KPMG

IFRS Perspectives

Update on IFRS issues in the US

February 2017

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It's a two-GAAP world, but the US market is deeply invested in IFRS

The SEC recently reiterated[1] that IFRS has become "very significant for both US investors and companies." We estimate that, as of today, the use of IFRS and US GAAP as an accounting framework to support capital formation is about equal around the globe, when looking at relative market capitalization of shares publicly traded.[2]

More than 120 countries around the world have adopted IFRS, making IFRS a must-know for US companies that intend to attract foreign investors, are contemplating raising capital outside the United States, or that are engaged in cross-border M&A transactions. The SEC also confirmed[1] that 525 Foreign Private Issuers with a combined worldwide market capitalization of more than $7 trillion currently apply IFRS for their US listing. In addition, nearly 90% of initial offerings of foreign equity in the United States were conducted through exempt offerings for which IFRS financial information is usually used.

At the same time, it has become clear that we will not see use of IFRS by domestic SEC registrants in lieu of US GAAP in the foreseeable future.

The IASB and the FASB have acknowledged that convergence, as a standard-setting strategy, is no longer a priority for either board. Since the formation of the IASB in 2001, the FASB and the IASB have worked on approximately 35 projects to achieve convergence of IFRS and US GAAP at various levels. There are notable successes, including revenue recognition, business combinations and fair value measurement. However, the IASB and the FASB have recently followed dissimilar paths for their projects on financial instruments and insurance.

As a result, a two-GAAP world has emerged. Preparers with a global footprint will continue to deal with US GAAP/IFRS differences. Indeed, this creates additional challenges for cross-border transactions: a higher cost of capital than would be the case with one GAAP, additional systems and/or processes to track both GAAPs, etc. But the fact that only 10 to 15 years ago more than 70 different accounting frameworks existed globally, having evolved into a two-GAAP world with the two GAAPs being broadly comparable is still a tremendous accomplishment.

Future issues of this newsletter will address some of the specific issues companies face working in this two-GAAP world. We hope you'll find our newsletter a trusted source of insight as you work with these challenges.

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[1] Working Together to Advance High Quality Information in the Capital Markets. Wesley R. Bricker, SEC Chief Accountant; December 5, 2016.

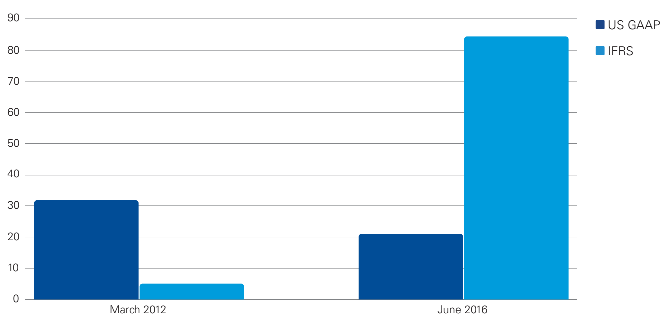
[2] We estimate that the use of US GAAP is predominant for purposes of capital formation in the form of public or registered debt.

IFRS adoption in Japan will affect US subsidiaries

Japanese companies with overseas subsidiaries can choose from US GAAP, IFRS as issued by the IASB, Japan's Modified International Standards (endorsed version of IFRS), and Japanese GAAP (JGAAP). Historically, Japanese Foreign Private Issuers (FPIs) have used US GAAP or JGAAP with a reconciliation to US GAAP. However, over the years IFRS has slowly but surely gained momentum in Japan.

The Financial Services Agency (FSA), the Japanese financial regulatory body, has allowed Japan's listed companies to use IFRS since 2010. In 2013, the FSA eased regulations for applying IFRS. As a result, the number of companies that either have applied or have decided to apply IFRS has increased significantly. As of February 2017, there are 133 such companies – representing 4% of listed companies, but approximately 25% of the listed market capitalization in Japan. We expect this trend will continue in the coming years.

Number of listed companies in Japan applying either US GAAP or IFRS



In contrast, the number of Japanese companies applying US GAAP has been decreasing.

This trend has direct consequences for US subsidiaries of Japanese groups. JGAAP allows companies to consolidate their subsidiaries using their financial statements prepared under US GAAP or IFRS, with a few adjustments. Therefore, US subsidiaries of Japanese groups have often been reporting under US GAAP whether the group was a JGAAP or US GAAP preparer. There is no such permission under IFRS. Therefore, as Japanese groups adopt IFRS, their US subsidiaries will also need to convert to IFRS for consolidation purposes.

Source of the numbers

- IFRS Application Around the World – Jurisdictional Profile: Japan; IASB
- Voluntary Application of IFRS (Current and scheduled); Tokyo Stock Exchange
- IFRS Adoption Report; Financial Services Agency

Converting from US GAAP to IFRS

There are three main reasons a US company may want to consider adopting IFRS – as a substitute for, or to complement, its US GAAP financial statements.

- To access international capital markets that require financial statements prepared in accordance with IFRS. This has been an increasing trend recently, both for mid-sized firms unable to generate sufficient investor interest/capital in the United States, and for larger firms seeking access to previously untapped markets.[3]
- The fact that a US-based company has foreign investors, intends to attract foreign capital providers, or has significant foreign operations.
- As a result of being acquired by a foreign company that prepares IFRS financial statements.

Converting to IFRS is a significant finance transformational event for a company and may be prompted by any of the reasons stated above. The long-term effects on a company go beyond accounting – and if planned right can improve various aspects of the organization. We have accumulated the following lessons learned from prior IFRS conversion projects.

Ten factors for success

1. A well-developed and 'living' plan, including realistic timelines and clear accountability.
2. Buy-in from senior management and members of the audit committee from the outset.
3. Sufficiently focused and appropriately engaged company resources, including a designated Project Management Office.
4. A comprehensive and detailed accounting gap analysis, leading to an impact assessment of process, data and systems, people and change, and other potentially impacted business areas.
5. Timely involvement of the external auditor.
6. Tailored training delivered throughout all phases of the IFRS implementation project – designed to meet the various needs of specific company personnel.
7. Early assessment of regulatory requirements, such as pro forma financial information, prospectuses, specific disclosures, number of comparative years, etc.

[3] Statistics from the Committee on Capital Markets Regulation – Continuing Competitive Weakness in U.S. Public Capital Markets; October 28, 2016.

8. Careful management of internal controls: An IFRS implementation opens many opportunities to reengineer/transform key processes and systems; such integrated efforts create very significant risks and challenges that need to be carefully managed.
9. An effective protocol for resolving, cataloging and sharing technical accounting and key process issues.
10. Proactive and early development of sufficiently comprehensive messaging to support the organization's level of engagement, consistency in execution, and clarity and consistency of external communication.

Five key things to consider

1. The first step in any plan should be to perform an accounting gap assessment. This can take anywhere from 4–8 weeks depending on the size and complexity of your business – but it is vital to identify areas where differences will arise and help to focus any future implementation.
2. Any IFRS adopter, for the purpose of external financial reporting, needs to apply IFRS 1, *First-time Adoption of IFRS*. This requires retrospective application of IFRS with some required exceptions and elective exemptions, and specific disclosures.
3. Like US GAAP, IFRS has significant new standards for revenue recognition, leases and financial instruments.

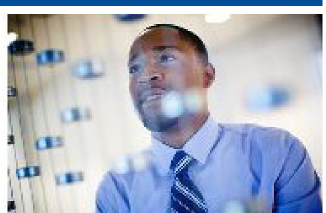
   These standards aren't fully aligned with their US GAAP counterparts. For example, if you have already begun your lease assessment in anticipation of ASC 842, *Leases*, you will need to rethink the process under IFRS due to the differences between the two standards, although the information gathered to inventory all leases will still be useful.

   In contrast, the new revenue recognition standards are largely converged, so any work done to date to prepare for US GAAP adoption should largely carry over. However, there remain some challenging differences in the detail (read our Top 10 differences between IFRS 15 and ASC 606).

   However, US companies may directly adopt the new IFRS leases and revenue standards as part of the first-time adoption of IFRS – to bypass the additional efforts of changing to the new standards after IFRS adoption.
4. Each applicable regulatory framework may bring additional complexities in areas such as pro forma financial information, separate acquiree's financial reporting, and accounting reconciliations.
5. Finally, converting to IFRS is more than an accounting exercise. It will impact systems, processes, people and other business areas – and all of these areas need to be considered when moving forward with a potential conversion.

Aspects executives need to address when converting to IFRS

Accounting and Reporting



Systems and Processes

Business

People

Revenue: Top 10 differences between IFRS 15 and ASC 606

The new revenue standards, IFRS 15 and ASC 606, originally published in May 2014, are substantially converged. However, in 2016 the IASB and the FASB issued separate amendments to clarify their respective guidance and, in the case of the FASB, to provide some practical expedients to the requirements.

Except for the amendment to the principal vs. agent guidance (revenue being presented on a gross or net basis), these amendments may create differences in certain areas. This is in addition to the differences that already existed in the original versions of the standards. The FASB made more changes to its standard by providing more application guidance and additional practical expedients.

We have identified the 10 key differences between IFRS 15 and ASC 606 that we believe are the most significant. This selection is based on the potential impact on earnings that these differences may have (excluding certain industry-specific implications), as well as the complexity they may create to comply with both GAAPs.

Step of the revenue model	Difference
Step 2: Distinct goods and services	Shipping and handling activities – FASB policy election
Step 3: Transaction price	Measurement date for noncash consideration
Step 3: Transaction price	Sales taxes – FASB policy election
Contract costs	Reversal of previously impaired contract acquisition and contract fulfillment costs
Sales outside ordinary activities	Sales of in-substance nonfinancial assets
Onerous contracts	Determination of provisions for loss-making and onerous contracts
Transition	Effective date for nonpublic companies
Transition	Definition of 'completed contract'
Disclosures	Remaining performance obligations
Disclosures	Interim disclosures

These differences may be challenging for companies that report under both US GAAP and IFRS – e.g. a US subsidiary of a foreign multinational company that uses IFRS for group reporting with local reporting under US GAAP, or vice versa. Foreign Private Issuers that file IFRS financial statements will face a more subtle issue. The IASB has made it clear that IFRS preparers are not required to consider the decisions of the FASB and the US Transition Resource Group for Revenue Recognition for guidance in applying IFRS 15.

Here are the differences explained in more detail.

IFRS 15	ASC 606	Consideration for preparers
Step 2: Distinct goods and services: Shipping and handling activities – FASB policy election		
No policy election. The company determines if shipping and handling activities are distinct from the shipped goods (i.e. a performance obligation). If so, some revenue is allocated to the shipping activity and deferred until shipping and handling occurs.	Policy election to treat shipping and handling activities undertaken by the company after the customer has obtained control of the related goods as a fulfillment activity (i.e. not a performance obligation). All revenue and costs are then recognized upon transferring control of the goods to the customer.	When the customer obtains control of the goods before shipping, the shipping and handling activities may be a separate performance obligation. The US GAAP policy election simplifies the accounting and accelerates recognition of the revenue and costs relating to the shipping and handling activities in comparison to IFRS.
Step 3: Transaction price: Measurement date for noncash consideration		
IFRS 15 (as with current IFRS) does not specify a measurement date for noncash consideration to be received in a revenue contract.	Noncash consideration is measured at contract inception.	Noncash consideration, such as shares or advertising, is measured at fair value for inclusion in the transaction price. Fair value can be measured at contract inception under both IFRS and US GAAP. Other dates (e.g. when the consideration is received) are acceptable under IFRS 15, but are not permitted under US GAAP.

IFRS 15	ASC 606	Consideration for preparers
Step 3: Transaction price: Sales taxes – FASB policy election		
No policy election. The company evaluates whether sales and similar taxes are collected on behalf of a third party (e.g. government) on a jurisdiction-by-jurisdiction basis (i.e. a principal vs. agent evaluation).	Policy election to present all sales and similar taxes on a net basis.	The US GAAP practical expedient simplifies the presentation of sales taxes, in line with current US GAAP. Current IFRS (IAS 18) already requires a principal vs. agent evaluation for sales tax presentation. This may result in some taxes being presented on a net basis and others on a gross basis under IFRS, with a different presentation under US GAAP when the policy is elected.
Contract costs: Reversal of previously impaired contract acquisition and contract fulfillment costs		
Required	Prohibited	Under IFRS, an entity recognizes a reversal of an impairment loss that has previously been recognized when the impairment conditions cease to exist. Any reversal of the impairment loss is limited to the carrying amount, net of amortization, that would have been determined if no impairment loss had been recognized.
Sales outside ordinary activities: Sales of in-substance nonfinancial assets		
Sales of nonfinancial assets, such as property, plant and equipment (IAS 16), intangible assets (IAS 38) and investment property (IAS 40), are accounted for using the measurement and derecognition guidance of IFRS 15. Sales of a subsidiary or equity method investee continue to be accounted for under the deconsolidation guidance (IFRS 10 and IAS 28, respectively).	Sales of nonfinancial assets and in-substance nonfinancial assets scoped in ASC 610-20 are accounted for using the contract existence, separation, measurement and derecognition guidance in ASC 606. Sales of a subsidiary that only has nonfinancial assets and / or in-substance nonfinancial assets and is not a business are scoped into ASC 610–20. This includes partial sale transactions. Sales of a subsidiary or group of assets that constitutes a business or not-for-profit activity continue to be accounted for under the deconsolidation guidance (ASC 810).	For example, if a subsidiary that has only a building and does not represent a business is sold for a fixed price plus a contingent fee: — Under IFRS, the deconsolidation guidance (IFRS 10) applies and the gain or loss is measured using the fair value of expected proceeds. — Under US GAAP (ASC 610-20), the company estimates the transaction price following the variable consideration guidance that is subject to constraint.
Onerous contracts: Determination of provisions for loss-making and onerous contracts		
Onerous revenue contracts are accounted for under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. A provision is recognized when the unavoidable costs of meeting the obligations under a contract exceed the economic benefits to be received.	US GAAP has no general guidance for recognizing a provision for onerous contracts, but instead focuses either on types of contracts or on industry-specific arrangements. Current guidance is unchanged except for losses on long-term construction- and production-type contracts, where an entity is allowed to determine the provision for losses at either the contract level or the performance obligation level.	IFRS and US GAAP are likely to remain unaligned for the foreseeable future.

IFRS 15	ASC 606	Consideration for preparers
Transition: Effective date for nonpublic companies		
Annual periods beginning on or after January 1, 2018.	Annual periods beginning after December 15, 2017 (public business entities and certain not-for-profits) or after December 15, 2018 (other entities).	Nonpublic business entities that have an IFRS parent may need to adopt the revenue standard one year earlier compared to what would be required for US stand-alone financial statements.
Transition: Definition of 'completed contract'		
Completed contract for the purposes of transition is a contract for which the company has transferred all of the goods or services identified under legacy IFRS, regardless of whether all of the revenue has been recognized. Legacy IFRS revenue guidance continues to apply to revenue or adjustments to revenue arising from completed contracts after the transition date.	*Completed contract* for the purposes of transition is a contract for which all (or substantially all) of the revenue was recognized under legacy GAAP.	In an effort to simplify the transition, both GAAPs permit not applying the new requirements to completed contracts. Because the definition of a completed contract differs and US GAAP permits entities to apply the new standard either just to open contracts or to both open and completed contracts, the population of contracts to analyze may differ. Overall, transition options are slightly different between the two GAAPs, so that opening numbers may not be similar under IFRS and US GAAP.
Disclosures: Remaining performance obligations		
Disclosure relief in two situations. An entity needs to disclose the aggregate amount of the transaction price allocated to unsatisfied or partially satisfied performance obligations and when it expects to recognize this amount as revenue, unless: — the contract is one year or less; or — the entity qualifies for the practical expedient to recognize revenue in the amount that is has the right to invoice.	Disclosure relief in four situations. Additional to the two exceptions under IFRS 15, ASC 606 permits not including variable consideration in the disclosure of remaining performance obligations when variable consideration: — is a sales- or usage-based royalty for a license of intellectual property; or — meets the criteria to be allocated entirely to a wholly unsatisfied performance obligation, or to a wholly unsatisfied distinct good or service that is part of a single performance obligation under the series guidance.	Under IFRS 15, the entity needs to estimate certain variable consideration for disclosure purposes only, even when those estimates are not needed for the recognition of revenue.
Disclosures: Interim disclosures		
Disclosure of disaggregated revenue.	Similar to annual disclosures – e.g. disaggregated revenue, contract balances and remaining performance obligations.	IFRS 15 has fewer disclosure requirements for interim financial reporting than ASC 606.

To learn more about the revenue standards:

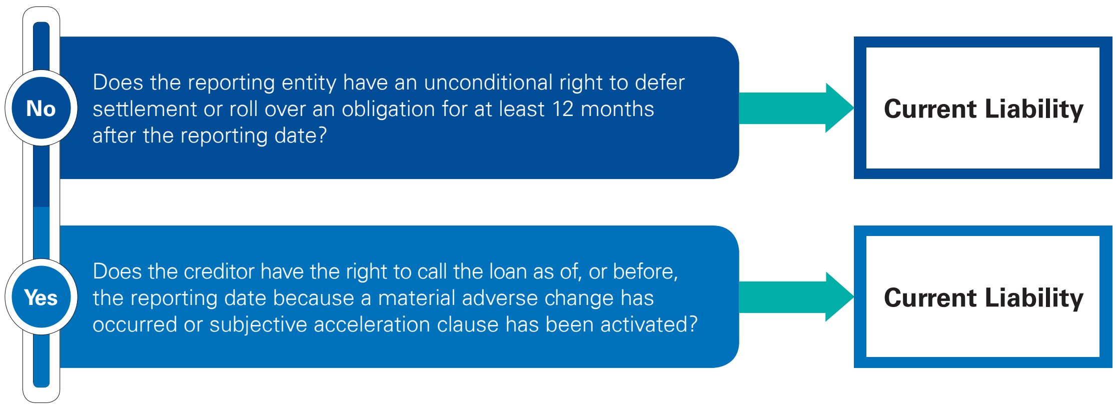
— Visit our revenue Resource Page.

— Take a look at our publication: IFRS Compared to US GAAP.

Current/noncurrent debt classification (IAS 1 vs. ASC 470)

The current/noncurrent classification of debt is important to investors because it changes a company's working capital and liquidity portrayal.

Debt arrangements often contain creditor protective clauses, including quantitative debt covenant clauses, material adverse change clauses, subjective acceleration clauses, or change in control clauses. The treatment of these features in classifying debt can result in significant differences regarding the current/noncurrent classification of debt under IFRS vs. US GAAP on the statement of financial position.



IFRS focuses on the conditions – e.g. contract breaches and waivers – existing at the reporting date, while US GAAP considers post-balance sheet events. US GAAP also requires, in certain situations, a likelihood assessment as of the reporting date as to whether the creditor will be able to accelerate repayment of the debt. IFRS does not consider likelihood or probability assessments.

IFRS focuses on existing conditions at the reporting date

Under IFRS, a financial liability that is due within 12 months from the reporting date, or is payable on demand, is classified as current. This applies to a loan with terms that enable the lender to call the loan at any time, even if such a loan may not be due to be settled within 12 months of the reporting date.

A loan with breached conditions at the reporting date is also classified as current. Unlike US GAAP, this is true even if the lender has agreed, after the reporting date but before the financial statements are authorized for issue, not to demand repayment as a result of the breach.

Under US GAAP, a liability is not classified as current if, after the reporting date but before the financial statements are issued or available for issuance, the debt is refinanced or the lender has waived its right to demand repayment for more than 12 months from the reporting date.

IFRS has no specific guidance on subjective acceleration clauses

When assessing the appropriate classification of debt for an IFRS reporting entity, compliance with loan covenants should be assessed as of the reporting date. Covenant tests using information after the reporting date should be disregarded even when the likelihood of a breach at such future date is probable; however relevant disclosures might be appropriate.

US GAAP provides specific guidance on current/noncurrent classification when an otherwise long-term debt agreement includes a subjective acceleration clause. Classification of debt is based on the likelihood (remote, reasonably possible or probable) that the creditor will accelerate repayment of the liability, which may result in debt classified as current under US GAAP that would be classified as noncurrent under IFRS.

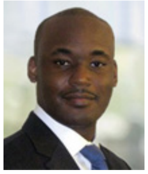
Future developments

Both the IASB and the FASB have proposed amendments to their respective guidance on the balance sheet classification of debt. The IASB proposals are only intended to clarify the existing requirements. However, the FASB proposes to simplify its guidance, which would bring US GAAP closer to IFRS on the matter of subjective acceleration clauses and debt that is refinanced in the post-balance sheet period.

The key difference would be on covenant breach waivers obtained after the reporting date, but before the financial statements are issued: US GAAP would continue to classify the debt as noncurrent whereas under IFRS such arrangements are classified as current.

To learn more about the differences between IFRS and US GAAP, take a look at our publication: IFRS Compared to US GAAP.

For more information please contact:



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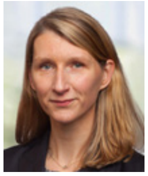

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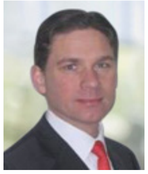

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