFRS

**6.38** Three areas of future concern were mentioned frequently by respondents: the revised business combinations standard (IFRS 3 (Revised)), disclosure of operating segments information (IFRS 8) and the anticipated exposure draft on revenue recognition expected to be released in 2010.

### BUSINESS COMBINATIONS

**6.39** Respondents with an interest in M&A activity expressed concerns over a number of key differences that arise on adoption of IFRS 3 (Revised) “Business Combinations” from the previous standard. Notably, comments focused on the areas of contingent consideration and acquisition-related costs.

**6.40** Respondents commented unfavorably on the new accounting for contingent consideration, arguing that earn-outs and other forms of contingent consideration will be recorded at fair value on the acquisition date, irrespective of the likelihood of payment. As subsequent changes in the fair value of contingent consideration arrangements generally will be recorded in earnings, they argued that earnings will be more volatile. They also commented that valuations to determine the fair value of that contingent consideration would likely require complex valuation techniques, and questioned the value this would deliver.

**6.41** Respondents also commented unfavorably on the new accounting for acquisition-related costs, where such costs will be recognized separately from the M&A transaction and generally expensed as incurred, rather than being included in goodwill. A number of respondents commented that having to expense deal costs which can invariably be high, could lead to unwillingly revealing potentially price sensitive M&A activity in a reporting period preceding an acquisition.

### OPERATING SEGMENTS DISCLOSURE

**6.42** Respondents were broadly in favor of the types of disclosures that IFRS 8 “Operating Segments” requires and to the principal of the market looking at information used by management to analyze performance. However, the practical aspects of disclosing key performance metrics under local GAAP and

reconciling to published IFRS GAAP measures were seen as possibly confusing. Respondents who commented on the negative aspects noted that this would add significant additional disclosures to their financial statements and require a lot of input in collating/analyzing the data as well as in the judgment needed to identify the function that is Chief Operating Decision Maker (CODM). There was also some concern aired around whether or not analysts and investors would look at this information.

**6.43** Some respondents also noted their concerns in the context of mixing GAAP information in their IFRS 8 disclosures, and the confusion that this could create. As mentioned earlier, a number of respondents did not convert all trading subsidiaries to IFRS and a number continued to focus on local GAAP in analyzing performance. The need to identify this discrete financial information and explain it to the market was something about which companies had concerns. It will be interesting to see how companies have addressed this issue in their 2009 IFRS financial statements. It may lead to voluminous disclosures or alternatively, entities may choose to re-focus the information provided to their CODM onto IFRS financial information to analyze performance.

### REVENUE RECOGNITION

**6.44** A number of respondents, particularly in the technology sector, expressed their concerns about the joint IASB/ FASB project on revenue recognition, and the expected new standard committed to be issued by June 2011. Those respondents generally took the view that IAS 18 had worked well in practice, focusing on the principles of revenue recognition, and although they were supportive of any standard that improves comparability of revenue for users of financial statements, felt that this could be done by providing much more detailed disclosure around revenue recognition adopted by individual companies. They did stress their concerns about the FASBs involvement in this improvement project. Here they perceived a clear potential for moving IFRS much closer to a US model for revenue recognition, which is perceived as being much more form-driven, with bright line rules embedded in many instances.

**6.45** US GAAP has loosened its grip somewhat recently in one of the more restrictive areas of revenue recognition, by allowing companies more leeway in accounting for multiple-element arrangements (excluding software). This was completed by the FASB<sup>7</sup> specifically to address criticism that previously existing US GAAP did not reflect the underlying economics of the transaction by requiring a company to have either vendor-specific objective evidence of selling price or verifiable objective evidence of selling price to be able to recognize revenue as the elements are delivered.

**6.46** This change has in fact shown more of a move towards practice adopted under IFRS for similar arrangements, and should give more comfort to our respondents that any new joint revenue recognition standard is much more likely to be principles-based.



<sup>7</sup> Source: FASB Accounting Standards Update No. 2009-13 "Multiple Deliverable Revenue Arrangements."

## ▶ 7. IFRS FOR SMALL AND MEDIUM-SIZED ENTITIES

- 7.1** In July 2009, the IASB issued IFRS for SMEs, a self-contained standard of some 230 pages. In this new standard a number of the full IFRS principles for recognizing and measuring assets, liabilities, income and expenses have been simplified, topics not relevant to SMEs have been omitted, and the number of required disclosures have also been significantly reduced.
- 7.2** A number of face-to-face discussions that we have had with CFOs of public entities occurred before the issuance of IFRS for SMEs. Our interviewees therefore did not discuss IFRS for SMEs and the possible affects that it may have on their subsidiaries in future periods.
- 7.3** However, given the significance of this new standard we felt it appropriate to include some background on IFRS for SMEs for consideration in future periods.
- 7.4** It should be noted that it is for standard setters in individual jurisdictions to consider which entities, if any, will be required or permitted to use IFRS for SMEs. As discussed in Section 3, in August 2009 the UK ASB issued a consultation paper entitled "The Future for UK GAAP" which sets out proposals for the future reporting requirements of UK and Irish entities.
- 7.5** This proposal would replace existing GAAP in the United Kingdom and Ireland with a choice of IFRS, or IFRS for SMEs, for all but the smallest companies. That consultation paper recommends mandatory adoption of IFRS, or IFRS for SMEs in the UK and Ireland for financial years beginning on, or after, January 1, 2012. Other national standard setters may, or may not, follow suit, multinational companies will need to consider this issue with respect to their subsidiary companies, and where appropriate, pay attention to and participate in decisions their subsidiaries may take. In Canada non-publicly accountable enterprises will have a choice of IFRS or the recently issued Accounting Standards for Private Enterprises (ASPE). ASPE is effective for year ends beginning on or after January 1, 2011, however early adoption is permitted.
- 7.6** Here we will focus on the aims of the standard and the issues that entities adopting IFRS in their group accounts, or who have already adopted IFRS, should consider regarding either their own adoption of IFRS for SMEs or that of their subsidiaries possible adoption of IFRS for SMEs.

### AIMS OF IFRS FOR SMES

- 7.7** One aim of IFRS for SMEs is to provide a standard for entities in countries that have no national GAAP. IFRS for SMEs will provide an accounting framework for countries that have entities that are not of the size, nor have the resources, to adopt full IFRS.
- 7.8** Another aim is to provide countries that already have an established national GAAP with an alternative, IFRS standard that will be recognized and understood across different territories. This is expected to help ease transition to full IFRS for growing entities once they become publicly accountable.

### CONSIDERATIONS IN CHOOSING IFRS FOR SMES OVER IFRS

- 7.9** In issuing IFRS for SMEs, the IASB considered the level of detail and complexity in the required standards under IFRS, including required disclosures in financial statements, recognizing the difficulties and costs for private companies in preparing fully-compliant IFRS financial statements. There are likely to be significant time and cost savings for any entity preparing financial statements in accordance with IFRS for SMEs as a consequence of the reduction in complexity of accounting and necessary disclosures. This is one area where our respondents were in agreement when comparing local GAAP financial statement disclosures to full IFRS disclosures.
- 7.10** Entities who aspire to list debt or equity publicly in the short to medium-term should consider whether or not it is worthwhile to carry out an initial adoption of IFRS for SMEs to then have to carry out further conversion to full IFRS before any public offering of debt or equity securities is made. Whilst there may be short-term gains in adopting IFRS for SMEs now, it may be more beneficial in the medium-term to switch immediately to full IFRS upon phase-out of local GAAP reporting. Management should focus on this as a key issue in determining which of IFRS for SMEs and full IFRS should be chosen.

**7.11** Parent companies that are adopting IFRS either mandatorily or voluntarily, or are anticipating future adoption of IFRS, such as in Japan or the United States, should be significantly involved in any decisions involving their subsidiaries adoption of either IFRS for SMEs or IFRS. In such circumstances, a parent company may:

- Look to use the subsidiary as a “bite-sized” conversion project for purposes of later adoption of IFRS across the group. If a subsidiary adopts IFRS for SMEs rather than IFRS that knowledge sharing opportunity will be lost.
- Use the opportunity to move foreign subsidiaries, where applicable, to one set of accounting standards, simplifying the monthly consolidation process to the parent’s existing GAAP. If a subsidiary chooses on its own to adopt IFRS for SMEs this will not lead to such streamlining, and would lead eventually to permanent monthly GAAP reconciliations between IFRS and IFRS for SMEs.
- Choose to be involved in the election of accounting policies by a subsidiary where that subsidiary chooses to adopt full IFRS; as such decisions typically cannot be undone when the parent company adopts full IFRS. In addition, elections that subsidiaries deem best for themselves may not necessarily be best for the parent company. Such elections may also vary widely among subsidiaries, leading to inconsistency and confusion.

**7.12** IFRS for SMEs will provide certain benefits to the producers of financial information, in both less complexity in accounting and less time being spent on disclosure requirements. But planning what is the best fit for the wider group, or future plans for the business, may identify that adoption of IFRS for SMEs, where applicable, is a better option than choosing IFRS. Each parent company should consider carefully the wider aspects before choosing either option.



## ▶ 8. CONCLUSION

- 8.1** IFRS adoption was not an easy journey for public companies and respondents worked extremely hard during an intense period of change. All commented on the need to plan ahead and be focused on the task at hand. We asked them to provide us with an anecdote, a key message to those contemplating future IFRS adoption, below are some of the responses:

**"Start early and develop analysts' expectations."**

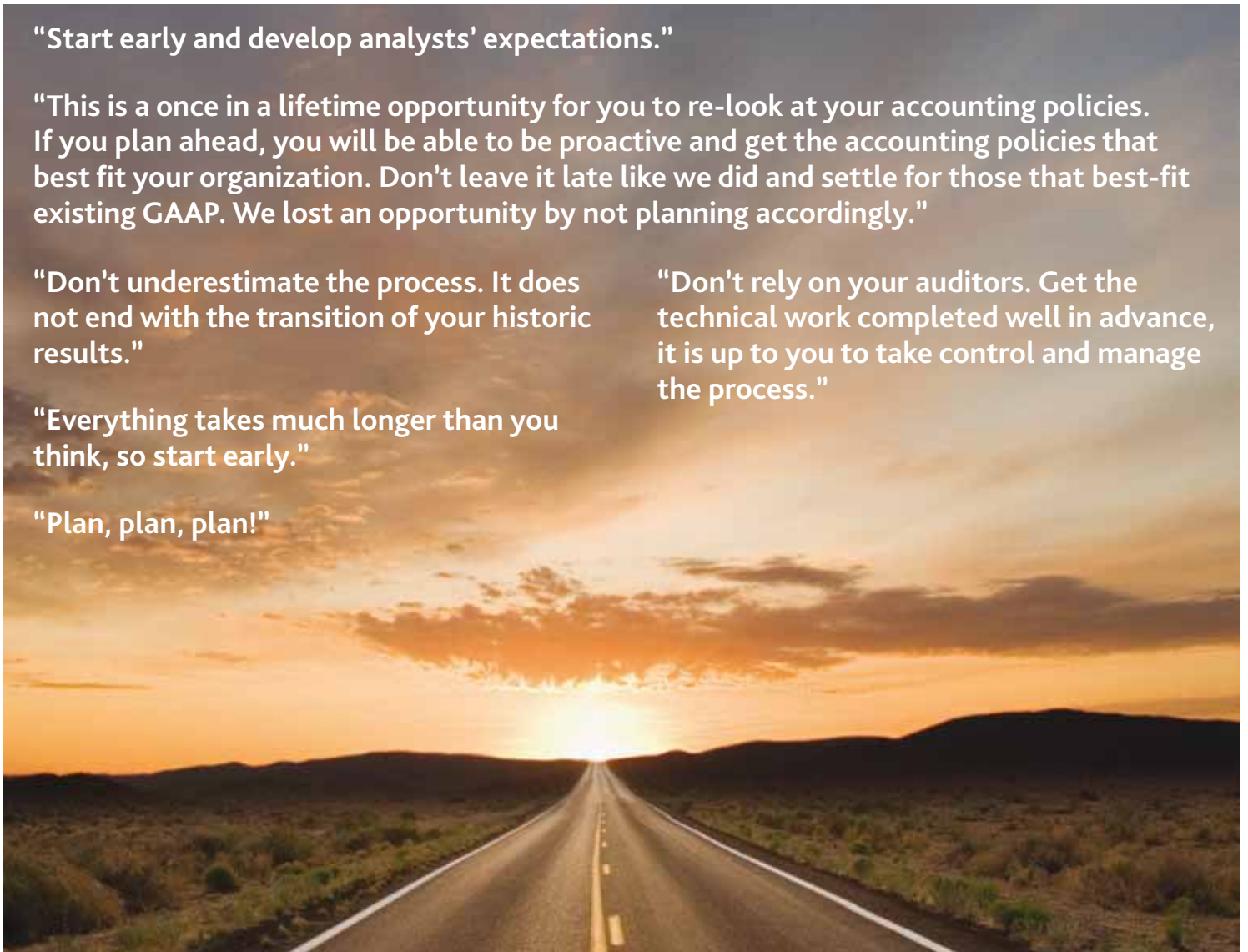
**"This is a once in a lifetime opportunity for you to re-look at your accounting policies. If you plan ahead, you will be able to be proactive and get the accounting policies that best fit your organization. Don't leave it late like we did and settle for those that best-fit existing GAAP. We lost an opportunity by not planning accordingly."**

**"Don't underestimate the process. It does not end with the transition of your historic results."**

**"Don't rely on your auditors. Get the technical work completed well in advance, it is up to you to take control and manage the process."**

**"Everything takes much longer than you think, so start early."**

**"Plan, plan, plan!"**



# ▶ ACKNOWLEDGEMENTS

We would like to thank the following companies for giving their time so generously:

## 2009 RESPONDENTS

- AVG Technologies N.V.
- Concurrent Technologies Plc
- The Conygar Investment Company PLC
- Dealogic (Holdings) plc
- Epistem Holdings Plc
- Eurasian Natural Resources Corporation PLC
- Fairpoint Group plc
- Faroe Petroleum plc
- Goals Soccer Centres plc
- GW Pharmaceuticals plc
- iomart group plc
- Jelf Group plc
- LMS Capital plc
- Numis Corporation Plc
- The ReThink Group plc
- RDF Media Group plc\*
- Ridge Mining plc\*\*
- Sepura plc
- Shed Media plc
- Sopheon Plc
- Tottenham Hotspur plc
- Vectura Group plc

## 2007 respondents\*\*\*

- Alexon Group Plc
- Alizyme plc
- Alternative Investment Strategies Ltd
- Detica Group plc
- Emerald Energy Plc
- Axis-Shield plc
- GlaxoSmithKline plc
- GKN Plc
- Pearsons plc
- Eurotunnel
- Electra Private Equity PLC
- J Sainsbury plc
- French Connection Group plc
- SThree PLC
- Wolfson Microelectronics plc
- Marylebone Warwick Balfour Group Plc
- Oxford Instruments plc

\*RDF Media Group plc delisted from AIM on February 2, 2009, and is now RDF Media Ltd.

\*\* Ridge Mining Plc was taken over by Aquarius Platinum Limited on June 30, 2009.

\*\*\* In 2007, two companies chose not to be acknowledged.

We would also like to thank the following people who contributed to this survey: Claire Brennan, Alan Dalziel, Fiona Gibson, Emily Jones, Graham Marjoribanks, Caroline Marwein-Smith and Anya Murphy.

