IFRS: Changes in the Brazil Statutory Reporting Environment

Potential Implications for U.S. Companies

Overview

In Brazil, listed companies and certain regulated financial institutions are required to publish their consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) beginning in 2010. All other Brazilian companies are required to prepare financial statements and/or maintain local accounting records using new Brazilian accounting standards (BR GAAP) that are based on IFRSs. With the adoption of more than 40 new accounting standards and interpretations in 2010, BR GAAP will now be substantially converged with IFRSs. For most companies in Brazil, this means that they will essentially complete the implementation of IFRSs for local purposes in 2010.

The new standards are the result of the efforts between the International Accounting Standards Board (IASB), the Brazilian Federal Council of Accounting (CFC), the Brazilian Accounting Pronouncements Committee (CPC), and the Brazilian Securities and Exchange Commission (CVM) to eliminate significant differences between BR GAAP and IFRSs and reinforce Brazil´s commitment to achieving BR GAAP and IFRSs.

By the end of 2010, Brazil will have substantially converged its accounting standards with IFRSs, and U.S. multinational companies with Brazilian subsidiaries should be prepared for this change.

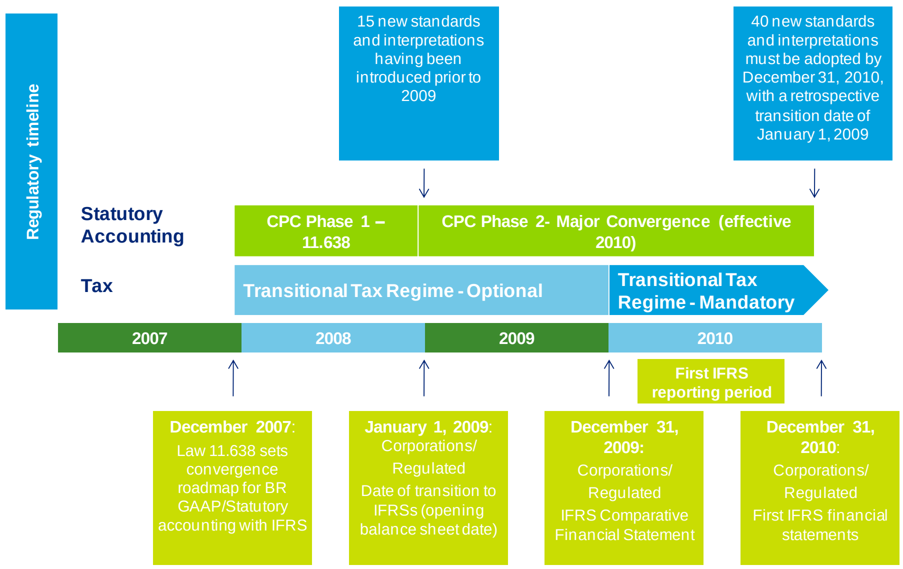
How might these recent developments in Brazil affect U.S. companies?

These recent developments are expected to affect all Brazilian legal entities, including Brazilian subsidiaries of U.S. multinational companies, whether or not they are required to publish audited financial statements for statutory reporting purposes. Brazilian subsidiaries will be facing a potential near-term mandatory conversion that — if not properly planned — could create unanticipated and difficult challenges.

These potential challenges include complications that the U.S. parent company may face if the Brazilian subsidiary makes accounting policy decisions unilaterally, which may need to be revisited or reversed at some later date when the U.S. parent company addresses these issues as part of a broader IFRS conversion. There are also potential tax impacts which should be carefully managed as well, particularly due to the potential implications for distributable reserves, transfer pricing, and other tax considerations.

Timeline and standards

Significant progress towards convergence with IFRSs has been made in BR GAAP since the convergence path was adopted less than three years ago. With only 15 new standards and interpretations having been introduced prior to 2009, a major convergence milestone will be reached this year, with more than 40 new standards and interpretations effective in 2010, resulting in BR GAAP being substantially converged with IFRSs. Given the breadth of accounting topics covered by the new standards, as well as the requirement to apply them retrospectively to January 1, 2009, companies should evaluate the impact of these changes and relevant timing considerations.



The new BR GAAP standards (issued by the CPC) are substantially consistent with the related IFRSs, with very few differences. Generally, these differences relate to restrictions on the choices permitted under BR GAAP as compared to IFRSs (e.g., prohibition on the use of a revaluation model for fixed assets and the mandatory use of proportionate consolidation only for jointly-controlled entities) as well as to specific transition rules for first-time adoption. Note that the new standards must be adopted by December 31, 2010, with a retrospective application date of January 1, 2009 for comparative presentation purposes. In all cases, the implementation transition adjustments must be recorded in the local books and records by January 1, 2010.

Who is impacted

- **Corporations ("Sociedades Anônimas"— S.A.)** — In accordance with Brazilian Corporate Law, these companies must prepare and publish annual statutory financial statements prepared in accordance with the new BR GAAP and audited by an independent auditor registered with the Brazilian CVM. Additionally, publicly-listed corporations must also file consolidated financial statements prepared in accordance with IFRSs quarterly and annually with the CVM beginning in December 2010. Corporations are generally not eligible to use the BR GAAP for SMEs. Many Brazilian subsidiaries of U.S. multinational companies are organized as private companies (non-corporations).
- **Large private companies (including *limitadas — ltdas)*** — Since 2008, all large private companies (i.e., non-corporations) that have more than R$240 million of total assets or more than R$300 million of gross revenues have the same requirements as corporations as noted above; however, these statutory financial statements are not required to be published. These companies are not eligible to use the BR GAAP for SMEs.
- **Other private companies** — While not required to prepare or publish annual statutory financial statements, private companies that do not meet the definition of "large" companies must maintain local accounting books and records using the new BR GAAP and with the Brazilian civil code and tax legislation. These companies generally have the option of using BR GAAP for SMEs (based on IFRS for SMEs).

The Brazilian civil code, corporate law, and tax legislation generally require that all companies maintain accounting books and records in accordance with BR GAAP. Publicly listed companies and certain regulated financial institutions must also file consolidated financial statements prepared in accordance with IFRSs. The extent of the requirements and the options available will depend on how the companies are legally organized and their size.

A tax challenge

With relatively few tax accounting methods specifically defined in the Brazilian tax legislation, the determination of taxable income has historically been derived largely from BR GAAP and statutory accounting methods. As part of the overall convergence plan, local tax authorities implemented a Transitional Tax Regime (RTT) with the objective of neutralizing the impacts of the significant accounting changes being implemented. The RTT is optional in 2008 and 2009, and mandatory in 2010 until such time as new tax legislation is implemented, and requires that companies apply the old BR GAAP accounting methods (utilized prior to 2008) in the determination of taxable income. While tax neutrality is the goal, the current limited guidance from the local tax authorities has made it difficult for most companies to determine how and to what extent the RTT is applicable (e.g., book and tax depreciation methods, transfer pricing models, determination of goodwill in future business combinations). Complicating the challenge is also the recent public digital accounting and electronic tax reporting rules, which include new requirements in fiscal 2010 for the determination of taxable income and temporary differences.

Finally, the RTT is limited in its scope. The determination of distributable profits and dividends, interest on equity, and the new thin capitalization rules will be based on the new BR GAAP bases and, are therefore, likely subject to short-term volatility and uncertainty until the new accounting changes are fully implemented by companies during 2010.

Preparing for the changes

Brazilian subsidiaries of U.S. companies will likely be implementing the new BR GAAP standards or adopting a version of the IFRS for SMEs in 2010. Regardless of the path that the Brazilian subsidiaries select, they will likely be dealing with significant change and challenges and there are some key steps that U.S. companies should consider taking:

- Understand the impact of adopting the new BR GAAP both from an accounting and tax perspective
- Assess and address the short-term implications on distributable reserves and cash repatriation strategies
- Plan to ensure a cost-effective implementation
  - Address key stakeholder questions regarding the potential impacts (e.g., repatriation plans, transfer pricing, other tax considerations)
  - Analyze potential impacts with longer lead-times relative to process and system implications
  - Provide training and working sessions to identify challenges and implications of this transition
  - Develop resource estimates and a plan of attack
- Assess the impact on in-flight process and system modifications, including relevant internal controls (e.g., conversion and reconciliations to U.S. GAAP)
- Monitor the Brazilian financial reporting environment and provide appropriate support to subsidiaries
- Consider long-term benefit opportunities
- Leverage the adoption of IFRS-equivalent standards to develop practical experience and tools and templates to apply to subsidiaries in other jurisdictions and to broader IFRS efforts
- Tax planning opportunities, particularly given the connection between Brazilian tax reporting and statutory requirements

Deloitte personnel are ready to meet with you to help you better understand these requirements and to provide broad multidisciplinary assistance. We have a dedicated group of professionals with extensive experience and a demonstrated track record assisting clients in their IFRS implementations, across various industries, in the U.S., Brazil, and around the globe. We offer broad assistance, providing accounting, financial reporting, tax, systems, and technology consulting services.

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