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IFRS in the Life Sciences: *Broad implications*

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IFRS in the Life Sciences:

Broad implications

Analyze the companies that are moving assertively toward International Financial Reporting Standards (IFRS), and you'll note several predominant characteristics. Most have global operations, complex organizational structures, and aggressive competition. They are often publicly held. And they frequently are known for innovation and leadership.

In other words, they sound a lot like a global life sciences company.

If this description fits your company, chances are you or someone in your organization is already thinking about IFRS. And that's a positive sign, because conversion to IFRS is inevitable. Recent developments have shifted the discussion from the abstract and distant to the concrete and near-term. "If" is no longer part of the conversation; "when" is the relevant term.

By 2011, it's likely that virtually every country in the world will either permit or require IFRS. It is also expected that within the next five-to-seven years, the Securities and Exchange Commission (SEC) will mandate IFRS reporting for all U.S. exchange-listed companies. The more thought and planning you put into the process now, the easier your task will likely be down the road.

In late August 2008, the Securities and Exchange Commission (SEC) announced that it would issue a proposed IFRS "roadmap" that would include a timetable and appropriate milestones for mandatory transition to IFRS starting for fiscal years ending on or after December 15, 2014. The SEC will also propose specific rule changes that would provide a limited number of U.S. issuers an option of using IFRS in their financial statements for fiscal years ending on or after December 15, 2009. (For the latest news and information on IFRS, visit www.deloitte.com/us/ifrs.)

If you think the year 2014 gives you plenty of breathing room, think again. A conversion effort that is both sane (in the sense of avoiding the fire-drill type atmosphere that characterized compliance with Sarbanes-Oxley and the Year 2000 computer problem) and successful (one that can stand up to the scrutiny of regulators, analysts, and your independent auditor) will require a lengthy runway. In mid-2008, the American Institute of Certified Public Accountants announced that it considered a 3-5 year timeline to be reasonable for transition to IFRS. Other organizations have made similar determinations.

Challenges and Opportunities in Life Sciences

As is becoming increasingly apparent, an IFRS conversion is not primarily an exercise in reshuffling the chart of accounts, nor is it principally a technical accounting and financial reporting matter. In fact, your company is likely to spend significant amounts of time addressing concerns around tax, valuation, treasury, legal, people, technology, and communications.

Clearly, a great deal of work lies ahead. Yet, despite these challenges, you may find that the benefits of reporting under IFRS outweigh the costs.

Companies with global operations usually grapple with numerous statutory reporting requirements under different accounting standards in each country. In such cases, there are significant benefits that can be gained from transitioning the financial reporting of all global subsidiaries and affiliates to IFRS — including potential for reduced lead time in preparing consolidated financial statements, reduced consolidation issues, improved controls, reduced personnel costs, and a centralized approach to addressing statutory reporting issues. Transitioning to a global standard carries the possibility of enhancing shareholder value.

Consider these factors:

Conversion provides a fresh look at current practices. If your close process includes reconciling multiple GAAPs and dealing with a variety of sub-ledgers, manual adjustments, data hand-offs, and accounting overrides, you may want to consider a fresh look at your policies and procedures. IFRS provides this opportunity.

Conversion can be a catalyst for streamlining and consolidation. As your company expands through growth and acquisitions, your information technology systems may become increasingly convoluted. Many companies operate a patchwork of legacy accounting and ERP systems — software that can't talk directly, leading to error-prone adjustments and reconciliations. Moving to IFRS provides a chance to streamline and consolidate these disparate systems.

IFRS offers an opportunity to use principles-based accounting. Many finance professionals have become increasingly frustrated with U.S. GAAP and its voluminous rules for dealing with accounting issues. For a decade or more, CFOs and other finance executives have openly pined for principles-based accounting to help standardize and improve the reliability of financial reporting. IFRS answers that wish.

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IFRS helps open the doors of the global marketplace. Adopting IFRS may improve access to foreign capital markets by giving foreign investors greater insight into a company's financial performance. Such investors may be more comfortable with or have more confidence in a globally accepted set of accounting standards. Companies themselves can also benefit from improved ability to benchmark with peers and competitors.

The Capital Markets' Perspective

Among the many tasks associated with IFRS adoption, communication with analysts and the capital markets regarding the anticipated changes will be imperative. While the underlying corporate economics will not change, the recording and reporting implications will likely result in key differences. Leading companies will likely analyze the impact on earnings from adoption, as well as the changes expected to periodic earnings in their long-term outlook projections.

IFRS & Start-ups

Many smaller companies in the life sciences often create additional value through an IPO or transaction. If that describes your situation, it may make sense to think about IFRS now. Reporting under a global standard such as IFRS may broaden the pool of prospective suitors and help accelerate the end game — a liquidity event.



Chart the Course

If you take only one action after reading this document, we suggest it be this: Develop an IFRS implementation roadmap. To kick off this effort, ask yourself and your team a few preliminary questions to gauge the potential impact of IFRS on your company:

- Have we inventoried our current IFRS reporting requirements, if any?
- How many local generally accepted accounting principles (GAAPs) do we currently report under?
- How many of our business units already prepare IFRS financial statements?
- How might our access to capital be impacted by an IFRS conversion?
- How many of our competitors have converted? Is there an expectation that they would switch to IFRS, if given the choice in the U.S.?
- Do we have a major ERP or finance transformation project in the works?
- Are we involved in or considering a major acquisition?
- What is the level of IFRS knowledge within the company, both domestically and globally?
- What would be the impacts on our company of a possible IFRS requirement in the U.S.?
- Have we assessed the cost and benefits of adopting IFRS?

Of course, your IFRS implementation roadmap will be significantly more detailed than merely addressing these few questions. Given the far-reaching scope of IFRS, the roadmap may assess the impact on each department in your organization, including finance, human resources, tax, legal, information technology, and investor relations. Other stakeholders may also be involved, including the board, audit committee, shareholders, and your external auditor.

By determining your costs, benefits, and timing up front, you can avoid the rushed approach (and unnecessary expense) that some companies experienced through initiatives such as the Sarbanes-Oxley Act and the Year 2000 computer issue.

A carefully designed roadmap may empower your company to convert on its own terms. By taking a measured and informed approach, you increase the likelihood of identifying value in an exercise that otherwise may be reactive and solely compliance driven. The value may show itself in the form of reduced costs of implementation, standardization and centralization of statutory reporting activities and related controls, greater consistency of accounting policy application, and possibly core finance transformation. Through your roadmap, you can independently validate perceptions and dispel misconceptions. And you can justify your decisions before the board, shareholders, other stakeholder groups, and the financial analyst community.

Which Approach Will Work for You?

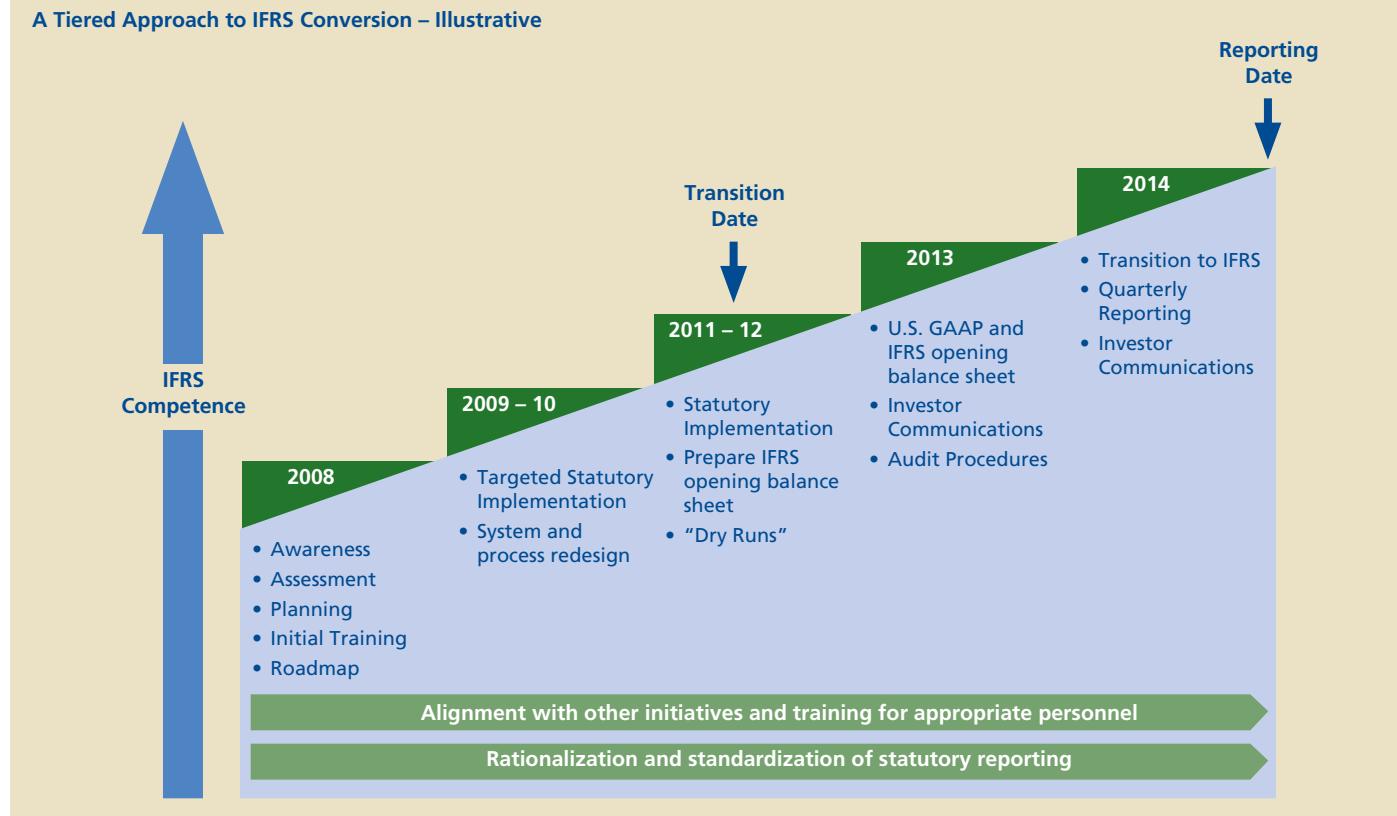
Generally speaking, two approaches to IFRS conversion predominate: all-in and tiered. The former is characterized by a relatively short timeframe; simultaneous conversion of all reporting entities; dedicated project teams; and commitment of significant resources. The latter is conducted over a more extended period; with phased conversion of reporting entities; with at least some personnel retaining their "day job" duties; and with a spreading out of project costs.

When the European Union converted to IFRS in 2005, it was, for most companies, an all-in effort driven by the tight timelines imposed by

the European regulators. Without the luxury of time to convert on a staggered basis, most companies were forced to rush through the process, leading to inevitable inefficiencies and ineffectiveness.

A tiered approach – staged, rational, and measured – to IFRS conversion will likely provide better results. This comes with a seemingly self-contradictory caveat: You'll have to act fast if you want to go slow. That is, if you want to reap the potential benefits of phasing in your conversion, you'll need to start planning soon.

Companies that choose a tiered strategy should consider staggering their conversions on a country-by-country or region-by-region basis. As each group moves through the stages (see graphic, "A Tiered Approach to IFRS Conversion," below), the processes developed and lessons learned are applied to the next group.



Key Impacts of IFRS Implementation

Technical Accounting	Process and Statutory Reporting	Technology Infrastructure	Organizational Issues
<ul style="list-style-type: none"> • Overall approach to IFRS implementation • First time adoption policy considerations, including reporting dates and use of exemptions • Ongoing policy considerations, including alternatives and approach to "principles" 	<ul style="list-style-type: none"> • Internal controls and processes, including documentation and testing • Management and internal reporting packages • Global reporting packages • Statutory reporting, including "opportunities" around IFRS adoption • Considerations for the impact of accounting changes on compliance with U.S. government cost accounting standards and federal acquisition regulations 	<ul style="list-style-type: none"> • General ledger and chart of account structure, including performance metrics • Global consolidation • Sub-system issues related to configuration and data capture • Capabilities to manage multiple GAAP accounting during transition 	<ul style="list-style-type: none"> • Tax structures • Treasury and cash management • Legal and debt covenants • People issues, including education and training, compensation structures • Internal communications • External and shareholder communications

More Than Accounting and Financial Reporting

Without question, IFRS will impact the general ledger and financial statements. But in a relative sense, the accounting and financial reporting may be the easy part. How you handle the nonfinancial aspects of the transition to IFRS may be a far more accurate indicator of your success. Among the areas warranting your attention are human resources, legal, tax, treasury, and technology.

Human Resources: As noted, IFRS involves much more than reorganizing the chart of accounts. It represents a change that cascades well beyond the finance department.

Consequently, human resources issues may be a major concern. A conversion project will place increased demands on your personnel, which may come at a time when you are least able to handle it. Finance organizations have streamlined in recent years, downsizing accounting functions through reduced hiring, layoffs, and attrition, as well as outsourcing or offshoring key functions. Unfortunately, these personnel reductions may mean that the people who could best help with your IFRS efforts are no longer available.

Recruiting may pose another challenge, particularly in the United States. College accounting programs across the country represent an important pipeline for keeping finance functions staffed and operating. Yet, most U.S. university accounting programs are only now beginning to develop comprehensive instruction on IFRS.

This issue can be addressed through training programs in the U.S. and internationally, to help key personnel become proficient in both IFRS and U.S. GAAP.

Legal: The ripple effects of conversion to IFRS will surely be felt by your legal department. Many contracts will need to be examined for possible impact, and some agreements, including debt compliance covenants, will need to be renegotiated and restructured.

The life sciences industry has a well-documented propensity for joint ventures, profit-sharing agreements, and other collaborative arrangements. The contractual underpinnings of all these relationships will need to be revisited.

Education and retraining will also come into play for the legal team. IFRS principles and associated guidance from the Securities and Exchange Commission will need to be analyzed and understood from a legal perspective.

Tax: Tax considerations will likely fall into four categories: tax accounting differences, pre-tax accounting methods, tax planning, and information systems.

Although IAS 12 and FAS 109 have a similar approach, differences do exist in the details. Many of the current differences are expected to disappear as a result of the IASB's project on income tax accounting. Some of those differences include balance sheet classification of deferred tax assets and liabilities; prohibition against backward tracing; and the treatment of investments in subsidiaries. Some key differences are expected to remain, which may have a significant impact on organizations, including the IAS 12 requirement to book a provision for current and deferred taxes arising from intercompany cross-border transactions; recording deferred taxes on the differences that arise due to re-measuring nonmonetary assets from functional currency to local currency; using intrinsic value to calculate deferred taxes on share-based payments; and the determination of uncertain tax positions.

The differences will be of particular interest to a global life sciences company and should be considered in the initial assessment process, rather than after a conversion is well under way.

It will also be important to address the tax consequences of the pre-tax differences between IFRS and U.S. GAAP because a conversion to IFRS will require changes to several financial accounting methods. Consequently, companies may need to re-evaluate their existing tax accounting methods. If there is a change in the accounting method used for financial reporting purposes, companies must consider issues such as:

- Is the new financial reporting standard a permissible tax accounting method?
- Is the new book method preferable for tax reporting purposes?
- Is it necessary to file changes in methods of accounting?
- Will there be modifications in the computation of permanent and temporary differences?
- How will reporting in accordance with IFRS impact the computation of taxable earnings and profits, foreign source income, and investments in subsidiaries?
- How will a change to IFRS impact local country statutory reporting and tax payable?

Differences of particular interest to life sciences companies include: the treatment of research and development expenditures; revaluation of property, plant, and equipment; component depreciation; disallowance of the LIFO inventory valuation method; and the timing of deferred tax recognition of tax law changes.

And don't forget the potential impact on tax planning, which has long been driven by its impact on the effective tax rate. For example, the requirement to book current and deferred taxes on intercompany cross-border transactions can have a significant impact on transfers of intellectual property and supply-chain structuring. It is incumbent upon the tax director to evaluate the potential impact and determine whether there may be opportunities to mitigate any detrimental results by accelerating tax planning strategies to occur prior to conversion to IFRS.

All of the tax differences discussed will have an impact on the way data is gathered and processed for tax purposes. ERP systems will need to be evaluated to ensure necessary tax information can be gathered, tax provision systems will need to be adjusted and it will be necessary to determine if legacy systems must be maintained. Advanced planning in the assessment process will likely mitigate difficulties related to technology.

Treasury: Moving to a global financial reporting model may open up access to new sources of capital. Many global lenders, global private equity firms, and international exchanges require or prefer IFRS reporting due, in part, to its increased transparency into fair values and comparability to other investments or companies. Thus, these sources potentially become new avenues for capital funding, particularly in the current U.S. dollar environment.

Note, however, that greater use of fair value may create more volatility in your company's access to capital. That is, not only can reporting under IFRS potentially open up access to additional capital in a favorable fair value environment, but it can also serve to limit the additional capital in an unfavorable fair value environment.

Furthermore, with reporting or disclosure under fair value, management will likely need to understand, evaluate, and manage the expected market reactions to reported volatility in values. This will represent new territory for most U.S.-headquartered life sciences companies.

Additional impacts of IFRS on the treasury function may include the following:

- Companies that choose to present fair value may consider the need to lower their leverage models to ensure that market fluctuations can be adequately absorbed by equity.
- Companies may need to consider and revise existing debt terms for covenants based on U.S. GAAP metrics or financial results which don't make sense or are no longer attainable under IFRS.
- The clearer view that lenders get into the fair value of collateral (whether presented on the balance sheet or disclosed in the footnotes) may alter their evaluation of creditworthiness and may impact the terms of new debt instruments related to collateral values and covenants.

Technology: IFRS is expected to have wide-ranging impacts at different levels of the IT systems architecture. The realignment of the company information systems will pose a real challenge for IT (along with the rest of the organization). Virtually all applications and interfaces in the system architecture can be affected, from the upstream or source of data to the farthest end of the reporting tools. As such, time and resource needs may be significant.

As you plan changes to your IT systems, you will need to take into account external factors such as local and international regulations, financial consolidation of subsidiaries, stock markets, and external auditors. This business transformation should not be considered a one-step project. It may be necessary to implement short-term initiatives strategically designed to institute an effective long-term solution for the organization.

Potential Technology Impacts

Upstream Source Systems and Transformation Layer	General Ledger and Financial Applications	Reporting Data Warehouse Planning and Calculation Engines	Downstream Reporting Capabilities
Differences in the accounting treatment between current accounting standards and IFRS will create a need for new input data.	Differences in the accounting treatment between current accounting standards and IFRS will likely drive changes to general ledger design, chart of accounts, as well as sub-ledgers and feeds.	IFRS has much more extensive disclosure requirements, requiring regular reporting and usage of financial data that may not be standardized in current data models.	The differences that arise in the accounting treatment between current accounting standards and IFRS will create a need for changes in reporting.
Data and transactions that are captured, stored and ultimately sent to the financial systems may not have all the needed attributes or qualities.	Multinational companies may ultimately realize a need to re-develop general ledger platforms or additional sets of books to ensure compliance with multiple financial reporting requirements.	Increased need for documented assumptions, sensitivity analyses; potential factors that could affect future development may expand the scope of information managed by financial systems.	Assumption changes from period to period can introduce significant volatility and require detailed support for derivation and rationale for changes, requiring design of additional reports.
Sub ledgers within the ERP may have additional functionality to support IFRS that is currently not being utilized but could be implemented.	Multi-ledger accounting functionality within newer releases of ERP's may be considered for long-term solutions.	Reporting warehouse feeds to calculation engines may need to be adjusted in a standardized way to support reporting processes.	External reporting templates will likely require revisions to reflect IFRS requirements.
Transformation layer not likely to have been designed with IFRS in mind; data sender/receiver structures may need to be adjusted.	Changes to IFRS will likely necessitate redesigned accounting, reporting, consolidation, and reconciliation processes, which may impact configurations of the financial applications.	Data governance functions and meta data repositories (potentially including data dictionary, ETL & business intelligence tools) may need to be adjusted to reflect revised data models.	Increased disclosures such as sensitivity tests and roll-forwards may require additional ad hoc query capabilities.
Over time the potential for acquisitions of companies using IFRS will increase; altering source systems and Extract, Transform and Load (ETL) tools to provide all needed data elements will make integrations significantly more efficient.	Differences that arise in accounting treatment between current accounting standards and IFRS may create a need for new expense allocations and other calculations.	Current valuation systems may not have functionality to handle IFRS requirements.	

The Business Case for IFRS

Not everyone is sold on the merits of IFRS. If you find yourself needing to convince others, consider some of these talking points:

- 1. Global positioning:** We do business globally; our brand is international; we are expanding into new markets. Our financial reporting should be a reflection of this operational reality.
- 2. Cost savings:** We are currently reporting under multiple standards —U.S. GAAP, local GAAPs, and IFRS. Consolidating to a global reporting standard and eliminating a large number of reconciliations will yield potentially significant savings.
- 3. Inevitability:** IFRS is coming. If we start soon, we can implement a phased, efficient, and orderly process and avoid the chaos that has typified other major projects. Many issues in the industry, such as R&D or product manufacturing, are long-term by nature, and the impact of IFRS will need to be considered in tandem.
- 4. Alignment:** We are already undergoing a major [ERP/finance transformation/systems/fill in the blank] project. If we integrate our IFRS conversion effort with this project, we can make better use of our resources while ensuring that the two work harmoniously together.
- 5. Internal control:** Accounting policies and procedures will be refreshed during an IFRS conversion project; the number of financial reporting standards used and reconciliations required will drop dramatically. Net result: improved accuracy and timeliness of financial reporting are likely.

Technical Accounting Issues for Life Sciences Companies

U.S. GAAP and IFRS differ in key ways, including their fundamental premise. At the highest level, U.S. GAAP is more of a rules-based system, whereas IFRS is more principles-based. This distinction may prove more vexing than it initially appears, because most accounting and finance professionals in the U.S. have been schooled in the rules of U.S. GAAP. The overriding lesson from their years of study and work was this: If you have an issue, look it up. Under U.S. GAAP, voluminous guidance attempts to address nearly every conceivable accounting problem that might arise. And if that guidance doesn't exist, it generally is created. On the other hand, IFRS is a far shorter volume of principles-based standards, and consequently requires more judgment than American accountants are accustomed to.

This represents a significant change in mindset — one that finance organizations should be prepared to address. Additional training and consultation will likely be necessary, along with a more robust policy manual to ensure that any decisions that are made in the IFRS adoption are consistent across the company.

Beyond the issue of rules versus principles, IFRS also can pose particular technical accounting challenges to life sciences companies. A chart showing several U.S. GAAP/IFRS differences follows.

Technical Accounting Differences

Topic	Potential Differences	Some Potential Implications		
		Financial Statements	Process/IT	Other Considerations
Consolidations	When to consolidate and application of the control definition	IAS 27 follows a governance and economic indicators model and requires consideration of potential voting rights. Under US GAAP, a voting or variable interest model is applied and potential voting rights are generally not considered.	Increased judgment in determining consolidation policy Processes and data capture for financial information of controlled entities	Existing arrangements should be inventoried and analyzed to identify differences
Equity Investments	Unlisted equity instruments	Under IAS 39, the investment is measured at fair value, if it can be reliably measured. Under US GAAP, the investment is measured at cost less "other than temporary" impairments, if any.	Increased documentation requirements	Increased management judgment and estimation related to fair value
Share based payments	Measurement date – Non-employees	Under IFRS 2, fair value should be measured at the date the relevant goods or services are received. If the goods or services are received on more than one date, the entity should measure the fair value of the equity instruments granted on each date when goods or services are received. Under US GAAP, the measurement date is based on the earlier of the counterparty's commitment to perform (where a sufficiently large disincentive for non-performance exists), or when actual performance is complete. Further in situations where performance may be required over a period of time but the equity award is fully vested and nonforfeitable on the date of contract, the measurement date could be the date the contract is entered.	Equity systems modifications may be necessary as well as changes to cost tracking and allocations	Human resource and budgeting

Technical Accounting Differences, cont.

Topic	Potential Differences	Some Potential Implications		
		Financial Statements	Process/IT	Other Considerations
Share based payments, cont.	Modification of an award by a change in performance condition (improbable to probable)	Under IFRS 2, compensation expense is based on the grant date fair value. Under US GAAP, the incremental compensation cost is measured as the difference between the fair value of the award before and after modification.	Equity systems modifications may be necessary and changes to cost tracking/allocations	
	Graded vesting	Under IFRS 2, compensation cost is recognized on an accelerated basis to reflect the vesting as it occurs, resulting in higher compensation expense recognized earlier. Alternatively, under US GAAP, an option exists to recognize the amortized expense on a straight-line basis or to recognize on an accelerated basis.	Equity tracking and other measurement processes	
	Calculation of tax benefits	Under IFRS 2, deferred tax is computed based on the tax deduction for the share-based payment under the applicable tax law (i.e. intrinsic value). Under US GAAP, the deferred tax asset is based on the GAAP expense recognized and trued up at the realization of the tax benefit.	Income tax processes	
	Recognition of payroll taxes	Under IFRS 2, the estimated liability is recognized at the grant date, or as service is provided over the vesting period. Under US GAAP, a liability is recognized upon exercise of the nonqualified stock option.	Income tax processes	Income taxes
Revenue Recognition	Timing of revenue recognition	As compared with IFRS, US GAAP has highly specific and specialized revenue recognition guidance. IFRS lacks specific guidance related to certain issues or industries. For example, in multiple element arrangements, IAS 18 requires revenue to be recognized separately for each separately identifiable component, based on the substance of the transaction. EITF 00-21 and other US GAAP guidance establish detailed criteria to be satisfied for each element and explicit guidance on the evidence needed to support the fair value of each separate element.	Documentation processes and controls Collaboration agreement processes and impact of milestone payments	Contract design Increased management judgment Business development Change management
Inventory	Accounting method	LIFO is permitted under US GAAP but is not permitted under IAS 2.	Inventory system changes	Tax effect of change could be substantial
	Reversal of impairment write-downs	Under US GAAP the impaired value becomes the new cost basis and therefore reversals of impairment are prohibited. Under IAS 2, reversal of the impairment charge is required if certain criteria are met.	Processes/Controls around reversal of inventory impairment	Standard costing
	Measurement of carrying value	A lower of cost or net-realizable-value (NRV) approach is used under IAS 2 to measure inventories. NRV is defined as the estimated selling price in the ordinary course of business, less the estimated cost of completion and to make the sale. Under US GAAP, inventories are stated at lower of cost or market, where market is defined as replacement cost, provided it does not exceed NRV (or NRV reduced by a normal profit margin). Where replacement cost is lower than the current carrying value, even if NRV exceeds carrying value, this may result in inventory write-downs being required under US GAAP but not IFRS.	Inventory system changes Processes/Controls around measurement calculations	Financial accounting coordination with operations Considerations for inventory manufactured prior to regulatory approval
Intangibles (R&D)	Development Costs (e.g. FDA bright line test, milestone payment considerations)	Under IAS 38, development costs can be capitalized once certain criteria are reached. Development costs are expensed when incurred under US GAAP.	Processes around project accounting and tracking Processes around measurement and classification	Change management for R&D personnel to assess impairment triggers

Technical Accounting Differences. cont.

Topic	Potential Differences	Some Potential Implications		
		Financial Statements	Process/IT	Other Considerations
Impairment	Long-lived Assets – Reversal of impairment	Under IAS 36, reversal of an impairment charge is required when certain conditions are met. Under US GAAP, the impaired value becomes the new cost basis and therefore reversals of impairment charges are prohibited.	Process and data capture around reversal of asset impairment	Increased effort and resources Income taxes
	Long-lived Assets - Impairment methodology	Under IAS 36, the assessment is based on a one step approach comparing the higher of the "value in use", which is generally the discounted present value of the future cash flows, or the fair value less costs to sell. US GAAP has a two step approach requiring an assessment of impairment using undiscounted cash flows. If the carrying value is higher in step one, any impairment is measured based on the carrying value compared to its discounted cash flows. Therefore, additional impairment may occur under IFRS.	Data capture around the recoverable amount	Increased effort and resources Income taxes
	Goodwill - Level of impairment testing	Under IAS 36, the level of impairment is assessed at the cash generating unit ("CGU"), which is the lowest level of identifiable cash flows, or a group of CGUs which may differ from the reporting units as classified under US GAAP.	Allocation of assets and goodwill to CGU	Income taxes
	Goodwill -impairment methodology	Under IAS 36, the recoverable amount of CGU (higher of value in use or FV less costs to sell) is compared to the carrying value. US GAAP requires a two step process requiring a comparison of the fair value of the reporting unit with its carrying amount, including goodwill. The fair value refers to the price that would be received to sell the unit as a whole in an orderly transaction between market participants. If the fair value is less than the carrying amount, the impairment is measured by the implied fair value of goodwill compared to its carrying amount, where the implied fair value is based upon a hypothetical purchase price allocation.	Process is reduced from two steps to one	
Business Combinations	Acquired In-process Research & Development (IPR&D)	Under IFRS 3, acquired IPR&D is capitalized based on technical feasibility and remains on the balance sheet, subject to impairment. Amortization commences when the assets become available for use. Alternatively under US GAAP, acquired IPR&D is recognized in the opening balance sheet, but then written off immediately if there is no future use. Additionally, deferred taxes are not provided on acquired IPR&D that has no alternative use. (Note: IPR&D treatment will converge in 2009 under US GAAP.)	Processes and systems for tracking in-use date	Deferred taxes Periodic reassessments for impairment triggers and change management of R&D personnel
	Measurement date	Under IFRS 3, shares issued as consideration are recorded at their fair value as of the date of exchange. Under US GAAP, shares issued as consideration are measured at their market price over a reasonable period of time (i.e. a few days) before and after the date the acquisition is agreed to and announced. This date will usually be some time prior to the "date of exchange" under IFRS. (This will change in 2009.)	Measurement processes	
	Contingent consideration	If a portion of the purchase consideration is contingent on a future event, such as achieving certain profit levels, IFRS 3 requires an estimate of the amount to be included as part of the cost at the date of acquisition where it is probable that it will be paid and can be reliably measured. Conversely, under US GAAP, contingent consideration is generally excluded from the initial purchase price. The additional cost is not recognized until the contingency is resolved or the amount is determinable. (This will converge in 2009 under FAS 141[R].)	Measurement processes and tracking status of contingencies	Existing agreements should be inventoried Increased management judgment and

Technical Accounting Differences, cont.

Topic	Potential Differences	Some Potential Implications		
		Financial Statements	Process/IT	Other Considerations
Business Combinations, cont.	Negative goodwill	Under IFRS 3, any excess of fair value of net assets over the purchase price after reassessment is recognized immediately in the income statement.	Measurement processes	
	Restructuring liability	Under IFRS 3, the acquirer may only recognize a restructuring provision as part of the acquired liabilities when the acquiree has at the acquisition date an existing liability for restructuring recognized in accordance with IAS 37. Under US GAAP, the requirements are less stringent for recording a restructuring liability at the date of acquisition under EITF 95-3, which states that a restructuring liability can be recognized at the acquisition date if the restructuring relates to the acquired business and certain conditions are met. (In 2009, under FAS 141 R, measurement differences will be eliminated.)		
Pensions – Actuarial Gains and Losses	Measurement and classification difference	Under SFAS 158, actuarial gains and losses are recognized directly in other comprehensive income and recycled into the income statement in future periods. Under IAS 19, an accounting policy choice exists for actuarial gains and losses: (i) recognize in directly equity in a statement of recognized income and expense (recycling to the income statement not permitted); (ii) recognize through profit and loss; or (iii) recognize amounts that exceed a 10% "corridor" through profit or loss.		Coordination with actuaries
Pensions – Prior Service Costs	Measurement difference	Under SFAS 87 (as amended), prior service costs related to benefits that have vested are generally amortized over the remaining service period or life expectancy. Under IAS 19, prior service costs related to benefits that have vested are recognized immediately.		



The European Experience

In July 2002, the European Parliament passed legislation requiring listed companies to convert to IFRS by 2005. The short timeframe and extensive reach of the directive had many companies scrambling to comply. Anecdotal reports suggest that the conversion placed significant resource pressure – human and financial – on finance teams and their companies at large.

A more tangible measurement of the effort can be found by comparing the length of European companies' 2004 (local GAAP) and 2005 (IFRS) financial statements. The latter averaged more than 50 percent longer than the former; in some instances, reports doubled in length. Much of the increase can be attributed to an increased level of disclosure in the financial statements in areas such as judgments made and assumptions used.

Certain accounting issues proved especially vexing during the transition, including asset impairments, financial instruments, and lease accounting.

Among the lessons learned from the European experience were the following:

The effort was often underestimated. The original misconception that conversion was solely an accounting issue was replaced with a growing realization that the initiative was larger and more complex.

Projects often lacked a holistic approach. Because of the limited view cited above, companies frequently did not take the collateral effects into consideration, such as the impacts on IT, HR, and tax.

A late start often resulted in escalation of costs. Those few companies that anticipated conversion and took steps to prepare for it were in much better shape than those that did not. Companies that delayed their response paid a price for it, in terms of higher costs and greater diversion of resources.

Many companies did not achieve “business as usual” state for IFRS reporting. The highest quality financial data is obtained when companies fully integrate IFRS into their systems and processes. The compressed timeframes often precluded this possibility; instead, first-year financials were often produced using extraordinary, labor-intensive, and unsustainable measures.

Several companies are only now starting to explore benefits from IFRS implementation. Due to multiple constraints, the first-year effort in the EU was focused more on “getting it done.” Potential benefits in terms of reducing complexity, increasing efficiency, decreasing costs, and improving transparency had to be deferred.

Smoothing the Transition

If you decide an accelerated IFRS conversion is desirable, here are a few considerations for smoothing implementation:

Leverage existing projects: If you are already going through — or have recently completed — an enterprise resource planning (ERP) or finance transformation project, now may be the time to consider IFRS adoption. Recent versions of major ERP systems are designed to accommodate IFRS, which can be mapped in, usually with significant cost savings.

Conduct a trial run: Implementation might be easier if you take a bite-sized approach starting with a single country or reporting entity. Use existing reporting requirements and local country IFRS requirements to your advantage. For example, subsidiaries in countries adopting IFRS over the next three years may be good candidates for your trial run. Learn from this initial conversion exercise, and apply the lessons learned to your global rollout down the road.

Consider shared services centers: IFRS provides a compelling reason to establish shared services centers, to potentially consolidate dozens of local GAAPs down to a single reporting standard. Geographically-dispersed finance offices could be drastically reduced or even eliminated in favor of a central finance function, strategically located to take advantage of tax incentives, payroll savings, and facilities cost reductions. In many cases, this concept is already aligned with the strategic direction life sciences companies have taken or are currently considering relative to their finance function.

Strengthen controls: IFRS offers the opportunity to implement standardized frameworks and processes to enhance the overall control environment.

Refresh your policies: Conversion to IFRS drives a need to revisit consolidations, equity investments, share based payments, revenue recognition, inventory, and other accounting policies (as discussed starting on page 6). In other words, IFRS provides a refresh exercise for accounting policy implementation, with the aim of more accurate and timely financial reporting.

Improve your access to capital: Capital is migrating away from the U.S. for a number of reasons, including the weakness of the dollar, the credit crisis, and the growth of foreign financial centers in Europe and Asia. Regardless of the cause, when it comes to raising capital, trends are clearly global. IFRS can potentially improve liquidity and access to capital by offering greater transparency, in the form of full and better disclosure, to investors.

Access to capital may also be enhanced by virtue of aligning with a common standard. Markets and investors have been demanding a common standard for years, and IFRS has increasingly served that need. As such, companies reporting under IFRS may have an improved ability to access other capital markets that have adopted the standard.

Time for Leadership

You are in an enviable position, because you possess knowledge that many others in your organization may not: the movement toward IFRS is inexorable, and the initiative involves multiple corporate functions, not solely finance.

So you have a choice: either sit back and wait for it to happen (with all the attendant uncertainty and risk), or mobilize your company to attempt to extract every possible benefit and dodge every avoidable obstacle.

In other words, it's time for leadership.

By starting now, you will likely spread out your costs, get the jump on your competition, and reel in scarce talent before it vanishes. You can avoid the fire-drill atmosphere that characterizes most last-minute projects. You can improve your processes and systems. You can integrate with other initiatives, such as an ERP upgrade or a merger or acquisition. Most important, you can do it on your own terms, at a pace that suits your company and its circumstances.

Life sciences companies are characterized by intensive activity that places major demands on financial and human resources. An IFRS project cannot be a distraction from the primary activities of your business. It must be integrated, coordinated, and aligned. It starts now with some preliminary questions and a carefully drawn roadmap. And it ends somewhere in the next decade when you report for the first time under a single unified standard. Whether the journey from here to there is rocky or smooth may be entirely up to you.



Resources

Deloitte has extensive experience in the life sciences industry with considerations relating to IFRS and its implementation. With thousands of IFRS-experienced professionals in our global network, we provide an array of services related to IFRS and, as a multidisciplinary organization, are positioned to assist companies in addressing a wide range of IFRS issues.

Deloitte offers companies assistance with:

- Evaluating the potential impacts of IFRS
- Assessing readiness for IFRS conversions
- Implementing IFRS conversions, providing support with technical research, project management, and training
- Addressing the implications of IFRS in such areas as tax, finance operations, technology, and valuation

Deloitte's Life Sciences Practice

Many life sciences organizations are faced with the promise of great discoveries and the challenges of market fluctuations and increasing regulation. For pharmaceutical, biotechnology, medical products, and technology and device companies, the life sciences industry is changing at an unprecedented rate. These organizations face a host of issues: the impact of managed care, new therapeutic discoveries, revolution in research and development and drug discovery, securing patents and intellectual property protection, evolution of the biotech sector, emergence of the specialty and generic sectors, access to capital, royalty and revenue recovery, mergers and acquisitions, shifting markets and sources, worldwide efforts to control health care costs, and an evolving regulatory and compliance environment.

Our Life Sciences practice can help you respond to market forces and increase your possibilities by addressing these and other challenges in today's complex environment. We work with our clients on many issues, including:

- Auditing and Assurance
- Strategic Alliances and Collaborations
- Corporate Governance, Internal Control and Sarbanes-Oxley Accountability
- Food and Drug Administration, Regulatory, Clinical Trials and Office of Inspector General Compliance
- Rebate and Pricing Strategy and Compliance
- Intellectual Property Protection
- Tax Jurisdictional Strategies & Compliance
- Technology Solutions and Implementation
- And more...

Visit www.deloitte.com/lifesciences for more information.

Deloitte's Online Resources

For a wealth of online resources related to IFRS, visit www.deloitte.com/us/ifrs. Available materials include newsletters, whitepapers, pocket guides, timelines, webcasts, podcasts, and more.

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