



CPAs & Business Advisors

17501 East 17th Street, Suite 100 • Tustin, California 92780-7924
(714) 505-9000 • Fax (714) 505-9200 • www.hmwc CPA.com • cpas@hmwc CPA.com

Member:
American Institute of Certified Public Accountants
Alliance of Merger & Acquisition Advisors
AHA Affiliated Healthcare Advisors

Global Representation:
INTEGRA  INTERNATIONAL

Be prepared: New accounting standards are fast approaching

Since 2008, the United States has been slowly moving closer to adopting International Financial Reporting Standards (IFRS). Transitioning to IFRS from U.S. Generally Accepted Accounting Principles (GAAP), seen by most experts as inevitable, could have significant consequences for real estate companies. In other words, be prepared for major changes.

The dawn of IFRS

Earlier this year, the Securities and Exchange Commission (SEC) announced that, come 2011, it will decide whether to incorporate IFRS into the U.S. financial reporting system and, if so, when and how (but no earlier than 2015). According to the SEC, IFRS has the potential to provide a common platform for financial reporting that best allows investors to compare financial information.

At the same time, the Financial Accounting Standards Board has been working with the International Accounting Standards Board to *converge* IFRS and GAAP. Under this initiative, the two boards are striving to improve both sets of standards by narrowing the differences between them. While the SEC regulates only public companies, its adoption of IFRS could very well trickle down to private companies, just as many provisions of the Sarbanes-Oxley Act did. Users of private businesses' financial statements, such as lenders, may demand the use of IFRS so they can better assess the companies' financial position, cash flows and performance. Fortunately, a pared-down version of IFRS for small and midsize businesses is available.

Potential effects

Adoption of IFRS could have widespread repercussions for financial reporting by real estate companies. For one, GAAP is rules-based and prescriptive, and it comes with mountains of authoritative guidance; IFRS is principles-based and requires more judgment.

IFRS financial reporting could affect several critical areas, including:

Compensation. Different rules regarding revenue recognition could change the amount of commissions and performance incentives that are calculated based on revenue.

Investment properties. IFRS allows a company to account for investment properties either at historical cost or at fair value (FV) with unrealized gains and losses reported in earnings. Note that, even if a company opts to continue with historical cost, it must still disclose the FV of the properties in footnotes, which could affect lenders' assessment of the company's creditworthiness.



CPAs & Business Advisors

17501 East 17th Street, Suite 100 • Tustin, California 92780-7924
(714) 505-9000 • Fax (714) 505-9200 • www.hmwccpa.com • cpas@hmwccpa.com

Member:
American Institute of Certified Public Accountants
Alliance of Merger & Acquisition Advisors
AHA Affiliated Healthcare Advisors

Global Representation:
INTEGRA  INTERNATIONAL

Debt covenants. Covenants based on measurements under GAAP may need to be revised under IFRS.

Impairment of assets. GAAP takes a two-step approach to determine impairment losses, but IFRS employs a one-step test that can lead to earlier recognition of losses. Further, under IFRS, long-lived assets must be reviewed annually for reversal indicators, and an impairment loss must be reversed if recovery occurs.

Real estate sales. IFRS lacks GAAP's detailed rules regarding accounting for sales of real estate. It treats such sales largely as it does sales of other assets, with recognition triggered by the transfer of risks and rewards of ownership.

Accounting for tax purposes may also be affected. Unless the IRS modifies its rules, IFRS adoption could create accounting headaches, as tax returns — which are typically based on historic values (not FVs) — will differ even more from financial statements prepared in accordance with IFRS.

Making the transition

Transitioning to IFRS will take time and resources — likely more than you expect. Getting an early start might ease some of the associated headaches. Your tax and financial advisor can help you assess how IFRS may affect you.