



Drive for the global GAAP

An automotive industry
comparison of
US GAAP and IFRS



Contents

1 Understanding US GAAP vs. IFRS: An automotive industry perspective

3 US GAAP and IFRS among major vehicle manufacturers and suppliers

5 Key differences between US GAAP and IFRS

6 Revenue recognition

8 Research and development costs

11 Tooling

13 Accounting for loss contracts

15 Impairment of assets

17 Restructuring costs

Other areas

19 Joint ventures

20 Union payments

21 Asset-backed securities entities

22 Inventories

23 Appendix – the evolution of IFRS

Understanding US GAAP vs. IFRS: An automotive industry perspective



The growing complexity of compliance and the struggle to agree on a single set of globally accepted accounting standards is increasingly relevant for multinational automotive companies. The primary reason is increased capital markets activity resulting from mergers and acquisitions, carve-outs, restructurings and private equity transactions combined with production shifts to emerging markets and increased scrutiny of analysts, investors and regulators.

For years, the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have been supporting the concept of a single set of high-quality global accounting standards that can be consistently applied by issuers and auditors, and more easily understood by investors worldwide. However, as closely as they worked to find common ground, the FASB and the IASB were also committed to their own standards. When, in 2003, the European Union (EU) mandated the adoption of International Financial Reporting Standards (IFRS) by all EU-listed companies from 2005 onward, the concept of international standards received a major boost.

These developments, coupled with the increasing attractiveness of the European and Asian capital markets, led emerging and transitioning economies – Brazil, China, India and Russia – to announce plans to converge their existing financial reporting standards to IFRS. Other established markets including Canada, Chile, Israel and Korea have also chosen to migrate from their local GAAP standards to IFRS as early as 2011.

IFRS is emerging as the leading set of financial reporting standards for the world's capital markets – with more than 100 countries already adopting or permitting IFRS, or basing their local GAAP on the principles of IFRS. The U.S. Securities and Exchange Commission (SEC) is debating whether IFRS should be permitted as an alternative to US GAAP for US domestic companies.

The SEC proposal

Since 1982, the SEC has required foreign private issuers (FPIs) – non-US companies listed on an US stock exchange - to use US GAAP as their basis for financial reporting to the SEC or to provide a reconciliation of their reported net income and assets from their local country GAAP to US GAAP.

However, on 15 November 2007, the SEC ruled unanimously that FPIs (effective immediately) be allowed to file financial statements without reconciliation to US GAAP, provided that statements are prepared using IFRS as issued by the IASB. This ruling was a historic shift in thinking on the part of the SEC, and strongly suggests that IFRS may one day be the globally accepted accounting standard.

This notion is also supported by a Concept Release issued by the SEC in August 2007, requesting feedback on policy issues related to the possible use of IFRS by domestic registrants. The Concept Release is not a proposal to allow US registrants the option as such; rather, it seeks input to identify what would be necessary to reach an appropriate level of understanding if the SEC were to allow US registrants to file using IFRS.

In December 2007, the SEC held roundtables to discuss the Concept Release. The discussions consisted of four separate panels and included representatives from public companies, auditing firms, investor groups, academia, rating agencies, the legal community and government agencies.

The roundtable participants expressed very strong support for a single set of high-quality global accounting standards that could be used by companies around the world, for the benefit of users and companies alike. There was also agreement among the majority of panelists that US issuers should ultimately be required to adopt IFRS.

The SEC Roadmap

On 27 August 2008, the SEC approved for public comment its long-awaited proposed "Roadmap" related to the eventual use of IFRS by US companies. The proposed Roadmap anticipates mandatory reporting under IFRS beginning in 2014, 2015 or 2016, depending on the size of the issuer, and provides for early adoption in 2009 by a small number of very large companies that meet certain criteria. And it is possible that the SEC will later decide to permit other companies to early adopt at some point in time prior to the mandatory date of conversion. The Roadmap also identifies several milestones that the SEC will consider in making its decision in 2011 about whether to proceed with mandatory adoption of IFRS.

With the issuance of the proposed Roadmap, the SEC took its most significant step toward the adoption of a single set of high-quality global accounting and financial reporting standards that everyone can use.

We at Ernst & Young have been saying for some time now that the conversion to IFRS for at least public companies in the US is a matter of "when and how" and not "if." The announcement of the proposed Roadmap is a big step toward the realization of that statement. At first glance, 2014 might sound like it's a long way off. However, many companies have already taken the first steps toward preparing for the seemingly inevitable conversion to IFRS.

We expect more dialogue on this topic over the next several months followed quickly by diagnostic and implementation related activities. Everyone interested in the future of US capital markets should pay close attention to what could become a historic milestone in US financial reporting.

US GAAP and IFRS among major vehicle manufacturers and suppliers

The following table provides an overview of the accounting principles currently applied by major automotive vehicle manufacturers and Tier 1 suppliers as of this writing.

The table illustrates that the accounting principles applied by each company is highly correlated to the geographic region where the company is headquartered, with US GAAP limited to the “Big 3” within the vehicle manufacturer group. The picture is different for suppliers, with many of them headquartered in the US and listed on the US stock exchange, while there are relatively few listed suppliers headquartered in Asia.

Neither US GAAP nor IFRS are required for companies in Asia. However, some report financial information in accordance with US GAAP and the standards of their country of domicile. Currently, major Asian companies in the automotive sector are headquartered in Japan; however, this could change.

On 8 August 2007, the Accounting Standards Board of Japan (ASBJ) and the IASB announced the “Tokyo Agreement” to accelerate convergence between Japanese GAAP and IFRS. The agreement aims to eliminate major differences (as defined by an assessment undertaken in 2005) between the Japanese GAAP and IFRS by the end of 2008, with the remaining differences being removed on or before 30 June 2011.

		US GAAP	IFRS	Other
Vehicle manufacturers				
Chrysler	US	●		
Ford	US	●		
General Motors	US	●		
Daimler	Europe		●	
Fiat	Europe		●	
Peugeot Citroen	Europe		●	
Volkswagen	Europe		●	
Renault	Europe		●	
BMW	Europe		●	
Porsche	Europe		●	
Toyota	Asia	●		
Mitsubishi	Asia			●
Mazda	Asia			●
Nissan	Asia			●
Hyundai	Asia			●
Subaru	Asia			●
		US GAAP	IFRS	Other
Supplier				
ArvinMeritor	US	●		
Dana	US	●		
Delphi	US	●		
Eaton	US	●		
Federal-Mogul	US	●		
Goodyear	US	●		
Johnson Controls	US	●		
Lear	US	●		
TRW	US	●		
Visteon	US	●		
Autoliv	Europe	●		
Continental	Europe		●	
Faurecia	Europe		●	
GKN	Europe		●	
Michelin	Europe		●	
Bosch	Europe		●	
Valeo	Europe		●	
ZF	Europe		●	
Magna	Canada	●		
Denso	Asia			●
Bridgestone	Asia			●

Emerging markets – a journey toward IFRS

The global automotive industry remains vibrant in its second century of operation, even as it moves through a historic geographic transition. Global light vehicle production has grown at an average 4.5% annual rate over the past five years, and now stands at 70 million units per year. Virtually all of the growth has been – and is expected to be – outside of the traditional industry markets of North America, Western Europe, Japan and South Korea. Spurred by the rapid market growth in China since 2002, production in emerging markets accounted for 99% of the global incremental 11 million unit increase over the past five years. This trend is expected to continue over the next decade, with 91% of the global growth forecast to come from the emerging markets. The automotive industry's mature markets are not shrinking and still account for two-thirds of all automotive production currently, but the primary areas of industry growth in the near-term are in countries such as China, India, Russia, Brazil and Mexico.

China

On 15 February 2006, the Ministry of Finance released 39 Chinese Accounting Standards (CAS) for Enterprises, one basic standard, 38 specific standards and related application guidance. All listed companies were required to apply the new accounting standards system effective 1 January 2007. China's Accounting Standards for Enterprises were developed with a view to achieve convergence with the equivalent accounting principles within IFRS.

India

In July 2007, the Council of the Institute of Chartered Accountants of India (ICAI) decided to fully converge with IFRS issued by the IASB from the accounting periods commencing on or after 1 April 2011. Similar to other countries, such as those within the EU, the expectation is that IFRS will be adopted for listed companies and other public interest entities such as banks, insurance companies and large-sized entities.

Russia

The initial plan for a transition to IFRS was developed in 2004 when the Ministry of Finance issued order N 180 "Statutory Accounting and Financial Statements Development Concept for 2004-2010." However, the date of transfer to preparation of consolidated financial statements in accordance with IFRS is to be determined by the law on consolidated financial statements.

The Ministry of Finance is still working on a draft of the law on preparation of consolidated financial statements in accordance with IFRS and on a draft of a new federal law on accounting. It is anticipated that the new law on consolidation will define the timing for transition to IFRS for different types of companies in Russia (public and non-public). However, because the law is going through numerous readings with the state authorities (State Duma), no final date has been established for the implementation of IFRS.

Brazil

On 13 July 2007, the Securities and Exchange Commission of Brazil (CVM) issued CVM Instruction No. 457 which governs the preparation and disclosure of consolidated financial statements in accordance with IFRS. According to CVM Instruction No. 457, public companies shall, starting from reporting periods ending in 2010, present their consolidated financial statements according to IFRS, as issued by the International Accounting Standards Board – IASB. Through the 2009 reporting cycle, public companies may elect to present their consolidated financial statements in accordance with IFRS as issued by the IASB, in lieu of Brazilian accounting standards.

Mexico

Since June 2004, the Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF – Mexican Board for the Research and Development of Financial Reporting Standards) is responsible for setting financial reporting standards in Mexico: Normas de Información Financiera (NIF – Mexican Financial Reporting Standards). The CINIF is following an approach to converge its standards with IFRS by adopting local standards (NIF) that correspond to IFRS.

Key differences between US GAAP and IFRS

While the US and international standards do contain differences, the general principles, conceptual frameworks and accounting results between them are often similar, even though the areas of divergence seem to have disproportionately overshadowed these similarities. The two sets of standards are generally more alike than different for most commonly encountered transactions, with IFRS being largely, but not entirely, grounded in the same basic principles as US GAAP. US issuers should also be aware that, although the conceptual frameworks of both sets of standards are similar, there remain a number of differences in the detailed requirements, some of which can be significant depending on a company's specific facts and circumstances.

One of the most important factors to consider in understanding IFRS is that it offers a more "principles-based" approach, as opposed to the "rules-based" approach of US GAAP. IFRS has fewer bright lines and less interpretive and application guidance than does US GAAP. Therefore, with broad principles and little interpretive guidance, IFRS will require a significant amount of professional judgement to determine the appropriate accounting treatment. In some circumstances, this approach may lead to different interpretations by different companies, both of which may be acceptable depending on the specific circumstances of each. The IASB is firmly committed to issuing standards with broad principles. Ernst & Young and other constituents are focused on working toward a more consistent application.

While there are few differences that pertain solely to automotive companies, there are certain areas of which automotive companies should be mindful. We have compared several selected issues in the areas of revenue recognition, research and development costs, tooling, restructuring costs and onerous contracts, for both vehicle manufacturers and suppliers in the automotive sector.



Revenue recognition

Issue

Revenue recognition policies used by vehicle manufacturers are highly dependent upon the underlying contractual terms. Vehicle manufacturers might enter into various types of agreements with their customers when selling products and services.

The more significant revenue recognition issues include multi-element contracts, extended warranties, minimum resale value guarantees and discount retail financing. The most frequently reported revenue recognition issue disclosed by vehicle manufacturers in their accounting policy notes to the financial statements is the existence of buy-back or repurchase commitments generally related to fleet sales, such as sales to daily rental car companies.

Similarities

Overview

Revenue recognition under both US GAAP and IFRS is dependent upon the completion of the earnings process. Under both sets of accounting standards, revenue is not recognized until the earnings process is complete and the revenue is realized. Ultimately, both sets of accounting standards base revenue recognition on the transfer of risks and rewards and attempt to determine when the earnings process is complete. Both accounting standards also contain revenue recognition criteria that, while not identical, are similar. For example, under IFRS, one recognition criterion is that the amount of revenue can be measured reliably, while US GAAP requires that the consideration to be received from the buyer be fixed or determinable.

Buy-back commitments

Buy-back commitments principally represent arrangements whereby a vehicle manufacturer guarantees specified trade-in or resale values for "sold" vehicles. Such guarantees provide the customer with the right to return purchased vehicles to the manufacturers. Under both sets of standards, given the lack of a transfer of risks and rewards under the buy-back commitment, such transactions generally do not qualify for immediate revenue recognition as a vehicle sale, but are accounted for as leases. Depending on the precise contract terms and conditions, most of these arrangements qualify as operate leases.

Under both sets of standards the proceeds are recorded as deferred revenue at the time of the sale. The difference between the proceeds and the guaranteed repurchase amount is recognized in revenue over the term of the lease, generally using a straight line method. Also at the time of the sale, the cost of the vehicles is recorded as an asset under lease and the difference between the cost of the vehicle and the estimated value as of the time of the repurchase is depreciated in cost of sales over the term of the lease. For the presentation of the operating lease asset, different practices, such as other assets, property, plant and equipment or inventories, can be observed.

Significant differences

While there are substantial similarities, differences in the timing of revenue recognition may exist as a result of differing levels of specificity between the two accounting standards. US GAAP provides an extensive amount of prescriptive guidance with substantial amounts of additional guidance provided by the SEC and their Staff Accounting Bulletins and related literature. Conversely, a single standard (IAS 18) exists under IFRS which contains accounting principles and illustrative examples of specific transactions.

A summary of the guidance most relevant to the automotive sector is provided to the right.

Convergence

The FASB and the IASB are currently conducting a joint project to develop concepts for revenue recognition and a standard based on those concepts. Currently, the boards are planning to publish a discussion paper in 2008 outlining a single contract-based revenue recognition model that will allocate customer consideration to the vendor's performance obligations based on fair value measurements. The amount of consideration allocated to each performance obligation will be recognized as revenue when the obligation is extinguished. A final converged standard is expected sometime in 2011.

	US GAAP	IFRS
Sale of goods	Public companies must follow SAB 104 Revenue Recognition which requires that delivery has occurred (the risks and rewards of ownership have been transferred); there is persuasive evidence of the sale; the fee is fixed or determinable; and collectibility is reasonably assured.	Revenue is recognized only when risks and rewards of ownership have been transferred, the buyer has control of the goods, revenues can be measured reliably, it is probable that the economic benefits will flow to the company and costs of the transaction can be reliably estimated.
Multiple elements	Specific criteria are required in order for each element to be a separate unit of accounting, including delivered elements that must have standalone value and undelivered elements that must have reliable and objective evidence of fair value (EITF 00-21). If those criteria are met, revenue for each element of the transaction can be recognized when the element is complete.	IAS 18 requires recognition of revenue on an element of a transaction if that element has commercial substance on its own. On the other hand, if the contract terms cannot be understood without reference to a series of transactions as a whole the transactions are linked and accounted for as a single transaction. IAS 18 does not provide specific criteria for making that determination.



Research and development costs

Issue

Historically, the automotive industry has incurred significant research and development (R&D) expenditures. Vehicle manufacturers and automotive suppliers often incur preproduction costs related to products they will sell to their customers.

Vehicle manufacturers would expect to ultimately recover design and development costs through the pricing of the product. Reimbursement, if any, of a supplier by a vehicle manufacturer for the design and development incurred might take different forms, such as:

- ▶ contractually guaranteed reimbursement; or
- ▶ implicitly guaranteed reimbursement through the pricing of the product or other means.

Such reimbursements are often embedded into long-term supply arrangements.

For financial reporting purposes, the investment in R&D raises the question whether the expected future benefit gives rise to a capitalization of R&D expenditures.

The definitions of R&D are substantially similar under US GAAP and IFRS.

FAS 2 *Accounting for Research and Development Costs* (FAS 2) defines **research** as “planned search or critical investigation aimed at discovery of new knowledge with the hope that such knowledge will be useful in developing a new product or service or a new process or technique or in bringing about a significant improvement to an existing product or process.” IAS 38 *Intangible Assets* (IAS 38) views research as “original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.”

Under FAS 2, **development** is defined as “the translation/application of research findings or other knowledge into a plan or design for the production of new or substantially improved products and processes before the start of commercial production or use,” while IAS 38 defines **development** as “the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.”

Design usually refers to activities such as drafted technical drawings that explain how a specific component should be manufactured, the technical specifications of a component or how a system is built from various components.

Research, development and design work is often referred to informally by companies as **engineering** activities, as the distinction between the various categories of expenditure can be difficult to establish and, aside from the accounting treatment, be of no importance operationally.

The phases of the product development process can be summarized as follows:



The accounting for development costs depends on contractual agreements between the vehicle manufacturer and the supplier.

Similarities

Under US GAAP, R&D costs (outside the scope of a business combination) are primarily addressed by FAS 2 and EITF 99-5 *Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements* while under IFRS R&D cost are addressed by IAS 38 *Intangible Assets*.

Under both accounting models, research costs are expenses as incurred. Development costs to be capitalized, if any, comprise all directly attributable costs necessary to create, produce and prepare the asset and shall be amortized over the lesser of the life of the related asset or productions cycle determined by:

- (a) the period over which the asset is expected to be available for use by the entity (e.g., the life cycle of a vehicle); or
- (b) the number of production or similar units expected to be obtained from the asset.

Significant differences

	US GAAP	IFRS
Development costs – general accounting principle	Development costs are generally expensed as incurred unless addressed by a separate standard, as discussed below.	Development costs are capitalized as intangible assets when technical and economic feasibility of a project can be demonstrated in accordance with specific criteria. Some of the stated criteria include: demonstrating technical feasibility, intent to complete the asset and the ability to sell or use the asset in the future, as well as others. Capitalization starts when all criteria are met.
Development costs – supplier/vehicle manufacturer arrangements	<p>EITF 99-5 specifically addresses preproduction costs incurred by a supplier related to products, and costs to design and develop molds, dies and other tools that will be used to produce products they will supply to their customers under long-term supply arrangements. According to EITF 99-5, development costs should be capitalized if:</p> <ul style="list-style-type: none"> ▶ a contractual guarantee (e.g., a legally enforceable agreement in which the amount of reimbursement can be objectively measured and verified) for reimbursement exists for design and development costs that otherwise would be expensed; or ▶ the supply arrangement provides the supplier the noncancelable right (as long as the supplier is performing under the terms of the supply arrangement) to use customer-owned molds, dies and other tools during the supply arrangement; or ▶ the supplier owns the molds, dies and other tools that will be used in producing products under a long-term supply arrangement. 	<p>No specific industry guidance exists under IFRS.</p> <p>It is appropriate to distinguish between development (preproduction) costs incurred related to products and development costs related to design molds, dies and other tools that will be used to produce products. Additional analysis is required when involving subcontractors in determining if the criteria requiring capitalization are met. Costs for the development of products and supplier-owned molds, dies and other tools that will be used in producing the products under a long-term supply arrangement should be capitalized as intangible assets under the provisions of IAS 38, unless IFRIC 4 requires a different accounting for embedded leases.</p>

When FAS 2 was issued in 1974, the FASB objected to capitalization of R&D expenses since the Board took the position that the relationship between current R&D costs and the amount of resultant future benefits to an enterprise is so uncertain that capitalization of any R&D costs would not be useful in assessing the earnings potential of the enterprise. The Board further assumed that it was unlikely that one's ability to predict the return on an investment and the variability of that return would be enhanced by capitalization. For other industries – e.g., the software industry – the FASB took a different position allowing for respective capitalization.

When the IASB introduced IAS 38, it prescribed capitalization of development costs by noting that an enterprise can, in some instances, determine the probability of receiving future economic benefits from an internally generated intangible asset. Some constituents also observed that:

- ▶ the non-recognition of investments in intangible assets in the financial statements distorts the measurement of an enterprise's performance and does not allow an accurate assessment of returns on investment in intangible assets;
- ▶ some uncertainties that may exist about the value of an asset do not justify a requirement that no cost should be recognized for the asset; and
- ▶ it should not matter for recognition purposes whether an asset is purchased externally or developed internally. Particularly, there should be no opportunity for accounting arbitrage depending on whether an enterprise decides to outsource the development of an intangible asset or develop it internally.

Under US GAAP, development costs are generally expensed as incurred and reported as a separate line item within the statement of operations, unless another treatment is permitted by a separate standard. Under IFRS, development expenses are reported on a "net" basis within profit and loss with gross expenditures reduced by amounts capitalized and increased by the amortization of previously capitalized development expenses. IAS 38.126 requires the separate disclosure (on the face of the income statement or in the notes) of the total R&D costs incurred. Any capitalized amounts, including related additions, are disclosed as a component of property, plant and equipment. The following table summarizes R&D expenses reported by some vehicle manufacturers within the notes to their IFRS financial statements (all numbers are for the year ended 31 December 2007):

Vehicle manufacturers

(Millions EUR)	Fiat	Peugeot	Renault	Volkswagen
Gross R&D expenses	1,741	2,074	2,462	4,923
Thereof capitalized	(932)	(754)	(1,287)	(1,446)
Amortization	685	752	675	1,843
Other	42	-	-	-
Reported R&D expenses	1,536	2,072	1,850	5,320

Convergence

For the previously outlined issues, no further specific convergence is planned at this time. However, with the introduction of FAS 141R *Business Combinations*, the FASB acknowledged that – within a business combination – “the requirement to write off assets to be used in R&D activities if they have no alternative future use resulted in information that was not representationally faithful.” Thus, FAS 141R requires that an asset be recognized for R&D assets acquired in a business combination regardless of whether they have an alternative future use, which is consistent with the requirements of IFRS 3 Business Combinations. The FASB also rejected concerns that the fair value may not be measurable and that the low likelihood of success does not represent probable future economic benefits – both arguments driving the accounting for R&D expenses under FAS 2. The FASB agreed that the accounting for R&D expenditures is inconsistent depending on how they are acquired. While not specifically on the FASB agenda, certain practitioners speculate that the FASB may reconsider the accounting for R&D expenditures.

Tooling

Issue

The accounting for tooling transactions is highly complex and dependent upon the contractual and other arrangements between the vehicle manufacturer and supplier. These terms and conditions can vary significantly from one company to the next and by region within the same organization. Contractual arrangements may provide that the tooling equipment is to be owned either by the supplier (supplier-owned tooling) or vehicle manufacturer (customer-owned tooling). When the tooling equipment is owned by the vehicle manufacturer, the vehicle manufacturer often reimburses the supplier for all or part of the manufacturing cost of the tooling equipment. Often the costs incurred by the supplier for manufacturing the tooling equipment exceed the tooling contributions from the vehicle manufacturer. However, there may be situations in which the tooling contributions from the vehicle manufacturer exceed the tooling costs. The tooling contribution may take the form of lump sum payments or piece price reimbursement over the production life cycle. Piece price reimbursement may implicitly contain a margin intended to compensate the supplier for the cost of manufacturing the tooling equipment, or conversely, the piece price may be reduced to reflect the "profit" on the manufacturing of the tool. As the pricing for the parts supply is based on a price per unit, the amount of costs that will be recovered by the supplier depends on the volume of parts sold over the life cycle of the tooling equipment. Such volumes are generally not guaranteed by the vehicle manufacturer. The vehicle manufacturer usually grants the supplier a right to use the tool owned by the vehicle manufacturer over the life of the related program.

Similarities

Supplier-owned tooling

Under both sets of accounting standards, costs incurred for supplier-owned tooling are capitalized by the supplier in a manner similar to property, plant and equipment. Assets are subsequently depreciated on a systematic basis based on the lesser of the physical life or the economic life of the tool (which generally will be limited by the life of the products).

Customer-owned tooling

A typical product arrangement between a vehicle manufacturer and a supplier often consists of two major components:

- ▶ the order from the vehicle manufacturer to the supplier to manufacture tooling equipment; and
- ▶ the subsequent parts production from using that tooling equipment (parts supply).

Accordingly, tooling and parts contracts in the automotive industry can be viewed in two different ways:

- ▶ as separate contracts for manufacturing the tools and for the production of the parts; or
- ▶ as formally separate, but in substance, "all-in-one" (multiple-element) contract for tooling and parts.

Separate contracts	"All-in-one" contract
The vehicle manufacturer and supplier have a contractual agreement for the construction of tooling equipment and the amount of the reimbursement by the vehicle manufacturer is also specified in the contract. The supplier does not have any contractual obligation or right to subsequently manufacture parts. The tooling contract is not linked to any future contract for the parts series production.	The vehicle manufacturer and the supplier may formally have two separate agreements for the construction of specified tooling equipment and for supplying parts. However, these two contracts may be linked together as part of a multiple-element arrangement. For example, it may be the case that the tooling development and manufacturing costs of the supplier are higher than the tooling contribution received from the vehicle manufacturer, but the unit price agreed upon for the parts contains a profit margin for the supplier which compensates for the excess cost incurred from manufacturing the tooling equipment and provides for a normal margin for the part manufacturing.

In practice, many automotive suppliers operate under an all-in-one contract approach and make the tool as a means to winning the related part production contract. We believe it is rare for automotive suppliers to enter into tooling contracts without a contract for the parts series production. Essentially, there is a presumption that those contracts are economically linked and need to be viewed as an “all-in-one” contract.

The accounting for customer-owned tooling under US GAAP is complex and covered by a combination of accounting principles, including SAB 104 *Revenue Recognition*, EITF 99-5 and EITF 00-21 *Revenue Arrangements with Multiple Deliveries*.

The IFRS guidance for tooling-related transactions is based upon the provisions of IAS 18 *Revenues*, IAS 16 *Property, Plant and Equipment* and IFRIC 4 *Determining whether an Arrangement contains a Lease*.

Analyzing the appropriate accounting treatment is complex and dependent upon many factors, including:

- ▶ terms of the tooling and production contracts (overall, there is diversity internationally on the terms and conditions of tooling contracts, the fact whether the contract is in writing, and if the supplier is already contracted for the parts production before agreeing on the tooling contract);
- ▶ suppliers contractual or inherent right to use the tool during the production process; and
- ▶ history of tooling and production agreements with the supplier.

Also the legal title to the tool and the right to deliver the aftermarket varies internationally. Hence all facts and circumstances require a careful evaluation and drive the respective accounting.

Reimbursement for tooling projects is reflected as revenue based upon the nature of the contract. Depending upon the analysis of specific factors, the difference between cost and reimbursement is generally capitalized and amortized (expensed) in an appropriate and systematic manner over the shorter of the life of the tool or the life of the production contract. Capitalized amounts are subject to periodic impairment analysis.

Significant differences

The conceptual view on the accounting for tooling is similar for US GAAP and IFRS; however, the complexities and factors that require detailed analysis will make this a key area of focus for each automotive manufacturer and supplier.



Accounting for loss contracts

Issue

Vehicle manufacturers often pressure suppliers for significant price reductions, in some cases demanding immediate price cuts to retain existing contracts. This pressure causes many component manufacturers to relocate production to lower-labor cost areas when logistically feasible.

Suppliers institute cost-cutting measures to avoid loss of market share and erosion of margins. Some larger component makers are also demanding upfront rebates of future savings from price cuts from their own suppliers in order to keep business agreements.

Companies not meeting productivity or price reduction goals may find themselves in situations in which their piece price billed to the vehicle manufacturer does not cover their costs.

Similarities

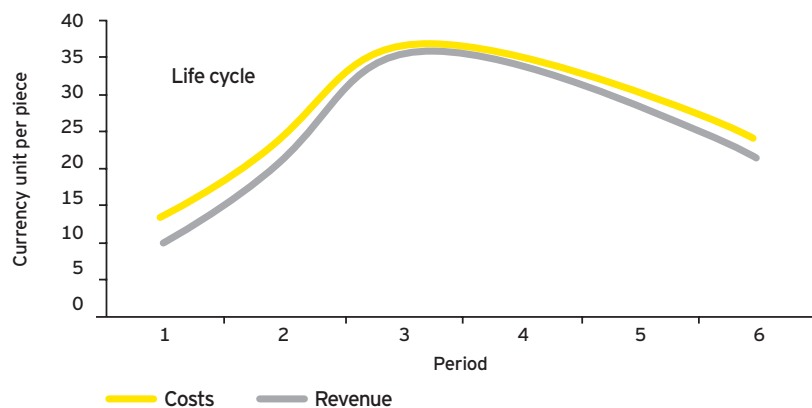
Under US GAAP, nearly all supply contracts are considered executory contracts and there are only limited instances in which this has been defined in the context of accounting guidance. EITF Issue No. 03-17 refers to an executory contract as "a contract that remains wholly unperformed or for which there remains something to be done by either or both parties of the contract." IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, refers to an executory contract as "a contract under which neither party has performed any of their obligations or both parties have partially performed their obligations to an equal extent." The definition of an executory contract is substantially the same under US GAAP and IFRS.

The accounting for executory contracts that are expected to result in aggregate losses to the entity over the remaining term of the contract as performance commitments are fulfilled (e.g., estimated costs to complete are expected to exceed future benefits, that is, "onerous contracts") may significantly differ between US GAAP and IFRS.

Significant differences

	US GAAP	IFRS
Recognition	Accounting guidance is limited and practice is mixed; however, a liability generally should not be recognized for expected losses on executory contracts, except when contracts include guaranteed minimum quantities or when an arrangement is within the scope of authoritative literature that specifically provides for the accrual of such losses (e.g., firm purchase commitments for raw materials, chapter 4, statement 10 of ARB 43; and the lower of cost or market considerations for work in process and finished goods taking into account net realizable value, chapter 4, statement 6 of ARB 43). Also, impairment issues, for long-lived assets committed to such contracts, must be considered under FAS 144.	Related inventories and tangible and intangible assets are tested for impairment before the accounting for an onerous contract is considered. No provisions are accrued for future operating losses. A provision for onerous contracts is set up for contractual present obligations. An onerous contract is defined as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Hence, a blanket purchase order or a nomination letter alone might not meet the contractual obligation requirement. The unavoidable costs under a contract reflect the least net cost of exiting the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil (e.g., cancellation cost). The time value of money needs to be reflected for long-term provisions if the discounting effect is material.
Measurement	Not applicable.	Present value of the expenditures expected to be required to settle the obligation.

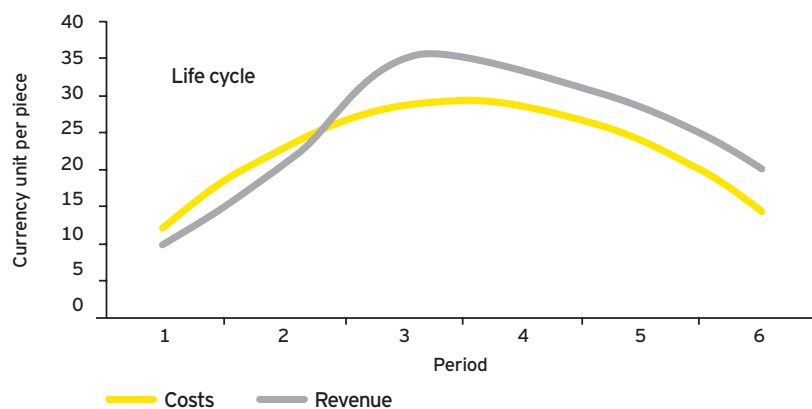
The illustrations to the right are examples of potential costs and revenues over the life cycle of a product. On the top, costs exceed revenues throughout the life cycle, thus, resulting in an aggregated loss qualifying for a provision for onerous contracts. On the bottom, costs exceed revenues over the ramp-up period before revenues catch-up, bringing the product into an aggregated gain. Even though the product incurs a loss over a certain period, this situation would not allow the company to reserve for such losses since the product is still expected to be profitable over the entire contract life.



Convergence

No further specific convergence actions are planned on this topic. An exposure draft proposing amendments to IAS 37 was issued in 2005, and a final standard is expected to be issued no earlier than in the first half of 2009.

IAS 37 currently provides little guidance as to when a provision for an onerous contract should be recognized. Consequently, the exposure draft proposes to add some further guidance in this area. The exposure draft notes that if a contract would become onerous as a result of an entity's own actions, the liability should be recognized only when that action is taken. For example, costs of terminating a contract that was not previously considered onerous would only be recognized when the contract is terminated in accordance with its terms.



Impairment of assets

Issue

Challenging market conditions have resulted in overcapacity and reduced market share for US vehicle manufacturers. In addition, these factors and commodity cost increases have impacted operating margins and resulted in significant operating losses for both the vehicle manufacturers and the supply base in North America. Vehicle manufacturers and suppliers have to regularly re-assess their asset valuations and evaluate tangible and intangible assets for potential asset impairment.

Year ended 31 December (millions US\$)	2007	2006
Delphi	98	172
General Motors	259	1,513
Ford (Automotive sector)	2,400	3,800
Visteon	95	22
Dana	89	280

Source: 10-K filings

North American vehicle manufacturers and suppliers continue to report significant impairment charges in fiscal year 2007 even though it appears that the major hit was taken in 2006.



Similarities

Both US GAAP and IFRS contain similarly defined impairment indicators for assessing the impairment of long-lived assets. Both standards require goodwill and intangible assets with indefinite lives to be reviewed at least annually for impairment regardless of the existence of impairment indicators. Additionally, both accounting standards require that an asset found to be impaired is to be written down and an impairment loss recognized. FAS 142 *Goodwill and Other Intangible Assets*, FAS 144 *Accounting for the Impairment of Disposal of Long-Lived Assets* and IAS 36 *Impairment of Assets* apply to most long-lived and intangible assets, although some differences exist regarding the scope of the existing standards. Despite the similarity in overall objectives, differences exist in the way in which the impairment loss is calculated, recognized and measured, which could result in material differences in the magnitude of impairment charges to be taken to profit and loss.

Significant differences

	US GAAP	IFRS
Long-lived assets		
Review for impairment indicators	Performed whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.	Assessed at each reporting date.
Method for determining impairment	Two-step approach requires a recoverability test be performed first (carrying amount of the asset is compared to the sum of future undiscounted cash flows generated through use and eventual disposition). If it is determined that the asset is not recoverable, an impairment loss is calculated.	One-step approach requires that impairment loss be calculated if impairment indicators exist. No recoverability test based on undiscounted cash flows.
Impairment loss calculation	The amount by which the carrying amount of the asset exceeds its fair value, as calculated in accordance with FAS 157 <i>Fair Value Measurements</i> .	The amount by which the carrying amount of the asset exceeds its recoverable amount is the higher of: (i) fair value less costs to sell; and (ii) value in use (the present value of future cash flows in use including disposal value). (Note that the definition of fair value under IFRS may differ to that calculated under FAS 157.)
Goodwill		
Method of determining impairment – goodwill	Two-step approach requires a recoverability test to be performed first at the reporting unit level (carrying amount of the reporting unit is compared to the reporting unit fair value), then an impairment loss is calculated.	One-step approach requires that an impairment test to be done at the cash generating unit (CGU) or group of CGU's level by comparing the CGU's carrying amount, including goodwill, with its recoverable amount.
Impairment loss calculation	The amount by which the carrying amount of goodwill exceeds the implied fair value of the goodwill within its reporting unit.	Impairment loss on the CGU/group of CGU's (amount by which the CGU's carrying amount, including goodwill, exceeds its recoverable amount) is allocated first to reduce goodwill to zero, then the carrying amount of other assets in the CGU/group of CGU's are reduced pro rata, based on the carrying amount of each asset.
Impairment loss calculation – indefinite life intangible assets	The amount by which the carrying value of the asset exceeds its fair value.	The amount by which the carrying value of the asset exceeds its recoverable amount.
Reversal of loss	Prohibited for all assets.	Prohibited for goodwill. Other long-lived assets must be reviewed annually for reversal indicators. If appropriate, loss may be reversed up to the newly estimated recoverable amount, not to exceed the initial carrying amount adjusted for depreciation.

Convergence

Impairment is one of the short-term convergence projects agreed to by the FASB and IASB in their 2006 “Memorandum of Understanding.” Impairment remains one of the most sensitive US GAAP vs. IFRS differences. Nonetheless, the current workplan no longer lists the project as an active project.

Restructuring costs

Issue

Automotive vehicle manufacturers and suppliers in North America have ridden a wave of restructuring actions this decade, but for different reasons. Many suppliers incurred a great deal of debt during the consolidation wave of the late 1990s, and have been inclined to shed non-core assets to raise money to service the debt. Pressure to cut costs has also driven a significant amount of component part production to lower cost countries, making some existing facilities redundant. Vehicle manufacturers based in the US have seen their combined market share erode to less than 50% (from nearly 70% a decade ago) as foreign brands have expanded their offerings into every vehicle segment. Even though total industry sales levels have remained near historical highs, the “Detroit 3” are reducing excess capacity to better align production with current market share and recent sales projections. All this activity has led to a significant amount of restructuring activity.

Similarities

Under both sets of standards, any effect a restructuring effort might have on long-lived or non-current assets (e.g., fixed assets such as production equipment) is outside the scope of the following discussion of restructuring costs. These effects are discussed in FAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*, IAS 36 *Impairment of Assets* and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and fall under the general requirements of those standards.

Under US GAAP, restructuring costs outside the scope of a business combination are addressed in FAS 146 *Accounting for Costs Associated with Exit or Disposal Activities*. To define restructuring, FAS 146 makes reference to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* defining restructuring as a program that is planned and controlled by management, and materially changes either:

- ▶ the scope of a business undertaken by an entity; or
- ▶ the manner in which that business is conducted.

Hence, the definition of a restructuring is substantially the same. Examples of restructuring actions may include the sale or termination of a line of business; the closure of business locations in a country or region or the relocation of business activities from one country or region to another; changes in management structure, for example, eliminating a layer of management; and fundamental reorganizations that have a material effect on the nature and focus of the entity's operations.

Under IFRS further guidance is to be found in IAS 19 *Employee Benefits* and IFRS 2 *Share-based Payment* for employment-related restructuring costs.

Under both GAAPs, restructuring costs associated with an exit or disposal activity that do not meet the criteria to be a discontinued operation are included in income from continuing operations before income taxes in the income statement. However, the timing of recognition might differ between US GAAP and IFRS. Specific requirements apply if the exit or disposal activity involves a discontinued operation. In such cases, the costs associated are presented as a single amount on the face of the income statement. The IFRS definition of a discontinued operation is more restrictive than under US GAAP since it requires that the operations represent a “major” line of business or geographical area of operations which is not a requirement under US GAAP.

Significant differences

	US GAAP	IFRS
Recognition	<p>Under FAS 146, a liability for a cost associated with an exit or disposal activity shall not be recognized before a liability is incurred, except if permitted otherwise by the standard. Even when management has committed itself to a detailed exit plan, it does not follow automatically that the costs of that exit plan may be provided for; thus, an entity's commitment to an exit or disposal plan, by itself, is not the requisite past transaction or event for recognition of a liability. Instead, each cost is examined individually to determine when it is incurred.</p> <p>US GAAP distinguishes one-time employee termination benefits, contract termination costs (excluding capital lease contracts) and other associated costs.</p> <p>FAS 146 allows the costs of involuntary employee termination to be recognized when management has committed to a detailed plan of termination; identified the number, function and location of the employees expected to be terminated; and communicated this plan to the employees.</p> <p>The employee termination costs are recognized immediately when employees are not required to render service until they are terminated in order to receive the termination benefits or if employees will not be retained to render service beyond the minimum retention period.</p> <p>Liabilities for other exit costs are recognized in the period in which they are incurred, for example, when goods or services related to an exit or disposal activity are received. Consequently, other exit costs generally will be recognized later than under IAS 37. This is because IAS 37 places emphasis on the recognition of the costs of the exit plan as a whole, rather than on the recognition of individual liabilities.</p>	<p>IFRS requires recognition of a provision for restructuring costs if certain criteria are met. One of those criteria is that the entity has a present legal or constructive obligation to a detailed exit plan. The plan needs to be detailed and specific, have created a valid expectation in those affected that the plan will be carried out and to be put into operation without delay or significant alteration.</p> <p>In practice, this means that the detailed plan must identify the business or part of the business concerned, location, function and approximate number of employees who will receive termination compensation. A formal public announcement of the restructuring will, if it is made in sufficient detail, create a valid expectation in other parties such as customers, suppliers and employees that the restructuring will take place.</p>

Convergence

An exposure draft proposing amendments to IAS 37 was issued in 2005, with a final standard expected no earlier than in the first half of 2009. One of the main objectives of the amendments is convergence with US GAAP to align application guidance for costs associated with restructuring in IAS 37 with the requirement in FAS 146.

The current version of IAS 37 states that an entity has a constructive obligation to restructure only when it has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring. Therefore, it recognizes a provision for the direct expenditures arising from the restructuring.

The exposure draft proposes that non-financial liabilities for costs associated with a restructuring should be recognized on the same basis as if they arose independently of a restructuring, namely when the entity has a liability for those costs. The exposure draft proposes guidance for applying this principle to two types of costs that are often associated with a restructuring: termination benefits and contract termination costs.

Other areas

Joint ventures

Automotive companies frequently establish joint operations with either competitors or local companies either in their domestic markets or more often in foreign markets. In China, many foreign operations were historically structured by setting-up a joint venture between the foreign automotive company and a Chinese joint venture partner.

Under US GAAP, joint venture accounting falls under the rules of APB 18 *The Equity Method of Accounting for Investments in Common Stock* while under IFRS IAS 31 *Interests in Joint Ventures* applies.

US GAAP	IFRS
<p>To qualify for a corporate joint venture, no joint venturer can have control or de facto control over the joint venture.</p> <p>Account for investments in common stock of corporate joint ventures by the equity method in consolidated financial statements.</p>	<p>Under IFRS, entities may account for a jointly controlled entity applying proportionate consolidation or, alternatively, using the equity method.</p> <p>When proportionate consolidation is used, one of the two reporting formats identified below shall be used.</p> <ul style="list-style-type: none">▶ Combine share of each of the assets, liabilities, income and expenses of the jointly controlled entity with the similar items, line by line, in financial statements.▶ Include separate line items (line by line) for share of the assets, liabilities, income and expenses of the jointly controlled entity in financial statements.

In September 2007, the IASB issued an exposure draft ED 9 *Joint Arrangements* that proposes the elimination of proportionate consolidation of joint ventures. Nonetheless, based on the proposed new principles, the accounting might still be similar to the application of proportionate consolidation once ED 9 is approved and issued as IFRS 9.

Union payments

In the US, automotive companies have agreed with unions on lump sum payments to union employees in lieu of all or a portion of an increase in their base wage rate. Companies believe that, in certain circumstances, those lump sum payments reduce or eliminate increases in base wage rates during the period that would otherwise be required. The specific terms of the lump sum payments vary (e.g., the payments might occur upfront and may relate to prior service or at a later point in time following a “vesting” period), but ordinarily there is no requirement to refund the money to the company if the employee terminates. While these types of payments have become less common in practice, the accounting guidance is as follows:

US GAAP	IFRS
<p>Under US GAAP, the accounting for lump sum payments under union contracts (not individual employment contracts) is discussed under EITF 88-23.</p> <p>According to EITF 88-23, all or a portion of a lump sum payment may be deferred and amortized when it is clear that the payment will benefit a future period in the form of a lower base wage rate than otherwise would have existed.</p> <p>In the course of the discussion of EITF 88-23, the SEC Observer noted that EITF 88-23 relates solely to union contracts and not to individual employment contracts or any other situation involving compensation payments to individual employees. The SEC Observer also noted that deferral of a lump sum payment is appropriate only when there is no evidence whatsoever that the payment might be related to past services.</p>	<p>Under IFRS, no specific accounting rules have been developed for such lump sum payments to unions.</p> <p>For lump sum payments where there is no requirement for the employee to refund to the company if terminating the employment, capitalization (and amortization) of the payments as an asset generally would not be appropriate since the company does not have control over the employee and the future economic benefits.</p> <p>However, if the payment were to a point in time in the future, it may be appropriate to build up a provision over the time the employee is required to stay (e.g., the “vesting” period) to earn the right to receive a payment (liability of uncertain timing or amount).</p>

Asset-backed securities entities

Automotive companies frequently use securitization transactions involving special purpose entities (SPEs) to diversify their funding sources.

The accounting for such transactions can be fundamentally different between US GAAP and IFRS with regard to the conclusion on whether a SPE requires consolidation into the consolidated financial statements. It is possible that a SPE under US GAAP may not require consolidation as a SPE under IFRS, and vice versa.

US GAAP	IFRS
<p>FAS 140 <i>Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities</i> provides that qualifying SPEs (QSPEs) are not to be consolidated by the transferor if certain restrictive criteria on the QSPEs' activities are met.</p> <p>FIN 46(R) <i>Consolidation of Variable Interest Entities</i> provides guidance for determining (i) whether an entity is a variable interest entity (VIE) and (ii) if so, its primary beneficiary, or accounting parent. A VIE is evaluated for consolidation based on all contractual, ownership, or other interests that expose their holders variability in returns of the entity. These interests are termed variable interests. The holder of a variable interest that receives the majority of the potential variability in returns of the VIE is the VIE's primary beneficiary, and is required to consolidate the VIE.</p> <p>The FASB is expected to propose amendments of FAS 140 and FIN 46(R) that would (i) eliminate the use of QSPEs and (ii) identify the primary beneficiary of a VIE as the entity that has the power to direct significant decisions that could impact the VIE and could result in potential significant gains or losses to that party. Readers are cautioned to closely monitor developments in this area.</p>	<p>IAS 27 defines subsidiaries as all entities under the control of a parent. SIC-12 <i>Consolidation - Special Purpose Entities</i> interprets how the definition of control applies to SPEs, and hence when SPEs are subsidiaries. Under IFRS, SIC-12 requires an SPE to be consolidated when the substance of the relationship between an entity and the SPE indicates that the SPE is controlled by that entity. Control is assessed by analyzing the substance of the relationship, based on an analysis of risks and rewards.</p> <p>The IASB is currently discussing amendments to IAS 27 and SIC-12 proposing a new definition of control.</p>

Inventories

ARB 43 and IAS 2 are both based on the principle that the primary basis of accounting for inventory is cost. Both define inventory as assets held for sale in the ordinary course of business, in the process of production for such sale or to be consumed in the production of goods and services. The permitted techniques for cost measurement, such as standard cost method or retail margin method, are similar under both US GAAP and IFRS. Further, under both sets of standards, the cost of inventory includes all direct expenditures to ready inventory for sale, including allocable overhead, while selling costs are excluded from the cost of inventories, as are most storage costs and general administrative costs.

	US GAAP	IFRS
Costing methods	“Last in first out” (LIFO) is an acceptable method when the Company has elected this method for tax purposes. Consistent cost formula for all inventories similar in nature is not explicitly required.	LIFO is prohibited. Same cost formula must be applied to all inventories similar in nature or use to the entity.
Measurement	Inventory is carried at the lower of cost or market. Market is defined as current replacement cost as long as market is not greater than net realizable value (estimated selling price less reasonable costs of completion and sale) and is not less than net realizable value reduced by a normal sales margin.	Inventory is carried at the lower of cost or net realizable value (best estimate of the amounts inventories are expected to realize, taking into consideration the purpose for which the inventory is held). This amount generally should equal fair value less costs to sell.
Reversal of inventory write-downs	Any write-downs on inventory to the lower of cost or market create a new cost basis that subsequently cannot be reversed.	Previously recognized impairment losses may be reversed, up to the amount of the original impairment loss when the reasons for the impairments no longer exist.

Appendix – the evolution of IFRS

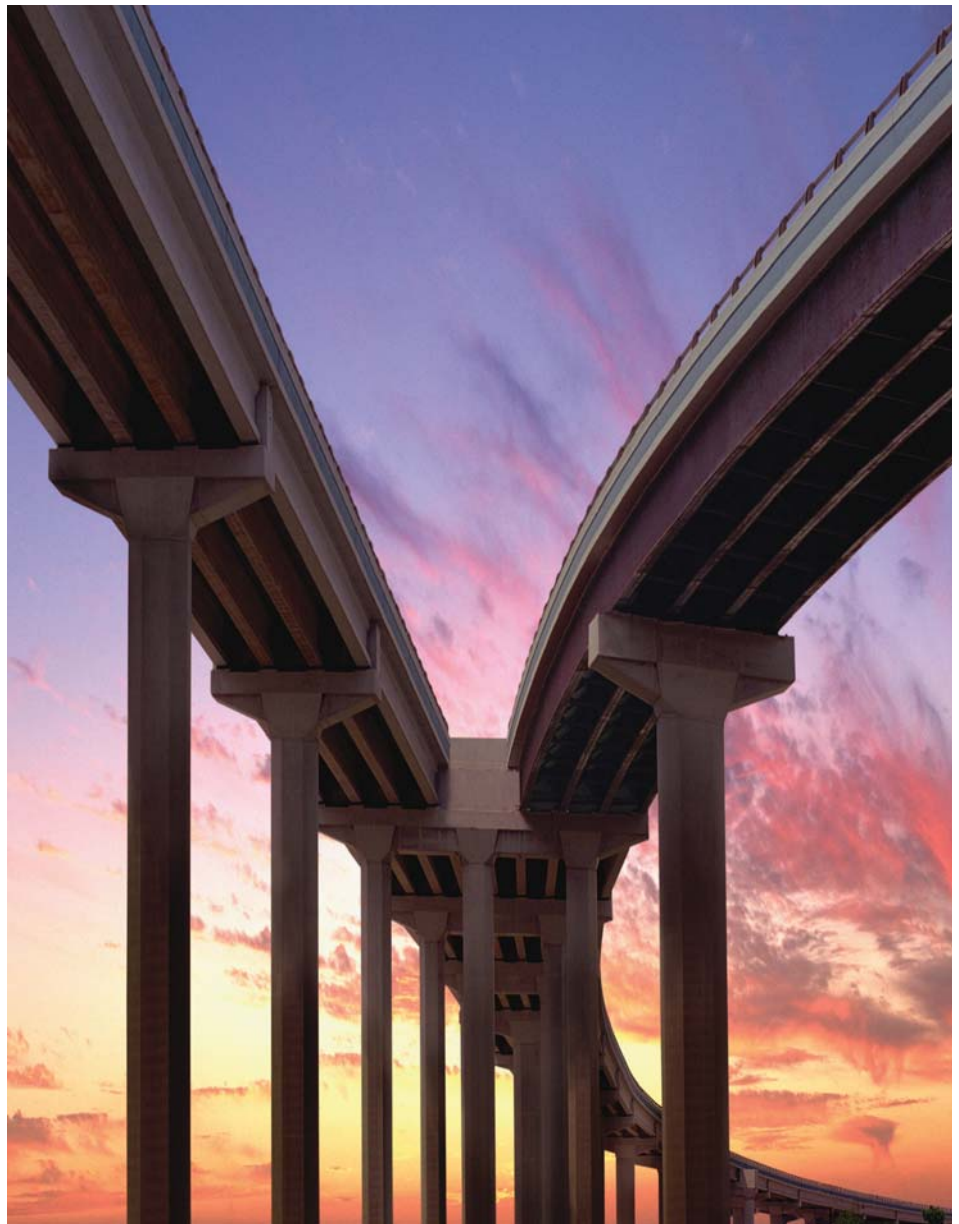
This appendix provides a high-level overview of key milestones in the evolution of international accounting standards.

Phase I – 2001 and prior

- ▶ **1973: International Accounting Standards Committee (IASC) formed.**
The IASC was founded to formulate and publish International Accounting Standards (IAS) that would improve financial reporting and that could be accepted worldwide. In keeping with the original view that the IASC's function was to prohibit undesirable accounting practices, the original IAS permitted several alternative accounting treatments.
- fi **1994: IOSCO (International Organization of Securities Commissions) completed its review of then-current IASC standards and communicated its findings to the IASC.**
The review identified areas that required improvement before IOSCO could consider recommending IAS for use in cross-border listings and offerings.
- fi **1994: Formation of IASC Advisory Council approved to provide oversight to the IASC and manage its finances.**
- fi **1995: IASC developed its core standards Work Program. IOSCO's Technical Committee agreed that the Work Program would result, upon successful completion, in IAS comprising a comprehensive core set of standards.** The European Commission (EC) supported this agreement between IASC and IOSCO and "associated itself" with the work of the IASC towards a broader international harmonization of accounting standards.
- fi **1997: Standing Interpretations Committee (SIC) established to provide interpretation of IAS.**
- fi **1999: IASC Board approved a restructuring that resulted in the current International Accounting Standards Board (IASB).** The newly constituted IASB structure comprises: (1) the IASC Foundation, an independent organization with 22 trustees who appoint the IASB members, exercise oversight and raise the funds needed; (2) the IASB (Board), which has 12 full-time, independent board members and two part-time board members with sole responsibility for setting accounting standards; (3) the Standards Advisory Council; and (4) the International Financial Reporting Interpretations Committee (IFRIC) (replacing the SIC) is mandated with interpreting existing IAS and IFRS standards, and providing timely guidance on matters not addressed by current standards.
- fi **2000: IOSCO recommended that multinational issuers be allowed to use IAS in cross-border offerings and listings.**
- fi **April 2001: IASB assumed standard-setting responsibility from the IASC.** The IASB met with representatives from eight national standard-setting bodies to begin coordinating agendas and discussing convergence, and adopted the existing IAS standards and SIC interpretations.
- fi **February 2002: IFRIC assumed responsibility for interpretations of IFRS.**

Phase II - 2002 to 2005

- ▶ **July 2002: EC required EU-listed companies to prepare their consolidated financial statements in accordance with IFRS as endorsed by the EC, generally from 2005 onward.** This was a critically important milestone that acted as a primary driver behind the expanded use of IFRS.
- ▶ **September 2002: Norwalk Agreement executed between the FASB and the IASB.** A “best efforts” convergence approach was documented in a Memorandum of Understanding in which the Boards agreed to use best efforts to make their existing financial reporting standards fully compatible as soon as practicable and to coordinate future work programs.
- ▶ **December 2004: EC issued its Transparency Directive.** This directive required non-EU companies with listings on an EU exchange to use IFRS unless the Committee of European Securities Regulators (CESR) determined that the national GAAP was “equivalent” to IFRS. Although CESR advised in 2005 that US GAAP was “equivalent” subject to certain additional disclosure requirements, the final decision as to US GAAP equivalency and what additional disclosures, if any, will be required, has not been reached.
- ▶ **April 2005: SEC published the “Roadmap.”** An article published by then SEC Chief Accountant discussed the possible elimination of the US GAAP reconciliation for FPIs that use IFRS. The Roadmap laid out a series of milestones, which if achieved, would result in the elimination of the US GAAP reconciliation by 2009, if not sooner.



Phase III - 2006 to present

- ▶ **February 2006: FASB and IASB published a Memorandum of Understanding (MOU).** The MoU reaffirmed the Boards' shared objective to develop high-quality, common accounting standards for use in the world's capital markets and further elaborated on the Norwalk Agreement. The Boards would proceed along two tracks of convergence: (1) a series of short-term standard setting projects designed to eliminate major differences in focused areas; and (2) the development of new common standards when accounting practices under both GAAPs are regarded as candidates for improvement.
- ▶ **August 2006: CESR/SEC published a joint work plan.** The regulators agreed that issuer-specific matters could be shared between the regulators, following set protocols and that their regular reviews of issuer filings be used to identify US GAAP and IFRS areas that raise questions in terms of high-quality and consistent application. The plan also provides for the exchange of technological information to promote the modernization of financial reporting and disclosure. Finally, the staff of both regulators agreed to dialogue on risk management practices.
- ▶ **Ongoing throughout 2007: SEC continued to meet milestones on its Roadmap.** In March 2007, the SEC hosted a roundtable to discuss the effects the acceptance of IFRS would have on investors, issuers and capital raising in the US capital markets. Representatives from all parties to the financial reporting process overwhelmingly supported the elimination of the US GAAP reconciliation requirement. In July 2007, the SEC issued a summary of its observations regarding FPIs that adopted IFRS for the first time in 2005. Also, in July 2007, the SEC issued a proposed rule to eliminate the requirement for IFRS filers to reconcile to US GAAP, followed by a Concept Release in August 2007 that asks public to comment on the possible use of IFRS by US domestic registrants.
- ▶ **November 2007: SEC ruled unanimously that FPIs (effective immediately) are allowed to file financial statements without reconciliation to US GAAP, provided that statements are prepared using IFRS as issued by the IASB.**
- ▶ **December 2007: SEC held roundtables to discuss the August 2007 Concept Release.** The roundtable participants expressed very strong support for a single set of high-quality global accounting standards that could be used by companies around the world. There was also agreement among the majority of panelists that US issuers should ultimately be required to adopt IFRS.
- ▶ **27 August 2008: SEC approved for public comment its long awaited proposed "Roadmap" related to the eventual use of IFRS by US companies.** The proposed Roadmap anticipates mandatory reporting under IFRS beginning in 2014, 2015 or 2016 depending on the size of the issuer and provides for early adoption in 2009 by a small number of very large companies that meet certain criteria. And it is possible that the SEC will later decide to permit other companies to early adopt at some point in time prior to the mandatory date of conversion. The Roadmap also identifies several milestones that the SEC will consider in making its decision in 2011 about whether to proceed with mandatory adoption of IFRS.

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