

10 Minutes on the Emerging Influence of IFRS*

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Discerning the impact on US companies

Highlights

- Financial reporting in the United States is being influenced by IFRS in significant ways as the FASB and IASB converge their accounting guidance over the next few years.
- Convergence will accelerate the effects of IFRS, regardless of how the SEC proceeds.
- IFRS impacts US business dealings—for multinationals *and* domestic companies— independent of convergence.
- Understanding the business implications of IFRS is a competitive imperative for US companies.

As US companies and policymakers stay focused on working through the economic crisis, transition to International Financial Reporting Standards has understandably moved down the priority list, for now.

IFRS is nonetheless already affecting US companies. The impact will broaden considerably over the next few years as ongoing convergence of US GAAP and IFRS changes a dozen key areas in financial reporting guidance. Meanwhile, companies are feeling the indirect effect of IFRS adoption by their foreign subsidiaries and counterparties, particularly in customer and vendor transactions.

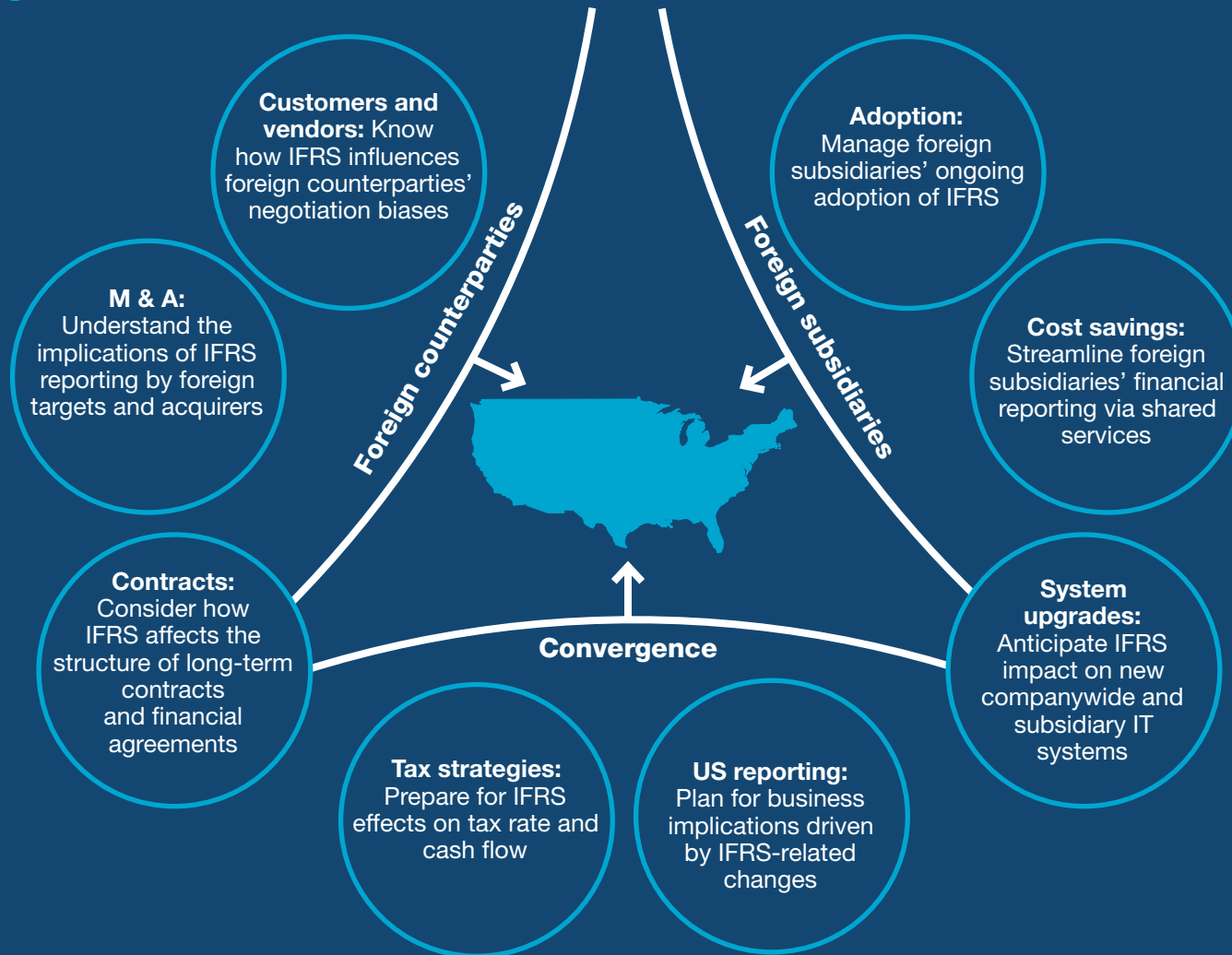
To take these developments in stride, companies need to assess where IFRS intersects with their financial reporting and business decisions, both here and around the globe.

US businesses are not insulated from IFRS:

1. More key US trading partners will soon be adopting IFRS—Brazil in 2010, Canada and South Korea in 2011, and Mexico in 2012—joining EU members and other countries that trade extensively with the United States.
2. To obtain the best economic outcomes, US companies will need to know how IFRS accounting may influence the way counterparties structure deals and transactions.
3. US multinationals should manage their foreign subsidiaries' IFRS-adoption decisions from day one, to ensure that they align with the parent company's financial-reporting and business objectives.
4. Newly converged accounting guidance will replace multiple US standards in fundamental areas over the next few years, bringing a period of constant change to US financial reporting.

At a glance

IFRS is affecting US companies on multiple fronts



Where IFRS adoption stands in the US

With the financial markets and our economy still in turmoil, the SEC has justifiably shifted its focus to issues more pressing than IFRS adoption.

Calls for tighter regulation of the financial system; demands that enforcement of current regulation be stepped up; the changing of the guard at the Commission—these are just some of the matters requiring the SEC's immediate attention.

Indecision 2011

The SEC's relative inattention to the matter of IFRS adoption has left some companies uncertain what to do. For a number of them, the SEC's ultimate approval of its proposed timeline for IFRS adoption (a decision the SEC is slated to make in 2011) would mean those companies should start their conversion planning now.

Understandably, most businesses are reluctant to pour time and resources into preparing for an eventuality the SEC has yet to confirm—expenditures many businesses can ill afford right now. But companies that ignore IFRS in the short term could end up making similar (and more costly) expenditures on the back end (e.g., necessary operational changes), as well as forfeit opportunities (e.g., to streamline systems). It makes sense, therefore, for companies to stay mindful of the potential impact of IFRS—not just the impact via eventual US adoption, but also the ongoing effect of IFRS on US business today and over the next few years.

IFRS is indirectly impacting US companies at home...

IFRS has maintained a steady presence here ever since quietly gliding onto US shores several years ago. That presence was reinforced with last year's launch of the converged standards on business combinations and will grow substantially over the next few years. Nearly a dozen additional standards converging US GAAP and IFRS are scheduled to debut in the United States by 2011, which will drive major changes in the balance sheets of many companies.

Convergence = constant change

Jointly undertaken by the FASB and the IASB, the convergence effort has the overarching goal of improving the quality and comparability of financial reporting across the globe. Fundamental areas affected by the project include revenue recognition, leases, pensions, and consolidations, with numerous implications for corporate financial reporting in each area—and more importantly, implications for business-related decision-making.

Although the changes will arrive piecemeal, they'll come in quick succession. And they will be substantial. The converged standard on revenue recognition, for instance, will supplant over one hundred pieces of guidance under US GAAP.

Keeping pace with the changes, and coping with their magnitude, will take considerable time and resources.

Staying ahead of the game

Companies that want to be prepared should start planning for two possible alternatives: Convergence alone, and convergence coupled with eventual IFRS adoption. Multiple financial reporting outcomes could result from either alternative and, in turn, lead to various business consequences. Devising strategies around a range of potential scenarios can help companies prepare for those eventualities.

Take leasing: Under US GAAP, a company is able to structure long-term leases in a way that keeps them off the books. Such structuring may no longer be an option under eventual converged guidance, and that could affect significant areas, such as debt covenants. Companies that bear this possibility in mind are apt to make better-informed decisions about their current long-term leasing strategies and finance agreements. Similar thinking may serve companies well in other areas where upcoming converged standards might change the state of play.

...and directly impacting them in business dealings abroad

The impact of IFRS on US companies—whether via contract negotiations with global counterparties or through a parent’s consolidation of its foreign subsidiaries’ financial statements—will widen over the next few years, as more countries adopt IFRS for both capital-market and statutory purposes.

Study your counterparty’s phrase book

The reporting language of foreign counterparties can influence their rationale for structuring deals and transactions a certain way (just as US GAAP can influence US companies). Understanding the interplay between a counterparty’s accounting and economic objectives helps put US companies on better strategic footing in negotiations. For instance, knowing the logic behind how a joint venture is reported under IFRS can help a US company understand (and foresee) its foreign counterparties’ accounting motives in contract negotiations, as well as give it a window into the counterparties’ business thinking.

The parent belongs in the driver’s seat

For multinational companies, IFRS adoption by foreign subsidiaries can increase global efficiencies. To reap those benefits, however, multinationals need to make sure their subsidiaries’ IFRS-reporting decisions are aligned with the parent’s financial-reporting and business objectives.

Misalignment may lead to suboptimal conditions: Diverse (and potentially irreversible) application of IFRS by a company’s various subsidiaries could make consolidating the different financial statements cumbersome. It could also force parent companies down roads they’d rather avoid upon eventual adoption of IFRS—e.g., in nuanced areas such as the treatment of pensions and foreign currency translation.

Parent companies can steer clear of such problems by managing how their subsidiaries go about IFRS adoption. For that to happen, management needs to understand the alternative conversion routes and their consequences. Only with a clear sense of those elements can it drive the conversion process in a direction most beneficial to the company overall.

Get ready...for what's already happening

The next several years will bring a near-constant rate of change to US financial reporting. Whether the change arrives through convergence, an SEC-mandated move to IFRS, or continued IFRS adoption by counterparties and subsidiaries, the effect will be considerable.

Watching which way the wind blows

The companies best poised to adapt to ongoing changes are already incorporating IFRS-awareness into their thinking. Such companies not only stay apprised of how IFRS influences their foreign counterparties and subsidiaries, but also take into consideration how newly converged standards may affect long-term contractual commitments initiated today.

For instance, one of the various areas companies may want to start taking a careful look at is revenue recognition. Certain corporate business policies have long been influenced by US GAAP, which requires companies to clear numerous administrative or operational hurdles before recognizing revenue. Sales strategy, salesperson compensation, cash management, investor communications—even information-system design—are all touched by how a company recognizes revenue. Many of the current hurdles are likely to disappear or change under the converged guidance. That will transform the sales playbook for many US companies.

Businesses that are actively anticipating and planning for these and other potential developments can make the most of IFRS-related changes.

Upcoming 10Minutes topics

Toward a safer, smarter supply chain

Global networks have delivered efficiencies. They've also led to a proliferation of suppliers, intermediaries—and risks. 10Minutes discusses how companies can rationalize their supply chains in this economic downturn by identifying their most critical partners and strengthening relationships with them for long-term advantage.

Navigating the infrastructure landscape

The US infrastructure is in massive need of regeneration. 10Minutes discusses current challenges and looks at the issues companies need to understand.

How PwC can help

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