

## IFRS White Paper: Fair Value Measurement

Red Moon Solutions is excited to present the following article as the first in a series of articles that explores International Financial Reporting Standards with a focus on fixed and intangible assets. This first article provides:

- A brief background of IFRS
- Specific challenges and implications regarding the tax effects of Fair Value Measurement
- A timeline for IFRS to take effect
- IFRS preparation considerations

Upcoming articles will build on this foundation and offer practical considerations as IFRS relates to property, plant and equipment, and accounting for impairment of long-lived and indefinite-lived assets.

### Who should read this article?

Any large multinational corporation with property, plant & equipment (PPE) as one of the most significant items on its balance sheet will be dramatically impacted. Specifically:

- IFRS compliance will have an enormous impact on accounting systems (and downstream tax systems/modules) due to new methodologies. Changes to systems take time.
- IFRS compliance will have a direct effect on depreciation taken, resulting in new calculations and higher/lower depreciation and higher/lower taxes paid.
- IFRS compliance will affect tax processing.
- IFRS compliance will affect book-to-tax differences.

While the deadline to comply with IFRS may be a few years away, the time to prepare is now.

### IFRS: An overview

For the past 60 years, tax and accounting departments that have complied with GAAP standards now will be complying with IFRS; this does not mean that accounting will start over from square one, but some long-standing GAAP rules will be open to interpretation under IFRS. And, as with any accounting standards change, there will be challenges.

Current accounting policies and current accounting mentality will have to deal with the far-reaching effects of these new standards — from the corporate boardroom to the local CPA. U.S. accountants will be forced to interpret the new accounting principles of IFRS, rather than relying on their usual prescription of GAAP rules. This translates into a





reduction of GAAP rules that entail more than 20,000 pages to the reduced IFRS interpretations that necessitate approximately 2,000 pages.

The International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) have been working to merge International Financial Reporting Standards (IFRS) and U.S. generally accepted accounting standards (GAAP), in order to create a single set of global reporting standards for the international accounting world – eliminating differences and improving standards. Ultimately, the objective is to make financial reports more consistent from country to country. For example, an investor in Australia could more easily interpret the income statement and balance sheet of a U.S. company applying IFRS.

### **Challenge: Applying Fair Value Measurement**

One area certain to be a challenge is the application of fair value when applied to property, plant and equipment.

The IASB's starting point in developing the exposure draft (ED) was the equivalent U.S. standard, SFAS 157 Fair Value Measurements as amended. The proposed definition of fair value is identical to the definition in SFAS 157 and the supporting guidance is largely consistent with U.S. GAAP. Fair Value is defined as:

*The price that would be received to sell an asset or that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date.*

However, the application of fair value upon assets is one area where IFRS and GAAP diverge. For example:

- IFRS basis is either historical cost or the revalued amount. GAAP basis is historical cost.
- IFRS useful life, residual value and method of depreciation are reviewed annually. GAAP useful life, residual value and method of depreciation are only reviewed when a change in events or circumstances dictate the current method is no longer appropriate.
- IFRS depreciates each component when an item of property, plant and equipment that is composed of individual components uses different rates or methods. GAAP permits component accounting, but does not require it.
- IFRS exercises revaluation on property, plant and equipment when fair value can be measured reliably. Revaluations on method, useful life and residual value are reviewed at the annual reporting date. GAAP does not exercise revaluation of property, plant and equipment.
- IFRS defines residual value as the current net selling price for an asset of disposal age in the condition expected at the end of its useful life. Residual value is only adjusted downward. GAAP defines the residual value of property as the discounted present value of expected proceeds on future disposal, which may be adjusted up or down.

### Effects of Fair Value Measurement

This change in accounting standards will reach beyond application of IFRS fair value standards to property, plant and equipment. There will be a trickle down effect on taxes, effective tax rate, deferred tax balances, state apportionment and possibly tax return accounting methods. Specifically, this could mean a change in:

- The amount of tax paid when taxes are based on net worth, capital stock or net book value – especially if the taxing jurisdiction decides to base compliance on IFRS.
- The effective tax rates. Effective tax rates are based on the ratio of income tax expense to pretax income. The convergence to IFRS would affect the numerator and denominator in this calculation.
- Deferred tax balances. Application of a new fair value on the basis of assets will require a recalculation of deferred tax balances due to new temporary differences.
- Calculation of a state apportionment factor relative to restating property, plant and equipment to fair market value.
- State property taxes where property taxes are based on financial statements or book balances.
- Tax return accounting methods (possible change). The Treasury Department and the IRS continue to evaluate the issue of whether or not to expand the definition of eligible method to include IFRS.

### IFRS Timeline: When will IFRS affect me?

For the 20 largest listed companies worldwide by market capitalization, the move will be optional in 2010. The next wave of large firms, those remaining publicly traded worldwide organizations, will take place in 2014.

Of course, this all depends upon meeting the seven subjective milestones the SEC has laid out as the pathway for acceptance in 2011:

1. Improvements in accounting standards
2. Continued funding of the International Accounting Standards Committee Foundation
3. Improvements in the ability to use interactive data for IFRS reporting
4. Education and training in the U.S. related to IFRS
5. Limited early use of IFRS beginning with filings in 2010, where this would enhance comparability for U.S. investors. Eligibility would be determined by the prevalence of the use of IFRS and the significance of the issuer in a given industry. The SEC has estimated that a minimum of 110 companies could be eligible
6. The anticipated timing of future rulemaking by the Commission
7. Implementation of the mandatory use of IFRS, including considerations relating to whether or not mandatory use of IFRS should be staged or sequenced among groups of companies based on their market capitalization



### **IFRS Ready: Prepare Your Organization for IFRS**

IFRS may seem as though it is ages away, but there are some things you may want to start doing now to prepare:

- Determine if your organization is an accelerated filer according to the SEC; thus moving to IFRS in 2014 (or sooner versus later).
- Gain support from your CIO or CFO on a plan for projects that encompass IFRS training and new process implementation.
- Scrutinize your tax and accounting processes for the changes and consequences you will confront when managing your depreciable assets and analyze how these will affect your organization.
- Determine how your GL asset module can handle new FMV measurements and recalculation of assets.
  - Is it able to keep a separate book of assets for evaluations, projections and final compliance?
- How will this data be translated into the tax depreciation subsystem, module or third party tool? Evaluate your fixed asset software to ensure it is up to the challenge of IFRS.
  - Can your current fixed asset software handle multiple accounting books to accommodate GAAP, IFRS, and customizable books?
  - Can your current fixed asset software handle the recalculation of the asset data easily in an automated way with new FMVs, useful lives and methods?
  - Can you run those calculations to project accounting and tax outcomes?



### **IFRS Equipped: Technology to the Rescue**

One technology company that is in the forefront of IFRS and its effects to fixed asset depreciation is Red Moon Solutions LLC. Red Moon Solutions' fixed assets management product, *Fixed Assets Manager (FAM)*, provides a high-end, database-driven asset management system that allows scalable asset depreciation tracking for an unlimited number of assets and an unlimited number of books. The ability to accommodate an unlimited number of books makes it ideally suited for companies with more complex distributed asset holdings—companies that are in the accelerated filer category and complying with IFRS.

"We continue to stay abreast of the IFRS dialogue," said Jennifer Coleman, Product Development Director, Red Moon Solutions. "Fortunately, FAM is designed to accommodate multiple books, thus, the technical infrastructure to accommodate the additional IFRS book is already in place," explains Coleman.



### **Summary**

IFRS will be upon us before we know it. The change in accounting standards will reach beyond application of IFRS fair value standards to property, plant and equipment to affect taxes, effective tax rate, deferred tax balances, state apportionment and possibly tax return accounting methods. Advanced education on IFRS effects will help you navigate the uncharted waters so that you can effectively comply with its standards. Similarly, beginning to plan for IFRS, even as small as assessing your tax supporting technology's ability to support IFRS, can keep you on course.

### **References**

1. IFRS compared to US GAAP: An Overview-KPMG LLC
2. International Financial Reporting Standards and State Taxes: Uncharted Territory-Deloitte
3. Roadmap for the Potential Use of Financial Statement Prepared in Accordance with International Financial Reporting Standards by US Issuers-Securities and Exchange Commission
4. IASB Exposure Draft on Fair Value Measurement – May 2009
5. IFRS Ten Reasons Why Tax Must Be Involved-Ernst & Young
6. IASB publishes draft guidance on fair value measurement-AccountingWEB on 5/27/2009

### **About the Author**

Susan N. Sabatini is an Enrolled Agent with the U.S. Department of the Treasury as a federally authorized tax practitioner with technical expertise in the field of taxation. For more than a decade, Susan has focused on tax technology. She can be reached at her Red Moon Solutions office at 941.379.7114 or at [susan.sabatini@redmoonsolutions.com](mailto:susan.sabatini@redmoonsolutions.com).

### **About Red Moon Solutions**

Red Moon Solutions offers a wide variety of tax technology services and solutions such as Fixed Assets Manager™, AuditRoom™, eTaxCalendar™, Like-Kind Exchange Matching™, and Section 382 Built-In Gain Solution. Red Moon empowers tax professionals with the solutions they want.

Built to support the tax practice of one of the largest U.S. accounting firms, Red Moon's software is flexible, able to provide solutions to Fortune 500 companies and small businesses alike. With completely customizable and scalable options, Red Moon's client-focused software excels in the marketplace. Experience it today: [www.redmoonsolutions.com](http://www.redmoonsolutions.com).