Getting the Jump on IFRS

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The long journey toward adoption of International Financial Reporting Standards (IFRS) has been a procrastinator's dream. Each year, it seems, publicly traded U.S. companies have been put on notice that implementation of the new standards is imminent, only to see the timeline stretched out yet again. Now it appears U.S. companies won't have to adopt IFRS until 2015 or later.

Though that deadline may seem quite a way off, if you work for a global company, you need to continue full steam ahead with your preparations, which are likely to be time-consuming and affect many operations within the organization. One multinational in particular, Archer Daniels Midland (ADM), is well down the path to IFRS readiness. ADM's experiences with preparing for IFRS—which included several fits and starts—may be useful to your organization as it embarks on its own IFRS journey.

Establishing the Scope of the Project

Based on its humble beginnings, Archer Daniels Midland seems to be an unlikely candidate for using IFRS. Founded in Minneapolis as a linseed-crushing company in 1902, it has grown into a global powerhouse that turns crops into renewable products that serve the needs of a growing world. ADM trades, transports, stores, and processes corn, oilseeds, wheat, and cocoa into food ingredients, animal feeds, and plant-based fuels and chemicals. Net sales for the year ended June 30, 2011, were $81 billion.

ADM employs approximately 30,000 people and operates in more than 75 countries on six continents. Given that kind of global reach, the company couldn't ignore IFRS for long. Many of the countries that ADM operates in have already adopted the new standards or are in the process of doing so. (Country-specific timelines for convergence are listed at www.ifrs.org; click on the link marked "Global Convergence.")

To become IFRS-prepared, ADM launched a 12-week diagnostic project with the assistance of an external advisory team. The goal of the project was to develop a high-level company roadmap for conversion to IFRS, with the focus on identifying differences between U.S. Generally Accepted Accounting Principles (GAAP) and IFRS for accounting and reporting requirements; reviewing current business processes and information systems for any necessary changes; and assessing and planning for any tax impact from IFRS. Assessing the impact of IFRS can be challenging for multinational companies because it's more conceptual and has less "bright line" guidance than GAAP.

ADM's diagnostic project involved looking in detail at the following areas: financial statement presentation, consolidations, joint ventures, associates, business combinations, and inventory. Additional areas the company considered were fixed and intangible assets, asset impairment, financial instruments, fair value measurements, and foreign currency. It also examined leasing, income taxes, contingencies, and revenue recognition. (Disclosure issues were identified separately.) Table 1 lists these key areas of concern and some important questions that were asked internally for each one.

The company also identified the challenges it would need to address during IFRS conversion. For example, how much would the conversion cost, and how would the process be communicated? What challenges would be faced in educating and training the accounting groups and divisional support teams? Would existing internal controls developed under the Sarbanes-Oxley Act (SOX) have to be changed? What processes would have to be reexamined for efficiency and applicability before significant IT changes were put into place?

ADM Rolls Up Its Sleeves

An area of major concern to ADM—and one that should be of concern to virtually any multinational company transitioning to IFRS—was that financial reporting doesn't occur in a vacuum. If financial reporting changes, the processes and information technology supporting the financial reporting must change first. As such, ADM smartly recognized the importance of involving the information technology team very early in the IFRS transition planning process. Think for a moment: New information systems might be needed for any new data required to be collected under IFRS. Systems development, testing, and training must also be planned for, as well as the possibility that multibasis accounting standards—with differing information demands—may be part of the transition and will need to be handled as seamlessly as possible.

Next, the ADM transition team identified several key areas that would need to be addressed for the company to be in full compliance with IFRS. Let's take a closer look at each one.

Disclosures. ADM found that several specific IFRS changes would affect their company. For example, all first-time IFRS adopters such as ADM must prepare three years' worth of comparative financial statements. These more extensive disclosures are required because IFRS allows different applications for the same financial reporting that must be further explained because of less bright-line guidance. ADM already provides extensive disclosures under GAAP, as evidenced by the fair value of financial instruments listed in the company's annual Form 10-K report to the U.S. Securities & Exchange Commission (SEC). Nevertheless, even *more* disclosure would probably be required under IFRS.

LIFO. Another major difference between GAAP and IFRS that would affect Archer Daniels Midland is that IFRS doesn't allow the "last in, first out" (LIFO) inventory method that ADM uses. LIFO is an important issue for many U.S. corporations because if it's currently used for income tax purposes, it must also be used for financial reporting purposes. If LIFO isn't allowed for financial reporting, it wouldn't be allowed for income tax purposes, either. Therefore, corporations such as ADM would owe more taxes because LIFO reduces taxable income in times of rising prices, as is currently the situation in the

Table 1: What the ADM Project Looked At

KEY AREA	SAMPLE QUESTIONS
Financial Statement Presentation	Does the entity present other comprehensive income in its statement of changes in equity?
Consolidations	Does the reporting entity have Variable Interest Entities (VIEs)? Does the reporting entity have de facto control over any nonconsolidated entity?
Joint Ventures	Has the investor made any nonmonetary contributions to jointly controlled entities?
Associates	Does the investor hold currently exercisable potential voting rights in investees, or are such rights held by others?
Business Combinations	Did the entity acquire less than 100% of the acquiree?
Inventory	Does the reporting entity use the LIFO method to value inventory? Have inventories that were written down to their market value recovered in value during the reporting period?
Fixed and Intangible Assets	Is the reporting entity interested in changing its current approach to measuring a class of property, plant, and equipment (PP&E) to the revaluation model allowed under IFRS? Did the entity incur costs relating to research and development activities (other than software development costs)?
Asset Impairment	Do impairment indicators of long-lived assets exist at the date of transition to IFRS? Did the entity recognize a goodwill impairment charge in an acquisition of less than 100% of the acquiree?
Financial Instruments	Does the reporting entity have investments that don't have readily determinable fair values, such as unquoted equity securities? Has the reporting entity achieved partial derecognition by transferring a portion of an entire financial asset?
Fair Value Measurements	Does the principal market used to determine fair value differ from the most advantageous market for the item being measured?
Foreign Currency	Does the reporting entity have a corporate structure composed of multiple levels of subsidiaries and parent companies, with different functional currencies, that are ultimately consolidated into the reporting entity?
Leasing	Has the reporting entity entered into any arrangements that convey the right to use an asset or assets other than PP&E? Has the reporting entity entered into any sale-leaseback transactions?
Income Taxes	Does the entity have any uncertain income tax positions?
Contingencies	Does the reporting entity have potential obligations resulting from past events that haven't been recorded because it's not "probable" under ASC 450 that an outflow of resources will be required to settle the obligations?
Revenue Recognition	Has the reporting entity entered into bill-and-hold sales arrangements? Does the reporting entity have long-term construction-type contracts where revenue is recognized using the percentage-of-completion (POC) method?

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United States. That said, it remains to be seen how U.S. companies would handle the move away from LIFO in transitioning to IFRS.

Depreciation, Fixed Assets, and Impairment. IFRS allows fixed assets to be recorded at either cost or fair market value, but GAAP allows only the cost method. Under IFRS, companies must decide whether to use cost or fair market value for an entire asset class and then apply it consistently. Assets can be written up to fair market value, with the write-up accounted for as equity and the additional depreciation flowing through the income statement. Of special interest to ADM is the treatment of biological and agricultural assets. These types of assets must be revalued to fair market value, with the write-up flowing through the income statement. Investment properties are treated similarly. (For a deeper dive into the particulars, see the authors' article, "A New Paradigm of Reporting: The Basics of International Financial Reporting Standards," in the January 2010 issue of *The CPA Journal*.)

In addition, IFRS depreciates fixed assets on a "component" basis vs. a "whole asset" basis under GAAP. The former means that some parts of an asset could be on a different depreciation schedule than other parts of the same asset. This could have a big effect on ADM with regard to its recent purchase of five oceangoing dry-bulk ships to haul commodities to and from ports around the world. The ship's many different components could be on different depreciation schedules (the engines vs. the body of the ship, for example). It's highly possible, therefore, that ADM is going to have to develop an information system application solely for the purpose of tracking the many asset components and accompanying depreciation schedules of not only its fleet of ships but its processing plants, storage and distribution centers, research facilities, and corporate headquarters.

Asset impairment, too, would apply to ADM and many other multinational corporations. Asset impairment is recorded under GAAP when the carrying value of the asset exceeds the sum of the undiscounted cash flows associated with it. Once impairment is recorded under GAAP, the write-down can't be reversed if the asset's fair value increases. Under IFRS, an impairment is recorded when the carrying value of the asset exceeds its fair value, which usually leads to an earlier recognition of impairment than under GAAP. Yet impairment charges can be reversed up to the original carrying value of the asset under IFRS.

Leases. Most multinationals, including ADM, use leasing arrangements, the majority of which are classified as operating leases and are therefore off-balance sheet. For a lease to be capitalized as an asset under GAAP, one or more of four criteria must be met:

- Ownership of the leased asset is transferred to the lessee.
- A bargain purchase option is included in the lease.
- The term of the lease is equal to 75% or more of the estimated economic life of the leased asset.
- The present value of the minimum lease payments is greater than or equal to 90% of the fair value of the leased asset.

IFRS, on the other hand, indicates that if the lease transfers "substantially all" of the major ownership aspects of the asset, then it should be treated as an asset on the balance sheet (capitalized, that is). Once again, when examining leases, GAAP provides a series of "bright lines" to follow, whereas IFRS is more "principles-based" and conceptual.

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) are working on a joint IFRS project for leases, with the goal of developing a single new approach that assures that all assets and liabilities arising from a lease contract will be recognized on the balance sheet. As ADM and other multinationals eventually transition to IFRS, it's likely that all leases will be shown on the balance sheet and that operating leases no longer will be allowed. This will ensure transparency and limit off-balance-sheet financing arrangements.

Research and Development. ADM participates in a variety of basic and analytical research in the areas of food applications, emulsifiers, and biofuels, to name a few. The current accounting method under GAAP, for ADM and all other U.S. publicly traded companies, is to expense research and development costs as they're incurred. IFRS, however, would treat research and development very differently by allowing companies to capitalize some costs when certain technological and economic criteria have been met. The new standards would thus promote a positive impact on net income because R&D wouldn't always be expensed but, rather, would be amortized over the period of time the company expects to benefit from its investment.

Revenue Recognition. GAAP currently requires persuasive evidence to recognize the sale of goods. IFRS, on the other hand, mandates that revenues be measured "reliably" and that significant risks and rewards of ownership be transferred to the buyer during a typical sale.

GAAP and IFRS agree that revenues must be reasonably collectible and reliably measured and that the delivery of goods or services must have occurred. It's estimated that IFRS would, in general, demonstrate higher revenue than as estimated under GAAP.

How would these changes in revenue recognition impact ADM and other publicly traded corporations? For one, certain transactions, such as sale-leaseback arrangements, wouldn't be treated the same under GAAP and IFRS. IFRS probably wouldn't allow a sale-leaseback arrangement to be recognized as revenue because the risks and rewards of ownership wouldn't transfer with the sale of goods, as demonstrated by the leaseback feature. But the IASB is aware of these issues and is currently working with the FASB on an updated standard to more completely converge GAAP and IFRS on revenue recognition across industries.

Consolidation. From time to time, ADM and other multinationals acquire part of another company in order to grow, so the question of consolidation then arises when preparing financial reports. GAAP has traditionally had bright-line rules regarding when to consider an acquisition as an entity to consolidate vs. an entity accounted for under the cost or equity method. The rules have usually involved the percentage of ownership, with 50% or higher requiring consolidation into the parent company's financial statements. IFRS, however, is focused less on the absolute percentage of ownership and more on the issue of "control" over the acquired entity.

The IASB and the FASB are working together to rewrite the standards on consolidation to reflect the "control" concept. The Boards have tentatively decided that a reporting entity that holds more than half the voting rights in an affiliate meets the power element of the control definition in the absence of other arrangements. They've also decided that a reporting entity with less than half of the voting rights in an affiliate, but which can legally or contractually direct those activities that significantly affect the parent company's returns, meets the power element of the control definition. Therefore, under IFRS, ADM and other multinationals may find that more entities must be rolled into the parent company's financial statements than previously determined under the older GAAP rules.

A Well-Executed Roadmap

As you can see, for ADM and other global corporations transitioning to IFRS, there are both challenges and benefits. The challenges, of course, are the many possible differences between GAAP and IFRS that must be accommodated, as explained in detail earlier. Some of the benefits include streamlined global reporting, easier access to foreign capital markets and investments, and a smoother facilitation of cross-border acquisitions or joint ventures. This may make the numerous challenges—and the costs associated with them—easier to swallow.

As your own company transitions to the new standards, it must carefully weigh these pros and cons and then plan early. Take your cue from ADM, which is well along the path to IFRS preparedness. The company's diagnostic project has carefully pinpointed the many areas that must be addressed on the road to convergence.

ADM has done its homework in advance of IFRS. Now it's time to do yours. **SF**

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"How to Adopt IFRS in Five Steps," September 2011, pp. 53-60.

"Accounting for Income Taxes: A Misfit in the Convergence of Standards?" May 2011, pp. 49-53.

"The Road to Convergence: Business Combinations Under IFRS and GAAP," February 2011, pp. 46-51.

"Pursuing the Vision: Interview with Robert Herz, Chairman of the Financial Accounting Standards Board (FASB)," September 2010, pp. 38-41.