

IFRS industry series

Driving change

Examining International Financial Reporting Standards for the US trucking industry



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What companies can do now

The heart of the matter

US financial reporting will
see unprecedented change
over the next several years

International Financial Reporting Standards (IFRS) have been affecting US companies for some time, whether through the companies' business dealings with non-US customers and vendors that use IFRS or through non-US subsidiaries' adoption of IFRS. Soon, US trucking companies will feel the increasing effects of IFRS at home as key aspects of accounting principles generally accepted in the United States (US GAAP) and IFRS continue to converge.

The next several years will bring near-constant change to US financial reporting. IFRS will be a main driver of the change, coming at trucking companies on a variety of fronts:

- Convergence of key areas of US GAAP and IFRS
- Ongoing adoption of IFRS by subsidiaries and competitors, as additional countries switch to IFRS (adoption may be further accelerated now that there is a version of IFRS tailored to small and medium-sized entities)
- Continued influence of IFRS on foreign counterparties' structuring of deals and transactions, as additional key US trading partners adopt IFRS for capital-market and statutory purposes
- Ultimate adoption of IFRS in the United States

Recent developments

In February 2010, the Securities and Exchange Commission published a statement of continued support for a single set of high-quality global accounting rules. The commission acknowledged that IFRS is best positioned to be the global standard. The statement described the issues and the events that must occur this year and in 2011, when the SEC expects to make a final decision on whether, when, and how to incorporate IFRS in the US domestic reporting system.

The commission further stated that if it does move forward with IFRS in 2011, businesses will need adequate time for their transition and IFRS reporting would begin in approximately 2015 or 2016. Timing for the convergence projects has since been pushed back, but the SEC stated that this change will not impact its ability to make a decision on IFRS in 2011. Although a final decision has yet to be made, these developments indicate the SEC's continued commitment to the objective of a single set of high-quality standards.

In addition, IFRS adoption is ongoing elsewhere in the world. Multinational companies need to closely manage IFRS adoption by non-US subsidiaries. Adoption elections that non-US subsidiaries deem best for themselves won't necessarily be best for their US parent or the organization as a whole.

These elections can have a wider impact than just accounting; they could impact broader corporate initiatives such as tax planning. In addition, elections may vary widely among subsidiaries, diminishing the potential benefit and cost savings from having one set of accounting principles within a company. A working understanding of IFRS, corporate oversight, and careful planning can help to maximize the benefits of a consistent adoption.

Looking forward

IFRS will impact the trucking industry as a whole, but the specific impact of a transition will vary from one trucking company to another. We believe that using the insights gained from this paper, executives in the trucking industry will have a better understanding of the potential impact of IFRS on their industry and individual companies.

An in-depth discussion

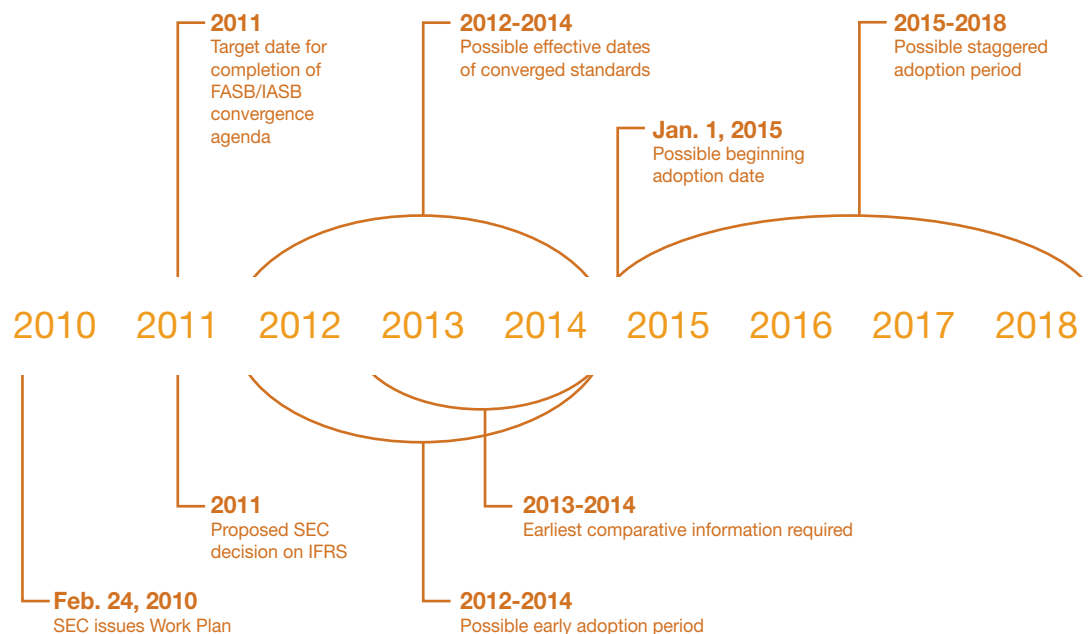
How IFRS may affect your company

A good working knowledge of International Financial Reporting Standards is no longer just optional for companies in the United States, but a business imperative. As more and more companies apply IFRS and US GAAP and IFRS continue to move closer as a result of convergence, US companies must consider how to prepare for the impact of convergence, global IFRS adoption, and potential US adoption of IFRS.

The trucking industry is no exception. It will be affected on all fronts, including:

- Property, plant, and equipment
- Lease accounting
- Revenue recognition
- Derivatives and hedge accounting
- Taxes
- Share-based payments
- Provisions
- Joint ventures
- First-time adoption exemptions and exceptions

Although there is still time before the formal date of conversion to IFRS, the window in the United States is relatively narrow, especially for such a complex industry as trucking. Assuming that the SEC determines in 2011 to incorporate IFRS into the US domestic reporting system, a possible timeline may be:



Property, plant, and equipment

Maintenance facilities as well as trucks, tractors, and trailers are common elements across trucking companies. Depending on a trucking company's asset management strategies and holding patterns, the differences between the accounting models for property, plant, and equipment (PP&E) could have a significant impact on the company's financial results.

Measurement

Under IFRS, companies have a choice on how to measure PP&E. They can choose to use either the historical cost method and carry the assets at cost less accumulated depreciation and impairment charges or the revaluation method and revalue the assets regularly to fair value. The use of the revaluation model is rare in the industry and typically results in increased future depreciation charges. For assets carried under the historical cost method or revaluation method, it is important for companies to review the assets' useful life, residual value, and depreciation method at least annually.

Under both IFRS and US GAAP, routine maintenance costs are expensed as incurred.

Depreciation

Under IFRS, an entity is required to depreciate separately the significant components of PP&E if they have different useful lives. This is known as the "component approach." The component approach applies to buildings, such as maintenance facilities, whereby air-conditioning systems, elevators, roofs, and electronic equipment may have different depreciable lives. Upon IFRS adoption, the identification of asset components is usually a complex and cumbersome process because of a lack of detailed records maintained for this purpose.

Often, input from operating personnel will be necessary to ensure assumptions in "componentizing" are appropriate. This process can have significant ramifications for future asset disposals or abandonments.

An important element of IFRS emerges in how assets are grouped for impairment testing. The measurement of impairment under IFRS is performed on individual assets, unless an individual asset does not generate cash inflows that are largely independent of other assets or groups of assets.

US GAAP allows three alternatives for major maintenance and overhauls: expense as incurred, capitalize, or the built-in overhaul method. Under IFRS, the costs of major maintenance and overhauls are recognized in the carrying amount of the item of PP&E and depreciated over the period of time until the next major overhaul, provided such costs meet the definition of an asset (i.e., probable of future economic benefits and reliably measurable). Any remaining carrying amount relating to the previous major overhaul is derecognized.

Under US GAAP, the component approach is not required, and trucks could be depreciated over the weighted-average life of the assets.

It is likely the unit of property used for US tax purposes will be substantially different than for financial reporting purposes under IFRS, thus creating disparities between book and tax records. Tracking fixed-asset additions, disposals, and repairs based on different units of property is expected to be complex as well as administratively burdensome.

Impairment

Under IFRS, impairment testing is a one-step process that requires the asset's carrying value to be compared to the higher of fair value less costs to sell or value in use (which is typically a pre-tax, discounted cash-flow model reflecting the entity's intended use). This same impairment model is used when assessing all types of assets, including long-lived tangible and intangible assets and goodwill; the same cannot be said for US GAAP, in which different impairment models are used based on the type of asset being evaluated.

In contrast, under US GAAP, impairment is a two-step process for PP&E to be held and used. First, recoverability is assessed on an undiscounted cash-flow basis, then the impairment is measured as the amount by which the carrying amount exceeds the fair value of the assets.

An important element of IFRS emerges in how assets are grouped for impairment testing. The measurement of impairment under IFRS is performed on individual assets, unless an individual asset does not generate cash inflows that are largely independent of other assets or groups of assets. In these cases, impairment is measured at the cash generating unit (CGU) level. A CGU is the smallest identifiable group of assets that generates cash inflows, largely independent of cash inflows from other assets or groups of assets.

IFRS requires the discount rate for value-in-use calculations to be determined on a pre-tax basis. Thus, a CGU's pre-tax cash flows should be discounted at the pre-tax discount rate. In many cases, the only observable market rate of return is a post-tax discount rate. This is the case, for example, where the discount rate is derived

from an entity's weighted average cost of capital, which many companies look toward when estimating the appropriate discount rate for a CGU.

Deriving a pre-tax discount rate from a post-tax discount rate is a complex exercise and generally not a matter of grossing up with the effective tax rate (this would be appropriate only if there are no growth in cash flows and no deferred tax). For fair value less cost to sell calculations, it is appropriate to use post-tax cash flows and a post-tax discount rate.

Finally, under IFRS, an impairment of long-term assets (excluding goodwill) can be reversed, while US GAAP does not allow for a reversal of impairment. An entity must assess at the end of each reporting period whether there is any indication that an impairment loss recognized in prior periods for an asset, other than goodwill, may no longer exist or may have decreased. If any such indication exists, the entity shall estimate the recoverable amount of that asset, and the carrying amount is increased to its recoverable amount (not to exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior periods).

Lease accounting

Trucking companies commonly use leasing arrangements for their trucks, tractors, and trailers. These arrangements may be from the lessor or lessee perspective. From the standpoint of the lessor, the trucking company may offer a full-service lease arrangement that includes maintenance services, insurance, and taxes. These leases are typically classified as operating leases.

From the standpoint of the lessee, trucking companies may opt for a less capital-intensive option and lease their trucks, tractors, or trailers. Under either framework, there may be differences in the accounting classification of such leases. IFRS primarily focuses on the overall substance of the transaction, while US GAAP applies quantitative breakpoints or bright lines.

When transitioning to IFRS, companies should give careful consideration to the classification of leases. A common pitfall is not reevaluating the initial lease classification on the date of transition, whereby inappropriate classification could result. For example, a 15-year lease period for an asset with a 20-year useful life might be a finance (capital) lease at inception. However, if the reassessment is done with two years left on the lease, it may well be an operating lease. Therefore, at the transition date, leases must be assessed assuming the IFRS lease guidance had been applicable at the inception of the lease. The lease classification at the transition date will then be based on this assessment.

While lease classification criteria are generally consistent under IFRS and US GAAP, under IFRS there are no quantitative breakpoints or bright lines to apply. US GAAP contains specific quantified thresholds, such as whether the present value of the minimum lease payments equals or exceeds 90 percent of the fair value of the leased asset. Therefore, the conclusion on the classification of leases could be different under IFRS than US GAAP.

In August 2010, the FASB and IASB jointly issued a leasing exposure draft addressing accounting by both the lessee and lessor for which the final standard is expected to be issued by mid-2011. Under the new approach, the operating lease accounting model would be eliminated. As such, all rights and obligations under lease arrangements, including those in effect when the new standard is issued, would be accounted for as assets and liabilities on the balance sheet—representing a major change from current practice.

The exposure draft proposes that lessees and lessors should apply a right-of-use model in accounting for all leases, which means that:

- a. A lessee would recognize an asset representing its right to use the leased asset for the lease term and a liability to make lease payments
- b. A lessor would recognize an asset representing its right to receive lease payments and, depending on its exposure to risks or benefits associated with the underlying asset, would do one of the following:
 - i. Recognize a lease liability while continuing to recognize the underlying asset (a performance obligation approach)
 - ii. Derecognize the rights in the underlying asset that it transfers to the lessee and continue to recognize a residual asset representing its rights to the underlying asset at the end of the lease term (a derecognition approach)

Assets and liabilities recognized by lessees and lessors would be measured on a basis that:

- a. Assumes the longest possible lease term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease

- b. Uses an expected outcome technique to reflect the lease payments, including contingent rentals and expected payments under term option penalties and residual value guarantees, specified by the lease
- c. Is updated when changes in facts or circumstances indicate that there would be a significant change in these assets or liabilities since the previous reporting period

This area will be important to follow from a convergence perspective, especially since the current and past practice for trucking companies has been to enter into lease contracts with terms that qualify for operating lease treatment. At present, US GAAP and IFRS account for the lease payments arising from operating leases by recognizing them in the period in which they occur. The proposals would require lessees to recognize the assets and liabilities arising from these leases, thereby increasing the trucking companies' assets and liabilities and potentially impacting financial covenants related to long-term debt or other agreements.

on the sale would normally be recognized if the sale was executed at the fair value of the asset. It is not necessary for use of the asset associated with the leaseback to be minor. This is contrary to US GAAP, where immediate recognition of the full gain is normally appropriate only when the use of the asset associated with the leaseback is minor.

Under IFRS, when a sale-leaseback transaction results in a finance lease, the gain is amortized over the lease term, irrespective of whether the lessee will reacquire the leased property. However, under US GAAP, the gain is amortized in proportion to the amortization of the leased asset.

Embedded leases

Trucking companies often enter into outsourcing arrangements. For example, a trucking company may outsource its data processing functions. Such arrangements, although they do not have the legal form of a lease, may convey a right to use an asset for a payment or series of payments—that is, a lease in accordance with Accounting Standard Codification (ASC) 840-10-15,

When transitioning to IFRS, companies should give careful consideration to the classification of leases. A common pitfall is not reevaluating the initial lease classification on the date of transition, whereby inappropriate classification could result.

Sale-leaseback transactions

Sale and leaseback is frequently used to raise capital in the trucking industry. The transaction involves the sale of a pool of trucks, tractors, and/or trailers and the leaseback of the same assets, usually under a finance lease. The future lease payments and the sale price are often interdependent because they are negotiated as a package.

Where differences exist, IFRS may lead to earlier gain recognition. Under IFRS, when a sale-leaseback transaction results in a lease classified as an operating lease, the full gain

Leases (formerly known as EITF 01-8, *Determining Whether an Arrangement Contains a Lease*), and International Financial Reporting Interpretations Committee (IFRIC) Interpretation 4, *Determining Whether an Arrangement Contains a Lease*. Although these interpretations are similar, the outcome may be different because of the differences in the leasing standards.

Transition to IFRS may also cause differences since EITF 01-8 allowed arrangements that existed prior to the effective date to be grandfathered, while IFRIC 4 requires full retrospective application.

Revenue recognition

Trucking companies generally generate revenue based on the rendering of services. These services include transportation management solutions, intermodal freight solutions, and drayage work. The service offerings are rendered through relationships with thousands of third-party carriers integrating their own equipment. US GAAP and IFRS require different methods for recognition of revenue from service arrangements.

US GAAP requires that revenue from service arrangements be recognized using the proportional performance or completed performance method, unless the service arrangements fall under the scope of construction or production-type contracts.

Revenue for transportation services often includes multiple elements such as transportation, customs clearing, and warehousing. One of the most common revenue recognition issues in both accounting models has to do with (1) determination of when transactions with multiple deliverables should be separated into components and (2) the way revenue gets allocated to the different components. While the broad concepts in this area are similar and often result in similar conclusions under US GAAP and IFRS, the potential for different conclusions also exists. US GAAP focuses on detailed separation and allocation criteria, whereas IFRS focuses on the economic substance of the transaction(s).

The objective of the converged standard is to increase the consistency of revenue recognition for similar contracts, regardless of industry.

Under the proportional performance method, revenues are recognized as specific outputs under the service arrangement. In contrast, under the completed performance model, revenues are recognized only when the service is completed in its entirety.

IFRS requires use of the percentage of completion method in recognizing revenue under service arrangements, unless progress toward completion cannot be estimated reliably (in which case a zero-profit approach is used) or when a specific act is much more significant than any other (in which case revenue recognition is postponed until the act is executed). The stage of completion of a transaction may be determined by a variety of methods, including ones that are input-based. An enterprise should use the method that reliably measures the services performed. Depending on the nature of the transaction, the methods include surveys of work performed, services performed to date as a percentage of total services to be performed, and the proportion of costs incurred to date to the estimated total costs of the transaction.

In June 2010, the FASB and IASB released an exposure draft outlining a new revenue recognition model, which is a contract-based approach focusing on the assets and liabilities that are created when an entity enters into and performs under a contract. The objective of the converged standard is to increase the consistency of revenue recognition for similar contracts, regardless of industry.

Under the proposed model, an entity would identify the contract with the customer, identify the separate performance obligations in the contract, determine the transaction price, allocate the transaction price to the separate performance obligations, and recognize revenue when the entity satisfies each performance obligation.

The proposal defines a performance obligation as an enforceable promise in the contract that includes both explicit and implicit promises to transfer goods and/or services to a customer. If an entity promises to provide more than one good or service, it would account for each promised good or

service as a separate performance obligation if the good or service is distinct. A good or service is distinct if either the entity or another entity sells an identical or similar good or service separately, or the good or service has a distinct function and a distinct profit margin.

Transaction price and variable consideration

The transaction price is the amount of consideration that an entity receives, or expects to receive, from a customer in exchange for transferring goods or services promised in the contract and reflects the probability-weighted amount of consideration that the entity expects to receive from the customer.

If the amount is variable, an entity would recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. The transaction price can be reasonably estimated if the entity has experience or access to others' experience with similar types of contracts and the entity's experience is relevant to the contract because the entity does not expect significant changes in circumstances. If some of the consideration amount can be reasonably estimated, but not all, the transaction price would include only the amount that can be reasonably estimated.

Trucking companies may offer discounts to their customers for shipping a specified cumulative volume or shipping to and/or from specific locations. Under the proposed revenue recognition model, these discounts would be considered variable consideration. For example, if a freight move is expected to generate \$1,000 of revenue based on contract rates, with a potential volume discount to the customer of \$100 per load if a certain volume target is met for the year, then \$100 of the \$1,000 consideration would be variable consideration. Under the model, if the company is able to reason-

ably estimate the transaction price (it has experience with identical or similar types of contracts, and this experience is relevant because the company does not expect circumstances surrounding these types of contracts to change significantly), then the company would record revenue based on the probability-weighted amount of consideration it expects to receive after weighing the possible outcomes.

Under current US GAAP, volume discounts are recorded as a reduction to operating revenues based on actual or projected future customer shipments when they are both probable and estimable.

Allocation of transaction price

An entity would allocate the transaction price to all separate performance obligations in proportion to the stand-alone selling prices of the goods or services underlying each of these performance obligations at contract inception. The entity would then update the transaction price over the life of the contract to reflect changes in circumstances.

Transfer of control

Under the proposed model, an entity would recognize revenue when it satisfies a performance obligation and control of a promised good or service transfers to the customer, which is when the customer is able to direct the use of and receive the benefits from the good or service.

When the promised goods or services underlying a separate performance obligation are transferred to a customer continuously, an entity would apply to that performance obligation one revenue recognition method that best depicts the transfer of goods or services to the customer. Acceptable methods include methods based on an entity's outputs or inputs and on passage of time.

Identifying the performance obligations in a contract will be critical in applying the proposed model and will require significant judgment. This may be particularly challenging for service arrangements and long-term contracts. Also challenging will be determination of when performance obligations should be combined and when they should be separated, which will be a key driver in determining the amount and timing of revenue recognition.

Companies should carefully consider the indicators of control transfer and assess whether under the new model there is a continuous transfer of control for the services performed. Careful consideration of the model's principle for revenue recognition and the indicators that demonstrate that the customer has obtained control is needed to determine when the revenue should be recognized. The indicators of control transfer are difficult to apply to certain service transactions such as transportation services,

This will be an important area to follow from a convergence perspective, especially since industry-specific GAAP that allows for a policy choice for revenue recognition will be replaced by a new model.

Net versus gross

Management will need to consider whether the company is acting as a principal or an agent in a contract; this particularly applies to trucking companies with subcontracted transportation arrangements. Management should consider whether its performance obligation is to transport the goods or services or to arrange for another party to transport the goods or services in determining whether it is the principal or the agent. This proposed principle is consistent with current revenue guidance under US GAAP and IFRS, and therefore no significant impact is expected on the trucking industry.

Companies should carefully consider the indicators of control transfer and assess whether under the new model there is a continuous transfer of control for the services performed.

and more guidance may be helpful in making the assessment as to when control transfers. For some companies, this may result in a significant change in the timing of revenue recognition.

In addition, if the recovery of freight costs is expected under the contract and generates or enhances resources of the entity that will be used in satisfying performance obligations in the future, the costs would be deferred as an asset until the related revenue is recognized. Costs of obtaining a contract (costs of selling, etc.) will be expensed as incurred.

Derivatives and hedge accounting

Trucking companies may use derivative financial instruments to assist in managing their overall exposure to fluctuations in interest rates (interest rate swaps), foreign currency (foreign-exchange contracts), and fuel prices (long-term fuel-purchase contracts). Although the hedging models under IFRS and US GAAP are founded on similar principles, there are a number of application differences. Some differences result in IFRS being more restrictive, others less restrictive. As companies work to understand and embrace the new opportunities and challenges associated with adopting IFRS in this area, it is important that they thoroughly consider the data requirements and underlying systems support.

Areas where IFRS is more restrictive than US GAAP include the nature and frequency of measuring and assessing hedge effectiveness. As an example, US GAAP provides for a shortcut method that allows an entity to assume no ineffectiveness and, hence, bypass an effectiveness test as well as the need to measure quantitatively the amount of hedge ineffectiveness. The US GAAP shortcut method is available only for certain fair value or cash flow hedges of interest rate risk using interest rate swaps when certain stringent criteria are met.

IFRS has no shortcut method equivalent. IFRS does acknowledge that in certain situations little or no ineffectiveness could arise, but IFRS does not provide an avenue whereby an entity may assume no ineffectiveness. Because the shortcut method is not accepted under IFRS, companies utilizing the shortcut method under US GAAP will need to prepare the appropriate level of IFRS-compliant documentation if they want to maintain hedge accounting.

The documentation will need to be in place no later than at the transition date to IFRS if hedge accounting is to be maintained on an

uninterrupted basis. For a trucking company whose first IFRS-based financial statements will be issued for the three years ended December 31, 2014, hedging documentation needs to be in place as of January 1, 2012, if the entity wants to continue to apply uninterrupted hedge accounting.

IFRS is also more restrictive than US GAAP in relation to the use of internal derivatives. Restrictions under the IFRS guidance may necessitate that entities desiring hedge accounting enter into separate, third-party hedging instruments for the gross amount of foreign currency exposures in a single currency, rather than on a net basis as many treasury centers do currently under US GAAP.

At the same time, IFRS provides opportunities not available under US GAAP in a number of areas. Such opportunities arise in a series of areas where hedge accounting can be accomplished under IFRS, whereas it would have been precluded under US GAAP. For example, under IFRS, an entity can achieve hedge accounting in relation to the foreign currency risk associated with a firm commitment to acquire a business in a business combination (whereas US GAAP would not permit hedge accounting).

At the same time, IFRS allows an entity to utilize a single hedging instrument to hedge more than one risk in two or more hedged items. This difference may allow entities under IFRS to adopt new and sometimes more complex risk-management strategies while still achieving hedge accounting. IFRS is also more flexible than US GAAP with respect to the ability to achieve fair value hedge accounting in relation to interest rate risk within a portfolio of dissimilar financial assets and in relation to hedging a portion of a specified risk and a portion of a time period to maturity (i.e., partial-term hedging) of a given instrument to be hedged.

The FASB and IASB have undertaken a project to significantly improve the decision usefulness of financial instrument reporting for users of financial statements. The project will replace the FASB's and IASB's respective financial instruments standards with a common standard. The boards believe that simplification of the accounting requirements for financial instruments should be an outcome of this improvement. The boards believe that this project will reconsider the recognition and measurement of financial instruments, address issues related to impairment of financial instruments and hedge accounting, and increase convergence in accounting for financial instruments.

As part of this project, in May 2010, the FASB issued a proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*. In addition, in November 2009, the IASB issued IFRS 9, *Financial Instruments*,

which covers classification and measurement of financial assets. The IASB made a decision to retain most of the existing classification and measurement guidance in International Accounting Standard (IAS) 39 for financial liabilities. However, the IASB also tentatively decided to propose changes to the fair value option for financial liabilities and issued an exposure draft, *Fair Value Option for Financial Liabilities*, in May 2010.

The IASB has also made tentative decisions about impairment and issued an exposure document on amortized cost and impairment in November 2009. This project is ongoing as the FASB and IASB continue to work toward achieving convergence.

Taxes

Transitioning to IFRS accounting policies will impact a company's tax function. From a financial reporting perspective, key differences exist between US GAAP and IFRS with respect to accounting for income taxes. These differences include: uncertain tax positions, share-based compensation, inter-company transactions, foreign exchange on nonmonetary assets, initial recognition, intraperiod allocation, outside basis differences, recognition of deferred tax assets, and tax basis. As a result of these and other differences, the accounting and disclosure requirements associated with income taxes, including the effective tax rate, may be impacted.

In addition to tax accounting, several components of a company's tax planning structure could also be affected by the transition to IFRS, including cash taxes, tax accounting methods, domestic and international tax planning, and transfer pricing. Further, a company's tax processes, systems, and internal controls may require modifications to properly reflect the transition to IFRS.

As companies progress in their IFRS efforts, it is critical that their tax function understands IFRS and the potential tax implications both in the United States and in each foreign jurisdiction in which the organization operates, develops a tax-specific implementation plan, and is thoroughly involved in the company's overall conversion process from beginning to end.

For more information on the tax considerations associated with the transition to IFRS, please visit our IFRS-Tax webpage at www.pwc.com/usifrs/tax.

Share-based payments

Scope

Despite the progress made by the IASB and FASB toward converging the frameworks in this area, a multitude of significant differences remains. Some awards categorized as nonemployee instruments under US GAAP will be treated as employee awards under IFRS.

Under US GAAP, the guidance is driven by the legal definition of an employee, with certain specific exceptions/exemptions. IFRS focuses on the nature of the services provided and treats awards to employees and others providing employee-type services similarly. For awards that are categorized as nonemployee instruments, the measurement date and expense will be different under US GAAP and IFRS.

Measurement and attribution

Differences within the two frameworks may result in differing grant dates and/or different classifications of an award as a component of equity or as a liability. Once an award is classified as a liability, it needs to be measured to fair value at each

period through earnings, which introduces earnings volatility while impacting balance sheet metrics and ratios. Certain types of awards (e.g., puttable awards and awards with vesting conditions outside service, performance, or market conditions) are likely to have different equity-versus-liability classification conclusions under the two frameworks.

In addition, companies that issue awards with graded vesting (e.g., awards that vest ratably over time, such as 25 percent per year over a four-year period) may encounter accelerated expense recognition and potentially a different total value to be expensed (for a given award) under IFRS. The impact in this area could lead some companies to consider redesigning the structure of their share-based payment plans. By changing the vesting pattern from graded to cliff, companies can avoid a front-loading of share-based compensation expense, although this may be desirable to some organizations.

Provisions

Provisions are liabilities of either uncertain timing or amount and usually involve management judgment in determining the appropriate accounting. Provisions commonly recorded in the trucking industry include environmental, legal, and restructuring. Based on the facts and circumstances, recording of these provisions under IFRS could differ in a number of ways compared with US GAAP.

Provision recording is required for both IFRS and US GAAP if the outflow of resources is

range, while for US GAAP, the low point of the range would be used to measure the liability.

The amount recognized as a provision for IFRS is the best estimate of expenditure required to settle the present obligation as of the balance sheet date. The anticipated cash flows are discounted to their present value if the effect of discounting is material. Under US GAAP, a provision is discounted only when the timing of the cash flows is fixed or reliably determinable.

In measurement of provisions, a range of possible outcomes is often established. When no amount within that range represents a better estimate of the provision than any other amount, there is a difference in the amount recorded under IFRS and US GAAP.

probable. However, the definition of *probable* is different under IFRS and US GAAP. In IFRS, *probable* is “more likely than not,” or greater than a 50 percent likelihood, while under US GAAP *probable* means “likely to occur,” which usually equates to 75 percent or greater in practice. This difference could lead to additional liabilities being recognized under IFRS that are not recognized for US GAAP.

In measurement of provisions, a range of possible outcomes is often established. When no amount within that range represents a better estimate of the provision than any other amount, there is a difference in the amount recorded under IFRS and US GAAP. For IFRS, a company would measure the provision based on the midpoint of the

At the time of this publication, the IASB is working on a stand-alone project on provisions. It has issued an exposure draft that proposes to require that potential liabilities be measured at the present value of the amount that an entity would rationally pay to be relieved of the obligation at the balance sheet date. If this amount is uncertain, then the provision is measured on a probability-weighted average of all possible outcomes.

Restructuring provisions

Companies may experience differences between IFRS and US GAAP in the timing of underlying events that trigger the recognition of restructuring provisions. A provision is recognized in IFRS when an entity is demonstrably committed to the restructuring. This

usually occurs when a company has a legal obligation or when the entity has a detailed formal plan for the restructuring. Communication to specific, affected employees is not required, although management must have raised the valid expectation in those affected that it will carry out the restructuring by starting to implement the plan or announcing its main features to those affected by it. Recognition under US GAAP for one-time termination benefits requires communication of the details of the plan to employees who could be affected.

Onerous contracts

Trucking companies often have long-term contractual arrangements, such as operating leases, fixed-price purchase agreements, and long-term service contracts, that may become onerous over time. A contract is onerous if the unavoidable costs of meeting the obligations under the contract exceed the economic benefits to be received. A provision for an onerous contract is recognized in IFRS when the contract becomes onerous regardless of whether the entity has ceased using the rights under the contract. US GAAP requires the entity to cease using the rights under the contract (i.e., the cease-use date) to record the provision for an onerous contract.

Further, IFRS generally requires recognition of an onerous loss for an executory contract if the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. US GAAP generally does not allow the recognition of losses on executory contracts prior to such costs being incurred.

Joint ventures

Joint ventures occur in the trucking industry because they allow entities to share the risks and capital costs of trucking-related services. Under US GAAP, the term *joint venture* refers only to jointly controlled entities, where the arrangement is conducted through a separate entity. The scope of

Accounting for joint ventures under IFRS depends on the type of arrangement identified. For example, if the arrangement results in a jointly controlled entity, IFRS permits the use of either proportionate consolidation or the equity method. If an arrangement does not result in a jointly controlled entity

A transition to IFRS would necessitate close consideration of business relationships and alliances to determine which arrangements may be accounted for as joint ventures.

joint activity is much broader under IFRS than under US GAAP. IAS 31, *Interests in Joint Ventures*, defines a joint venture as “a contractual agreement whereby two or more parties undertake an economic activity that is subject to joint control.”

(i.e., one entity has clear control through, for example, voting rights or qualitative factors), the controlling entity typically will follow consolidation accounting while the other entity will follow the equity method, provided significant influence exists.

The concept of joint control is the contractually agreed sharing of control of an economic activity, which exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control. This includes jointly controlled entities as well as jointly controlled operations (each venturer uses its own assets for a specific project) and jointly controlled assets (project carried on with assets that are jointly owned). A transition to IFRS would necessitate close consideration of business relationships and alliances to determine which arrangements may be accounted for as joint ventures.

Under US GAAP, proportional consolidation typically is not permitted.

US GAAP requires an assessment of whether the joint venture is a variable interest entity (VIE) before the accounting model can be determined. Under IFRS, such considerations fall under SIC Interpretation 12, *Consolidation—Special Purpose Entities*. This guidance may result in more entities being consolidated under IFRS because the consolidation requirements are less restrictive than under US GAAP.

First-time adoption exemptions and exceptions

The IASB grants limited exemptions from adoption requirements in specified areas where the cost of complying with them would be likely to exceed the benefits to users of financial statements. The IASB also prohibits retrospective application of IFRS in some areas, particularly where retrospective application would require judgments by management about past conditions after the outcome of a particular transaction is already known.

The selection and application of the optional exemptions can be complicated. Careful consideration and analysis should be applied to ensure the most appropriate actions are taken. The following chart summarizes the elections available to companies under IFRS 1, *First-time adoption of IFRS*.

Exemption	Choice	Exemption applies to all items? ¹
Business combinations (IFRS 3R)	For all transactions qualifying as business combinations under IFRS 3R, a company can choose to: <ul style="list-style-type: none"> • Not restate business combinations before the date of transition • Restate all business combinations before the date of transition • Restate a particular business combination, in which case all subsequent business combinations must also be restated and the IAS 36 impairment guidance must be applied 	No
Deemed cost	For property, plant, and equipment, a company can choose to measure the value using: <ul style="list-style-type: none"> • Fair value at the date of transition as deemed cost • A revaluation in accordance with previous GAAP as deemed cost • Fair value at the date of an event such as a privatization or an initial public offering as deemed cost • An allocation of an amount determined under previous GAAP as deemed cost The first two elections can also be applied to intangible assets that meet the criteria for revaluation in IAS 38 and to investment properties where the cost method in IAS 40 is applied. The first two elections may not be used for any other assets or for liabilities.	No
Employee benefits	Recognition of all cumulative actuarial gains and losses as an adjustment to opening retained earnings is allowed. Deferral of the recognition of future actuarial gains and losses using the corridor approach in IAS 19 may still be applied prospectively.	Yes
Cumulative translation differences	The cumulative translation reserve may be reset to zero.	Yes

¹ This column designates whether the exemption should be applied to all transactions ("Yes") or only selected transactions based on the guidance in IFRS 1 ("No"). This designation does not apply to assets and liabilities of a subsidiary that has already adopted IFRS. In that case (where a parent becomes a first-time adopter later than its subsidiary), IFRS 1 requires the parent to use the "same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the parent acquired the subsidiary." Once a subsidiary has adopted IFRS, the carrying amounts of assets and liabilities of that subsidiary cannot be adjusted later when the parent adopts IFRS (except as necessary to conform to the parent's policies).

Exemption	Choice	Exemption applies to all items? ¹
Compound financial instruments	A compound financial instrument does not need to be bifurcated if the liability component is not outstanding at the transition date.	No
Assets and liabilities of subsidiaries, associates, and joint ventures	A subsidiary that adopts IFRS later than its parent can elect to apply IFRS 1 or to use the carrying amounts of its assets and liabilities included in the consolidated financial statements, subject to eliminating any consolidation adjustments. If a parent adopts IFRS later than its subsidiary, the parent, in its consolidated financial statements, must measure the assets and liabilities of the subsidiary at the same carrying amounts as in the IFRS financial statements of the subsidiary, adjusting for normal consolidation entries.	No
Designation of previously recognized financial instruments	A company may choose to designate a financial instrument as a financial asset or financial liability “at fair value through profit or loss” or may designate a financial asset as available for sale at its transition date. If it is impracticable (as defined in IAS 8) for an entity to apply retrospectively the effective interest method or the impairment requirements of IAS 39, the fair value of the financial asset at the date of transition to IFRS shall be the new amortized cost of that financial asset at the date of transition to IFRS.	No
Share-based payment transactions (IFRS 2)	A company is encouraged (but is not required) to apply IFRS 2 to any equity instruments that were granted on or before November 7, 2002, or that were granted after that date and vested before the date of transition, but only if the company has previously disclosed publicly the fair value of the instruments, determined at the measurement date. In addition, a company may choose (but is not required) to apply IFRS 2 to a liability relating to share-based payment transactions that were settled prior to the date of transition to IFRS.	Yes
Insurance contracts (IFRS 4)	A company that issues insurance contracts and has a date of adoption before January 1, 2006, may choose not to restate comparatives for IFRS 4. The company applies its previous GAAP to insurance contracts for its comparatives.	No
Decommissioning, liabilities included in the cost of property, plant, and equipment	When accounting for asset retirement obligations, first-time adopters may apply a shortcut method by: <ul style="list-style-type: none"> • Measuring the liability at transition date in accordance with IAS 37 • Estimating the amount of the liability that would have been included in the cost of the related asset when the liability first arose • Calculating the accumulated depreciation on that discounted amount, as of the date of transition to IFRS 	No

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Exemption	Choice	Exemption applies to all items? ¹
Leases	A company may elect to assess whether an arrangement contains a lease at the date of transition, rather than at the inception of the arrangement.	No
Fair value measurement of financial assets and financial liabilities at initial recognition	First-time adopters can choose to measure their “Day One” profits on initial recognition of financial instruments either: <ul style="list-style-type: none"> Retrospectively to all transactions Prospectively for all transactions entered into <i>after</i> October 25, 2002 Prospectively for all transactions entered into <i>after</i> January 1, 2004 	No
Service concession arrangements	Companies may elect to apply the transitional provisions of IFRIC 12, rather than full retrospective application.	No
Borrowing costs	If the accounting treatment for capitalized interest required by IAS 23 is different than a company’s previous accounting policy, the company may apply IAS 23 to borrowing costs related to qualifying assets capitalized on or after January 1, 2009, or the date of transition to IFRS, if later.	No
Investments in subsidiaries, jointly controlled entities, and associates	In their separate financial statements, first-time adopters can measure their investment in subsidiaries, jointly controlled entities, and associates at one of the following: <ul style="list-style-type: none"> Cost, determined in accordance with IAS 27R Deemed cost, defined as fair value (determined in accordance with IAS 39) at the company’s IFRS transition date Deemed cost, defined as previous GAAP carrying amount at the IFRS transition date 	No
Transfer of assets from customers	If the accounting treatment for transfers of assets from customers required by paragraph 22 of IFRIC 18 is different than a company’s previous accounting policy, the company may apply IFRIC 18 to transfers of assets from customers on or after July 1, 2009, or the date of transition to IFRS, whichever is later. In addition, the first-time adopter may designate any date before the date of transition to IFRS and apply IFRIC 18 to all transfers of assets from customers received on or after that date.	No
Extinguishing financial liabilities with equity instruments	A first-time adopter may apply the transitional provisions in IFRIC 19, <i>Extinguishing Financial Liabilities with Equity Instruments</i> .	No

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Mandatory exceptions from retrospective application

There are also several mandatory exceptions to full retrospective application of IFRS. As described below, some of these exceptions may or may not have an impact on US companies:

Expected to impact US companies	Not expected to impact many US companies
Hedge accounting	Derecognition of financial assets and financial liabilities
Estimates	Classification and measurement of financial assets
Noncontrolling interests	

What this means for your business

What companies can do now

Independent of when the United States ultimately adopts IFRS, these standards are already having a significant impact on US businesses. The impact will only increase in the next several years as convergence takes place and eventual adoption of IFRS gains momentum.

Awareness and preparedness are essential. Given the timeline, companies should be thoughtful and measured in their approach as they consider this complex challenge. Following are our suggestions on what companies should do now:

- **Focus on the challenge.** The next several years will bring major changes to US financial reporting. Whether changes arrive through convergence, an SEC-mandated move to IFRS, or continued IFRS adoption by subsidiaries and counterparties, the effect on US businesses will be considerable.
- **Perform an assessment.**
 - Keep it high level and strategic.
 - Consider the implications for accounting, business strategy and policy, tax, financing, long-term contracts, stakeholders, compensation programs, systems, processes, and controls.
 - Anticipate the impacted behaviors of non-US customers and vendors using IFRS already.
- **Be poised to adapt to ongoing change.** Use scenario planning to incorporate likely convergence and IFRS adoption expectations into your strategic thinking and business planning. Closely follow SEC actions, new FASB and IASB standards, and the increasing international acceptance of IFRS and IFRS for small and medium-sized entities (SMEs) for statutory purposes.
- **Maintain corporate oversight.** Influence transition timing, strategies, and policy decisions of non-US subsidiaries that are increasingly likely to be using IFRS or IFRS for SMEs in the foreseeable future. IFRS adoption for statutory reporting continues in many territories. The United Kingdom is one example with a proposal to adopt IFRS for statutory purposes in 2012.
- **Identify initial steps.** Being mindful of the specific aspects of convergence and conversion that will take the longest to prepare for, and consider smaller, controlled, one-off projects and “easy wins” where desirable.

By staying focused on aspects of convergence and adoption that have a long lead time, trucking companies can stay ahead of the game. A new era of financial reporting language is approaching, and it will have a significant impact as a driver of change throughout the industry.

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