



Power & Utilities IFRS Webcast Series presents:

# Overview of the Impact of IFRS on Power and Utilities

Presenters: Jan Umbaugh and Brian Murrell

Moderator: Charlie Muha

November 7, 2008

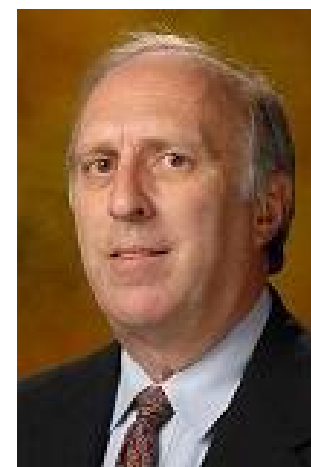
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# About your presenters

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Jan Umbaugh is an audit partner in Deloitte & Touche LLP and serves as Deloitte's National Professional Practice Director for power and utilities. In this role his activities include research and consultation on accounting and auditing issues for utilities clients and practice office personnel.

Jan has served Deloitte's largest power and utilities clients and also serves as the concurring review partner on many of them. He served two terms on the AICPA's Public Utilities Committee and is a contributing author to Accounting for Public Utilities. He has testified before several regulatory agencies in public utility proceedings.



**Jan Umbaugh**

Partner

Deloitte & Touche LLP

## About your presenters contd.

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Brian is a partner in Deloitte's Regulatory & Capital Markets Consulting (R&CM) group. He serves as the U.S. Energy & Resources IFRS lead for R&CM. Brian has significant experience with complex technical accounting guidance impacting energy companies under IFRS and U.S. GAAP.

Brian spent four years in Europe focused on assisting European energy companies convert to IFRS. He served as an IFRS thought leader for Deloitte's UK Firm and throughout Deloitte's European energy operations. Brian also was Deloitte's liaison to the International Energy Accounting Forum, an industry group focused on developing consensus around IFRS technical accounting conversion issues.



**Brian Murrell**  
Partner  
Deloitte & Touche LLP

# Agenda

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Introduction

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Background – How did we get here?

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Overview of accounting issues for the power and utilities

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Other impacts of IFRS adoption

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Considerations for a smooth transition to IFRS

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Closing remarks

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Question and answers

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Background:  
How did we get here?

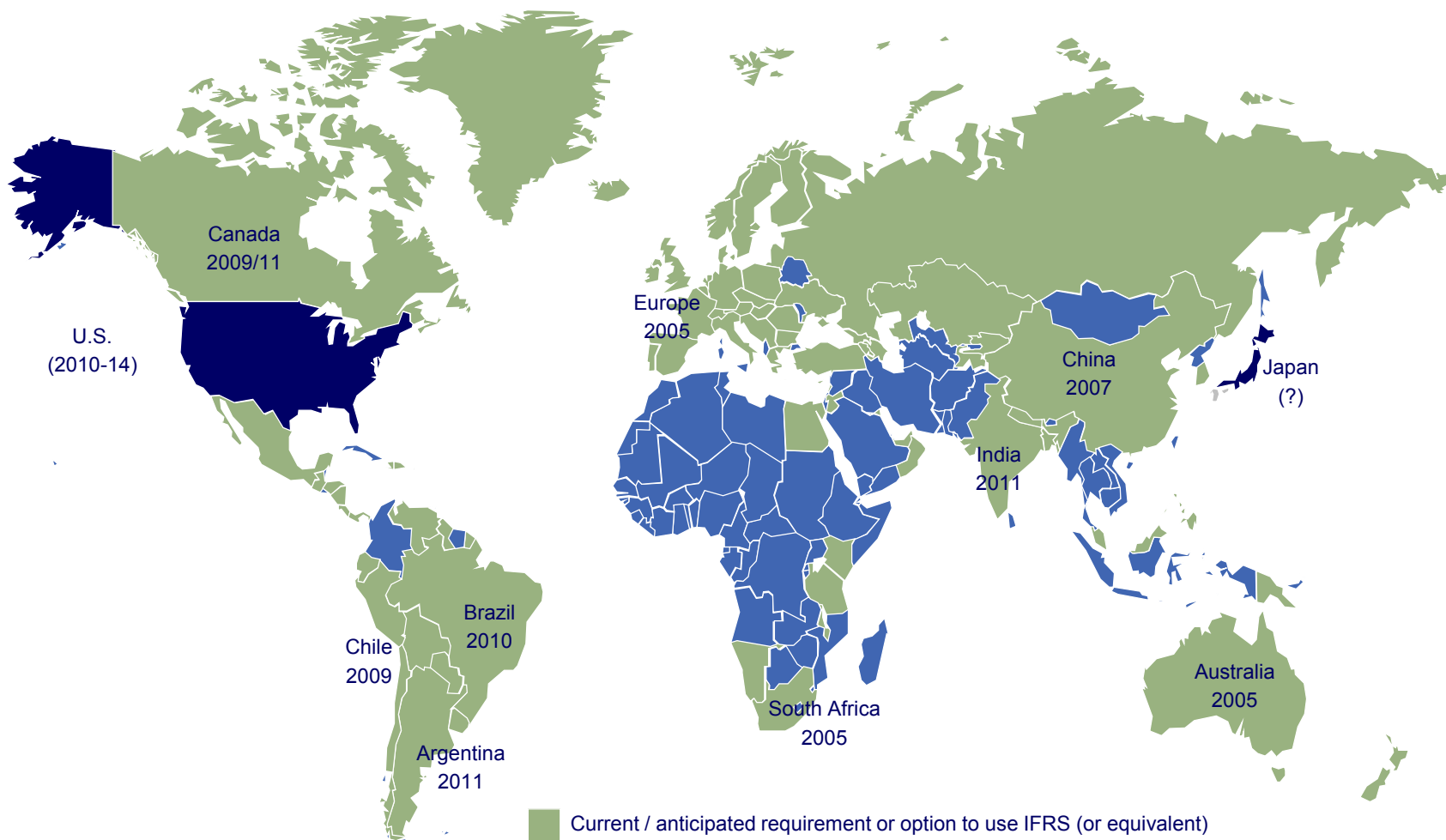
# A changing global financial reporting environment

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- Globally there is a significant movement towards a single financial reporting standard – International Financial Reporting Standards (IFRS)
  - Ongoing evolution of regulatory standards
    - International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) have reaffirmed convergence efforts
    - Greater cooperation amongst regulators on IFRS application issues
    - Movement in the U.S. to simplify financial reporting
    - Roadmap regarding use of IFRS by U.S. issuers
  - Considerable movement towards mutual recognition of financial reporting frameworks between the U.S. and the EU
    - U.S. GAAP in EU – Equivalence Initiative
    - IFRS in U.S. – IFRS Roadmap

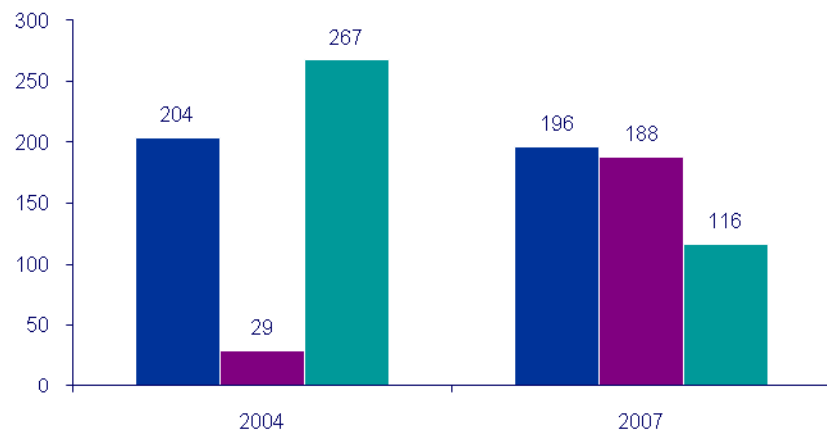
# Global move towards IFRS

IFRS is presently used in over 100 countries. By 2011, it is expected that all major countries will have adopted IFRS to some extent (including an option in the U.S.)

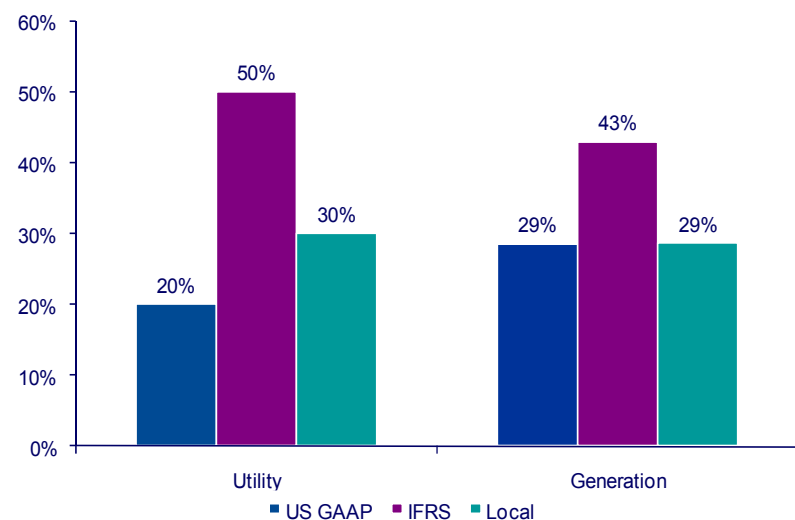


# Use of IFRS by global organizations

Global Fortune 500 moving to IFRS:



Energy Global Fortune 500 companies in 2007:



Company	Market Cap (in \$B)	Country	Accounting Standard
EDF Group	170.81	France	IFRS
E.ON	126.22	Germany	IFRS
Suez Group	83.56	France	IFRS
Iberdrola	72.78	Spain	IFRS
RWE Group	68.19	Germany	IFRS
ENEL	67.00	Italy	IFRS
Gaz de France	56.73	France	IFRS
Exelon	49.49	USA	U.S. GAAP
UES of Russia	47.09	Russia	Local
CEZ	43.86	Czech Repub	IFRS
Veolia Environment	42.78	France	IFRS
NTPC	41.57	India	Local
Fortum	37.29	Finland	IFRS
National Grid	37.29	UK	IFRS
Tokyo Electric Power	34.93	Japan	Local
Gas Natural Group	27.32	Spain	IFRS
Southern Co	26.41	USA	U.S. GAAP
Scottish & Southern	25.42	UK	IFRS
FPL Group	24.56	USA	U.S. GAAP
Reliance Power	24.32	India	Local

# Recent regulatory developments

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- The SEC issued a Concept Release on allowing U.S. issuers a choice between IFRS and U.S. GAAP
- Elimination of U.S. GAAP reconciliation for Foreign Private Issuers using IFRS
- FASB panel discussion of U.S. moving to IFRS
  - Encouragement from stakeholders for the SEC to set a definitive timeline for conversion to IFRS
- SEC IFRS Roundtable – August 2008
  - Discussion on performance of IFRS and U.S. GAAP during credit crisis
    - Consensus that IFRS held up well, if not better than U.S. GAAP
    - Fair value still remains a challenge under both standards
  - Discussion on areas where continued convergence is needed

## Recent regulatory developments contd.

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- Roadmap sets the stage for possible mandatory adoption of IFRS by U.S. issuers beginning with fiscal years ending after December 15, 2014 for large accelerated filers
- Roadmap contains certain milestones to be achieved
  - SEC Commission to review milestone progress in 2011 before issuing a final rule for mandatory adoption
- Roadmap would permit certain U.S. issuers the option to use IFRS for fiscal years ending after December 15, 2009
  - Three years of financial statements must be presented
  - Issuers must be in the top 20 companies in their industry based on market capitalization, and their industry peer group must predominantly report under IFRS

# FASB and IASB convergence efforts

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- In 2006, the FASB and IASB issued a memorandum of understanding (MOU) describing the priorities and milestones related to their completion of 11 major joint projects
- Examples of the convergence effort since the original MOU in 2006:
  - The FASB issued standards that introduced a fair value option and largely converged the accounting for business combinations in U.S. GAAP with that in IFRS.
  - The IASB issued new or revised standards on borrowing costs and segment reporting and is expected to issue a revised standard on joint ventures at the beginning of 2009.
- Reasons for more significant lack of progress include differences in views about:
  - Agenda size and project scope
  - The most appropriate approach, and
  - Whether and how similar issues in active projects should be resolved consistently

## FASB and IASB convergence efforts contd.

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- In September 2008, the FASB and IASB issued a MOU updating the priorities and milestones related to their completion of major joint projects by 2011
- The FASB is expected to decide whether its policy should be to adopt existing IFRS's or continue to develop standards that may or may not be entirely converged with IFRS's prior to mandatory adoption

# FASB and IASB convergence priorities

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- Business Combinations
- Financial Instruments
- Financial Statement Presentation
- Intangible Assets
- Leases
- Liabilities and Equity Distinction
- Revenue Recognition
- Consolidation
- Derecognition
- Fair Value Measurement
- Post-employment Benefits

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# Overview of accounting issues for power and utilities

# IFRS 1: First-time adoption

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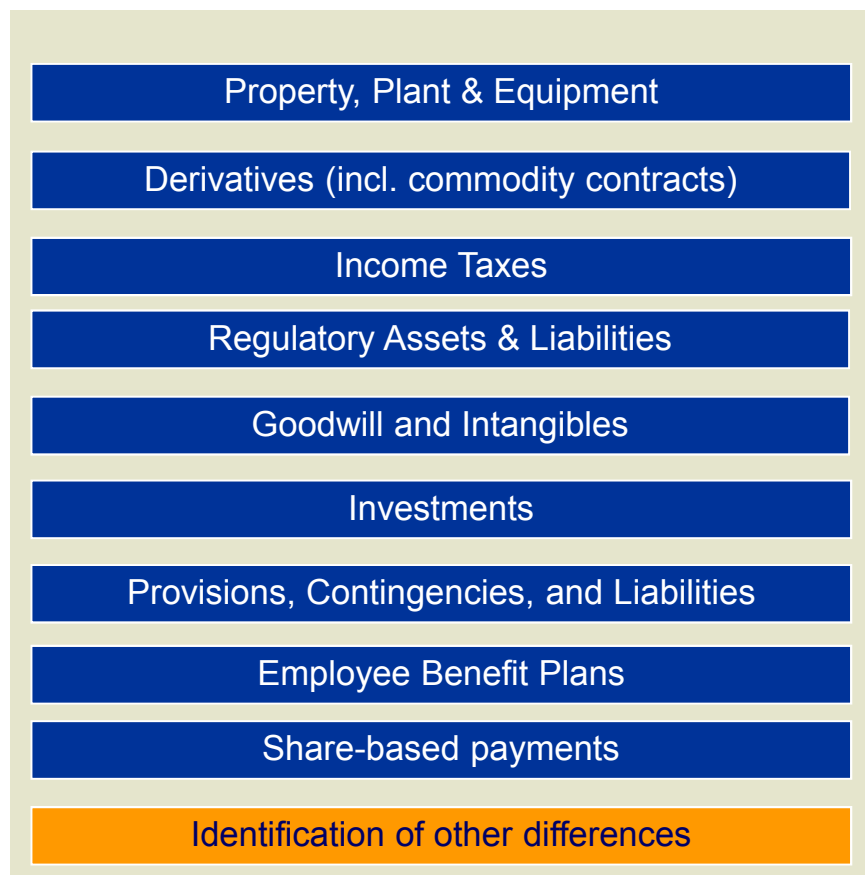
- Apply IFRS retrospectively at reporting date (with some exceptions)
- One year of comparative financial information and disclosures of effects of transition required (Note: SEC roadmap would require two years comparative)
- Transition adjustments recognized in retained earnings

Overall	Opening Balance Sheet	Disclosures
<ul style="list-style-type: none"> <li>▪ Identify key dates</li> <li>▪ Identify differences between existing accounting policies and IFRS and determine IFRS policies</li> <li>▪ Determination of estimates under IFRS</li> <li>▪ Elect and apply optional exemptions (9/25 proposed exemption for regulated PPE)</li> <li>▪ Apply mandatory exceptions</li> </ul>	<ul style="list-style-type: none"> <li>▪ Recognize all assets and liabilities required under IFRS (internal development costs)</li> <li>▪ Derecognize all assets and liabilities not permitted under IFRS (post acquisition restructuring)</li> <li>▪ Measure assets, liabilities and equity (impairment of assets)</li> <li>▪ Reclassify items (deferred tax items)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Identify areas where extensive disclosures will be required</li> <li>▪ Reconciliation of equity and income</li> <li>▪ Distinguish between policy changes, estimate changes and error corrections</li> <li>▪ Narrative discussion adjustments</li> <li>▪ Asset impairment</li> <li>▪ Deemed cost</li> </ul>

# Key workstreams affected by IFRS 1

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- IFRS adoption will have broad implications across a number of areas:



- IFRS 1 requirements are embedded in the entire effort and each of the specific accounts identified
- In some cases, an account or workstream identified is significant enough to warrant specific focus
- In other cases, accounts or workstreams can be combined in a joint implementation effort
- Best practice – focus effort on continual reassessment of other areas as the project progresses to ensure all impacted areas are considered

# Overview of select differences

Potential Differences	Potential Implications		
	Financial Statement	Process/Systems	Other
<b>Derivative Instruments</b>	U.S. GAAP guidance is more prescriptive than IFRS, particularly in core businesses that have significant contractual activities on a forward basis	May lead to potential policy changes and related changes to derivatives database and valuation systems/processes	Differing definitions will necessitate a review of contracts
<b>Income Taxes</b>	No specific guidance related to uncertain tax positions in IFRS; classification of deferred tax assets/liabilities between short -and long-term will be different	Tax accounts and processes for deferred taxes and uncertain tax liabilities may change; Additional temporary differences are likely	Taxable income that is typically based on reported book earnings will change; Record-keeping requirements are likely to increase
<b>Property, Plant and Equipment</b>	IFRS requires a componentization approach; Costs eligible for capitalization may also differ; revaluation at fair value is an option	Systems modifications may be necessary to track components and separate depreciation amounts	May cause potential difficulty in initial componentization exercise depending on age of assets, previous acquisitions; Will also have potentially significant tax implications
<b>Regulatory Assets and Liabilities</b>	No IFRS equivalent to SFAS 71; regulatory items may only be recorded if they meet the IFRS definition of assets or liabilities	May require additional analysis and assessment processes to determine whether specific items can be recorded on the balance sheet	Amounts previously deferred on the balance sheet based on SFAS 71 may now impact current income and consequently lead to earnings volatility

# Overview of select differences cont.

Potential Differences	Potential Implications		
	Financial Statement	Process/Systems	Other
<b>Asset Impairments</b>	Differing impairment assessments (e.g., one-step approach under IFRS) exist; IFRS impairments may be reversed	Will require changes in impairment analysis and more likely requirements to measure impairment amounts	Will lead to increased focus on periodic assessments and financial statement disclosures
<b>Asset Retirement Obligations</b>	Both standards have similar initial treatments, but IFRS amounts adjusted for discount rate changes	May need changes to systems to incorporate discounting impacts	May need increased monitoring of valuation inputs and their effects
<b>Joint Ventures</b>	IFRS differentiates between jointly controlled assets and operations versus jointly controlled entities/ventures	Systems modifications to manage differing consolidation processes	Proposed IFRS standard likely to remove proportionate consolidation option; potentially change evaluation of joint assets and operations

# Asset impairments

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- Differing impairment assessments (e.g., one-step approach under IFRS) exist
  - May lead to earlier impairments under IFRS
  - Could challenge the appropriate level of impairment for analysis and the determination of fair value
- IFRS impairments may be reversed, so tracking of impaired assets to determine amount of potential reversal is required
- Will lead to increased focus on periodic assessments and financial statement disclosures

# Asset retirement obligations

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- Both standards have similar initial treatments including frameworks that provide for a present value approach in measuring the liability obligation
- Risk-adjusted discount rates applied to decommissioning provisions are reset at each reporting date under IFRS based on current best estimates
- IFRS does not require assumption of third party profit in settlement cost
- May need increased monitoring of valuation inputs and their effects

# Joint ventures

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- IFRS differentiates between jointly controlled assets and operations versus jointly controlled entities/ventures
  
- Under IFRS:
  - Jointly controlled assets/operations – recognize your share of the assets/operations
  - Jointly controlled entities – either proportionate consolidation or equity method
  
- Proposed IFRS standard likely to:
  - Remove proportionate consolidation option
  - Change evaluation of joint assets and operations

# Overview of select differences cont.

Potential Differences	Potential Implications		
	Financial Statement	Process/Systems	Other
<b>Leases</b>	Lease classifications may differ; No bright line tests in IFRS; IFRS lease definition applies to the right to use any asset (more than just PP&E and land)	May have potential changes to lease revenue systems/processes; All contracts existing at transition will have to be evaluated to determine if they are leases under IFRS	Will require review of existing contracts
<b>Inventory</b>	IFRS does not permit LIFO	Need to adopt an alternative inventory method with potential changes to associated systems	If non-LIFO method is recognized for rate recovery, cash flows will be adversely impacted
<b>Environmental Liabilities</b>	U.S. GAAP has more specific recognition rules than IFRS	May have a reduction of U.S. GAAP-specific recognition parameters and increased focus on economic, legal factors	Specific rules are replaced by enhanced reliance on judgment, making standardized processes more difficult

# Leases

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- IFRS lease definition applies to the right to use any asset (more than just PP&E and land), except for some intangible assets
  
- Lease classifications may differ under IFRS
  - IFRS generally requires transfer of risks and rewards - no bright line tests
  - IFRS requires that the land and buildings elements of a lease be considered separately for purposes of lease classification
  
- IFRS adoption will require review of existing contracts:
  - Reevaluate whether existing contracts contain leases, and
  - Reevaluate proper lease classification of existing leases

# Inventory

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- IFRS does not permit LIFO - requires either FIFO or weighted-average cost method
  
- LIFO is only permitted for U.S. tax if it is also used for financial reporting
  - The financial reporting effects of adopting IFRS are charged or credited to retained earnings, however
  - Cumulative effect of changing tax methods of accounting is recognized as taxable income over four years (if change results in taxable income)
  
- If non-LIFO method is recognized for rate recovery, cash flows will be adversely impacted due to the reduction of LIFO layers

# Environmental liabilities

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- U.S. GAAP has more specific recognition rules than IFRS
  - Accruals are recorded under U.S. GAAP when payment is both probable (“likely to occur”) and reasonably estimable; amount recorded is based on most probable outcome
  - Provisions are recognized under IFRS when it is probable (“more likely than not to occur”) there will be an outflow of resources and a reliable estimate can be made; amount recorded is generally based on “best estimate” to settle the provision. There are situations where a weighted average approach is appropriate under IAS 37.

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# Other impacts of IFRS adoption

# “Substance over form”: what does that mean?

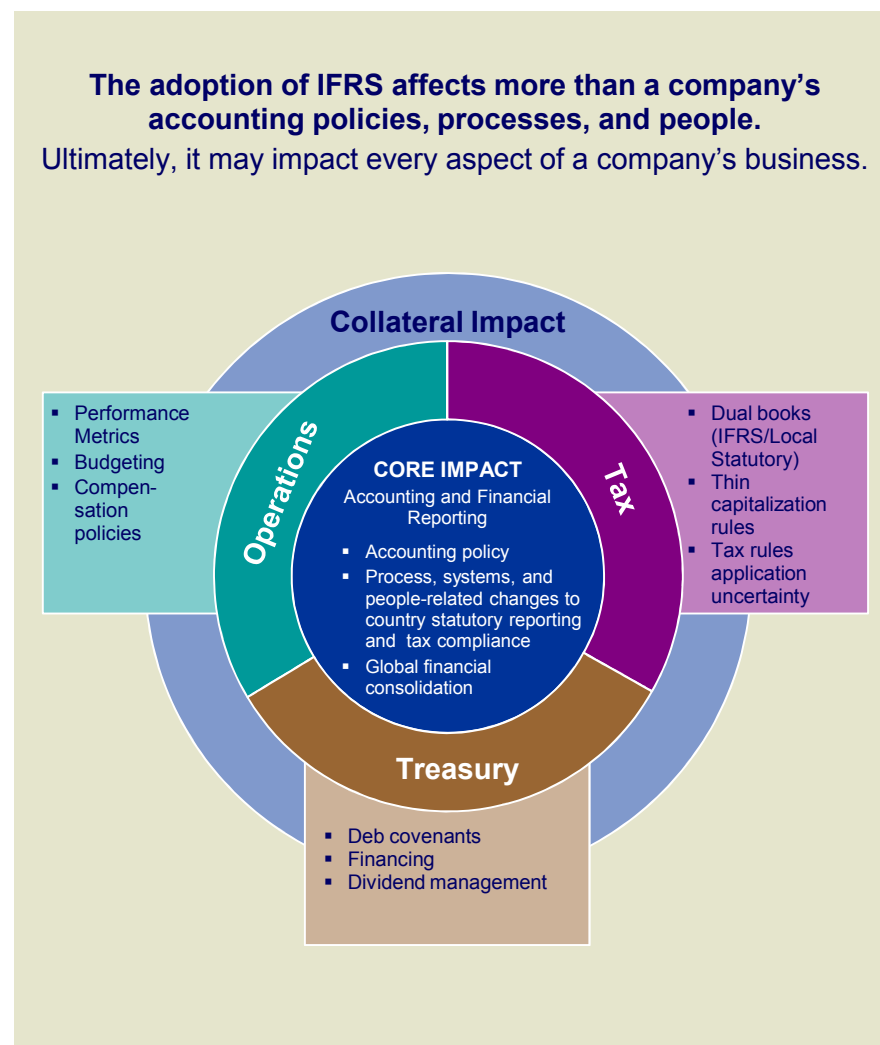
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IFRS	U.S. GAAP
<ul style="list-style-type: none"><li>▪ “Applying principles with judgment”</li><li>▪ Can be summarized into one eight inch thick book</li><li>▪ Decisions made by people who best understand the transaction(s)</li></ul>	<ul style="list-style-type: none"><li>▪ “Finding the answer”</li><li>▪ A 10-foot stack of literature from numerous sources</li><li>▪ Decisions reached by “technicians” based upon strict rules and edicts</li></ul>

- However, this does not mean there are no rules (there are)
- More freedom for companies to represent the actual substance of their transactions in the financial statements, based upon a sound understanding of the IFRS principles (and rules)
- Robust processes and controls needed to avoid abuses of this “freedom”

# Impacts beyond financial statements

- Core impact areas:
  - Technical accounting
  - Processes and systems
  - Risk monitoring and controls
  - Human resource matters
- Many other business areas affected:
  - Operations and Technology
  - Tax
  - Treasury
- Impacts multiple transacting areas:
  - Debt covenants
  - Compensation plans
  - Revenue contracts
  - Tax returns
  - Joint ventures and alliances
  - Investor communication



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# Considerations for a smooth transition to IFRS

# Lessons learned

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Conversion is complicated and takes time

- Different workstreams and milestone goals necessitate an overarching project management role
- Change in culture and thinking from a rules-based approach to a principles-based methodology, so although some technical accounting areas may be similar, but the significance of conversion efforts may be underestimated.
- Identify resource constraints early on and manage around other ongoing business responsibilities

Efforts best served by focusing on topical areas

- Many areas can be focused on in parallel, but only if designed as discrete workstreams with dedicated resources to ensure that continued progress is made
- Effort on converting financial instrument reporting alone under IAS 32 / 39 / IFRS 7 is as big of a task as converting the remaining accounting requirements

Coordination is key

- Coordinate efforts across multiple business units, geographies and obtain companywide buy in.
- Develop controls in parallel with operational changes across the organization
- Think through implications on “non-accounting” areas, such as impacts on systems capabilities and required modifications, impacts on tax treatments which may impact tax planning

Don't underestimate the need for training

- Training is key at all levels of the organization to ensure a smooth transition to IFRS
- Include everyone so the whole organization speaks the same “language”
- Tailor training programs by level and role within the organization (i.e., technical accounting personnel require a different level of education from front office/deal originators, legal, etc.)

# The EU experience

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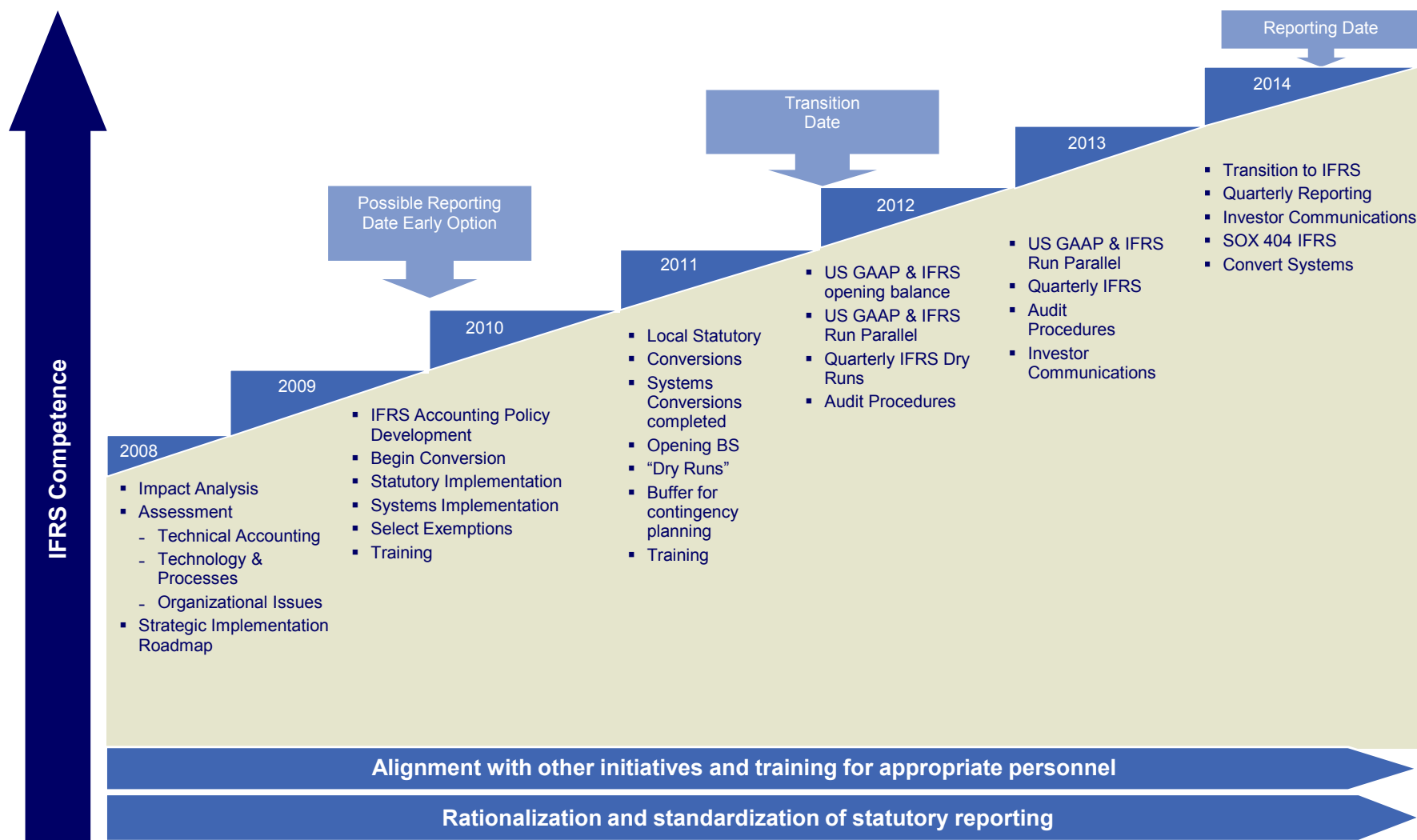
- Overall approach generally was to minimize differences from local GAAP
- Variety of performance measures were used
- Increased disclosure in financial statements
  - Judgments made and risk disclosures
- Use of IFRS 1 exemptions
  - Business combinations, CTA and pension exemptions widely used
- Significant impact on results, also compared to U.S. GAAP
  - Asset impairments, “split accounting” and components were significant issues

# Impact of IFRS on your company

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- Have we inventoried our current IFRS reporting requirements, if any?
- How many local generally accepted accounting principles (GAAPs) do we currently report under?
- How might our access to capital be impacted by an IFRS conversion?
- What is the level of IFRS knowledge within the company?
- What would be the impacts on our company of a possible IFRS requirement in the U.S.?
- Have we assessed the cost and benefits of adopting IFRS?
- What impacts will IFRS have on my utility rates?
- What changes should/can be made by regulators if IFRS is adopted?

# Illustrative IFRS Adoption Timeline



# Closing remarks

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# Closing

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- IFRS is becoming the global standard, either by direct adoption or indirectly through local GAAP conversion efforts
- Companies may be affected by IFRS sooner than they expect
- Take a balanced, reasoned approach to IFRS: adoption may not be mandatory (for now), but it will be prudent to plan ahead
- Consider the various impacts and associated costs and benefits
- Don't underestimate the implementation lead times involved
- Now is time to perform an assessment to evaluate the impact IFRS may have and what strategy your company will follow for adoption

# Deloitte resources

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- [www.iasplus.com](http://www.iasplus.com)
  - A news page (updated almost daily)
  - Detailed summaries of all standards and interpretations
  - E-learning modules for each IAS and IFRS
  - Model IFRS financial statements and disclosure and compliance checklists
  - Downloadable Deloitte publications relating to IFRS (over 100 publications available)
  - Background on all IASB and IFRIC agenda projects, plus decision summaries of all IASB and IFRIC meetings
  - Comparisons of IFRS and various local GAAP

## Deloitte resources (cont.)

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- [www.deloitte.com/us/ifrs](http://www.deloitte.com/us/ifrs)
  - Recent publications on IFRS issues
  - IFRS trainings
  - Resource library
  - Podcasts and Dbriefs
  - IFRS and U.S. GAAP pocket comparison
- DART (subscription only)
  - IFRS research materials
  - Q&A on key differences between U.S. GAAP and IFRS



# Questions and answers

# Power & Utilities IFRS Webcast Series

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**November 14, 2008**

*International Accounting Standards (IAS) 32 and 39 and Energy Transacting*

**November 21, 2008**

*IAS 12 – Income Taxes*

**December 12, 2008**

*IAS 16 – Property, Plant and Equipment*

**December 19, 2008**

*Regulatory Assets/Liabilities*

For more information, contact [USEnergyIFRS@deloitte.com](mailto:USEnergyIFRS@deloitte.com)

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