

IFRS'S FAR-REACHING IMPACT FOR LAW FIRMS

The globalization of capital markets and the need for enhanced comparability have been primary drivers toward the adoption of a single set of high-quality, globally accepted set of accounting standards. International Financial Reporting Standards, or IFRS, has the momentum to be such standards.

The SEC issued its Proposed Roadmap and, in February 2010, followed up with its Work Plan for the adoption of IFRS by U.S. registrants, but has yet to fully commit to IFRS. As a result, many reporting entities have chosen to ignore, at least for the present time, the differences between IFRS and accounting principles generally accepted in the United States ("US-GAAP"). However, more than 120 countries have already adopted or are in the process of adopting IFRS. Since U.S. domiciled businesses do not operate in a vacuum, IFRS demands our attention right now.

Despite the fact that the International Accounting Standards Board ("IASB") and Financial Accounting Standards Board ("FASB") have been working together to converge these standards, the differences between IFRS and US-GAAP can be significant and include, but are not limited to, revenue recognition, fair value accounting, accounting for leases, share-based compensation, and treatment of research and development expenditures. These differences may affect transactions with customers, vendors, employees, or sources of financing.

Further, IFRS may already be relevant to the following U.S. domiciled businesses:

(1) Those seeking capital or targeting foreign acquisitions;

Per the U.S. Council Foundation in their April 2009 report titled "How U.S. Multinational Companies Strengthen the U.S. Economy," there are over 2,200 U.S. multinational parents that own a majority (more than 50 percent) interest in a foreign entity. These 2,200-plus companies account for almost 25 percent, or more than \$2.5 trillion, of all private sector output, in GDP terms. These companies have a 50 percent or greater interest in approximately 24,000 foreign affiliates, which report in their home country GAAP and/or IFRS (with an anticipated move exclusively to IFRS). Further, there are approximately 11,000 U.S. entities that own more than 10 percent, but less than 50 percent of one or more foreign entities. Also relevant are the more than 9,000 foreign entities, which own close to 12,000 U.S. entities. Again, all of the foreign entities have to report in their home country GAAP and/or IFRS, which can have a significant impact on the comparability of operations as well as the record keeping requirements for all of these entities. With respect to listed entities, there are over 800 foreign companies listed on U.S. exchanges and over 200 U.S. entities listed on foreign exchanges.

- (2) Targets for acquisition by foreign domiciled businesses;
- (3) Subsidiaries of foreign domiciled parents; and
- (4) Entities with foreign subsidiaries and/or foreign trading

Among the issues that various stakeholders should consider:

- **Owners, boards of directors, and audit committees** should be aware that although cash flow likely would not be impacted by employing a different accounting platform, reporting under IFRS could have an impact on business valuations. It is important to understand what basis of accounting is used in the financial statements underlying a business valuation. Significant differences in reported revenues, net income, net assets, and net worth can arise, which could impact a valuation.

Audit committees need to be aware that an orderly transition to IFRS will

require modifications to accounting policies, information technology systems, business processes, and internal controls. For these reasons, audit committee representatives should currently communicate with their CEOs and CFOs regarding the implementation plans for adopting IFRS if and when required.

This group, along with attorneys that advise this group, should also remain cognizant of any local statutory IFRS financial reporting requirements of foreign subsidiaries. Such requirements can warrant significant conversion efforts and related costs.

- **CEOs, CFOs, and strategic management teams** should consider the effect of IFRS on key performance indicators, such as those which may affect loan covenants or employee compensation. Further, these stakeholders may need to consider certain commercially sensitive disclosures that may be required by IFRS.

- **CFOs and finance teams** will shoulder the largest burden in determining how IFRS might impact the following:

- Training of finance and accounting staff
- Financial accounting and reporting systems
- Debt covenants
- Budgeting
- Acquisitions and contingent consideration (i.e., earn-outs)
- Leases
- Tax planning (i.e., LIFO and transfer pricing)

- **IT management** will need to acquire or develop new systems or reconfigure existing systems to capture the necessary financial accounting and information for reporting under IFRS.

What Does This Mean for Law Firms and Attorneys?

Given the far-reaching impact of IFRS, it is critical that law firms and their attorneys become well versed in this new “language” in order to best serve clients. The following different attorney groups may be affected:

- **M&A attorneys** will likely see an increase in cross-border transactions where IFRS is the primary accounting method. In structuring such transactions, these attorneys will need to be conversant in the IFRS debt and equity classification requirements.

- **Tax attorneys** will need to work with their clients to reorganize any tax structures and strategies impacted by IFRS.

How J.H. Cohn Can Help

While, ultimately, the economics of existing agreements will not change under IFRS, attorneys must be aware that financial statements, covenants, price adjustments, and other terms established under US-GAAP very well may. Attorneys must be prepared to work with their clients to address these changes. The optimal time to learn more about these changes and how you can help your clients is now. ■

To learn more about how IFRS will impact your clients and how you can help them to prepare, please contact your J.H. Cohn client service professional or Bill Kowals, CPA, a J.H. Cohn partner and chairperson of the Firm's IFRS Committee, at wkowals@jhcohn.com or 877-704-3500.

For more information on J.H. Cohn's Law Firms Industry Practice, [click here.](#)

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When negotiating agreements that give consideration to future financial results (e.g., debt covenants, contingent rentals, contingent consideration in an acquisition, and employee incentive compensation), it is important to specify the basis of accounting that will be employed. Also, management and legal counsel need to be aware that existing agreements may require renegotiation.

- **Sales management**, in coordination with finance teams, will need to consider whether standard revenue arrangements created to allow for revenue recognition under US-GAAP need to be reevaluated when operating using IFRS. This factor could significantly impact the way an entity goes to market.

- **Investor relations** will need to consider the education of users of financial information and the manner in which stockholder communications are made.

- **Human resources professionals** will need to evaluate compensation arrangements, both cash incentive compensation and share-based compensation arrangements.

- **Corporate attorneys** serving management and boards should become involved in internal IFRS discussions early so as to become well versed on the documentation, policies, procedures, and protocols necessary to ensure IFRS compliance. Given that IFRS is principles based (as opposed to US-GAAP being rules based), the inherent risk of litigation will be increased. Corporate attorneys will need to work closely with their clients to properly manage these risks.

- **Corporate attorneys** involved in **contract agreements** must begin to consider the impact of IFRS on earn-outs, credit agreements, purchase agreements, sales contracts, and bonus plans. Any contracts that include provisions for leases, derivatives, and securitizations must also be reviewed. These contracts may need to be renegotiated in order to place the contract parties in positions contemplated by the original agreements. Further, contracts with US-GAAP provisions must be assessed in order to avoid a dual bookkeeping system.

California

Los Angeles

11755 Wilshire Boulevard
17th Floor
Los Angeles, CA 90025
310-477-3722

San Diego

4180 Ruffin Road
Suite 235
San Diego, CA 92123
858-535-2000

Warner Center

21700 Oxnard Street
7th Floor
Woodland Hills, CA 91367
818-205-2600

Cayman Islands

P.O. Box 1748 GT
27 Hospital Road
George Town, Grand Cayman
877-704-3500 x7839

Connecticut

Glastonbury

180 Glastonbury Blvd.
Glastonbury, CT 06033
860-633-3000

New Jersey

Roseland

4 Becker Farm Road
Roseland, NJ 07068
973-228-3500

Eatontown

27 Christopher Way
Eatontown, NJ 07724
732-578-0700

Lawrenceville

997 Lenox Drive
Lawrenceville, NJ 08648
609-896-1221

Metro Park

333 Thornall Street
Edison, NJ 08837
732-549-0700

New York

Manhattan

1212 Avenue of the Americas
Suite 1200
New York, NY 10036
212-297-0400

Charles Brucia & Co.,
A Division of J.H. Cohn LLP
1212 Avenue of the Americas
New York, NY 10036
212-682-2459

Frederic Kantor & Company,
A Division of J.H. Cohn LLP
1212 Avenue of the Americas
New York, NY 10036
212-727-2300

Long Island

100 Jericho Quadrangle
Suite 223
Jericho, NY 11753
516-482-4200

White Plains

1311 Mamaroneck Avenue
White Plains, NY 10605
914-684-2700