IFRS Solutions Center
Volume 17, July 2010

IFRS Insights
Achieving a global standard

In this issue:

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Convergence update

On June 2, 2010, the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued a joint statement announcing their intention to modify their strategy to improve and converge International Financial Reporting Standards (IFRS) and U.S. generally accepted accounting principles (GAAP). That strategy was previously documented in the 2006 Memorandum of Understanding (MoU), which was updated in 2008 and reaffirmed in November 2009. The two boards stated that the purpose of developing a modified strategy was to "prioritise the major projects in the MoU to permit a sharper focus on issues and projects that [they] believe will bring about significant improvement and convergence between IFRS and US GAAP."

The FASB and IASB (the Boards) indicated that their constituents had voiced concerns about their ability to "provide high-quality input on the large number of major exposure drafts planned for publication in the second quarter" of 2010. To address these concerns, the Boards announced that they would stagger the issuance of significant exposure drafts (limited to four per quarter) and the timing of roundtables (to discuss comments with constituents). In addition, the Boards will issue a separate document to obtain input from constituents regarding effective dates and transition methods.

Following the announcement, Securities and Exchange Commission (SEC) Chairman Mary L. Schapiro issued a statement of support acknowledging that the modified plan should increase the quality of the standards and the feedback received from constituents. She also expressed confidence that the project timing changes will not negatively affect the SEC's work plan.

The Boards subsequently released a modified work plan in which they revised target dates for their MoU and other joint projects. They also issued a joint statement to the G20 leaders providing an update on their strategy. While the modified work plan largely retains the June 2011 (or earlier) targeted completion date for those projects for which "the need for improvement is most urgent," a few projects which they consider lower priority will be extended into the second half of 2011.

The following table outlines the new target date for each project.

MoU projects	Modified work plan dates						
	2010			2011			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	ED — Exposure draft(s) RT —Roundtables F — Final standard(s)						
Accounting for financial instruments	FASB ED	IASB ED (Hedging)	RT		F		
Balance sheet netting of derivatives and other financial instruments			ED	RT	F		
Revenue recognition	ED		RT		F		
Fair value measurements	ED			F			
Leases		ED	RT		F		
Financial statement presentation — main project		Staff draft[1]		ED		RT	F
Financial statement presentation — statement of OCI	ED		F				
Financial statement presentation — discontinued operations				ED			F
Derecognition of financial instruments — disclosure		IASB F[2]					
Consolidations		FASB RT	IASB F				
Consolidations — investment companies			IASB ED		F		
Financial instruments with characteristics of equity				ED		RT	F
Postemployment benefits	ED			F			
Other joint projects							
Insurance contracts		IASB ED					
Emissions trading schemes						ED[3]	

Next steps

The Boards indicated they will publish a consultation document about effective dates and transition methods. Look for additional information in upcoming issues of *IFRS Insights*.

[1] In the third quarter of 2010, the Boards expect to post to their Web sites a staff draft of proposed standards to reflect tentative decisions made to date to be used in extended shareholders outreach programs that are planned to be completed in the fourth quarter of 2010.

[2] The IASB will finalize improved disclosure requirements that are similar to recently amended U.S. GAAP requirements. In 2012, the FASB will conclude its post-implementation review of the application of its amended derecognition requirements. The Boards will then also decide about the nature and scope of any further improvements.

[3] Final standard expected in 2012.

Making it happen:
Dual reporting challenges

Recent activity by the Securities and Exchange Commission (SEC), Financial Accounting Standards Board (FASB), and International Accounting Standards Board (IASB) indicates that the United States will in all likelihood shift to International Financial Reporting Standards (IFRS). Although the potential timeline for adoption has been pushed back to allow for more focus on the current convergence efforts between U.S. generally accepted accounting principles (GAAP) and IFRS, the SEC has not yet made any decision to eliminate or adjust the three-year "dual reporting" period for companies adopting IFRS. Based on our experience, this dual reporting requirement will be one of the more significant challenges that information technology professionals will face in the conversion to IFRS.

Advanced planning will be one of the keys to a successful dual reporting solution and eventual transition to IFRS.

Dual reporting requirement explained

The November 2008 proposed SEC Roadmap mandated three years of audited financial statements (current year and two comparative periods). This effectively created a "dual" or "parallel" accounting and financial reporting requirement.

To illustrate, assume the SEC decides to make IFRS mandatory for large accelerated filers for fiscal years ending on or after December 15, 2015. In this case, a calendar-year company would be required to report using IFRS for the year ending December 31, 2015. In addition, the company would be required to provide audited GAAP and IFRS financial statements for the years ending December 31, 2013, and 2014. The figure below outlines the requirements and key milestones of this IFRS timeline.

Challenges for information technology

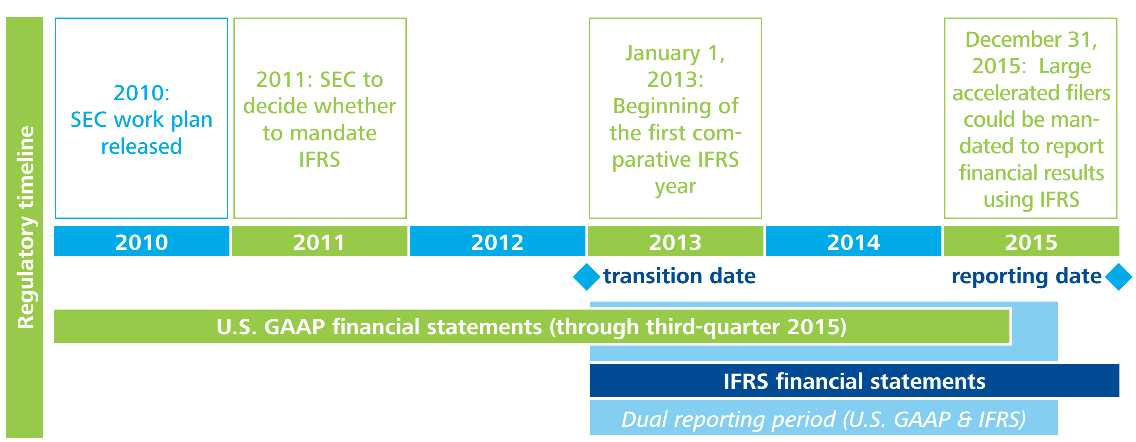
Dual reporting presents challenges for information technology (IT) including:

- The functionality of current and prior enterprise resource planning (ERP) releases may differ in their ability to handle IFRS requirements
- Upstream systems and sub-ledgers will often need re-work to fully cope with the new IFRS requirements
- Downstream systems (including the consolidation engine, budgeting, and reporting tools) will also be affected
- Long-term budgeting and planning systems will need to be modified once IFRS conversions are required

Over the past several years, IFRS has garnered substantial attention from major package ERP vendors and, as a result, all of the major packages now offer parallel ledger functionality. Using parallel ledgers, companies are able to portray financial results in more than one basis of accounting (i.e., GAAP and IFRS). Although this functionality has been created in the ERP packages, the steps to convert to IFRS will potentially include:

- Maintaining dual sets of books of account for three years
- Converting opening balances into amounts that are in accordance with IFRS
- Synchronizing management reporting with dual legal reporting standards
- Aligning consolidation, planning, budgeting, and forecasting with dual sets of books
- Stopping the use of U.S. GAAP, but continuing to use IFRS upon the transition date (for the SEC)
- Continuing to use U.S. GAAP for selective purposes such as Federal Energy Regulatory Commission (FERC) and Tax

Revised SEC timeline



System capabilities for dual reporting

One of the major decisions a company will face will be which IFRS dual reporting solution best supports the capabilities and objectives of its business. There are several alternatives available which utilize either a general ledger or consolidation approach to meet the IFRS requirements. Several criteria must be evaluated in order to determine the desired solution for reporting, including differences identified during the assessment phase, current ERP systems, IT architecture, and investment required to implement.

Following is an overview of the decision drivers and potential solutions to meet the dual reporting requirements.

Decision drivers			
• Financial statement impact • Current ERP release level	• Current sub-ledger and G/L structure • Current chart of accounts structure	• Long-term business / IT strategy • IFRS conversion strategy	• Time to conversion • Additional benefits derived from proposed solution

Solutions

	Sub-ledger	General ledger	Consolidation level
Pros	• Provides detailed data for financial analysis and reporting • Accounts for changes in the subsidiary's financial statements • May integrate with existing general ledger system and structure	• Balances between level of detail and effort of implementation • Accounts for changes in the subsidiary's financial statements • May integrate with off-line and 3rd party solutions	• Requires less implementation effort • Enables parallel / dual reporting with no impact on transactional ledgers or general ledger chart of accounts
Cons	• May require additional effort to capture necessary detail • May require additional ERP modules, off-line, or 3rd party solutions	• Limits detail available for management reporting • Requires reconciliation efforts between off-line solutions and general ledger	• Limits detail available for management reporting • Limits ability to reconcile between ledgers at subsidiary level • Requires manual intervention — prone to error • Is less sustainable as a long-term solution
Best fit	• High financial statement impact • Information is available at required level of detail • Sub-ledger detail is integral for managing the business	• Limited financial statement impact • Decreased need for detail for internal/external reporting	• Low financial statement impact • Calculations for adjustments are centralized

Actions to take now

Regardless of the option chosen, comparative financial reporting under both GAAP and IFRS will be required. This issue is particularly time-sensitive for those companies considering significant upgrades or new implementations of ERP or consolidation and reporting software. The implementation of the dual reporting solution must be carefully handled and considered. Upstream, downstream, consolidation, and reporting systems should be updated and configured to handle IFRS requirements.

Companies should perform an up-front assessment of accounting differences and the impacts to the organization in order to properly plan the transition to IFRS. Failure to identify the differences and anticipate the issues and risks could cause significant issues in closing and reporting.

Technical corner:
Financial statement presentation project

One of the items on the Financial Accounting Standards Board's (FASB) and the International Accounting Standards Board's (IASB) joint convergence agenda is a project pertaining to financial statement presentation. This project aims to take a "fresh look" at the manner in which financial information is presented in an entity's statement of financial position, statement of comprehensive income, and statement of cash flows.

The revised financial statement format is expected to be more cohesive and to be split between business (i.e., operating and investing) and financing activities, similar to the current presentation in the statement of cash flows. The purpose of requiring a single financial statement presentation is to enhance the usefulness of financial information and to increase the comparability and consistency of financial statements within and across entities.

Specific changes would include:

- **Statement of financial position** — requiring presentation of assets and liabilities by major activity within business (showing operating and investing activities separately) and financing categories.
- **Statement of comprehensive income** — requiring a single statement of comprehensive income grouped by using the same categories as those in the statement of financial position; further, disaggregation of line items in the statement would be required.
- **Statement of cash flows** — requiring separate presentation of the main categories of cash receipts and cash payments for each category (i.e., direct method) rather than reconciliation of net income to net operating cash flows (i.e., indirect method). However, a reconciliation of operating income to net operating cash flows would be required in the notes to the financial statements.
- **Notes to the financial statements** — requiring disclosure of the rationale used to classify assets and liabilities into categories and sections in the statement of financial position. In addition, an entity would be required to provide a reconciliation of beginning to ending balances of select assets and liabilities that management deems to be important to understanding the entity's financial position.

The financial statement project also includes the areas below and the related potential changes:

- **Discontinued operations:** The FASB has tentatively agreed to converge with the IASB and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, resulting in a discontinued operation being one of the following:
  - A component of an entity that either has been disposed of or is classified as held for sale, and that represents (or is part of a single coordinated plan to dispose of) a major line of business or geographical area of operations
  - A business that, on acquisition, meets the criteria for classification as held for sale
- **Other comprehensive income:** The proposal would eliminate the alternatives under U.S. GAAP for displaying other comprehensive income, requiring entities to present comprehensive income in one continuous statement that displays net income and the components of other comprehensive income, similar to one of the alternatives available under IFRS.

As a result of these potential changes, entities may need to reassess their financial reporting processes to evaluate the manner in which they will adhere to these new requirements. This assessment could include an evaluation of the information technology systems or other processes used to gather financial statement information, the internal controls over the financial reporting process, and the resources within the financial reporting function for implementing necessary changes.

Industry update:
IFRS considerations for the power & utilities industry

Power & Utilities (P&U) companies are keeping a watchful eye on both the progress of International Financial Reporting Standards (IFRS) for financial reporting and the continued convergence efforts between the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB).

While the industry in general is approaching IFRS cautiously, companies realize that ongoing IFRS developments are influencing the global accounting debates. Many companies are staying involved by monitoring developments, responding to proposed standards through the comment letter process, and providing direct input to the IASB (either individually or through industry associations) to ensure that the industry's views are represented in the standards-setting process.

Several issues are drawing the most attention: accounting for rate-regulated activities, for derivatives, and for componentization of assets under plant, property and equipment (PP&E) guidance.

Accounting for rate-regulated activities

Statement of Financial Accounting Standards No. 71 *Accounting for the Effects of Certain Types of Regulation* (FAS 71), which was codified primarily in ASC 980 – *Regulated Operations*, has been the key issue for regulated utilities. There is currently no equivalent standard under IFRS, so many in the industry were encouraged when the IASB took up a project on accounting for rate-regulated activities in 2009.

Following a comment period which closed in November 2009, the industry was anticipating further discussion and issuance of a final standard this summer, so regulated utilities could begin applying the new standard as soon as 2011 (timed to correspond with IFRS adoption by Canadian listed companies). However, given some strong differences of opinion expressed through the comment letter process, and in recognition of the large number of other convergence projects currently in play, the IASB decided to defer its decision on this project. The IASB discussed the proposed standard at its July board meeting and intends to revisit the issue again in the September timeframe.

From a U.S. perspective, IFRS will likely not be mandated for a few years. Canadian utilities, however, are dealing with this issue now and are considering alternative approaches for addressing the significant asset and liability balances that they presently recognize, along with current Canadian accounting rules. They are also considering how to address these issues in their 2011 IFRS reports, including the presentation of comparative data for prior periods. U.S. utilities will undoubtedly be reading the financial statement disclosures of their Canadian counterparts with keen interest for further industry perspective on how others are interpreting and addressing this key area in the absence of specific IFRS guidance.

Derivatives
As part of their joint agenda, the FASB and the IASB are in the process of updating their respective financial instrument standards. However, some significant areas for energy companies are not on the docket, namely scope considerations related to commodity-based contracts and to the extent such contracts qualify as "own use" or "normal" contracts, thereby exempting them from derivative accounting at fair value.

Hedge accounting is also subject to change. Some changes may prove helpful, such as permitting hedges of components of risk in non-financial contracts, and simplifying the required demonstration of hedge effectiveness. Other changes, such as limiting hedge de-designations, may limit companies' ability to prospectively apply hedge accounting in a meaningful way.

Plant, property, and equipment (PP&E)
Given the asset-intensive nature of P&U companies' operations, it is no surprise that accounting for PP&E is a significant issue. Componentization of assets has been a particularly challenging issue. Simply stated, IAS 16 *Property, Plant and Equipment* requires companies to separately identify and account for "significant components" of an asset. For example, a power plant may be comprised of a number of components, such as the physical building, a system of pipes and wires, the turbine itself, and even the individual turbine blades.

Determining what is "significant" involves judgment, which in turn drives a number of practical issues, such as how to address the related data needs and system processing requirements. These individual components are required to be separately depreciated and individually written off as they are replaced over time. Once components are determined, systems will need to be updated to reflect those components and their respective depreciable lives.

From a forecasting perspective, operating metrics and results may be more difficult to predict until companies better understand the impacts of changes to components' depreciable lives on depreciation expense. In terms of resources, companies are beginning to realize that significant systems challenges may need to be addressed to manage this accounting change.

The topics above are a sample of the accounting changes that may impact P&U companies under IFRS. Stay tuned for further communications regarding these and other accounting projects.

IFRS resources

Join us for two days of IFRS executive training in Houston on September 28-29. Check our website for more details and registration information.

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