

Staying ahead of IFRS challenges

Insights for pharmaceutical and life science companies



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Preparing now for change

The heart of the matter

IFRS to transform US financial reporting

Financial reporting by US companies will undergo unprecedented change over the next several years. International Financial Reporting Standards (IFRS) have already affected US-based Pharmaceutical and Life Sciences (PLS) companies. Some have encountered IFRS through their business dealings with non-US healthcare payers, providers, suppliers, or collaboration partners that use IFRS. Others have gained experience in applying the global standards through their non-US subsidiaries. Soon, as key aspects of US generally accepted accounting principles (US GAAP) and IFRS converge, financial reporting for US companies will reflect many swift and significant changes carrying wide-ranging business implications.

To keep pace, companies should prepare for challenges on several fronts:

- Increasing IFRS-US GAAP convergence
- Accelerating adoption of IFRS by non-US subsidiaries, potentially spurred by a newly tailored version for small and medium-sized companies
- Growing IFRS influence on the structure of foreign counterparties' deals and transactions as additional US trading partners adopt IFRS for capital market and statutory purposes
- Forthcoming IFRS adoption by the United States

In February 2010, the Securities and Exchange Commission (SEC) unanimously agreed to publish a statement of continued support for a single set of high-quality global accounting standards, which acknowledged that IFRS is best positioned to be the global standard. This statement described the issues and events that must occur between now and 2011, when the SEC expects to make a determination on whether or not to further incorporate IFRS into the US public markets. Continued IFRS-US GAAP convergence was a key point of focus in this determination. The SEC also reaffirmed its commitment to addressing the feedback from over 200 comment letters received on the proposed roadmap, and also to basing any move to IFRS on the best interests of US investors and markets.

The SEC said that it expects to provide public progress reports on the work plan beginning in October 2010. The Commission further stated that if it does move forward with IFRS in 2011, the transition will need adequate time, so IFRS reporting would begin no earlier than 2015.

Converge → Adopt

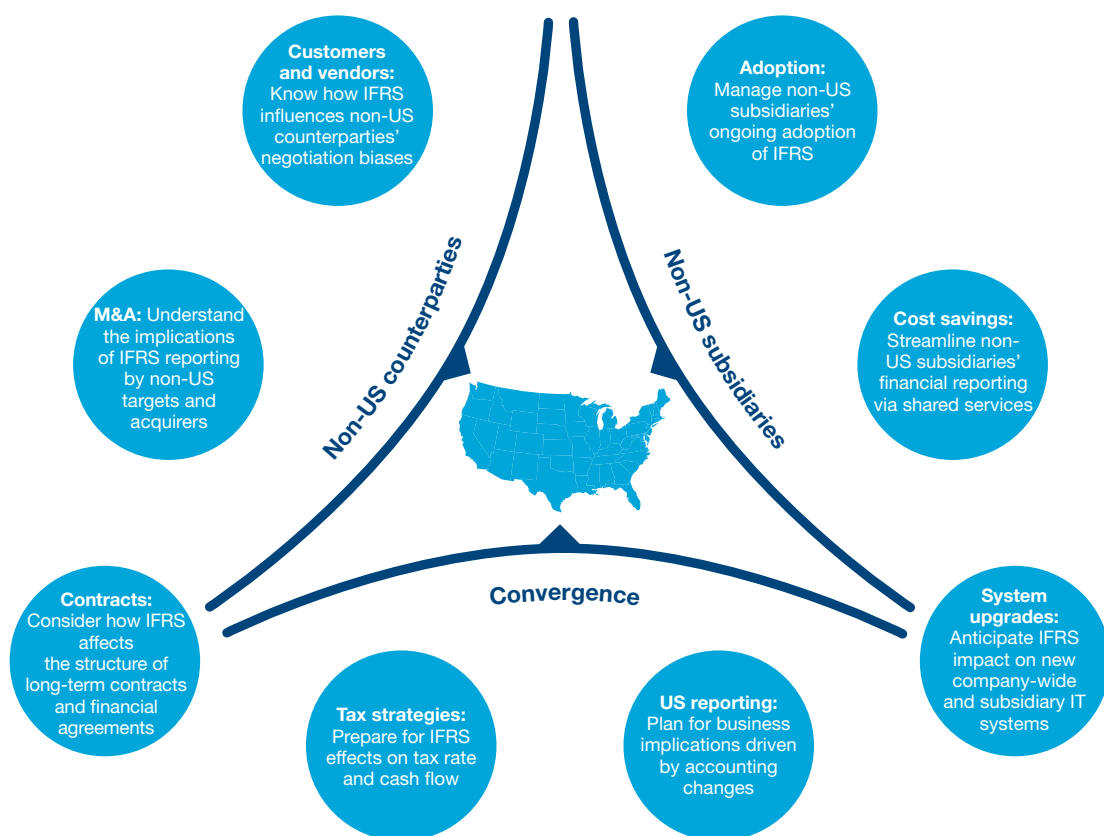
In the meantime, nearly a dozen new standards are likely to advance the convergence of US GAAP and IFRS by the end of 2011. As standards converge, many US companies and their investors will see major changes in financial statements. PLS companies should be aware that convergence will affect fundamental financial reporting components, such as debt and equity, revenue, leasing, consolidation, and financial instruments.

The consequences of these accounting changes, however, will go well beyond financial reporting. Tax policy, research collaborations, mergers and acquisitions, financial planning, systems requirements, and compensation structures are among areas that will bear the impact. Here we address these and other accounting and business challenges stemming from the move to IFRS and outline how PLS companies can begin dealing with them today.

An in-depth discussion

Examining the implications

IFRS affects US businesses in multiple ways, as illustrated below.



PLS companies are highly innovative businesses, generally requiring significant R&D over long periods. Recovering such investments involves a complex value chain that crosses multiple jurisdictions. The more significant and relevant IFRS issues are those associated with development programs, the supply chain, and tax planning. Accordingly, PLS companies should focus on the impact of converging standards and those aspects of IFRS adoption that affect long-term contracts and significant programs.

In the following pages, we detail the expected accounting differences common in the PLS sector that have aspects unique to the industry. For each area covered, we include a discussion of adoption and related business risks, with illustrative examples for the more complex topics. We have also included certain items not specific to PLS companies but whose impact is expected to be pervasive and significant. More complete coverage of accounting differences may be found in our annual *Similarities and Differences* publication.

For additional insights, we suggest you examine the results of European PLS companies that have completed the transition to IFRS. Examples include:

Bayer:	www.bayer.com
Boehringer-Ingelheim:	www.boehringer-ingelheim.com
GlaxoSmithKline:	www.gsk.com
Novartis:	www.novartis.com
Sanofi-Aventis:	www.sanofi-aventis.com

Nonfinancial assets

The guidance under US GAAP and IFRS as it relates to nonfinancial assets (e.g., intangibles and inventory) contains some striking differences that have potentially far-reaching implications. For example, the recognition and measurement of intangible assets could differ significantly under IFRS. With limited exceptions, US GAAP prohibits the capitalization of development costs, whereas development costs under IFRS are capitalized if certain criteria are met. Even in the case where US GAAP allows for the capitalization of software development costs, differences exist, depending upon whether the software is intended for internal use or for sale. Successfully navigating these differences will require coordination among several disciplines in PLS companies.

Capitalization of development costs

The potential differences between US GAAP and IFRS are as follows:

Issue	US GAAP	IFRS
PLS companies typically incur significant development costs, generally over a long period of time (e.g. through the date of obtaining regulatory approval). Additional development costs could be incurred after the initial product approval for matters such as product improvements and expansion to different markets or new indications.	PLS entities expense internal and external costs for research and development as incurred. Except for specific software projects, development costs cannot be capitalized.	<p>Development costs are required to be capitalized if all of the following can be demonstrated:</p> <ul style="list-style-type: none">• The technical feasibility of completing the asset for use or sale• The intention to complete the asset and use or sell it• The ability to use or sell the asset• The asset's probable future economic benefits and either the existence of a market or its usefulness for internal purposes• The availability of adequate technical, financial and other resources to complete the asset's development• The ability to reliably measure the expenditure attributable to the intangible asset <p>Relevant development costs include those for: line extension, introduction to new markets, third-party development of own intellectual property with buy-back options, certain costs of collaboration agreements, and development of alternative indications of an approved medication.</p>

Impact

Under IFRS, one significant barrier to capitalization is demonstrating the technical feasibility of the asset before all studies have been completed. International companies applying IFRS have generally taken the view that regulatory approval hurdles for safety and efficacy in development of a new drug or device preclude meeting the thresholds for capitalization. Accordingly, nearly all development costs through completion of the final studies supporting regulatory approval are expensed. In certain circumstances, IFRS preparers capitalize costs for approvals in secondary territories or where the approval threshold has been reduced through fast-track status.

A key factor in achieving the appropriate accounting is maintaining a robust dialogue among development, quality, marketing and finance personnel. For example, companies may possess empirical studies or have issued press releases with expected or anticipated approval dates, which could result in capitalizing prior to regulatory approval.

Enhanced transparency and communication between development, marketing and finance personnel may also facilitate management decisions surrounding development funding. Companies developing off-patent PLS products face different risks affecting their capitalization decisions. Though technical feasibility is often achievable, input from business operations on the number of expected competitors, pricing and cost will affect the determination of whether the asset will generate probable (greater than 50 percent likelihood as defined by IFRS) economic benefits. Conversely, approval of generic biologics (whether heart valves or biosimilars) currently face the same technical feasibility thresholds as the PLS innovators.

Business-wide implications

As PLS companies move to IFRS, one of the first steps is to clearly define the accounting policies and procedures for capitalizing development costs. This will help to determine the business impact. For example, some companies' historical development experience may support a determination that not capitalizing development costs is appropriate because the risk of development failure means the requirements of IAS 38 are not fulfilled. On the other hand, companies with positive approval track records may conclude that other regulatory milestones (e.g., Phase III study commencement, fast-track status, successful ANDA) meet the IAS 38 greater-than-50-percent requirement. Historical experience should be adjusted for the complexity of the compound in development.

If these determinations result in the capitalization of development costs, data requirements and collection processes must change. Data mining and planning (which can be performed before the move to IFRS) can ease the restructuring of account mapping. However, investment management and project accounting systems will need to be configured to build in multi-GAAP capabilities and track the status of development projects during the transition period to IFRS.

After moving to IFRS, schedule recurring quarterly meetings between development, marketing, quality, and finance personnel before the close to ensure all current information is considered in development capitalization or impairment decisions.

Controls surrounding the time and expense systems used to capture relevant costs might need to be updated to ensure data integrity. Management's review and approval process surrounding the nature of capitalized costs and the data-capture systems also might require modification. Further, whether the accounting systems can capture tax-deductible development costs needs to be determined to avoid the administrative burden of identifying them separately for tax reporting purposes.

Finally, companies will need to document development costs and related accounting conclusions on treatment of these costs. Such documentation should be consistent with other records used to support any R&D tax credit. A helpful by-product of the move to IFRS is the opportunity for better data gathering in support of tax authority examinations.

Interest incurred to fund development projects

Because PLS research and development projects are often cost intensive, some companies' capital structures may include debt funding, leading to interest costs. Like other development costs, IFRS requires companies to capitalize the related borrowing costs with some limitation, as the following table outlines.

Issue	US GAAP	IFRS
Further differences under capitalization of development costs may occur under IFRS because of associated interest costs.	Interest on loans received to fund research and development costs are expensed immediately. Interest can be capitalized only on assets that are constructed or otherwise produced for an enterprise's own use, or on assets intended for sale or lease that are constructed or otherwise produced as discrete projects. Development costs are not capitalizable; therefore the interest on such projects is also not capitalizable.	Borrowing costs incurred during development but before capitalization of development costs commences are expensed as they are under US GAAP. However, companies must capitalize borrowing costs directly attributable to the acquisition, construction, or production of a qualifying asset, which includes intangible assets, such as capitalized development costs. Capitalization of borrowing costs should cease when the product has been fully developed and is available for sale.

Impact

Under IFRS, the capitalization of interest costs will affect the timing of expensing of certain borrowing costs. Because these interest costs would be capitalized as part of the development-cost intangible asset, the expense would be recognized later, and the income statement classification would be an operating interest expense.

Business-wide implications

When funding development projects through borrowing, systems or manual calculations will need to be developed to appropriately capture the interest to be capitalized. Further, the change in timing and classification of interest costs will affect several metrics and rates, such as EBIT. Under US tax law, interest costs cannot be capitalized unless they are attributable to the production of designated property under §263A(f). Book-tax differences will arise therefore if items that are not qualified assets under US tax laws are required to be capitalized under IFRS.

Pre-launch inventory

Differences in timing of capitalization of inventory as well as treatment of write-downs and subsequent reversals may lead to significant differences between US GAAP and IFRS.

Issue	US GAAP	IFRS
In preparation for commercial product launch, PLS companies typically start purchasing inventory components and manufacturing product prior to obtaining regulatory approval.	Inventory costs should be capitalized to the extent recovery is probable and, therefore, qualifies as an asset. Judgment should be applied in determining the probability of the future economic benefit from inventory purchased or created prior to receiving regulatory approval. Inventory with no alternative future use should be expensed.	As with US GAAP, inventory for which recovery is probable should be capitalized. Such conclusions must be consistent with the preparer's determination of whether to capitalize internal development costs.
Companies are required to evaluate the carrying amount of capitalized inventory on a periodic basis. Write-downs in the PLS industry generally result from factors such as patent expiration, product redesigns, inventory expiration, market entrance of a similar product, changes in medical treatments, advances in medicine, product recalls or changes, or anticipated changes in third-party reimbursement policies.	After inventory is written down to the lower of cost or market, its value is not written up in the accounting records in future periods.	Additionally, in each period, a new assessment of net realizable value must be made. When the circumstances that caused the initial write-down have changed (e.g. subsequent regulatory approval), the write-down is reversed.

Impact

Companies may experience greater earnings volatility under IFRS because of subsequent recoveries of inventory write-downs. There are no alternatives with respect to this accounting principle.

Business-wide implications

Under IFRS, capitalized pre-launch inventory values are assessed each period, resulting in potential write-downs or reversals from previous periods. The company's accounting policy manual must clearly define the criteria used to determine capitalization, write-downs, and recoveries. This determination must be consistent with that for the company's treatment of capitalization of development costs. To comply with these policies, the company must be able to accurately track write-offs and maintain data for reassessing period-to-period value changes. As a result, management will have to assess and update, as needed, relevant information systems. At the same time, new controls may be required to track subsequent recoveries in value and prevent the amounts capitalized from exceeding those previously written off.

Sale of validation batches

Production of product in connection with a new plant or production line results in very different treatment under US GAAP and IFRS when this product is ultimately sold.

Issue	US GAAP	IFRS
PLS companies often produce product to validate a plant or production line and may be able to subsequently sell the product. Although US GAAP and IFRS permit the capitalization of such costs under certain circumstances, the treatment and recognition of the subsequent sale of validation batches differs.	Property, plant and equipment (PP&E) should be recorded at historical cost, which is the amount of cash or its equivalent paid to acquire an asset and includes directly attributable expenditures incurred in acquiring the equipment and preparing it for use. If validation batches are not salable, the cost thereof is included as part of the cost to ready the assets for their intended use. If, however, the validation batches are salable, their cost should be capitalized in inventory and subsequently recorded as cost when sold, resulting in gross revenue and cost of sales recognition.	Costs intended to be capitalized as PP&E include costs of testing whether the asset is functioning properly after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition. Accordingly, a gain relating to PP&E validation as a result of selling the validation batches would be accounted for as a reduction of the PP&E cost. Such reductions to the cost basis are appropriate only before the equipment is initially placed into service. Validation of a second-generation compound on existing equipment would not affect the cost basis of that equipment. They would be treated similarly to validation batches under US GAAP and capitalized in inventory if salable and subsequently recorded as revenue and cost of sales.

Impact

The sales proceeds from validation batches on PP&E, if any, will be treated as a reduction to property, plant, and equipment, not as a third-party sale under IFRS.

Business-wide implications

In addition to updating accounting policy manuals to reflect changes for IFRS, PLS companies will need to develop a process to track validation batch sales separately and reduce the cost of PP&E as such sales are made. As with previous asset discussions, management should assess information systems and make any necessary changes so that they accurately process these changes in PP&E carrying value and the prospective impact on depreciation expense.

The heightened potential for impairment and reversals of impairment may create greater earnings volatility under IFRS.

Revenue Recognition

Revenue arrangements in the PLS industry are often complex. They can cover the sale of products and services or collaborative arrangements that involve licensing of intellectual property and product development rights, manufacturing obligations, and commercialization activities. Accounting can be challenging because agreements tend to be unique and encompass a variety of deliverables.

PwC's recent publication, *The science of change: How will proposed changes in revenue recognition impact your company?* addresses recent changes to US GAAP standards for multiple-deliverable revenue arrangements. This publication focuses on similarities and differences between the new US GAAP standards and IFRS.

Unless a company adopts the new US GAAP standards on a retrospective basis, an entity may still have deferred revenue balances related to transactions accounted for under the previous multiple-deliverable revenue arrangement rules upon IFRS adoption. In such circumstances, the deferred revenue may be permanently lost if it did not meet the definition of a liability under IFRS at the transition date.

A joint revenue recognition project of the FASB and IASB resulted in a December 2008 discussion paper that addressed weaknesses in current guidance. The paper provided more extensive guidance on multiple-element arrangements and was aimed at resolving existing inconsistencies with the vast guidance provided under US GAAP. The proposed guidance may eliminate many of the differences noted below. For example, percentage-of-completion accounting is likely to be precluded if customers do not control the partially completed asset. When finalized, this guidance could also result in new industry revenue recognition models.

Multiple-deliverable revenue arrangements—separation and allocation

PLS entities frequently enter into complex multiple-element arrangements. For example, a license and development collaboration agreement might include the licensing of technology, research and development services, manufacturing services, and other deliverables, such as steering committee participation. Consideration might also be complex, coming in the form of an up-front fee, cost reimbursement, future milestone payments and/or royalty payments on product sales. Such agreements often last many years over the different phases of a product's life cycle.

Issue	US GAAP	IFRS
<p>Although recent changes have narrowed the gap between IFRS and US GAAP with respect to the separation based on estimates, differences still exist around the allocation of arrangement consideration of deliverables and the requirement for standalone value of delivered items.</p>	<p>The separation and allocation of consideration to multiple-element arrangements requires that:</p> <ul style="list-style-type: none"> • A delivered item have value to the customer on a standalone basis, and • If the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item is considered probable and substantially in the control of the vendor. <p>Allocation of the arrangement consideration to each element is based on a relative selling price. A hierarchy exists for determining selling price. An entity should use vendor-specific objective evidence (VSOE) if it exists. If not, an entity should use third-party evidence (TPE). If neither VSOE nor TPE is available, an entity should use its best estimate of the selling price for each element.</p> <p>Use of the residual method is no longer permitted (except for software transactions).</p>	<p>Revenue recognition criteria are usually applied separately to each transaction as a whole. In certain circumstances, however, it is necessary to separate a transaction into identifiable components to reflect the substance of the transaction.</p> <p>The separation and allocation of consideration for multiple elements is based on fair value. The determination of fair value does not require the use of a hierarchy. Methods to determine fair value include the value when sold separately, the market price of a similar product or service sold by a competitor, or an estimate of the future costs of supplying the product or service plus a reasonable standard margin.</p> <p>Use of the residual method to determine the fair value of a delivered element is permitted.</p>

Up-front and milestone payments

The multiple-element arrangements discussed above often include up-front and milestone payments as consideration to the seller.

Issue	US GAAP	IFRS
While some approaches for recognizing the up-front and milestone payments under US GAAP may yield similar revenue recognition results as compared to IFRS, differences between the acceptable methods under US GAAP and IFRS exist.	<p>Four acceptable methods may be used to account for up-front and milestone payments:</p> <ul style="list-style-type: none">• Milestone method. This provides for recognition of the milestone payment upon receipt. It is appropriate when the milestone payment is substantive and represents the culmination of a separate earnings process (e.g., completing Phase III clinical trials). Any up-front payment would still need to be spread over the entire arrangement when the payment was received and no separate earnings process has been completed.• Proportional performance method. Revenue is recognized in an amount equal to the lesser of (a) the amount due under the contract, or (b) an amount based on proportional performance to date.• Contingency-adjusted performance method. Revenue related to each payment is recognized over the contract's performance period, starting with commencement of the contract, but not	<p>Accounting for up-front and milestone payments is as follows:</p> <ul style="list-style-type: none">• Up-front payments that have been received without the provision of goods or services should be deferred and recognized over the relevant contract period. They should be recognized on a basis that is consistent with the services delivered over the contact period.• Contracts in which milestone payments are received in return for performing a service should be accounted for using the percentage-of-completion method. However the associated service fees are generally only payable in the event of a successful outcome. If the fee is entirely success-based, it is unlikely that an entity will be able to assert that it is probable that economic benefits will flow to the entity and that the costs incurred to date will be recoverable. Therefore, no revenue would be

Issue	US GAAP	IFRS
	<p data-bbox="841 493 1149 1123">before the removal of any contingencies for each milestone. This is similar to the proportional performance model, except it cannot be applied to amounts subject to a future milestone trigger or other contingency. Both models require the ability to estimate the total service to be provided. Additionally, the estimate of performance should be based on outputs unless a cost model can be asserted to represent the pattern of performance.</p> <ul data-bbox="812 1144 1136 1587" style="list-style-type: none"> <li data-bbox="812 1144 1136 1587">• Contract-term deferral method. This method treats all payments as up-front payments and the amounts received for achievement of the milestones are deferred and amortized from the achievement of the milestone to the end of the contract. This model is less preferable to the prior three, and its use is extremely limited. 	<p data-bbox="1214 493 1502 966">recognized until the milestones were completed. This type of revenue recognition is often referred to as the “milestone payment method.” Milestone payments not made in exchange for services and not deemed to be substantive should be recorded as deferred consideration and recognized over the remaining contract term.</p>

Service transactions

Many PLS companies provide services such as high-throughput screening, synthesis of chemical libraries, evaluation of drug candidates, and analytical services. Under these arrangements, the service provider may not be exposed to any development risk in the form of success-based milestones or other contingent fees.

Issue	US GAAP	IFRS
<p>US GAAP and IFRS require different methods for recognition of revenue from service arrangements. In certain circumstances, however, the application of the two methods may not have significantly different results.</p>	<p>Unless they fall within the scope of construction- or production-type contracts, revenue from service transactions should be recognized under one of two methods:</p> <ul style="list-style-type: none"> • Proportional performance • Completed performance • 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. When the proportional performance model is utilized, performance must be based on “output” measures and not input measures, such as costs incurred to date, unless the cost incurred is a reasonable representation of an output measure. 	<p>The percentage-of-completion method is required for service arrangements.</p> <p>The stage of completion of a transaction may be determined by a variety of methods, including input-based methods. An enterprise should use the method that reliably measures the services performed. Depending on the nature of the transaction, the methods may include:</p> <ul style="list-style-type: none"> • Surveys of work performed • Services performed to date as a percentage of total services to be performed • The proportion that costs incurred to date bear to the estimated total costs of the transaction <p>Factors to consider when selecting an inputs-or outputs-based model include:</p> <ul style="list-style-type: none"> • Whether the company has the right to receive payment based on costs incurred • Whether incurring costs represent revenue generating activities

Issue	US GAAP	IFRS
	<ul style="list-style-type: none"> <li data-bbox="797 552 1154 905">• If the services to be performed occur evenly over time, the service provider may use a “straight-line method” to recognize revenues under the arrangement, provided a more discernable pattern of performance is not available. <li data-bbox="797 915 1154 1136">• When the service falls within the scope of construction- and production-type contracts accounting, a percentage of completion approach can be used. 	<ul style="list-style-type: none"> <li data-bbox="1154 552 1520 905">• Whether costs are an integral part of the revenue-generating activities, are incidental, are incurred prior to performing specific service activities similar in nature to an operating/ start-up cost, or are akin to inventory or a prepaid asset <p data-bbox="1154 915 1520 1461">For practical purposes, when services are performed by an indeterminate number of acts over a specified period of time (for example, maintenance contracts), revenue is recognized on a straight-line basis over the specified period unless another method better reflects the stage of completion. When a specific act is more significant than any other acts, revenue recognition is postponed until the significant act is executed.</p> <p data-bbox="1154 1472 1520 1734">When the outcome of the transaction cannot be estimated reliably, revenue should be recognized only based upon expenses incurred and when such expenses are recoverable, using a zero-profit method.</p> <p data-bbox="1154 1745 1520 1837">IFRS does not permit the use of a contract-term deferral model.</p>

Example

A biotech company provides research services for a pharma company using its proprietary database technology to identify compounds that could be potential lead candidates for future development. The research period is two years, and the biotech company receives \$500,000 per quarter in exchange for research services. The services are on a best-efforts basis, and the biotech company will not refund or forfeit any portion of the fee if the compounds are not successful candidates for further development. The biotech company expects that it will deliver 10 compounds to the pharma company on a quarterly basis.

The biotech company estimates that cost to perform the research services will be \$1.3 million. Actual cost incurred is \$700,000 for year 1 and \$600,000 for year 2.

The revenue would be recognized as follows:

US GAAP

The biotech company will recognize revenue under the proportional performance method using the number of compounds delivered as the measure of performance. Accordingly the biotech company will recognize revenue of \$2 million in each year.

IFRS

The biotech company may use an output-based model comparable to US GAAP. However, it also commonly recognizes revenue under the percentage-of-completion method using actual cost incurred as the measure of percentage completed. Accordingly, the biotech company will recognize revenue of \$2.16 million (54 percent of \$4 million) in year 1 and \$1.84 million (46 percent of \$4 million) in year 2.

Consideration paid to customers

Companies in the PLS industry often enter into arrangements with customers, such as doctors and hospitals, where, for a fee, they receive information on the use of their products and/or post-operative patient recoveries. Obtaining such information from someone other than the doctors who perform the procedures or manage the post-operative care generally is not feasible.

Issue	US GAAP	IFRS
<p>US GAAP presumes that payments to customers are a reduction of revenue unless certain criteria are met. IFRS does not include specific guidance related to such classification. However, its general principle is that such payments should be classified based on the substance of the transaction.</p>	<p>The reduction-of-revenue rebuttable presumption can be overcome if:</p> <ul style="list-style-type: none"> • The vendor receives a separable benefit that could be obtained from someone other than the customer; and • The fair value of the benefit can be reasonably estimated. <p>To meet the first condition, the identified benefit must be sufficiently separable from the customer’s purchase of the vendor’s products such that the vendor could have entered into an exchange transaction with a party other than a purchaser of its products. This condition is typically difficult to satisfy in the PLS industry because it is rarely feasible to receive the benefit from someone other than the purchaser of the vendor’s products. Consequently, these payments are generally recorded as a reduction of revenue.</p>	<p>As with US GAAP, payment by the vendor needs to be reflected based on the substance of the transaction. However, IFRS does not include the requirement that a separable benefit could be provided by someone other than the customer. In most cases, the treatment would be the same under US GAAP and IFRS. However, based on the specific facts and circumstances, some payments to doctors and hospitals could be classified as an expense under IFRS rather than an offset to revenue.</p>

Business-wide implications

As with the other areas previously addressed, the implications of revenue recognition under IFRS go beyond changes in accounting. There will likely be a need to modify existing systems managing relevant data. For instance, moving to an inputs-based revenue model will require that systems accurately track the information necessary to support the accounting estimates. Similarly, because some revenue models require greater estimation, new internal controls will likely need to be designed to mitigate the inherent risk. Contract management also may be affected. For example, long-term contracts might carry over into IFRS transition years, requiring careful evaluation of relevant obligations under the contracts.

Income Taxes

The move to IFRS has broad tax implications for a PLS company, potentially affecting global cash-tax obligations, international tax planning, and underlying systems, processes, and controls. The book financial accounting aspects of IFRS have myriad tax considerations. Accordingly, tax executives are an essential part of the IFRS conversion process. Proper assessment of the tax impact of each potential accounting change requires not only insight into the applicable tax rules and regulations in various tax jurisdictions, but also knowledge of the detailed differences between US GAAP, IFRS, and, where applicable, local statutory accounting.

Unrealized intra-group profits

Issue	US GAAP	IFRS
PLS companies frequently take advantage of global capabilities with research, manufacturing, and distribution in different jurisdictions. This can result in complex internal supply chains with intra-group transfers of API, finished products, or intellectual property. The two frameworks require different accounting for the tax on unrealized intra-group activity.	The buyer is prohibited from recognizing deferred taxes on unrealized intra-group profits. For intercompany sales, any tax impacts to the seller are deferred and realized upon the ultimate third-party sale.	Deferred taxes on intra-group profits are recognized at the buyer's tax rate. Any tax impacts to the seller as a result of the intercompany transaction are recognized as incurred.

Impact

IFRS results in a deferred tax impact at the time of transfer, which is not recorded under US GAAP. Companies will need to modify their tracking of intra-group transaction tax impacts. Changes to both the IFRS opening balance sheet and the annual effective rate calculation should be expected.

Example

The following example demonstrates the deferred tax consequences of an intra-group transfer of intellectual property:

- Subsidiary A (Sub-A) and Subsidiary B (Sub-B) are owned by Company C.
- Assume Sub-A transfers a product license to Sub-B for \$100.
- Assume Sub-A and Company C have zero book and tax basis in the product license.
- Sub-A has a tax rate of 10 percent, and Sub-B has a tax rate of 40 percent.
- The asset has a 10-year useful life for book and tax purposes in Sub-B's jurisdiction.

Analysis

Company C and Sub-A have zero book and tax basis in the product license. After the transfer, Sub-B has a tax basis in the product license of \$100, but a consolidated book basis of zero, as the value is eliminated in consolidation. Sub-A generated a gain of \$100 as a result of the sale, which is also eliminated in consolidation.

	US GAAP		IFRS	
Tax entries in the period the transfer occurred				
Sub-A's current tax treatment for this transfer is consistent between IFRS and US GAAP, recognizing the tax charge for the gain on sale.	Dr. Current tax expense	\$10	Dr. Current tax expense	\$10
	Cr. Income tax payable	\$10	Cr. Income tax payable	\$10
	<i>To record income tax expense for Sub-A's gain of \$100 on the product license sale at its tax rate of 10%.</i>		<i>To record income tax expense for Sub-A's gain of \$100 on the product license sale at its tax rate of 10%.</i>	
Differences arise in the consolidation tax accounting. Under US GAAP, the eliminating entry defers the subsidiary tax effects. Under IFRS, the eliminating entry recognizes the basis difference between the consolidated book value of the product license and its tax basis in Sub-B's jurisdiction at the Sub-B tax rate.	Dr. Deferred charge	\$10	Dr. Deferred tax asset	\$40
	Cr. Current tax expense	\$10	Cr. Deferred tax benefit	\$40
	<i>To defer the tax impact of Sub-A's \$100 gain on the sale of the product license at its tax rate of 10%.</i>		<i>To recognize a deferred tax asset, as the tax basis exceeds the consolidated book basis by \$100. The deferred tax asset and related deferred tax benefit of \$40 is recognized at the Sub-B tax rate of 40% as the product license is held in this taxing jurisdiction.</i>	
Tax entries in the periods after the transfer occurred				
Sub-B's subsequent annual current tax treatment is consistent between IFRS and US GAAP, recognizing the current tax benefit for amortization of the product license.	Dr. Income tax payable	\$4	Dr. Income tax payable	\$4
	Cr. Current tax benefit	\$4	Cr. Current tax benefit	\$4
	<i>To record the income tax benefit of product license amortization over the 10-year useful life for tax purposes at the Sub-B rate of 40%.</i>		<i>To record the income tax benefit of product license amortization over the 10-year useful life for tax purposes at the Sub-B rate of 40%.</i>	
Once again, differences arise in the eliminating entries. Under US GAAP, the deferred charge is released as the product license is amortized. Under IFRS, the deferred tax asset is realized over this period.	Dr. Current tax expense	\$1	Dr. Deferred Tax Expense	\$4
	Cr. Deferred charge	\$1	Cr. Deferred Tax Asset	\$4
	<i>To recognize the deferred tax charge as the product license is amortized (\$10 deferral divided by 10-year life).</i>		<i>To recognize a reduction in the deferred tax asset, as tax amortization reduces the difference between tax and consolidated book basis. This is also calculated as 40% of the annual tax amortization of \$10. Note: This offsets the current tax benefit over the amortization period.</i>	

Over the term of the transactions, the income statement impact is the same, only the timing is different. The table below summarizes the consolidated tax expense recorded, demonstrating the timing difference in treatment of the tax impacts from this transaction.

Period	(Income) / Exp.	
	IFRS	US GAAP
Day One	\$(30)	\$ 0
Total of Periods 1 through 10	\$ 0	\$(30)

As this table demonstrates, the IFRS treatment recognizes the tax benefit of the product license transfer in the period in which the transfer occurred, whereas US GAAP recognizes the benefit over the use of the asset.

Business-wide implications

PLS companies must be prepared as they address intra-group profits under IFRS. For example, recorded tax assets could change significantly based upon assessed differences in assets transferred cross-border at the receiving location's balance sheet date. For enterprises with significant fluctuations in inventory levels between periods or significant property transfers, this difference could also affect the effective tax rate. This potential variability in taxes may further encourage companies to manage the amount of inventory in their vertical supply chain, benefiting working capital management and the related tax accounting. Additionally, the changes that come with IFRS might require recasting transfer pricing documentation and agreements with tax authorities and tax rulings that were based on US GAAP or local statutory accounting into IFRS.

The potential variability in reported income tax expense from intra-group transactions may encourage companies to more actively manage their vertical supply chains, benefiting working capital and the related tax accounting.

Share-based compensation

To attract, retain, and motivate employees, many PLS companies use share-based payments as a component of their compensation programs. While the FASB and IASB have made progress toward convergence in this area, a number of significant differences between the two frameworks remain. Upon adoption of IFRS, these differences could affect reported earnings, analyst estimates and projections, a company's effective tax rate, financial statement classification, and cash flows.

Graded vesting

Issue	US GAAP	IFRS
The vesting process is an important component of share-based compensation arrangements. Different approaches to the accounting have evolved over time in the United States, whereas IFRS allows only one approach.	Companies have a policy choice. Expense recognition for share-based payment awards with only service conditions and graded vesting schedules can be recognized over the requisite service period for each tranche of the award (accelerated method) or on a straight-line basis over the life of the entire award. Companies also have an option to value the award as a single award or to value the individual tranches separately.	Each installment of a graded vesting award is required to be treated as a separate grant. This requires separately measuring and attributing expense to each tranche of the award, thereby accelerating the overall expense recognition and likely resulting in a different total expense to be recognized. Entities are also required to separately value the four tranches individually vesting at the end of each year. This will normally result in a different total expense determination versus valuing the four tranches as a single award.

Impact

Companies that grant awards with only service conditions and graded vesting (e.g., where 25 percent of the awards vest in full each year over four years) may encounter accelerated expense recognition. The impact may be substantial, so some companies may want to consider redesigning the structure of their share-based payment plans. Given the long-term nature of equity compensation plans, companies should consider implications of decisions they make now in setting up these plans under both accounting frameworks.

Example

The following table illustrates the difference in expense recognition between an award with annual vesting over a four-year period under US GAAP and IFRS:

	US GAAP	IFRS*
Year One	25%	52%
Year Two	25%	27%
Year Three	25%	15%
Year Four	25%	6%

*Detailed computation of IFRS attribution:

	Year One	Year Two	Year Three	Year Four
Tranche 1	100%	0%	0%	0%
Tranche 2	50%	50%	0%	0%
Tranche 3	33%	33%	33%	0%
Tranche 4	25%	25%	25%	25%
Total	52%	27%	15%	6%

As the table demonstrates, companies under IFRS will incur much greater stock-based compensation expense in the earlier years of individual awards with service conditions and graded vesting.

Deferred taxes on share-based payments

The treatment of deferred taxes related to share-based payments is also an area of significant difference between US GAAP and IFRS.

Issue	US GAAP	IFRS
Prior to exercise or expiration, the two frameworks take different approaches to valuing deferred tax benefits from option awards. US GAAP simplifies the bookkeeping by linking back to the book expense recognized. IFRS uses a mark-to-market approach, which requires more detailed tracking by award and jurisdiction.	Deferred tax benefits are recorded for share-based payment awards that are expected to be deductible for tax purposes (such as nonqualified stock options in the United States). The amount of deferred tax benefit recorded is based on the amount of book compensation expense recorded for the share award. This benefit is recognized even if the award has no intrinsic value.	Deferred tax benefits are recognized in income only for those awards that currently have an intrinsic value that would be deductible for tax purposes. Valuation of the deferred tax asset is revisited at each reporting period. Adjustments to the deferred tax asset balance are recorded, within limits, through earnings.

Issue	US GAAP	IFRS
Upon exercise or expiration, the accounting converges, except that US GAAP allows offsetting of the tax benefits and expenses cumulatively in the “windfall tax pool.”	The accounting remains largely stagnant, regardless of share price movements, until the award is exercised or expires. At this point, the difference between the actual tax deduction related to the award and the tax benefit is generally recorded through equity (subject to certain limitations, windfall tax pools, etc.).	Application of this model results in greater variability of income tax expense/benefit recorded within the income tax provision and therefore greater volatility to a company’s effective tax rate. The windfall tax pool concept does not exist, requiring each award to be accounted for separately.

Impact

IFRS results in greater income statement variability. Changes in a company’s share price may directly (although inversely and within certain limits) impact the effective tax rate for outstanding share awards at each reporting period.

Example

As an example of the attribution methodology, assume the following information:

- A company has issued an award with a strike price equal to the grant date fair market value of the underlying stock
- The award vests over a 3-year period
- The company is subject to a 30 percent tax rate
- Forfeiture rate is 0 percent
- Intrinsic value of award is deductible for tax when the award is exercised by the employee
- Tax base is equal to the intrinsic value at the balance sheet date multiplied by the percent earned (vested)
- Tax benefit in P&L is limited to the tax effect of the book compensation charge
- Fair market value of stock:
 - At Grant \$360
 - End of Year 1 \$360
 - End of Year 2 \$450
 - End of Year 3 \$550
 - End of Year 4 \$740
 - End of Year 5 \$730
 - End of Year 6 \$600

The following table summarizes the accounting impact:

Year	Book Compensation Expense	Cumulative Book Compensation Expense	Tax-Effectuated Compensation Expense (30%)	Cumulative Tax-Effectuated Compensation Expense	Vested Intrinsic Value	Annual Deferred Tax Effect	Cumulative Tax-Effectuated Vested Intrinsic Value	Cumulative Tax Benefit in P&L	Cumulative Tax Benefit in Equity
1	120	120	36	36	0	0	0	0	0
2	120	240	36	72	60	18	18	18	0
3	120	360	36	108	190	57	75	75	0
4	0	360	0	108	380	57	114	108	6
5	0	360	0	108	370	(3)	111	108	3
6	0	360	0	108	240	(39)	72	72	0

The example demonstrates the uneven buildup of the deferred tax asset over the vesting period based on the fluctuation in the fair market value of the underlying stock. It also demonstrates an impact to the company's effective tax rate in the periods subsequent to vesting based on changes in the intrinsic value. Under US GAAP, the deferred tax impact due to the rising intrinsic value would only be assessed upon exercise.

Business-wide implications

As with many of the changes that will come with a move to IFRS, the first step is to provide a clear description of accounting for stock-based compensation in accounting policy manuals. A number of issues should be considered in the process. For example, if the straight-line method was used under US GAAP, the unvested options should be recast upon conversion to reflect graded vesting. This will lead to accelerated recognition of a portion of previously unrecognized share-based compensation directly to equity upon transition. Internal record-keeping systems or third-party equity ledgers should be designed to separately attribute and measure individual tranches of graded vesting awards as well. Bear in mind, though, that given the relative complexity of the application of graded vesting under IFRS, companies should be cautious in using manual workarounds, such as spreadsheet solutions, especially in a Sarbanes-Oxley 404 certification environment. Reassessment of the administration of equity compensation plans and consideration of changes to their broker-assisted exercise process also need to be carefully mapped out. Operationally, internal record-keeping systems or third-party equity ledgers must be able to calculate deferred tax adjustments at each reporting period. To correctly measure and recognize tax benefits over the life of share-based payment awards, such a calculation should incorporate the ability to track the following on a grant-by-grant basis:

- Changes in share price
- Vesting, forfeiture and exercise activity
- Cumulative share-based payment expense
- Recognized tax windfalls

Management will need to track obligations for each relevant grant by jurisdiction and applicable tax rate over the life of a share-based payment instrument.

Other areas

Business combinations—Acquired contingencies

Growth for many PLS companies is slowing due to a decrease in the approval of new drugs, introduction of competing devices and treatments, looming patent expirations, and competition from generics. In response, PLS companies are making strategic acquisitions, which allow them to re-energize the drug pipeline, leverage synergies, expand product portfolios, and optimize the sales force in relatively short time. It also helps them respond to customers, such as hospitals, that are increasingly looking for end-to-end solutions from a single vendor. Along with many of the acquisitions come significant contingent assets and contingent liabilities relating to items ranging from royalty arrangements to litigation.

Issue	US GAAP	IFRS
The business combinations standards under US GAAP and IFRS are close in principles and language. Major exceptions are recognition and measurement of contingent assets and contingent liabilities.	<p>Acquired liabilities and assets that arise from contingencies are recognized at fair value if the acquisition-date fair value can be determined. If the acquisition-date fair value cannot be determined, the asset or liability is accounted for in accordance with existing guidance over contingencies outside of a business combination.</p> <p>Recognized contingent assets and liabilities must be subsequently measured and accounted for using a systematic and rational basis depending on their nature. Companies need to develop policies for transitioning from the initial measurement of assets or liabilities arising from contingencies at fair value on the acquisition date to subsequent measurement and accounting at amounts other than fair value in accordance with other GAAP—to the extent the items are not periodically recorded at fair value under other GAAP (e.g., warranties, litigation)</p>	<p>The acquiree's contingent liabilities are recognized separately at the acquisition date as part of allocation of the acquisition cost, under the presumption their fair values can be reliably measured. Otherwise the contingent liability is not recorded. The contingent liability is subsequently measured at the higher of the amount initially recognized less cumulative amortization or, if qualifying for recognition as a provision under IAS 37, the best estimate of the amount required to settle the obligation.</p> <p>Contingent assets are not recognized, other than indemnification assets as part of the acquisition agreement related to specific recorded contingent liabilities.</p>

Impact

PLS companies are subject to litigation primarily related to product liability and patent claims. When transitioning to IFRS, companies will need to apply a significant amount of judgment for acquired contingencies and contingent assets. Such decisions could drive future earnings volatility and unpredictability.

To reliably measure contingent liabilities, some companies have concluded the best method for computing acquired contingencies is to use an actuarial model that takes into consideration historical litigation results and the litigation profile of the acquired company.

Example

Assume that in the year of transition, Entity A acquires Entity B, which has a significant contingent liability that Entity A believes is covered by insurance. Entity A would record the fair value of the contingent liability but not the contingent asset related to the insurance coverage because the contingent asset would not meet the IFRS virtually certain criterion. Under US GAAP, both would have been recorded at fair value.

Upon initial IFRS adoption, this difference would also apply to any acquisitions restated under the IFRS 1(R) exemption for business combinations.

Business-wide implications

Companies will have to perform rigorous due diligence related to acquired contingencies for acquisitions that fall under IFRS 3R. This includes documenting evidence of management's probability assessments and/or fair value estimates. It will be important to establish adequate controls covering such documentation, with appropriate reviews and approvals. Companies will also need to revise the methods used to calculate purchase price allocations and document assertions of probabilities associated with contingent assets and liabilities. It will be just as important to ensure appropriate information and documentation surrounding future acquisitions and any business combinations that may be recast upon initial IFRS adoption. Goodwill balances and related impairment assessments could be impacted by the change in recording acquired contingent assets and liabilities at the same time.

Insurance receivable (contingent assets)

Litigation and related insurance recoveries are common in PLS companies. As with acquired contingent assets and liabilities addressed above, US GAAP and IFRS have fundamental measurement differences relating to contingent assets (i.e. insurance recoveries) outside of acquisitions.

Issue

Companies may be unable to record offsetting insurance receivable balances in cases of insurance coverage under IFRS.

US GAAP

An asset should be recognized only when realization of the claim for recovery of a loss recognized in the financial statements is deemed probable and estimable. If insurance coverage is in dispute, the entity may deem recovery probable only after the dispute is resolved. With undisputed insurance coverage, most PLS companies record insurance receivables at or about the same time that they record associated liability.

IFRS

A contingent asset is recognized when the recovery is “virtually certain.” The threshold for this determination will be higher than that of “probable” recovery under US GAAP.

Impact

The “virtually certain” criterion has been defined by some IFRS companies as greater than 95 percent. In practice, this threshold is higher than under US GAAP.

Business-wide implications

Under IFRS, when making the determination that an insurance receivable is virtually certain, PLS companies need to produce sufficient evidence (e.g., confirmation from a third-party insurer or a legal interpretation as to the likelihood of success based on management’s interpretation of the insurance arrangement) to support this higher threshold. Companies should have appropriate levels of management review and approval.

Accounting for litigation provisions

Litigation issues are commonplace for PLS companies. Some fundamental differences in the recording of litigation provisions between US GAAP and IFRS could lead to challenges upon transition.

Issue	US GAAP	IFRS
Differences in the definition of "probable" may result in earlier recognition of liabilities under IFRS.	<p>A provision is recognized when it is probable that a company will have an unfavorable outcome. In practice, the threshold has been an estimate of certainty of approximately 75 percent.</p> <p>When measuring a provision that has a range of liability estimates, with no better estimate within the range, the lowest point in the range is required to be used.</p> <p>Additionally, discounting of the liability is not permitted unless there are fixed cash flows, in which case a credit-adjusted risk-free rate is used.</p>	<p>Provisions are also recorded when they are probable; however, this is defined as "more likely than not," which is considered greater than a 50 percent probability. Accordingly, companies may record additional provisions based on this lower threshold.</p> <p>When measuring a provision that has a range of liability estimates, the use of the midpoint of the range is required.</p> <p>Provisions are required to be discounted based on estimated cash flows using a pre tax rate reflecting the risks specific to the liability.</p>

Impact

If companies continue to follow the model and evaluation process they currently employ under US GAAP, significant income statement variability is possible surrounding litigation provisions under transition to IFRS. See further description in the example.

Example

- 12/31/2013: Original estimate for lawsuit was a range of \$0–\$50 million and no amount better than any other amount in the range
12/31/2014: No change
- 12/31/2015: Best estimate determined to be \$5 million (and settled for this amount shortly thereafter)

Provision balance as of December 31:

	2013	2014	2015	
US GAAP	\$ -	\$ -	\$5m	
IFRS	\$25m	\$25m	\$5m	
Income statement impact in each year:				
	2013	2014	2015	Total
US GAAP	\$ -	\$ -	\$5m	\$5m
IFRS	\$25m	\$ -	(\$20m)	\$5m

As indicated above, a potential for significant income statement variability exists if companies do not determine a “best estimate” contemporaneously, prior to IFRS transition. While the ultimate cumulative charge upon settlement would be the same under US GAAP and IFRS, the consequence of not deciding on a best estimate prior to IFRS adoption could yield significant period-to-period income statement variability.

Business-wide implications

The two main challenges for transition to IFRS revolve around the projection of the outcome of litigation. First is the matter of the opening balance upon transition: original US GAAP estimates are not revisited. In other words, a range that was documented for US GAAP purposes would be used for IFRS purposes. A higher reserve would result under IFRS. Second, companies reporting under IFRS typically decide on a best estimate of a potential settlement rather than on a range, which is common under US GAAP. As noted above, these companies would be required to use the midpoint of the range of exposure if no best estimate of the exposure can be determined. The controls surrounding litigation accruals will be important for management to consider when they make the transition to IFRS.

Further changes in accounting for nonfinancial liabilities have been exposed for comment by the IASB. The new model measures provisions using an “expected value” concept that will significantly alter the way PLS companies account for product liability and other litigation. For more information, please visit www.pwc.com/usifrs.

What this means to your business

What companies can do now

Independent of when the United States adopts IFRS, it is already having a significant impact on US businesses. Its influence will grow in the next several years as convergence takes place and IFRS adoption gains momentum.

In the near term, four main challenges require companies' attention on the IFRS front:

- Keeping pace with an unprecedented rate of financial reporting change as converged standards roll out in roughly a dozen key areas between now and the end of 2011 with effective dates likely extending to 2013
- Monitoring and managing subsidiaries' adoption of IFRS as more countries move to a single set of global reporting standards, particularly in the UK where the replacement of local GAAP with IFRS has been proposed
- Understanding the ways in which the structure of deals and transactions with non-US counterparties (particularly vendors and customers) may be influenced by those counterparties' increased interest in IFRS accounting outcomes
- Continued focus on longer lead-time differences between IFRS and US GAAP because convergence projects will not eliminate all current differences between the two sets of standards

To successfully face these challenges, PLS companies should:

- Assess the potential impact of convergence and IFRS adoption:
 - Use scenario planning to help incorporate likely convergence and IFRS adoption outcomes into strategic thinking and business planning.
 - Assess how the changes will affect the company's reporting, long-term contractual commitments, tax structures, financing, systems, and controls.
 - Consider how the actual accounting changes will influence customers and vendors.
- Oversee non-US subsidiaries' adoption of IFRS by closely monitoring their accounting policy elections as they adopt IFRS, and influence their transition timing and strategies (some such subsidiary elections will be retained in consolidation upon transition to IFRS).

By staying focused on aspects of convergence and adoption that have long lead times, companies can stay ahead of the game while pursuing small one-off projects and "easy wins," where desirable.

Adoption: Managing subsidiaries' adoption of IFRS

Many countries require or permit IFRS for statutory financial reporting purposes, and more countries plan to follow suit, particularly now that the IASB has issued a version of IFRS tailored to small and medium-sized entities, such as in the United Kingdom.

Multinational companies will need to closely manage the process of IFRS adoption by their non-US subsidiaries. Once a subsidiary makes an accounting policy election under IFRS (upon adoption), that decision typically cannot be undone (for statutory reporting purposes) unless the change clearly results in more relevant and reliable information. This is important because adoption elections that might be best for a subsidiary won't necessarily be best for its US parent. In addition, elections may vary widely among subsidiaries of a given company.

US multinationals therefore need to pay attention to, and actively participate in, their subsidiaries' IFRS adoption to avoid the unnecessary reporting complexity that divergent policy elections will create and to maximize the advantages of being on one set of global accounting standards.

System upgrades/implementations

Companies preparing to upgrade existing IT systems or implement new ones should carefully evaluate whether the systems can handle increased disclosure under IFRS and dual-reporting requirements (which will be required during the transition period and/or after their non-US subsidiaries have begun reporting under IFRS). IFRS capabilities should be assessed in conjunction with these system changes.

Also, under IFRS, companies may find the amount and type of information they need for external reporting changes. Identifying potential data gaps early will allow them to design IT systems that deliver the necessary information efficiently.

Tax strategies

IFRS adoption will affect effective tax rates. For example, a company may find that its debt-equity levels are affected, thereby limiting or increasing the amount of interest that may be deductible in a jurisdiction, with a related impact on the company's effective tax rate. There are also potentially significant cash-tax implications. In some jurisdictions, tax reporting aligns with statutory reporting. When IFRS is adopted for statutory reporting purposes in such a location, the impact can be significant.

These changes will be increasingly pervasive as more countries adopt IFRS for statutory accounting purposes outside the United States. Consequently, companies must consider how their current tax structuring and any further tax planning might be affected. They should also assess the potential tax impact of upcoming converged standards (not just the impact of eventual IFRS adoption) and devise appropriate tax planning strategies.

Non-US counterparties

Contracts

Adopting IFRS will have an impact on long-term contracts and financial agreements. For example, a company's debt covenants may specify a certain debt/equity ratio, which may change once the company applies newly converged standards or adopts IFRS, hence making it necessary for the company to renegotiate its debt agreements. In addition, compensation and bonus arrangements are often linked to financial metrics reported under US GAAP. Those metrics will change when the converged standards take effect and when the United States adopts IFRS. Anticipating the effects of these changes will help companies meet their strategic and external reporting objectives.

As PLS companies continue to negotiate long-term collaboration agreements, they should begin to consider the accounting for such agreements under IFRS. Convergence and potential adoption may lead to different accounting treatment than originally intended at the date of execution.

Mergers & Acquisitions

Consolidation within the PLS industry is expected to continue. As more countries adopt IFRS for statutory reporting purposes, knowledge and understanding of IFRS will be increasingly important for US companies that conduct due diligence in evaluating public and private non-US targets. Conversely, US companies that are targets may need to quickly share IFRS-based data with potential buyers.

Customers and vendors

Companies in the PLS industry deal with global customers and suppliers, many of which are located in countries where IFRS is the primary reporting language. A sound understanding of how IFRS affects the behavior of customers and vendors will promote better interactions with those counterparties.

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