

# ***2011 US GAAP convergence & IFRS survey***

How companies are preparing  
for convergence between  
US GAAP and IFRS

April 2011

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## ***Table of contents***

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***The heart of the matter*** **3**

### ***Convergence is coming***

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***An in-depth discussion*** **7**

#### ***What executives have to say***

Overview	7
Leasing	13
Revenue recognition	20
Financial instruments	25
Adoption of IFRS in the United States	27
Systems upgrades	29

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***What this means for your business*** **31**

### ***Don't get caught by surprise***

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*The heart of the matter*

Convergence is coming

*Corporate financial reporting is in the midst of a sea change.*

Corporate financial reporting is in the midst of a sea change. The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) are pursuing a dozen joint projects with the goal of converging and improving US GAAP and international financial reporting standards (IFRS).

In 2010, the boards narrowed their focus to several high-priority projects, notably leasing, revenue recognition, and financial instruments. These projects will have a substantial impact on financial reporting and beyond. At the same time, we expect the US Securities and Exchange Commission (SEC) to make a determination about the way forward for IFRS in the US late in 2011.

To assess the views of companies about the convergence process, its likely impact, and how they are preparing for related change, PwC conducted a survey of executives in finance and other functions. This paper summarizes the survey findings.

For a more in-depth technical overview of the major convergence projects, please refer to *US GAAP convergence and IFRS: What you need to know about the FASB and IASB's joint projects*—a compendium of our current convergence publications designed to provide you with one single, customizable reference resource as you manage the potential impact of the proposed standards on your company. That, along with corresponding updates, may be accessed on a dedicated site, [www.pwc.com/us/jointprojects](http://www.pwc.com/us/jointprojects).

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### *Major themes*

A few key themes emerged from our survey:

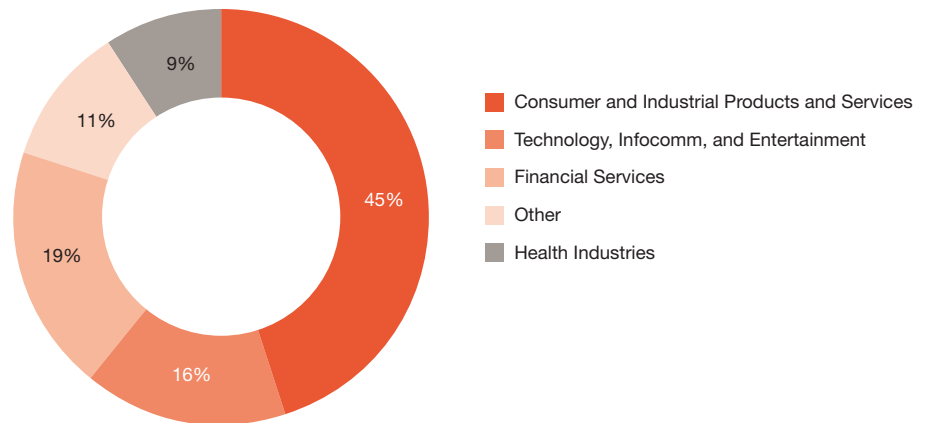
- Among respondents, the leasing project is expected to have the greatest impact.
- Revenue recognition ranks second in impact, with certain aspects of the proposed standard eliciting very strong reactions.
- Financial instruments, while not widely understood, is expected to have a significant impact on companies in all industries.
- Most companies have taken a measured approach to preparing for convergence-related changes.
- All of the convergence projects will have a major impact on companies' systems.

The rest of this paper addresses specific questions and responses, and concludes with brief recommendations.

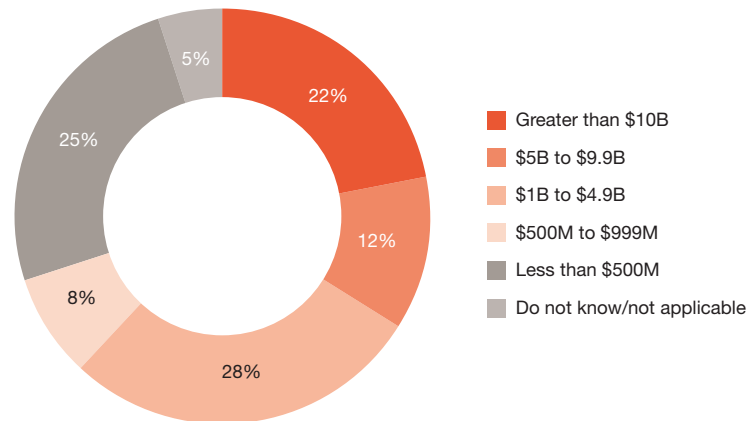
## Survey participants

PwC's online survey gathered over 1,400 responses over four weeks starting February 15, 2011. Respondents were mostly finance executives and professionals. Their companies ranged in size and industry, with almost half in consumer and industrial products and services. Some 85% were headquartered in the United States, with the majority operating internationally.

### Demographics: Industry



### Demographics: Revenue



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*An in-depth discussion*

What executives  
have to say

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## Overview

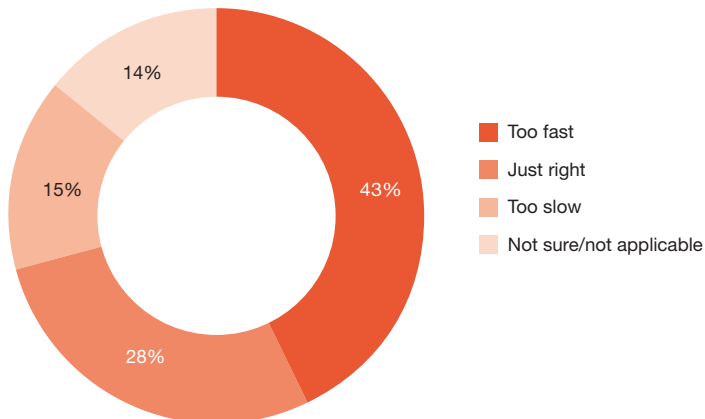
The first section of our survey included some overview questions, asking respondents for their thoughts on the overall pace of change and to gauge the expected impact of the convergence projects. We also asked respondents to rank the projects in a few key areas.

### Pace of standard setting

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#### What do you think of the pace of recent standard-setting activity?

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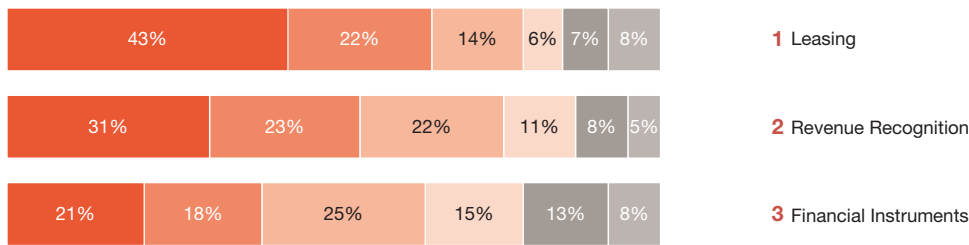


Some 43% respondents said the pace is too fast. To some extent, we were surprised that more people did not share that view; in fact, 15% thought the pace is too slow. This response may stem from recent changes reducing complexity that the FASB appears ready to approve. It may also be influenced by the expectation that the boards will allow ample time for implementation. In fact, the boards announced on April 14 that, in order to ensure high-quality standards and adequately evaluate and incorporate stakeholder feedback, they would extend the target date for completion of the priority projects from mid-2011 to the end of 2011.

*All of the projects are expected to have a pervasive impact on a large share of companies of all sizes and in all industries.*

**Overall impact—leasing vs. revenue recognition vs. financial instruments**

Rate the expected level of impact on your organization for each of the following upcoming convergence projects:

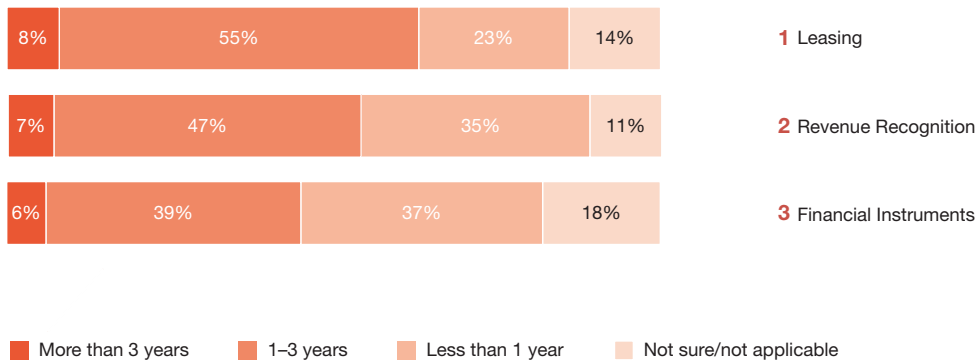


1—High   2   3   4   5—Low   Not sure/not applicable

All of the projects are expected to have a pervasive impact on a large share of companies of all sizes and in all industries. Given the nature of the proposed changes, respondents believed leasing would have the most pervasive effect. Even for financial instruments, more than half anticipated a moderate to high impact, yet in the survey demographics only 19% of respondents were in financial services—indicating an expected impact to non-financial services companies as well.

## Timing of implementation

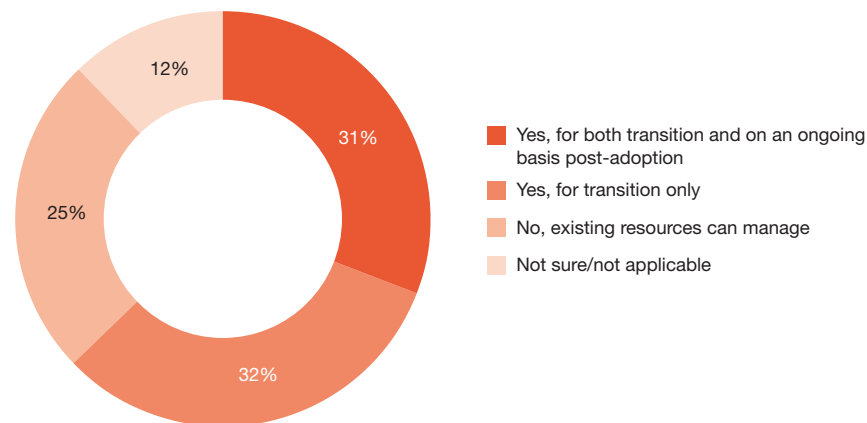
How much time do you expect it will take to implement each of the following upcoming convergence projects?



Not only will the standards impact a broad spectrum of companies, implementing them could take several years in many cases. Leasing changes, for instance, were expected to take more than one year to implement by 63% of respondents. Based on this feedback, mandatory effective dates prior to 2015 would present a challenge for some companies.

## Additional resources needed

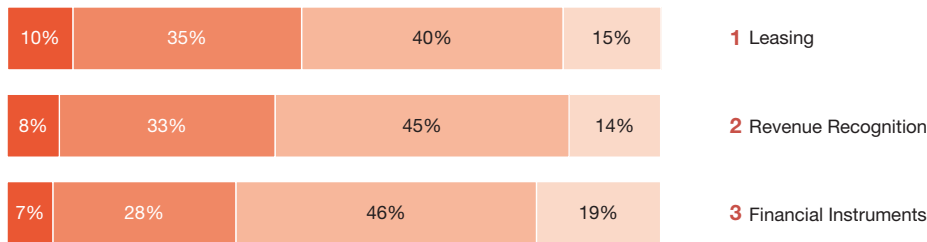
Do you believe you will need additional resources to manage the change associated with the convergence projects?



63% of respondents expected to need additional resources either for the transition only or for both transition and post-adoption, whereas just 25% thought existing resources would be able to manage. This is consistent with the anticipated impact and timing for implementation, and ties directly into our next question on companies' state of readiness.

## State of readiness

### Where is your organization in the process of analyzing the implications of the convergence projects?



- We have deployed resources and begun to actively plan for implementation
- We have performed a high-level assessment of the potential implications
- We have a general awareness of the impact
- Not sure/not applicable

For each of the projects, only 10% or fewer of respondents had deployed resources and begun active planning. Leasing, which is expected to have the most pervasive near-term impact, logically had caused the most preparation work. Most were assessing or monitoring the situation until final standards are approved. This largely aligns with our recommendations for most companies—until the final standards are released, companies should not necessarily be allocating significant time and effort to these projects. We currently recommend that most companies perform no more than a high-level assessment on the likely impacts of the leasing, revenue and financial instruments projects.

That being said, the nature of “assessments” varies significantly. In some companies, an assessment may be as simple as understanding which aspects of the proposed changes will require the most time and effort, in order to develop a plan. At the other end of the spectrum, a company may be evaluating, for one of the priority projects, where data resides, if data gaps exist, and what reach the accounting changes will have beyond the finance organization.

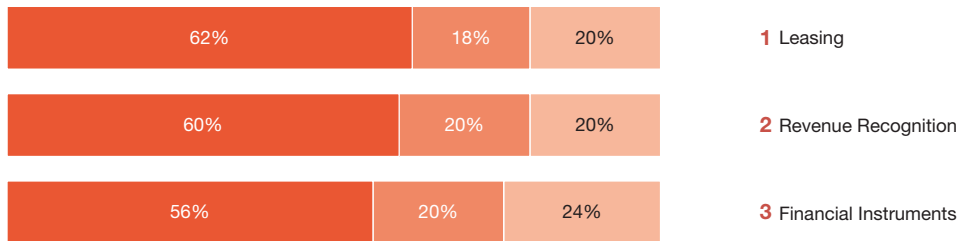
## Re-exposure is favored

Recent activity has demonstrated the boards' willingness to listen to constituent input and change their course. For example, the FASB has softened its controversial proposal to report all financial instruments at fair value. Likewise, the boards appear to be making changes that will ease complexity as they work on the revenue and leasing projects. As the boards revise their proposals, the question on the minds of many remains: will the revisions require re-exposure?

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### Do you believe the FASB should re-expose the proposed standard prior to issuance?

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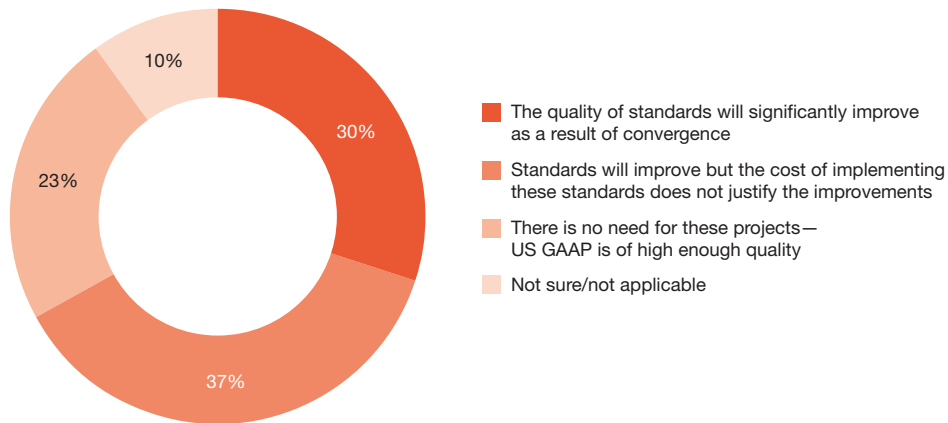


■ Yes   ■ No   ■ Not sure/not applicable

A majority of respondents wanted re-exposure on all three standards, in part because that will slow down the process. Boards generally agree to re-exposure only after a major course correction that was not anticipated in the questions asked originally, or if a proposal changes dramatically. That being said, with the timetable having been extended to the end of 2011 as opposed to mid-2011, the boards may be more inclined to re-expose all or major portions of these three standards.

## Quality and cost of the standards

The convergence projects are designed to improve the quality of US GAAP and IFRS and achieve convergence. In general do you believe?



Asking how the convergence projects would affect quality of standards elicited an interesting response: Roughly two-thirds of respondents thought the standards would be improved, while at the same time just under two-thirds thought the cost benefit was not sufficient to merit a change. While that adds up to roughly four-thirds, the key here is the overlap—where people thought quality would improve, but in short the expense is too great.

Cost is largely driven by the complexity that the proposed standards create. Many respondents believe the proposed new accounting models will be time-consuming and costly to implement. The boards have heard this message and have taken it to heart as seen in recent developments.

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## Leasing

The next section of the survey focused specifically on proposed changes in the area of leasing—how companies currently track their leasing information, analysis done to-date, and anticipated impacts to systems.

In August 2010, the FASB and IASB jointly issued an exposure draft (ED) on leases. Over 700 comment letters were submitted, and the boards have begun redeliberating the ED. In some ways, the boards have incorporated the extensive feedback received that the ED was overly complex. Thus, the boards have made tentative decisions to change some aspects of the proposals. Of course, no final decisions in these areas have yet been reached and the staff will conduct additional outreach. A final standard remains targeted for issuance in 2011.

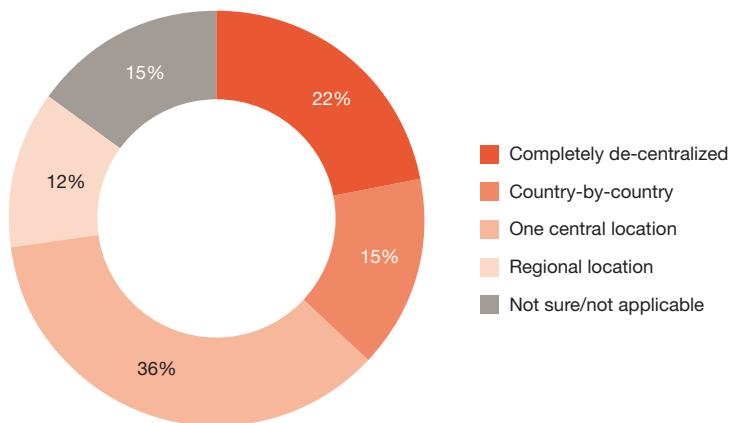
### Where's the data?

Among finance professionals, much of the stir about leasing changes comes back to data requirements. We asked respondents where information on leases resides in their companies, and what sort of systems are used to track leases.

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### Where does the information on your leases reside?

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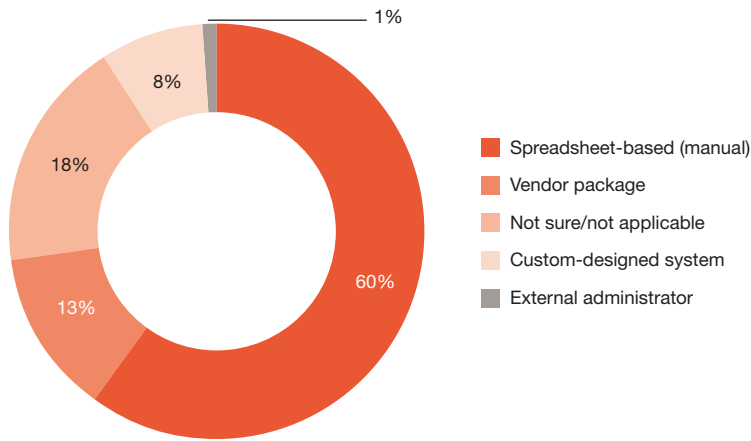
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*Ultimately many companies will need new or upgraded systems to help manage the change.*

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**What is the predominant system your organization currently uses to account for leases?**

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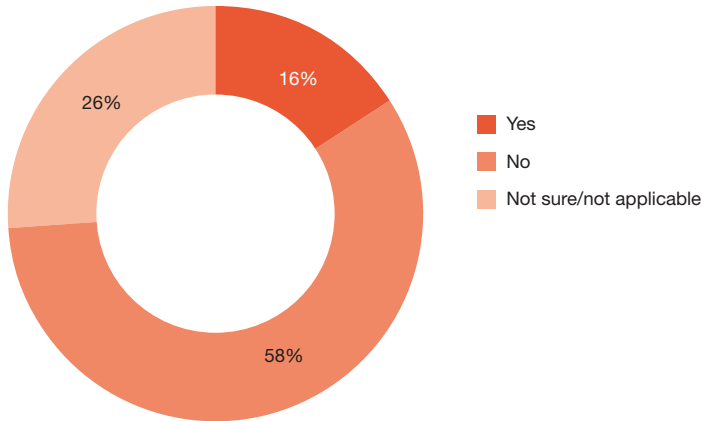


Many companies currently have decentralized leasing functions and data repositories, and track leases in spreadsheets. This combination makes for a challenging situation, one that may prove problematic in meeting the ongoing reporting requirements under the proposed new standard.

Spreadsheets tend to be an area of weak internal control—an important consideration given the shift from lease data that feeds a single financial statement note disclosure to data that feeds major line items on the balance sheet. We expect many companies will need to sharpen their focus on data access, data gaps, and data accuracy. Ultimately many companies will need new or upgraded systems to help manage the change.

## Third-party vendors

Have you had discussions with a third-party systems vendor or provider about their system's ability to meet the new standard?

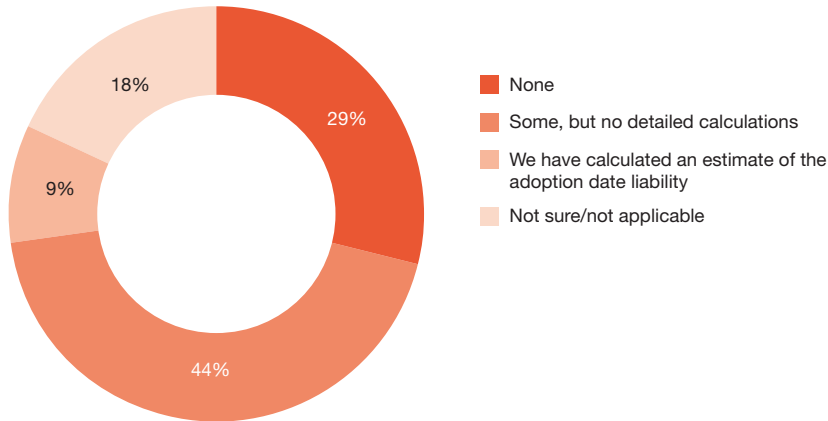


Very few respondents had talked with systems vendors at this point. That is not surprising, as most major vendors are more than a year away from having software with the ability to handle the proposed new leasing model. Moreover, the leasing deliberations have been a moving target.

That is not to say that companies should put their pencils down. While it is not necessary to rush into a new solution in the near term, companies should make sure they have a good understanding of their current system that handles leasing globally. They should know where the data in the system originates and how it is collected. Then they will be better prepared to make informed decisions on what needs to change and when—and take the appropriate steps—as soon as new solutions becomes available in the market.

## Estimating the lease liability

### How much analysis has been done to date to estimate the adoption date lease liability?

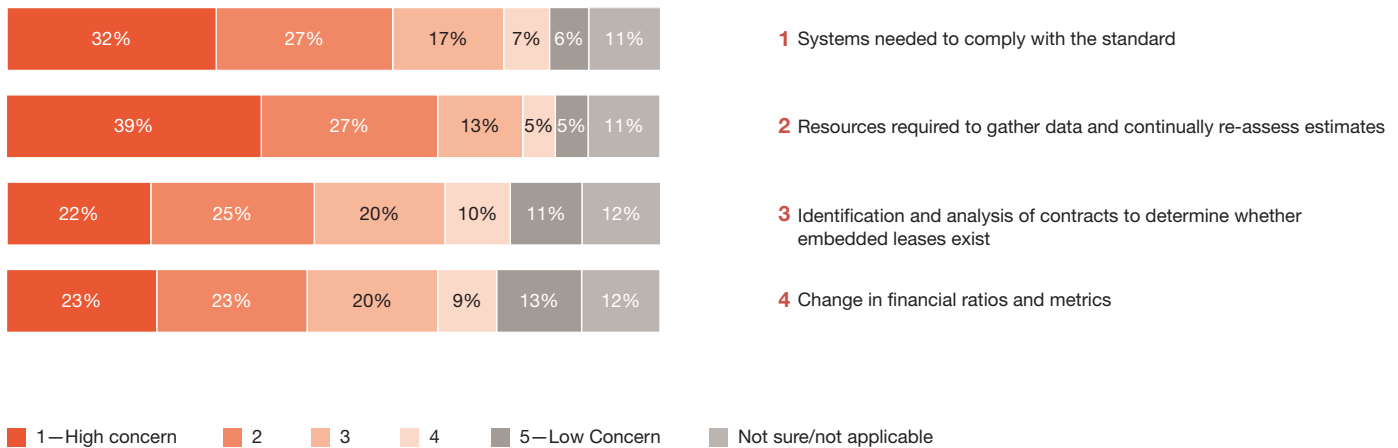


A large share of respondents, 53%, had started to address the question of what impact the proposed new leasing guidance may cause. In fact, 9% had moved that analysis to an actual estimate of liability on financial statement impacts. When the final standard is issued, more companies will likely calculate the estimated impact of the adoption date liability.

Interestingly, over 65% of the respondents that had estimated their lease liability indicated that the estimate was higher than originally expected. This may become a recurring theme, as more and more companies begin crunching numbers. That also means that analysts and credit agencies may be underestimating the quantum of the liability when adding back “debt-like” items for operating leases. Given that some of the proposed changes are softening in redeliberations, however, the actual impact may come back a bit more in line with expectations.

## Concern over implementation

Please indicate your level of concern for the following potential impacts of the leasing exposure draft.

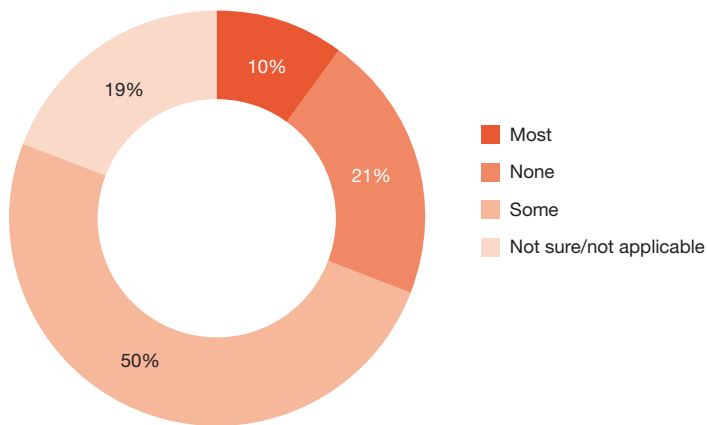


Asked about their level of concern over the difficulty of implementation, in four categories, some 60% or more of respondents had a moderate or high level of concern in each category. No surprises here—resources and systems will require the most attention.

*Key stakeholders should be kept informed as the convergence projects and related impacts unfold.*

### Stakeholder awareness

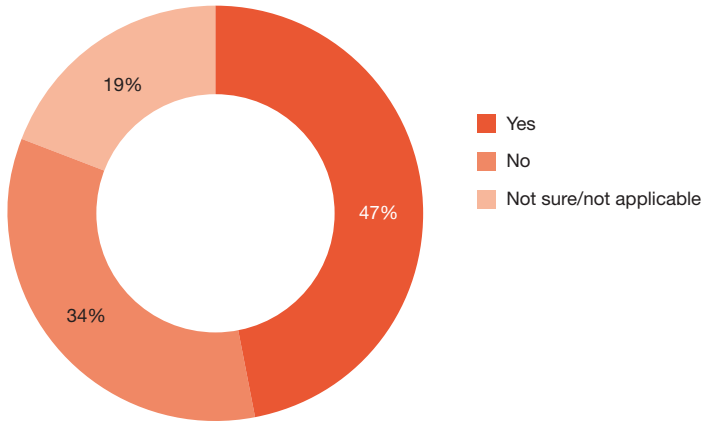
**To what extent have stakeholders outside of the finance/accounting department been educated on the proposed leasing standard?**



Stakeholders inside companies, but outside the accounting and finance departments, will need to be made aware of the changes to lease accounting. These stakeholders may include corporate real estate, treasury, operations, information/systems and legal. On one hand, there was a decent level of “some” awareness among these groups, and even 10% saying “most” have been educated. On the other hand, fully 21% said awareness has not spread outside the finance function. At a minimum, we believe that key internal stakeholders such as senior management and audit committees should be kept informed as the convergence projects and related impacts unfold. Key external stakeholders should also be a part of some companies’ communications plans.

## Inventorying the lease portfolio

Have you performed an inventory of your lease portfolio—for example, understanding what types of assets are leased and where the data resides?



Almost half of companies had taken at least a preliminary look at what types of leases exist in their portfolios, and where the data resides. A preliminary assessment benefits companies in two ways. It allows them to assess the directional impact on financial statements, and it starts to identify data gaps that may exist. That in turn helps to inform a longer-term implementation roadmap for the proposed leasing changes.

In summary, the proposed leasing guidance will have a major impact on many companies. Although the proposal is not yet final, there are steps companies can take. Preparing now for changes in data needs and identifying data gaps can result in a smoother implementation upon adoption.

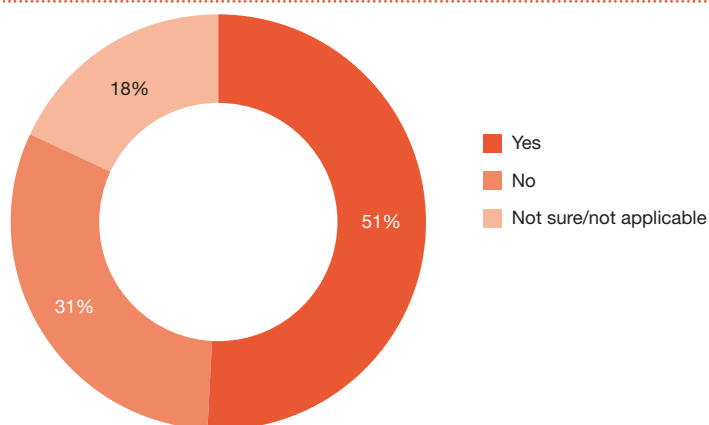
## Revenue recognition

The next section of the survey focused specifically on proposed changes in the area of revenue recognition.

After the FASB and IASB released their exposure draft on revenue recognition in 2010, they received many comments. Common concerns included the lack of clarity around the transfer of control for services, challenges in identifying and separating performance obligations, the accounting for warranties, and the model proposed for licenses of intellectual property. Concerns also surfaced about the practicality of full retrospective application (recasting financial information to prior periods). The boards have reached tentative decisions around several aspects of the proposed standard, but they continue to deliberate over other issues, with a final standard expected in 2011 and a likely effective date no earlier than 2014.

### Amount and timing of revenue recognition

Do you expect the proposed standard to impact the amount or timing of revenue recognition for your company?



Half of respondents expected this standard to have an impact on their company's amount and timing of revenue recognition. This is not surprising, given that the proposed standard will lead to a significant shift in how revenue is recognized in many circumstances. It moves away from specific measurement and recognition thresholds and removes industry-specific guidance.

*Half of respondents expect this standard to have an impact on their company's amount and timing of revenue recognition.*

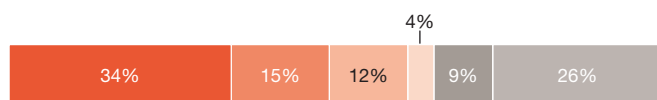
## Full retrospective application

### Full retrospective application as the only transition method option



1 Do you agree with this aspect of the revenue recognition exposure draft?

■ No ■ Yes ■ Not sure



2 Rate the relative significance of this aspect of the revenue recognition exposure draft

■ 1—High significance ■ 2 ■ 3 ■ 4 ■ 5—Low significance ■ Not sure/not applicable

Full retrospective—recasting prior period financials—provoked the greatest level of disagreement and greatest level of significance among survey respondents. Even those who agreed with full retrospective application noted that implementing the standard would require significant resources.

We understand the merit of applying the proposed requirements retrospectively to achieve consistency and comparability across periods presented, but there are a number of situations where retrospective application may be difficult to apply. Also, from companies' perspectives, it may be too costly for the benefits achieved. Companies will need to closely monitor this requirement, as it could result in significant incremental efforts in restating historical information.

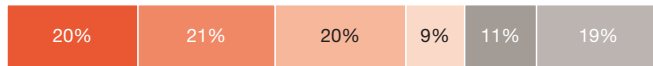
## Collection risk

### Collection risk reflected as reduction to revenue rather than bad debt



■ No    ■ Yes    ■ Not sure

1 Do you agree with this aspect of the revenue recognition exposure draft?



■ 1—High significance    ■ 2    ■ 3    ■ 4    ■ 5—Low significance    ■ Not sure/not applicable

2 Rate the relative significance of this aspect of the revenue recognition exposure draft

Collection risk reflected as a reduction to revenue was a close second in relative significance. More than half of respondents did not think that credit risk should be recorded as a reduction of revenue with subsequent changes in the assessment included in other income or expense.

PwC understands the conceptual view that a customer's credit risk should affect the measurement of revenue rather than the recognition of revenue. However, we disagree with the proposal to require subsequent changes in the assessment of credit risk in other income or expense (and not revenue).

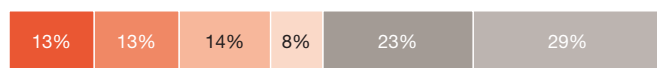
## Warranties as a deferral of revenue

### Warranties treated as a deferral of revenue rather than as a liability



1 Do you agree with this aspect of the revenue recognition exposure draft?

■ No    ■ Yes    ■ Not sure



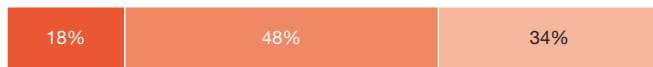
2 Rate the relative significance of this aspect of the revenue recognition exposure draft

■ 1—High significance    ■ 2    ■ 3    ■ 4    ■ 5—Low significance    ■ Not sure/not applicable

The survey showed significant disagreement with the prospect of treating warranties as a deferral of revenue rather than a liability—46% of respondents. Based on the feedback received, the boards have decided to change this aspect of the proposed model. They have tentatively decided that an entity should account for some warranties as a warranty obligation (a cost accrual, consistent with today's model), and others as a future service obligation, with revenue allocated to the unsatisfied obligation.

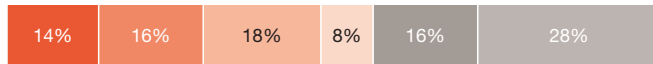
## Indicators of control transfer for services

### Indicators of control transfer for services to determine when revenue for services should be recognized



1 Do you agree with this aspect of the revenue recognition exposure draft?

■ No    ■ Yes    ■ Not sure



2 Rate the relative significance of this aspect of the revenue recognition exposure draft

■ 1—High significance    ■ 2    ■ 3    ■ 4    ■ 5—Low significance    ■ Not sure/not applicable

Many of the respondents agreed with the concept of having indicators of control transfer determine when revenue for services should be recognized, but found the guidance difficult to apply to service contracts. At the same time many anticipated that these changes would have a significant impact on their business. During the redeliberation process, the boards tentatively agreed upon new guidance for determining when to recognized revenue for services.

For many of these revenue recognition aspects, the process remains fluid and tentative decisions will be made over the next several months. Companies should keep current on the changes to understand how they could impact their business.

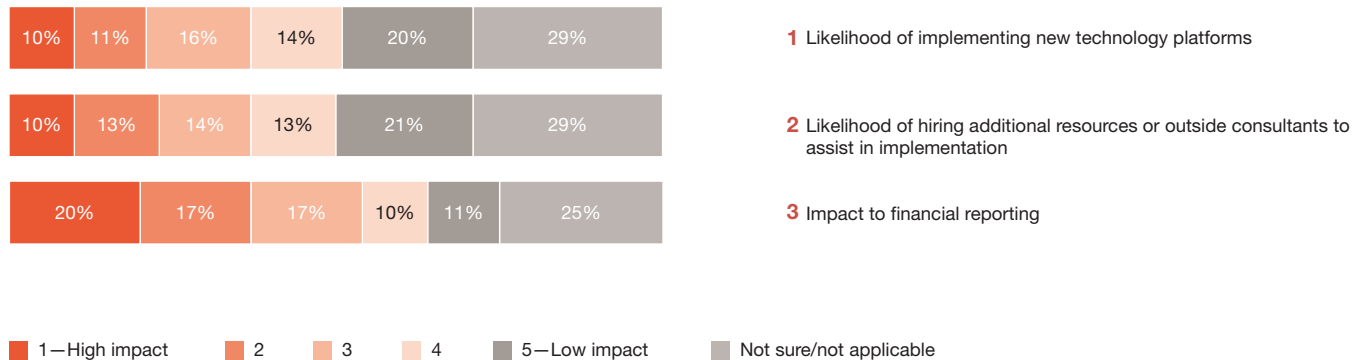
## Financial instruments

The next section of the survey focused specifically on proposed changes to financial instruments.

In May 2010, the FASB proposed changes to its standards on financial instruments accounting. That proposal included an entirely new classification and measurement model for all financial instruments, a new credit impairment model for debt instruments, and significant amendments to the guidance on hedge accounting. The FASB received over 2,800 comment letters – by far the most responses of any of the projects. The boards have since reached a number of tentative decisions in several key areas, but a great deal of unknown remains. As with the other convergence projects, stay tuned for further developments in the area of financial instruments.

### Impact on the business

In each of the following areas, please rate the likely impact the FASB financial instruments proposals will have on your business.

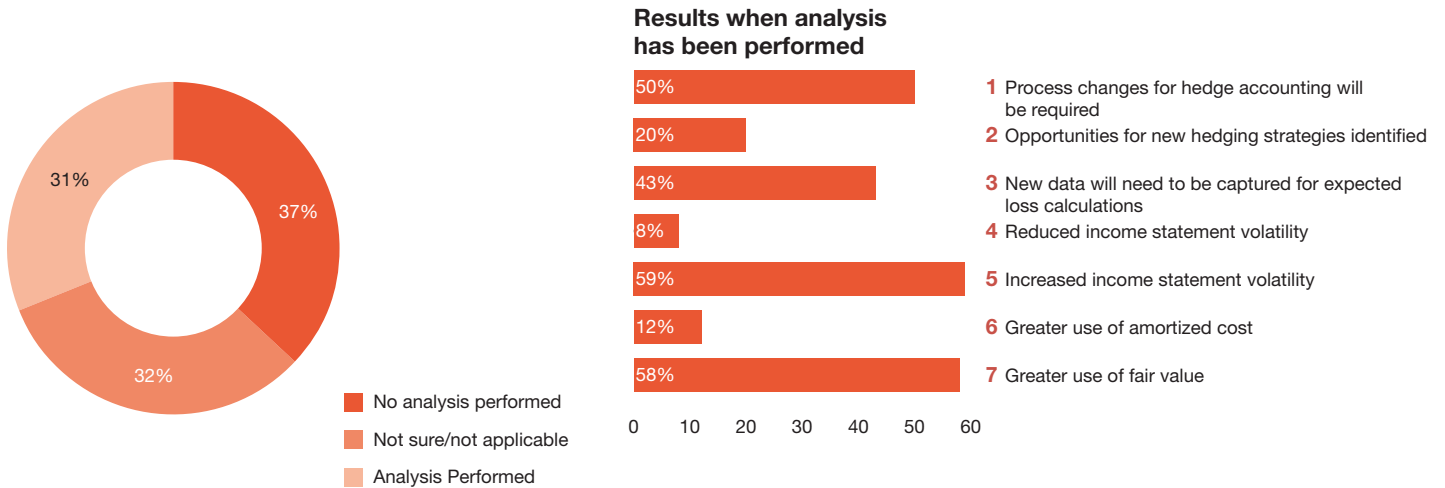


Most respondents said that the proposed standard would have a moderate to high impact on their financial reporting—not surprising given the magnitude of the changes and complexity within the standard.

But many respondents believed they can implement the proposed standard with existing personnel and technology platforms. In these two aspects, the financial instruments project differs from revenue and leasing, where many respondents believe additional resources and technology will be necessary.

## Analysis has been spotty

Has your organization performed any analysis of the likely impact of the financial instruments proposals and if so what do the results show?



Overwhelmingly, respondents have not performed an analysis regarding the impact of the financial instruments proposal on their business, or were not sure of the impact. This may be due to uncertainty as to what the final standard will look like, or simply because the financial instruments project may not be as well understood by non-financial services companies as the leasing and revenue recognition projects. Several factors come into play, including level of complexity and the expected timing of the final standard.

On the other hand, almost one-third of respondents have performed an analysis on the likely impact of the proposed financial instruments standard. The themes they identified are consistent with our expectations: greater use of fair value, increased income statement volatility, increased data needs, and required hedging strategy and process changes for hedge accounting.

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## Adoption of IFRS in the United States

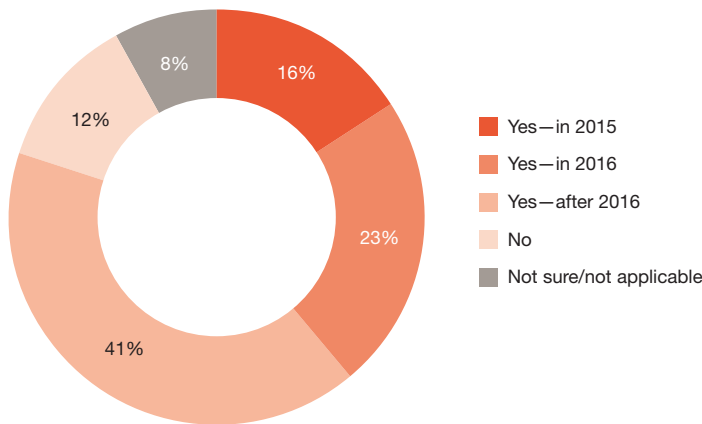
The next section of the survey focused specifically on respondents' anticipation of the future of IFRS in the US.

The SEC is expected to provide further guidance this year about whether, when, and how IFRS should be incorporated into the US financial reporting system. Regardless of what the SEC decides, IFRS is currently affecting US companies through their foreign subsidiary adoption of IFRS, and through merger and acquisition activities between US and foreign companies.

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### Do you believe IFRS will eventually be adopted in the US?

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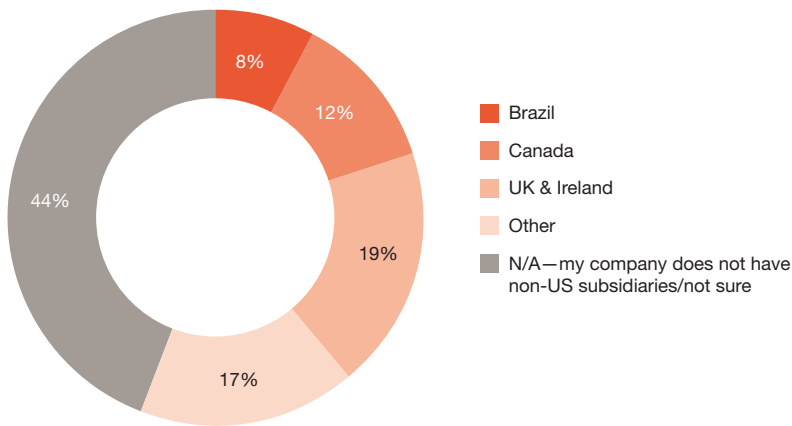
Approximately 40% of respondents said they believe IFRS will be adopted in either 2015 or 2016, and a similar share of respondents predicted adoption after 2016. Only 12% believed it would not be adopted. The dates may vary but the consensus is that adoption will occur, it is more just a matter of time, with a full 80% of respondents anticipating that IFRS will be adopted in the US at some point.

But to be clear, no matter when the SEC decides, if there are still significant differences between US and international accounting, we believe the SEC will allow for a significant transition period of at least roughly five years. That said, because of the current environment in the US, with significant governmental focus elsewhere, we are less optimistic that a mandatory date will be established as part of any decision in 2011. But if one were ultimately set, we believe the SEC would also allow some form of early adoption.

However, IFRS adoption continues elsewhere around the globe, and that continues to have an impact on US companies with international subsidiaries.

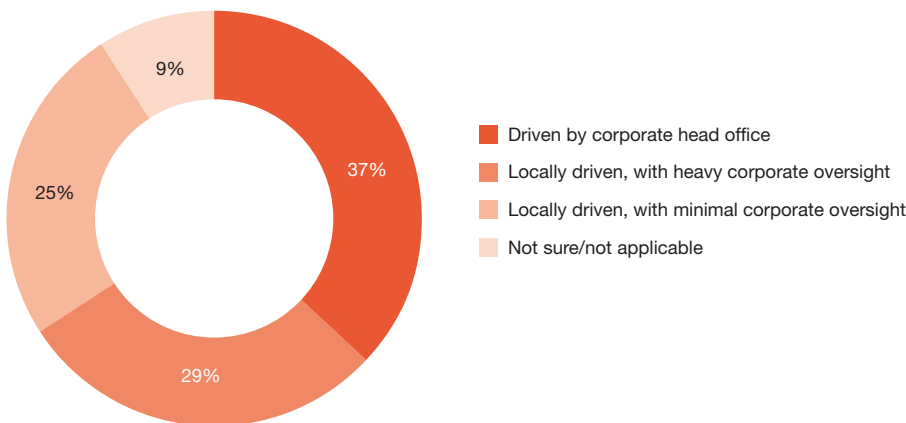
### Countries where efforts are greatest

**IFRS adoption continues elsewhere around the globe. Where are you focusing the greatest efforts with regards to IFRS?**



The chart above indicates that, of the options available, the UK and Canada were most on the minds of the respondents and their companies. This is not surprising given many US companies have significant subsidiaries in these two countries.

**How are you approaching these non-US adoption efforts?**



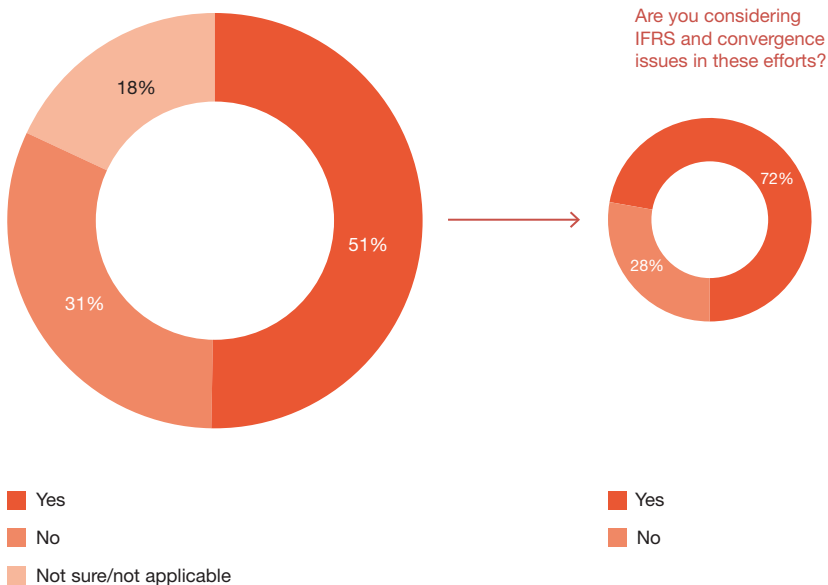
### Central or local control

Some 66% of the respondents' company efforts were either driven by the corporate head office or with heavy involvement by the center. This is reassuring, as we believe significant head office involvement is important to the conversion process.

## Systems upgrades

Implementing new accounting standards is not just an accounting matter. Both convergence and IFRS are expected to have a significant impact on systems impact. The next section of our survey focused specifically on what respondents are expecting in that regard.

**Are you currently planning any systems upgrades or implementations in the next two years, and are you considering IFRS and convergence issues in these efforts?**



Just over half of respondents said they are planning a systems upgrade in the next two years. Recent statistics outside of this survey indicate that companies have held off on major systems investments during the financial downturn, resulting in pent-up demand for systems upgrades. This would explain why these results were somewhat higher than expected.

It was encouraging to note that 72% of respondents were considering IFRS and convergence issues in future upgrades. Embedding IFRS or changes associated with convergence into technology planning is a good idea, as subsequent changes could be costly.

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*What this means for your business*

Don't get caught  
by surprise

*While the views of our survey respondents should not necessarily be construed as “best practices”, there are some key insights to be gained by comparing your company’s progress to that of the survey respondents.*

We hope these survey results have been enlightening as you consider the impact of US GAAP convergence and IFRS on your organization.

The timing and prioritization of convergence projects continues to evolve, but some of the most significant elements could be made mandatory as early as 2014 or 2015. While this seems distant, there is work to be done in advance of the effective dates given the level of change as well as the impact on comparative reporting periods. Most companies need not embark upon a full-blown adoption project right away, but there are steps that companies can take in the near term that will serve as strong building blocks for future adoption of the standards.

Each company is different, and therefore the impact of the proposed standards will differ from one company to another. Industry segment and business complexity will both play a role in determining the level of impact. As a baseline, companies should remain aware of the changes that result from the joint projects and should stay close to developments in these standards as the FASB and IASB continue their deliberations. Certainly, should your company have strong views on a topic, you might consider getting involved with the standard-setting process by responding to requests for comments or taking part in roundtable discussions and other standard-setter outreach activities.

Companies should also start to assess, at least at a high level, how the proposed changes will impact their company and form a point of view on the level of impact. Those companies that are impacted more heavily by the proposed changes should consider taking further steps to better understand the requirements and effectively begin to manage the change process.

By staying focused on aspects that have a long lead time, companies can stay ahead of the game while also pursuing small one-off projects and “easy wins” where desirable.





***To have a deeper conversation  
about how this subject may affect  
your business, please contact:***

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