

SMU  COX  
SCHOOL OF BUSINESS

# IFRS



Professor Wayne H. Shaw  
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## SEC Comments on Convergence

**February 23, 2010**

- Directed staff to develop a Work Plan of
- Whether
- When, and
- How
- The United States should transition to IFRS
- Work Plan will be evaluated in 2011
- New expected resolution date

— 2015

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## Perceived problems with IFRS

- Commenters who expressed this view noted that:
- IFRS is not sufficiently developed or applied in practice to be adopted as a single set of global standards (e.g., either IRDS lacks guidance in certain significant areas, or the guidance it does contain appears to or may allow too much latitude to achieve more comparable financial reporting than U.S. GAAP,
- Jurisdictional variants in the application of IFRS pose a significant challenge to the adoption of IFRS as a truly global reporting model; and
- The achievement of a genuine common global financial reporting model would require consistent application, auditing, and enforcement across countries.

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## Areas of Concern

- Sufficient development and application of IFRS for the U.S. domestic reporting system;
- The independence of standard setting for the benefit of investors;
- Investor understanding and education regarding IFRS;
- Examination of the U.S. regulatory environment that would be affected by a change in accounting standards;
- The impact on issuers, both large and small, including changes to accounting systems, changes to contractual arrangements, corporate governance considerations, and litigation contingencies; and
- Human capital readiness.

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## Sufficient development and application of IFRS

- A necessary element for a set of global accounting standards to meet these objectives is that they must be high quality, consisting of a “comprehensive set of neutral principles that require consistent, comparable, relevant and reliable information that is useful for investors, lenders and creditors, and others who make capital allocation decisions.
- Must be supported by an infrastructure that ensures that the standards are rigorously interpreted and applied.”

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## Sufficient development and application of IFRS (issues)

- IFRS is not as developed as U.S. GAAP in certain areas.”
  - For example, IFRS does not provide broad guidance for certain topical areas, such as accounting for certain common control transactions, recapitalization transactions
- IFRS lacks guidance for certain broad industries
- IFRS’s less prescriptive guidance
- The consistent and faithful application of IFRS

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## The independence of standard setting for the benefit of investors

- Whether the accounting standard setter's funding and governance structure support the independent development of accounting standards for the ultimate benefit of investors.
- Is standard setting accountable, independent, and free from undue influence that could affect the ability of U.S. investors to receive full, fair, and reliable disclosure.

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## Other Issues

- Regulatory Environment
  - Manner in which the SEC Fulfills its Mission
  - Industry Regulators
  - Federal and State Tax Impacts
  - Statutory Dividend and Stock Repurchase Restrictions
  - Audit Regulation and Standard Setting
  - Broker-Dealer and Investment Company Reporting
  - Public versus Private Companies
- Impact on Issuers
  - Accounting Systems, Controls, and Procedures
  - Contractual Arrangements
  - Corporate Governance
  - Accounting for Litigation Contingencies
  - Smaller Issuers versus Larger Issuers
- VI. Human Capital Readiness
  - Education and Training.
  - Auditor Capacity

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## Other Issues

- Regulatory Environment
  - Federal and State Tax Impacts
    - Analyze the effects on federal and state tax regulations, as well as issuers subject to such regulations.
    - Consider the impact of a change in SEC reporting on federal and state tax regulators.
    - Analyze constituent concerns associated with any potential changes, or lack thereof, to federal and state tax regulation.
  - Audit regulation
    - Consider the impact of such incorporation on PCAOB standards.
    - Consider the extent of , logistics for, and estimated time necessary to undertake any changes to the auditing standards.

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## Other Issues

- **Public versus Private Companies**
  - Analyze the effects of such incorporation for U.S. issuers on private companies, auditors, and investors.
  - Assess the extent of, logistics for, and estimated time necessary to undertake changes to accommodate any resulting implications on private companies.
- **Contractual Arrangements**
  - Assess the types and pervasiveness of contractual arrangements that would be affected by such incorporation and the manner in which they would be affected.
  - Determine the costs, ability, plans, and estimated time required to address concerns regarding affected contractual arrangements.

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## Other Issues

- **Corporate Governance**
  - Determine the potential effects on corporate governance and related concerns of such incorporation.
  - Determine possible approaches to address corporate governance concerns and the extent of, logistics for, and estimated time necessary to undertake these approaches.
- **Accounting for Litigation Contingencies**
  - Discuss with issuers, the legal profession, and investors concerns regarding accounting and disclosure requirements for litigation contingencies under IFRS.
  - Determine possible approaches to address concerns regarding accounting and disclosure requirements for litigation contingencies under IFRS and the extent of, logistics for, and estimated time necessary to undertake these approaches.
- **Smaller Issuers versus Larger Issuers**
  - Determine the manner in which the impact of such incorporation varies based on issuer size.
  - Determine possible approaches to mitigate concerns regarding any disproportionate effects on smaller issuers of such incorporation and the extent of, logistics for, and estimated time necessary to undertake these approaches.

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## Other Issues

- **Education and Training**
  - Evaluate the current level of IFRS expertise and extent of IFRS education and training needs among constituents.
  - Consider the extent of, logistics for, and estimated time to implement plans for future training among constituents.
- **Auditor Capacity**
  - Analyze concerns regarding auditor capacity constraints, including the effect on audit quality, cost, and audit firm concentration and competitiveness.
  - Determine possible approaches to mitigate these concerns and the extent of, logistics for, and estimated time necessary to undertake these approaches.

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## Major Continuing Projects

- Financial Instruments
- Consolidations
- Derecognition
- Fair Value Measurement
- Revenue and Cost Recognition
- Leases
- Financial Instruments with Characteristics of Debt
- Financial Statement Presentation

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## Consequences of Continuing Differences Between US GAAP and IFRS

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## Taxes

- Your client provides you with the following data for the year ended 12/31/10:

Current assets	
Cash	\$10,000
Accts Receivable	32,000
Inventory	42,000
Deferred Income Tax Asset	20,000
Total current assets	104,000
Current liabilities	
Accounts payable and accrued expenses	\$50,000

- The CFO comments that he is thankful that he met his requirement under the bank covenant to maintain a current ratio of 2:1, saying he would not want to renegotiate under current economic circumstances.
- He also notes that that Congress passed a reduction in the corporate tax rate to 10% for the 2010 year on 12/29/10. The President signed the bill on 1/4/11. He did not consider this in his calculations.
- What concerns would you have under the impending conversion to IFRS?

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## Other issues

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- Your client provides you with the following information. The CFO wonders if GAAP/IFRS differences in any of these areas have an effect on his debt to equity ratio and rate of return.

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## Taxes

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- The client has a significant NOL from its Polish operations. It now recognizes the deferred tax asset and places a valuation reserve against the asset; showing a net zero asset in the balance sheet. The CFO hears that IFRS does not permit the use of a valuation allowance.

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## Leases

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- The client intentionally leased the asset for 89% of the asset's fair value and 70% of the asset's life to avoid capital lease treatment.
- The fair value of the land in the lease arrangement was set at 24% of total fair value to avoid separate accounting for the land and therefore separate valuation of the 90%/75% rules.
- The client had a loss on a sale and leaseback that he deferred and amortized over the term of the lease since it did not relinquish more than a minor part of the right to use the asset.

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## Debt/Equity

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- The client issued \$25 million of preferred stock on January 1, 2010 to as part of a refinancing. The preferred stock is puttable by the counterparty at any time after December 31, 2013 pursuant to rights embedded in the terms of the stock.

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## Contingencies

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- The company is involved in a lawsuit for which they expect to have to pay an amount between \$2 million and \$3.5 million. The client has booked \$2 million.
- The most likely payment will be \$3.2 million.
- The company built a vault for \$500,000 in a building he began renting in 2010. It is contractually required to remove the vault at the end of the lease. It is likely a new lessee would use the vault. Therefore, the client estimates only a 10% probability that it will be required by the landlord to incur the \$150,000 (\$120,000 if removed by its people) to remove the vault.

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## Re-financed loans

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- The company took out a \$5 million loan with a one-time final payment due on June 30, 2011. The CFO informs you that he refinanced this debt on February 2011 for a further five years and would like to continue to classify this debt as non-current on their balance sheet at December 31, 2010. Financial statements are authorized for issuance on March 15, 2011.

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## H-T-M Investment Portfolio

- During 2009, the company recorded a \$870,000 portfolio writedown due to concerns over the decline of credit worthiness of the portfolio in that year. This year the portfolio recovered about 50% of the value and the company wants to write it back up.

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## Inventory

- The inventory footnote reported the following values:

	2010	2009
Inventory at cost	\$450,000	\$415,000
LIFO Reserve	(175,000)	(165,000)
Write-downs	(75,000)	(75,000)
Inventory	\$200,000	\$175,000

- 50% of the inventory is based on LIFO cost; the remaining inventory is part based on FIFO, lower of cost or market and the remaining based on weighted average, lower of cost and market.
- You determine that the inventory market decline last year was reversed this year and the inventory written down last year remains in stock this year.

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## Fixed Assets

- Assets in one line of business (both real and personal property) have greatly appreciated during the current year. The client complains that it has no way of noting this under U.S. GAAP and complains that the straight-line depreciation on the building does not capture the "economic" change in the asset.

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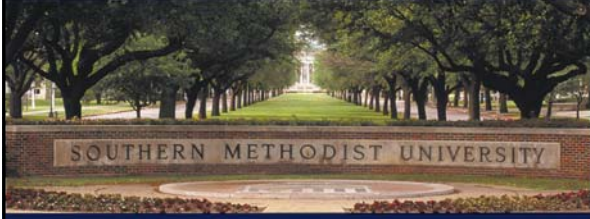
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Thank You



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