Incentives and Effects of Accounting Choices Following a Mandatory Switch from U.S. GAAP to IFRS: Evidence from European Firms

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ABSTRACT

This study examines the incentives and effects of the accounting choices made by six large European multinational firms that were cross-listed on the New York Stock Exchange and successfully transitioned to International Financial Reporting Standards (IFRS) from United States Generally Accepted Accounting Principles (U.S. GAAP) in 2007. We find that the decision of electing certain optional exemptions from a full retrospective application of IFRS depends on (1) the complexity and feasibility of restating prior financial statements; and (2) their effects on shareholders' equity and key financial ratios. We also find that most firms continued to use the accounting methods that are permitted under U.S. GAAP even after they switched to IFRS. In fact, we find a small average difference in return on equity after IFRS adoption and rather smooth debt-to-equity ratios around IFRS adoption for our sample firms. The results suggest that managers made discretionary accounting choices to minimize the impact of the transition to IFRS on the firms' profitability and leverage ratios.

Keywords: IFRS, U.S GAAP, IFRS 1, First-Time Adoption of IFRS

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INTRODUCTION

This study examines the incentives and effects of the accounting choices made by six large European multinational firms that were cross-listed on the New York Stock Exchange[1] and successfully transitioned to International Financial Reporting Standards (IFRS) from United States Generally Accepted Accounting Principles (U.S. GAAP) in 2007. Their experience with the conversion to IFRS from U.S. GAAP is a valuable source of information for U.S. issuers because, so far, no U.S. firms have prepared financial statements in accordance with IFRS. These six European firms are effectively comparable to some of the largest U.S. multinational firms for several reasons. First, their home countries (5 firms are from Germany and 1 firm is from Norway) have similar levels of economic development to the U.S. Second, these firms used U.S. GAAP for their consolidated financial statements for many years until they switched to IFRS. More importantly, these are among the largest European multinational firms that are directly competing with some of the largest U.S. multinational firms to raise capital in the U.S. and global capital markets. Finally, their reporting practices and strategies were generally designed to be in line with U.S. practices to increase the credibility of their financial statements and to attract U.S. investors. Therefore, their experience in transitioning from U.S. GAAP to IFRS may provide academics, regulators, and practitioners with useful information regarding the impact of IFRS adoption on the reporting practices of similar U.S. firms.

IFRS 1, *First-Time Adoption of IFRS,* requires companies to retrospectively apply IFRS as though the reporting entity had always prepared its financial statements in accordance with IFRS. However, for certain areas of financial reporting where the restating costs incurred by the firm may exceed the expected benefits to the users of financial information, IFRS 1 allows firms to take advantage of certain optional exemptions from a full retrospective application of IFRS. In total, IFRS 1 offers five mandatory and fifteen optional exemptions (see Appendix 1).

The transition process involves a great deal of managerial discretion over selecting the optional exemptions. Understanding how these European companies applied the guidance provided in IFRS 1 and selected new IFRS-based accounting policies as they began to prepare for their first IFRS financial statements would provide U.S. firms and regulators with valuable benchmark information. It would also promote a dialogue among peer firms in the U.S. to develop best practices and could further provide U.S. firms with a cost-effective pathway in making their reporting choices in the near future. More importantly, it helps researchers and regulators understand if the objectives of optional exemptions under IFRS 1, which are intended to ease the transition, have been undermined due to firms' abuse of the inherent flexibility provided by this standard.

Although the implementation of IFRS adoption has been examined in prior research, the results from these studies may not be directly useful for U.S. firms because differences exist in regulatory regimes, legal systems, business operation environments, economics, and accounting standards between the U.S. and European Union (E.U.). Most importantly, many such studies examine the impact of changing from non-U.S. domestic accounting standards to IFRS (e.g., Barth et al., 2008; Jeanjean & Stolowy, 2008; Cormier et al., 2009), which offer very limited implication for U.S. firms. Using six large European multinational firms that prepared their financial statements in accordance with U.S. GAAP before 2007, this study specifically investigates: (1) their choices of IFRS 1 optional exemptions from a full retrospective application of IFRS and the impact of these

choices on shareholders' equity and key financial ratios, including ROE and debt-to-equity; (2) major accounting differences between IFRS and U.S. GAAP; and (3) choices of alternative accounting methods allowed by IFRS. Our analyses also consider potential managerial incentives for electing certain optional exemptions and accounting methods allowed by IFRS.

We find that most of these firms discussed four (out of fifteen) optional exemptions, including: (1) business combination, (2) employee benefits, (3) cumulative (foreign exchange) translation differences, and (4) share-based payments in their footnotes to the consolidated financial statements. All of these firms elected the optional exemptions from a full retrospective application of IFRS 3 *Business Combinations* and IAS 21 *The Effects of Changes in Foreign Exchange Rates*. However, only three out of six firms elected optional exemptions from retrospective restatement of IFRS 2 *Share-based Payment* and IAS 19 *Employee Benefits*. This finding suggests that managers may have different incentives when electing the optional exemptions.

Our findings also indicate that managers were able to take further advantage of the optional exemptions available under the transitional rules in IFRS 1. We find that these firms continued to use the accounting methods that are permitted under U.S. GAAP even after they switched to IFRS. In fact, we find small average differences in ROE after IFRS adoption and rather smooth debt-to-equity ratios around IFRS adoption for our sample firms. Taken together, these findings suggest that managers may have different incentives when electing the optional exemptions. First, they may have considered the complexity and feasibility (or relative cost and benefits) of restating prior financial statements. Second, they may have intended to minimize the effects of prior year adjustments on financial statements and key financial ratios, such as ROE and leverage, in order to avoid introducing volatility into their financial statements.

The remainder of the paper is organized as follows. The next section discusses the movement and current status of IFRS in the U.S. Section 3 summarizes previous findings on the first-time adoption of IFRS. Section 4 describes our sample firms for this study. Section 5 analyzes the firms' choices of IFRS 1 optional exemptions and potential incentives for these choices. Section 6 reports and discusses the key accounting differences between U.S. GAAP and IFRS and their impact on key financial ratios. Section 7 presents evidence on earning management when transitioning to IFRS from U.S. GAAP. Section 8 summarizes the choices of alternative accounting methods allowed by IFRS. The final section discusses the implications of our findings for the first-time adoption of IFRS in the U.S. and avenues for future research.

IFRS IN THE U.S.

The U.S. Securities Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB) have consistently supported a single set of internationally accepted, high quality accounting standards, and regulatory bodies in the U.S. have shown continued consideration of IFRS adoption. On November 15, 2007, the SEC voted unanimously to allow foreign companies to issue financial statements prepared in accordance with IFRS without reconciliation to U.S. GAAP (SEC, 2007).[2] This signaled the SEC's acceptance of IFRS as being of similar quality to U.S. GAAP. In 2008, the SEC officially proposed a roadmap that would allow U.S. companies to prepare their financial statements in accordance with IFRS beginning in 2014 (SEC, 2008). With this roadmap, qualified U.S. companies would be allowed to prepare their first IFRS financial

statements before 2011.[3] After the release of the SEC's roadmap, major accounting firms conducted several surveys to gather the views of corporate executives regarding the transition to IFRS in the U.S. Their findings indicate that corporate executives believe the SEC's roadmap will have a positive effect on the conversion process and have already anticipated the mandatory adoption of IFRS in the U.S. For example, a survey conducted by Deloitte in July 2009 finds that almost 90% of 245 respondents viewed IFRS conversion to be highly or somewhat likely to become mandatory in the U.S. Managers of U.S. companies also appear to have been preparing themselves for the mandatory adoption of IFRS (Deloitte, 2009). For instance, 80% of respondents indicated that their companies are either performing or have performed an IFRS impact assessment. In addition, according to a survey conducted by PricewaterhouseCoopers (PwC) in September 2009, 43% of respondents (investment professionals) favored either a mandatory adoption date to change to IFRS as soon as possible or partial convergence followed by a mandatory change to IFRS (PwC, 2009).

However, on January 26, 2009, the SEC Chair Mary Schapiro announced that she would look at this entire area again carefully and would not necessarily feel bound by the proposed roadmap (SEC, 2009). On February 24, 2010, the SEC Statements directed the SEC staff to carry out a Work Plan (SEC, 2010) to address certain concerns including sufficient development and application of IFRS globally, independence of standard-setting bodies, and transition issues before the SEC makes its final decision on whether to require U.S. issuers to transition to IFRS. The SEC would also consider the progress of the convergence projects between the IASB and FASB under their Memorandum of Understanding in 2006. On May 26, 2011, the SEC issued a staff paper, "Exploring a Possible Method of Incorporation," that demonstrates a possible framework for incorporating IFRS into the U.S. financial reporting system through the combined elements of convergence and endorsement (SEC, 2011a). Finally, the staff published two papers on November 16, 2011, that compared IFRS and U.S. GAAP and offered an analysis of IFRS in practice in order to evaluate the major accounting differences between these two sets of standards (SEC, 2011b & c).[4]

Although incorporating IFRS into the financial reporting system for U.S. issuers has been on the agenda of the SEC since 2008, the SEC clearly stated that additional analysis and consideration of whether transitioning to IFRS is in the best interests of the U.S. securities markets in general and U.S. investors specifically, and further consideration is necessary before the final decision can be made in *Final Staff Report* (SEC, 2012). While the IFRS adoption in the U.S. remains uncertain, the FASB continues to represent U.S. interest in the IASB's standard-setting process and to converge U.S. GAAP and IFRS through its membership at the Accounting Standards Advisory Forum (ASAF). ASAF was established in early 2013 by the IFRS Foundation to improve cooperation among worldwide standard setters and advise the IASB on the IFRS development (FASB, 2014).

U.S. GAAP have been converging with IFRS since 2002 and the differences between US GAAP and IFRS are believed to have reduced (Henry et al., 2009). The SEC consistently supports a single set of high quality, global accounting standards and believes that IFRS is best positioned to serve as this set of standards. Recently, the SEC Chair, Mary Jo White, discussed the possible incorporation of IFRS in the U.S. in a speech at the annual U.S. Financial Accounting Foundation Trustees dinner on May 20, 2014 (SEC, 2014). While this study does not intend to predict the timing of IFRS adoption in the U.S., it provides insight as to the potential impacts on financial reporting of U.S. firms. It becomes increasingly important for a US capital market participant to be

financially bilingual as IFRS requirements elsewhere in the world can impact US companies through cross-border merger and acquisition activity, IFRS' influence on US GAAP, and the IFRS reporting demands of non-US stakeholders (PwC, 2014). In addition, large U.S. multinational corporations, however, have started using IFRS for their foreign subsidiaries where allowed by local law. Some U.S. subsidiaries of foreign-owned companies are also using IFRS (AICPA, 2014).

PREVIOUS FINDINGS ON THE FIRST-TIME ADOPTION OF IFRS

Although many comprehensive guidelines exist from the IASB, "Big Four" accounting firms, and consulting firms regarding compliance with IFRS 1, there are only a few studies examining the effect of the first-time adoption of IFRS in Europe. They can be classified as either survey or empirical studies.

Survey Results

The Institute of Chartered Accountants in England and Wales (ICAEW) provides the report *E.U. Implementation of IFRS and the Fair Value Directive* at the request of the European Commission (1997). Using 151 first-time adopters in 2005, the ICAEW survey finds that 91 firms restated their prior financial statements for IAS 31 *Financial Instruments: Disclosure and Presentation* and 84 firms restated their prior financial statements for IAS 39 *Financial Instruments: Recognition and Measurement.* In addition, 31 firms use fair value or revaluation as the deemed cost of property, plant, and equipment (IAS 16) or investment property (IAS 40). Interestingly, all firms that opt to use the corridor approach for actuarial gains and losses on defined benefit plans recognize all such gains and losses at the corresponding transition date (IAS 19). All examined firms elect the optional exemptions from a retrospective application for business combinations (IFRS 3), cumulative foreign currency translation differences (IAS 21), compound financial instruments (IAS 31), and share-based compensation (IFRS 2). These elections of optional exemptions are generally consistent with the firms we examine in this study, as discussed more completely in the following section.

With respect to implementation costs, the survey shows that the costs are higher for small firms (0.31% of sales for firms with sales below €500 million) compared to medium and large firms (0.05% of sales for firms with sales above €500 million). The estimated recurring costs of preparing IFRS financial statements in following fiscal years are 0.06% of sales for small firms compared to about 0.01% of sales for medium and large firms. Moreover, the costs of auditing IFRS implementation are significant, ranking as the second highest cost for small firms and third highest for large firms.

In contrast with the above survey results, the SEC's roadmap estimates that the average cost of IFRS transition using the approach similar to the one adopted by E.U. firms would be approximately 0.125% of revenue for U.S. issuers, and it would be approximately 0.13% of revenue using a more complicated approach to reflect the additional U.S. GAAP reconciliation disclosure. The SEC argues that the reason for higher transition costs is at least partially attributable to different filing obligations in the U.S., which requires three years of audited financial statements and internal controls over financial reporting. Although the SEC does not provide estimated guidance related to

transition costs for firms of different sizes, the experience of E.U. firms suggests that costs may be proportionately higher for small firms compared to large firms.[5]

In summary, consistent with Cormier et al. (2009), the first-time adopters of IFRS from U.S. GAAP appear to have taken advantage of the optional exemptions. Moreover, the implementation costs appear to be higher for small firms than medium and large firms, and large firms appear to be more prepared for this change than small firms. However, the above survey results do not provide any insights about the underlying rationale of managerial choice over optional exemptions from a full retrospective application of IFRS. For example, the ICAEW's survey does not provide any insights about the effect of restatements on firms' financial statements and key financial ratios when transitioning from U.S. GAAP to IFRS. It is likely that the increased real costs associated with the transition to and ongoing implementation of IFRS may tempt managers to elect optional exemptions when a restatement of prior year financial statements would have a significant (or negative) impact on the companies' financial statements and key financial ratios. This study fills the gaps in previous survey results.

Empirical Results

To our knowledge, there are a few studies that examine the effects of the first-time adoption of IFRS on earnings management (Cormier et al., 2009; Capkun et al., 2011), balance sheet adjustments (Garcia Osma & Pope, 2011), and accounting choices (Nobes, 2006; Cazavan-Jeny & Jeanjean, 2007; Kvaal & Nobes, 2012). These studies find that managers take the opportunity of the transition to IFRS from local GAAP to improve their reported earnings, balance sheet adjustments are negatively associated with earnings quality in subsequent periods, and national patterns of IFRS practice continue through the transition to IFRS period.

We believe Cormier et al. (2009) is the most relevant study to ours, which has directly examined the effect of the first-time adoption of IFRS on financial ratios. Using 106 French firms, Cormier et al. (2009) investigate whether and how managerial incentives influence the decision to elect the optional exemptions when first adopting IFRS. They argue that the cumulative effects of the mandatory and optional changes in accounting policies resulting from the first-time adoption of IFRS are charged to equity, which could affect key financial ratios such as return on equity, leverage, and price-to-book value. They find that the optional exemptions for employee benefits and cumulative currency translation differences generally have a negative impact on equity. They also find that firms that elect the optional exemptions with a negative cumulative effect of the optional changes in accounting policies are more likely to have: (1) higher equity before optional exemptions than the sample median; (2) positive sum of the mandatory equity adjustments at the transition date; and (3) lower prior-year leverage. They also find that these firms are less likely to cross list on a non-European stock exchange.

Overall, their findings suggest that French managers intended to maintain the level of shareholders' equity to avoid significant changes in key financial ratios, especially leverage, when electing optional exemptions for a retrospective application. However, similar to other studies in the literature, their findings may not directly apply to U.S. firms because these firms use French accounting standards to prepare financial statements before 2005. In addition, since optional and mandatory exemptions and mandatory equity adjustments will have effects on both ROE and debt-to-equity ratios, it is unclear why managers simply focus on smoothing debt-to-equity ratio.

SAMPLE FIRMS

Some publicly traded E.U. firms used U.S. GAAP to prepare their consolidated financial statements for various strategic reasons prior to the mandatory adoption of IFRS in E.U. in 2005 (Eierle et al., 2007). Member states of the E.U. might defer the mandatory application of IFRS until 2007 for firms that either listed debt securities only or applied different internationally accepted standards other than IFRS due to cross-listing outside the E.U. (European Parliament and Council, 2002). The latter especially applied to a small number of firms that cross-listed in the U.S. and prepared their consolidated financial statements in accordance with U.S. GAAP.

This study focuses on E.U. firms that prepared their consolidated financial statements in accordance with U.S. GAAP and were cross-listed on the New York Stock Exchange (NYSE) before they switched to IFRS in 2007. These firms provided dual financial reporting under both U.S. GAAP and IFRS in the year preceding a full adoption of IFRS. Panel A of Table 1 shows that only six firms (including five German and one Norwegian firms) were actually cross-listed on the NYSE. These six firms include Daimler, Siemens, E.ON, Hydro, SAP, and Deutsche Bank. In fact, these firms were cross-listed on the NYSE and had prepared their consolidated financial statements in accordance with U.S. GAAP for a number of years before they switched to IFRS in 2007. They shared similar business and reporting concerns to similar U.S. firms and pioneered the U.S. GAAP-to-IFRS conversion. Hence, learning from their dual reporting practice provides U.S. firms with valuable information for IFRS conversion in the near future.[6]

Table 1: Sample Firms

Panel A: Continental European firms that were cross-listed on the NYSE and switched to IFRS from U.S. GAAP in 2007

Countries	No. of Firms
Germany	5
Norway	1
Total	**6**

Panel B: Company List

SIC	Company Country	Industry	Transition Date	First IFRS Fiscal Year
3600	Siemens Germany	Electronic & Other Electrical Equipment	10/1/2006	2007
3711	Daimler Germany	Motor Vehicles & Passenger Car Bodies	1/1/2006	2007
1311	Norsk Hydro Norway	Crude Petroleum & Natural Gas	1/1/2006	2007
4900	E.ON Germany	Electric, Gas & Sanitary Services	1/1/2006	2007
7372	SAP Germany	Packaged Software	1/1/2006	2007
6022	Deutsche Bank Germany	Banks	1/1/2006	2007

CHOICES OF IFRS 1 OPTIONAL EXEMPTIONS

In preparing for the first set of IFRS financial statements, firms will need to apply the guidance in IFRS 1, *First-time Adoption of IFRS*. The principle of IFRS 1 is to have a full retrospective application of all IFRS standards. However, recognizing that a retrospective application can be difficult when data and information may not be available and/or reliable, IFRS 1 provides fifteen optional exemptions and imposes several mandatory exceptions to a full retrospective application of IFRS to ease the burden of first-time adoption (see Appendix 1). Decisions made in choosing optional exemptions under IFRS 1 will impact future financial statements. In addition to the pronouncement itself, readers may find useful summarized discussion and application of each item from "*Preparing Your First IFRS Financial Statements*" published by PricewaterhouseCoopers (2008) and "*IFRS 1 First-Time Adoption of International Financial Reporting Standards*" by Deloitte (2004).

Normally, companies designate a section of their annual reports to explain if particular exemptions permitted by IFRS 1 were applied.[7] Of the fifteen optional exemptions permitted by IFRS 1, most firms discussed only four items: (1) Business Combinations; (2) Employee Benefits; (3) Cumulative Foreign Currency Translation Differences; and (4) Share-Based Payment Transactions, as shown in Table 2. Although it cannot be ascertained that these are the only items applied, items that were not specifically mentioned are considered not material enough to warrant further discussion. For example, Deutsche Bank stated that "other options available under IFRS 1, which are not discussed here, are not material to the Group's business" (2007 annual report, p.107). Hydro indicated that "transition policies available under IFRS 1 that are not material are not included in the discussion" (2007 annual report, p. 47). Table 2 shows that all six firms took advantage of optional exemptions for business combinations and cumulative foreign currency translation differences. In addition, 3 of the 6 firms elected optional exemptions for employee benefits, actuarial gains or losses, and share-based payment. We provide a brief summary of relevant excerpts from financial statements to analyze how these firms dealt with the elected optional exemptions or restated prior financial statements if they chose not to elect optional exemptions.

Table 2: Summary of Electing IFRS 1 Optional Exemptions

Item	Standard	Title	Siemens	Daimler	Hydro	E.On	SAP	Deutsche Bank
1	IFRS 3R	Business combinations	Y	Y	Y	Y	Y	Y
3	IAS 19	Employee benefits		Y	Y			Y
4	IAS 21	Cumulative translation differences	Y	Y	Y	Y	Y	Y
8	IFRS 2	Share-based payment transactions	Y	Y				Y

Note: **Y** indicates that firms elected optional exemptions and did not restate prior financial statements.

Item 1: IFRS 3R Business combinations

According to IFRS 1, a reporting entity that chooses to apply this exemption is not required to restate business combinations to comply with IFRS 3R, *Business Combinations*, where control of the acquired firm was obtained before the IFRS adoption date. The assets and liabilities related to prior business combination were generally carried over based on U.S. GAAP.[8] However, goodwill must be tested for impairment at the date of transition to IFRS, using the impairment testing method required by IAS 36.[9] If the optional exemption is not elected, the reporting entity must restate prior business combinations in accordance with IFRS 3R, IAS 27R, and IAS 36.

We find that all six examined firms applied this optional exemption, electing not to restate business combinations before the date of transition. All these companies stated that business combinations that occurred before the date of transition were not restated retrospectively in accordance with IFRS 3. SAP and E.ON provide concise examples of disclosing how the firm dealt with this exemption:
SAP:

"*We have applied the business combination exemption in IFRS 1 and therefore have not restated business combinations that took place prior to January 1, 2006. The goodwill arising from these prior acquisitions did not contain additional identifiable intangible assets that should have been separated under IFRS. We have adjusted goodwill from past business combinations for contingent considerations for which payment was estimated to be probable.*"

E.ON:

"*…the provisions of IFRS 3, "Business Combinations", were not applied with respect to the accounting for business combinations that occurred before January 1, 2006. The goodwill maintained from this period did not include any intangible assets that had to be reported separately under IFRS. Conversely, there were no intangible assets that until now had been reported separately that had to be included in goodwill. As no adjustment for intangible assets was required relating to such business combinations, the goodwill reported under U.S. GAAP was maintained in E.ON's opening balance sheet under IFRS.*"

Item 3: IAS 19 Employee benefits on actuarial gains and losses

Firms applying U.S. GAAP are required to apply the corridor approach for actuarial gains and losses on employee benefit plans. Under this approach, such gains and losses are recorded as an adjustment to Accumulated Other Comprehensive Income on the Balance Sheet rather than impacting the Income Statement (via pension expense). When these gains and losses exceed the defined threshold, they are amortized over a specified period of time and taken to the income statement. IAS 19 allows firms to apply the corridor approach.[10] A retrospective application of the corridor approach therefore requires cumulative actuarial gains or losses from the inception of each pension plan to be determined and split between recognized and unrecognized gains or losses at each balance sheet date according to IAS 19. IFRS 1 requires a reporting entity to restate all

defined benefit plans under IAS 19 since the inception of those plans except for an optional exemption concerning actuarial gains or losses. Entities may elect to eliminate unrecognized actuarial gains and losses by setting them off against equity in the opening IFRS balance sheet, even if they elect to use the IAS 19 corridor approach in the future. We find four of the six companies (Daimler, Hydro, SAP, and Deutsche Bank) elected this optional exemption from a full retrospective application of IAS 19. Among these four firms, only SAP elected to follow the amended IAS 19[11] following the adoption of IFRS. The other three firms elected to follow the corridor approach permitted under IAS 19 after adoption of IFRS.
SAP discloses the following in its annual report for the year of IFRS adoption:

> *"We have elected to recognize all actuarial gains and losses and vested past service cost as at January 1, 2006 in equity. All actuarial gains and losses not previously recognized through application of the corridor approach under U.S. GAAP have been recognized at the date of transition in equity. Any actuarial gains and losses developing after January 1, 2006, will be recognized directly in Other components of equity for all of our defined benefit plans as allowed under IAS 19.93A."*

In contrast, Deutsche Bank provides the following brief disclosure:

> *"At transition, the Group recognized all cumulative actuarial gains and losses on defined benefit pension schemes and other post retirement benefits in shareholders' equity."*

The above two companies report a cumulative actuarial loss in their reconciliation disclosure. SAP reports a cumulative actuarial loss of €65 (€78) million as of January 1, 2006 (December 31, 2006), which is around 1% of the total shareholders' equity under IFRS. Deutsche Bank reports a higher cumulative actuarial loss of €1,056 (€966) million as of January 1, 2006 (December 31, 2006), which is around 3% (3.6%) of the total shareholders' equity under IFRS.

Daimler reports an extremely high cumulative actuarial loss of €7,728 (€7,670) million as of January 1, 2006 (December 31, 2006), which is around 24% (21%) of the total shareholders' equity under IFRS. Finally, Hydro reports a cumulative actuarial loss of €6,012 (€905) million as of January 1, 2006 (December 31, 2006), which is around 6.6% (1%) of the total shareholders' equity under IFRS.

On the other hand, Siemens and E.ON did not elect the optional exemption allowed by IFRS 1 and restated their financial statements to reflect retrospective application of IAS 19. In its 2005 financial statements, Siemens reveals that the firm had a cumulative actuarial loss of €849 (€1,667) million as of October 1, 2006 (September 30, 2006), which is around 3.50% (6.35%) of the total shareholders' equity under IFRS. E.ON, however, reports a cumulative actuarial loss of €1,391 (€81) millions as of January 1, 2006 (December 31, 2006), which is around 3% (0.15%) of the total shareholders' equity under IFRS. Neither firm explained the reason for this particular choice.

Overall, we find that most examined companies recognized a sizable amount of cumulative actuarial loss when transitioning to IFRS. Daimler and Siemens are interesting cases because their reported cumulative actuarial losses are large (21% and 6.35% of the total shareholders' equity under IFRS as of December 31 of 2006,

respectively) although they elected the optional exemption of applying IAS. It is possible that their cumulative actuarial losses could have been much larger had they not elected this optional exemption. Hence, managers of firms appear to have taken the advantage of the optional exemptions allowed by IFRS 1 to reduce the effect of restatement on firms' shareholders' equity.

Item 4: IAS 21 Cumulative Foreign Currency Translation Differences

IFRS requires an entity to restate the cumulative foreign currency translation reserve for all foreign entities since they were acquired or created. Any gain or loss on a subsequent disposal of the foreign entity will be adjusted only by those accumulated translation adjustments arising after the opening IFRS balance sheet date. On the other hand, an entity can choose an optional exemption that allows it to reset the cumulative foreign currency translation gains or losses as reported in shareholders' equity to zero. We find that all of the examined firms applied the optional exemption by setting the previously cumulative translation adjustment to zero at the date of transition. SAP disclosed the impact of this adjustment to Retained Earnings in its annual report as follows:

> "*We have elected to set the previously accumulated cumulative translation adjustment to zero as of January 1, 2006. This exemption has been applied to all subsidiaries in accordance with IFRS 1. The cumulative currency translation losses resulting from the translation of the financial statements of subsidiaries and associated companies that were recognized in Retained earnings amounted to €175 million.*"

The above translation loss accounts for nearly 3% of the total shareholders' equity under IFRS. Deutsche Bank is another company to report a more significant translation loss of €1,344 (1,328) million as of January 1, 2006 (December 31, 2006), which is around 4.6% (4%) of total shareholders' equity under IFRS. The remaining firms do not provide sufficient information for further analysis.

Item 8: IFRS 2 Share-based payment transactions

IFRS 1 requires an entity to apply IFRS 2 to a liability relating to a cash-settled, share-based payment that was settled prior to the date of transition to IFRS. Alternatively, an entity electing the optional exemption does not apply IFRS 2 *Share-based Payment* retrospectively to any equity instruments that were granted on or before November 7, 2002.[12] We find that Siemens, Daimler, and Deutsche Bank elected this optional exemption. The disclosure from Siemens is as follows:

> "*As permitted under IFRS 1, IFRS 2 Share-based Payments has not been retrospectively applied to all share-based payment awards. This exemption has been applied for all equity awards that were granted prior to November 7, 2002, as well as those equity awards granted prior to October 1, 2003, which vested before January 1, 2005* (the transition date). *All such equity awards exempted from IFRS 2 continue to be accounted for under the intrinsic value approach as allowed under U.S. GAAP.*"

In contrast, Hydro, E.ON and SAP applied a full retrospective application of IFRS 2. SAP, however, is the only company that discloses its choice and the impact of restatement on retained earnings below. The effect of the above adjustment is only about 0.7% of the total shareholders' equity under IFRS.

"*For our cash-settled and equity-settled share-based payment arrangements, we have not used the exemption of IFRS 1 in our opening balance sheet but adopted IFRS 2 Share-based payment retrospectively. As a result, the difference between the intrinsic value method and the fair value method was recorded in the opening balance sheet, increasing retained earnings by €42 million. Due to the fact that certain cash-settled share-based payment programs have been hedged, the increase in liabilities resulted in a €27 million offset, net of tax, of the recognized portion of the hedge instrument in Other Components of Equity.*"

Besides the above four major optional exemptions, some firms discussed optional exemptions related to: Item 2: Fair Value or Revaluations as Deemed Cost; Item 7: Designation of Previously Recognized Financial Instruments; and Item 12: Fair Value Measurement of Financial Assets or Financial Liabilities at Initial Recognition. Although items 7 and 12 are most relevant to Deutsche Bank, there is no disclosure on how reclassification of financial assets and liabilities following IAS 39 affects its financial statements.

Table 3 summarizes the prior year adjustments relating to the above four optional exemption items. Different from Cormier et al. (2009), we find that all four adjustment items are negative. Our finding is; however, consistent with other previous studies (e.g. Henry et al., 2009) that shareholders' equity under U.S. GAAP is generally higher than that under IFRS. In other words, the overall prior year adjustments are negative when switching to IFRS from U.S. GAAP. Many firms did not disclose the adjustments relating to cumulative translation differences and share-based payment transaction in their financial statements. We find that only SAP and Deutsche Bank disclose the total and breakdown of prior year adjustments in their IFRS-to-U.S. GAAP reconciliation disclosure. Other firms only reported the total differences in shareholders' equity between IFRS and U.S. GAAP.

In summary, we find that the effect of restatement on shareholders' equity could be significantly different between companies given the nature of business (or industry-specific factors), choice of accounting methods, and more importantly the election of the optional exemptions from retrospective application allowed by IFRS 1. We find that all the survey firms elect to apply the optional exemptions for business combinations and cumulative foreign translation difference, which could be driven by the fact that it is too complex or unfeasible to apply IFRS 3R and IFRS 21 retrospectively. In contrast, the decision on applying the optional exemptions for share-based payment (IFRS 2) and employee benefits (IAS 19) appears to differ among these firms. An interesting example is that three firms elected not to follow IFRS 2 and IAS 19 while the other three firms elected to follow these two standards. Overall, we find that disclosures regarding mandatory adjustments and choices regarding optional exemptions are often insufficient to warrant additional analysis.

Table 3: Prior Year Adjustment Relating to Optional Exemption
Percent of Total Shareholders' Equity under IFRS immediately before the adoption year

Exemption Item	1	3	4	8
Standard No.	IFRS 3R	IAS 19	IAS 21	IFRS 2
Standard Title	Business Combinations	Employee Benefits	Cumulative Translation Differences	Share-based Payment Transactions
Siemens	0	-6.35	NA	0
Daimler	0	-21	NA	0
Hydro	0	-1	NA	NA
E.ON	0	-0.15	NA	NA
SAP	0	-1	-3	-0.7
Deutsche Bank	0	-3.6	-4	0

NA: Not Available

RECONCILIATION OF KEY ACCOUNTING DIFFERENCES

IFRS 1 also requires the first IFRS financial statements to include a reconciliation of: (1) stockholders' equity from U.S. GAAP to IFRS at the transition date and at the end of the transition year; and (2) net profit from U.S. GAAP to IFRS for the transition year. Instead of providing major accounting differences in net income and shareholders' equity between U.S. GAAP and IFRS, we find that Hydro, SAP, and Deutsche bank voluntarily disclosed more detailed account-by-account reconciliations in which all the line items as reported in income statement, balance sheet, and statement of shareholders' equity were reconciled from U.S. GAAP to IFRS.

The 2006 reconciliation disclosures from our sample firms are summarized in Table 4. We find that, on average, net income and shareholders' equity are 7.21% and 1.48% higher, respectively, under IFRS than under U.S. GAAP for our sample firms. These results are somewhat different from Henry et al. (2009) who find that application of IFRS results in 2.11% higher net income and 11.64% lower stockholders' equity than application of U.S. GAAP using 75 European cross listing firms.

The above different finding could result from three causes. First, our study uses a smaller sample (6 companies) compared to Henry et al. (2009) (75 companies). Second, our sample firms prepared their financial statements in accordance with U.S. GAAP before they switched to IFRS in 2007. Hence, their 2006 financial statements were prepared in accordance with U.S. GAAP and were reconciled to IFRS. In contrast, the firms included in Henry et al. (2009) prepared their 2004, 2005, and 2006 financial statements in accordance with IFRS, which were then reconciled to U.S. GAAP in their Form 20-F. Third, the accounting differences between IFRS and U.S. GAAP for IFRS firms may not be necessarily similar to those for U.S. GAAP firms.

Table 4 also shows that five out of six firms report higher net income under IFRS than under U.S. GAAP with E.ON, Daimler, and Siemens having the highest percentages of change in net income (16.85%, 14.70%, and 9.05%, respectively). On the other hand,

three out of six firms report higher shareholders' equity under U.S. GAAP than under IFRS with Siemens and Deutsche Bank having the highest percentages of change in shareholders' equity (11.53% and -10.57%, respectively).

Finally, we examine the impacts of restatements on ROE, and find that four out of six firms have higher ROE under IFRS than under U.S. GAAP. More importantly, the average difference in ROE is close to zero, which suggests that managers attempted to minimize the impact of restatements on ROE when transitioning to IFRS from U.S. GAAP. We investigate the effect of restatement on leverage in the next section.

ROE AND LEVERAGE

The result reported in Table 4 implies that managers might have smoothed ROE when transitioning to IFRS from U.S. GAAP. To further investigate this possibility, we examine the pattern of ROE and debt-to-equity around the adoption period. Panel A of Table 6 shows that ROE under IFRS is rather smooth between the transition and adoption years for Daimler, SAP, and Deutsche Bank. In contrast, Hydro and E.ON have extremely higher ROE in the adoption year compared to the transition year (33.82% vs. 18.56% and 36.35% vs. 11.87%, respectively). Managers provide very limited explanation for this dramatic increase in ROE in the adoption year.

However, ROE for the year subsequent to IFRS adoption appears to vary between firms. For example, both Siemens and Daimler report a stable increase in ROE. In contrast, Hydro, E.ON, and Deutsche Bank report a dramatic decrease in ROE. In fact, both Hydro and Deutsche Bank have negative ROE in the year following IFRS adoption (i.e., 2008), implying that these two companies may have suffered significantly from the recent financial crisis. Overall, there is some evidence suggesting that certain firms might have strategized to minimize the impact of restatements on ROE when transitioning to IFRS from U.S. GAAP.

Table 4: Accounting differences between IFRS and U.S. GAAP

Panel A: Accounting Difference in Net Income (NI) at the transition date

Company	NI-IFRS (1)	NI-U.S. GAAP (2)	Difference (1)-(2)	Percentages [(1)-(2)]/(1)
Siemens	3,335	3,033	302	9.05%
Daimler	3,783	3,227	556	14.70%
Hydro	17,933	17,391	542	3.02%
E.ON	6,082	5,057	1,025	16.85%
SAP	1,836	1,871	-35	-1.91%
Deutsche Bank	6,079	5,986	93	1.53%
Mean	**6,508**	**6,094**	**414**	**7.21%**

Table 4: Accounting differences between IFRS and U.S. GAAP (Continue)

Panel B: Accounting Difference in Stockholders Equity (SE) at the transition date

Company	SE-IFRS (1)	SE-U.S. GAAP (2)	Difference (1)-(2)	Percentages [(1)-(2)]/(1)
Siemens	26,275	29,306	-3,031	-11.53%
Daimler	37,449	34,155	3,294	8.80%
Hydro	96,601	97,203	-602	-0.62%
E.ON	51,245	47,845	3,400	6.63%
SAP	6,123	6,136	-13	-0.21%
Deutsche Bank	33,475	32,808	667	2.00%
Mean	**41,861**	**41,242**	**619**	**1.48%**

Panel C: ROE under IFRS and US GAAP

Company	ROE-IFRS (1)	ROE-USGAAP (2)	Difference (1)-(2)
	%	**%**	**%**
Siemens	12.69	10.35	2.34
Daimler	10.10	9.45	0.65
Hydro	18.56	17.89	0.67
E.ON	11.87	10.57	1.30
SAP	29.99	30.49	-0.51
Deutsche Bank	18.16	18.24	-0.08
Mean	**16.90**	**16.17**	**0.73**

Table 5: Major Mean Accounting Differences

Accounting Differences	Net Income (%)	Stockholders' Equity (%)
Financial instrument	0.00	0.69
Inventory	-1.00	-0.33
R&D	-1.00	-2.41
Associate companies	2.00	-0.28
Deferred tax	0.00	1.45
Minority	-3.00	-2.38
Pension	-10.00	1.62
Other provision	0.00	0.14
Termination benefit	0.00	0.42
Others	-1.00	0.10

Note: the above percentages are derived from dividing individual accounting differences by net income and shareholders equity under IFRS, respectively.

Table 6: ROE and Leverage

Panel A: ROE under IFRS				
Company	**Year t-1 U.S. GAAP**	**Year t-1 IFRS (Transition year)**	**Year t IFRS (Adoption year)**	**Year t+1 IFRS**
Siemens	8.32%	11.00%	12.69%	13.63%
Daimler	9.45%	10.10%	10.13%	10.42%
Hydro	17.89%	18.56%	33.82%	-6.65%
E.ON	10.57%	11.87%	36.35%	25.18%
SAP	30.49%	29.99%	29.45%	25.73%
Deutsche Bank	18.24%	18.16%	17.57%	-12.69%
Panel B: Leverage under IFRS				
Siemens	2.15	2.16	2.08	2.09
Daimler	4.56	5.32	4.83	2.53
Hydro	1.42	1.43	0.67	0.75
E.ON	1.66	2.01	2.73	5.25
SAP	0.55	0.52	0.54	0.94
Deutsche Bank	33.33	47.35	53.50	68.01

Panel B of Table 6 reports the changes in the debt-to-equity ratio around the adoption period. Surprisingly, we find that the leverage ratios under IFRS and U.S. GAAP are rather similar, except for E.ON and Deutsche Bank, and that leverage under IFRS in both the transition and adoption years are again rather similar, except for Hydro and Deutsche Bank. We also find that the leverage ratio increases dramatically in the year following IFRS adoption except Siemens and Hydro. Overall, there is some evidence suggesting that managers may have successfully minimized the effect of transitioning to IFRS from U.S. GAAP on leverage, which is consistent with Cormier et al. (2009).

In summary, consistent with Capkun et al. (2011) and Cormier et al. (2009), we find evidence suggesting that managers may have stabilized both ROE and debt-to-equity ratio through certain accounting and optional exemption choices when transitioning to IFRS from US GAAP. This is the first study to document this finding for firms switching from U.S. GAAP to IFRS. We further investigate the role of accounting method and estimate choices in the next section.

CHOICES OF ALTERNATIVE ACCOUNTING METHODS

The first-time adoption of IFRS also presents companies an unprecedented opportunity to re-evaluate and change their accounting policies. A number of individual standards under IFRS permit companies to choose between alternative policies–for instance, the fair value model or the cost model for measurement of property, plant and equipment. We summarize the accounting choices made by our sample firms in Table 7 and include relevant discussion.

IAS 1, *Presentation of Financial Statements*, provides two options to classify expenses on the Income Statement: by function or by nature. All companies, except for E.ON, continue to classify expenses by function as reported under U.S. GAAP. E.ON stated in p. 141 of its 2007 Annual Report:

> *"As part of the transition to IFRS, classification of the Income Statement (p. 123) was changed to the nature of expense method, which is also applied for internal purposes."*

IAS 7, *Statement of Cash Flows*, permits use of either the indirect or direct method. The indirect method has been uniformly applied by all of the sample companies. IAS 7 also allows optional choices on the activity classification for Interest Expense, Interest Income, and Dividend Income in operating, investing, or financing activities. Although Deutsche Bank did not discuss the issue, all other companies have inherited their previous U.S. GAAP practices by classifying all of these items as operating activities.

IAS 2, *Valuation of Inventories*, allows two methods: FIFO or Average Cost. Because inventory is not material to SAP in the software industry and Deutsche Bank in the banking industry, there is no discussion on this issue. Siemens, Daimler and Hydro have essentially followed their previous U.S. GAAP practices by using FIFO. However, E.ON was the only company to use LIFO under U.S. GAAP and therefore selected the average method for IFRS reporting. This choice may be due to the fact that a restatement from LIFO to average cost would have had less of a financial impact than the switch from LIFO to FIFO. E.ON reports that the prior year adjustments due to change in inventory method is €134 (€348) million as of Jan. 1 2006 (Dec. 31, 2006).

IAS 16, *Property, Plant and Equipment*, allows either the Cost or Revaluation method for asset valuation. Interestingly, no companies chose to revalue their fixed assets. It is possible that firms believed the annual fair value assessment to be too cumbersome. Similar to U.S. GAAP, IFRS also allows various choices for depreciation methods. All firms, regardless of industry differences, have uniformly chosen to use the straight-line method, which is same as the previous accounting choices made under U.S. GAAP.

IAS 19, *Employee Benefits* (Actuarial gains and losses), permits immediate recognition of actuarial gains and losses to equity or application of the corridor approach, which is commonly used under U.S. GAAP. The choice on this item was an equal split. Daimler, Hydro and Deutsche Bank followed their previous U.S. GAAP practice by using the corridor method. SAP, Siemens, and E.ON selected the immediate recognition option.

In summary, consistent with Cazavan-Jeny & Jeanjean (2007) and Kvaal & Nobes (2012), we find evidence suggesting that managers have attempted to minimize the effect of transition to IFRS on financial statements and key financial ratios by electing accounting methods strategically. First, managers appear to keep those accounting methods that are accepted by both U.S. GAAP and IFRS. This is the first study to document this finding for firms switching from U.S. GAAP to IFRS. Second, managers seem to have chosen new accounting methods that have the smallest impact on financial statements and key financial ratios.

CONCLUSION

This study examines the incentive and effect of the reporting practices and accounting choices adopted by six large European multinational firms following a mandatory switch to IFRS from U.S. GAAP after 2005. Our findings indicate that managers consider the complexity and feasibility of restating prior financial statements when electing optional exemptions. They were also able to take the advantage of optional exemptions under the transitional rules in IFRS 1. Such decisions could be either driven by managers' consideration of relative costs and benefits of retrospective applications or due to managerial incentives to reduce the effect of first time adoption of IFRS on key financial ratios including ROE and debt-to-equity ratio. We find evidence that firms typically continued to use the accounting methods that are permitted under U.S. GAAP even after they switched to IFRS. Consistently, we find a small difference in ROE following IFRS adoption and stable debt-to-equity ratios around IFRS adoption, suggesting that managers made discretionary choices intended to minimize the impact of the transition to IFRS on key financial ratios. The findings of this study should provide some implication for the first-time adoption of IFRS in the U.S.

Although we examine only six firms, the characteristics and nature of these firms make them very comparable to large U.S. firms, and their experience with the transition from U.S. GAAP to IFRS provides peer firms in the U.S. with valuable insight into how the transition to IFRS may affect their operations and financial condition. The results suggest that U.S. capital market participants should expect minimal impact on financial statements when large U.S. multinational companies, similar to those the surveyed firms, change to IFRS reporting system from U.S. GAAP. Perhaps E.U. companies had anticipated unavoidable mandate of IFRS and chose to apply U.S. GAAP accounting policies similar to the principles underlie IFRS when the financial statements were reported under the regime of U.S. GAAP. It is possible that the experience of the firms examined in this study may not be indicative of the impact on small firms, those firms listed on stock exchanges other than the NYSE, or firms from countries with lower levels of economic development.

To further understand the IFRS transition practices, the sample can be expanded to include a larger number of U.S. GAAP users which converted to IFRS in 2005 when the standards became mandated in E.U. Future studies can examine whether accounting quality changed following a switch from U.S. GAAP to IFRS since the quality of financial reporting is a major concern of IFRS adoption in the U.S. Aside from the research application, this paper can also be used as a supplemental teaching material in learning IFRS transition practices.

Table 7: Accounting Choices

		Seimens	Daimler	Hyrdo	E.ON	SAP	Deutsche
IAS 1	**Presentation of Financial Statements**						
	Expenses Classification 1-Functional 2-Nature	1	1	1	2	1	1
IAS 7	**Cash Flow Statement**						
	Method: 1-Indirect 2-Direct	1	1	1	1	1	1
	Interest Expense: 1-Operating Activity 2-Financing Activity	1	1	1	1	1	nd*
	Interest Income: 1-Operating Activity 2-Investing Activity	1	1	1	1	1	Nd
	Dividend Income: 1-Operating Activity 2-Investing Activity	1	1	1	1	nd*	Nd
IAS 2	**Valuation of Inventories**						
	US-GAAP method 1-FIFO 2-Average 3-LIFO	1	1	1	3	nm*	Nd
	IFRS: 1-FIFO 2-Average	1	1	1	2**	nm	Nd
IAS 16	**Property, Plant And Equipment**						
	Valuation Method: 1-Cost 2-Revaluation	1	1	1	1	1	1
	Depreciation Method: 1-Straight Line 2-Accelerated Declining 3-SYD	1	1	1	1	1	1
	Life:						
	Factory and Office Buildings	20-50	5-50	20-50	10-50	25-50	25-50
	Technical machinery & equipment	5-10	3-30	4-30	10-65		
	Information technology equipment					3-5	
	Furniture & office equipment	5	2-33		3-25	5	3-10
	Equipment leased to others	3-5					3-15
	Automobiles					5	
IAS 19	**Employee Benefits**						
	Actuarial gains/losses: 1-Immediate Recognition 2-Corridor	1	2	2	1	1	2
IAS 21	**Foreign Exchange Rates** 1-Period end closing rate 2 Average 3-Spot rate of transaction date						
	Balance Sheet:	1	1	1	1	1	1
	Income Statement	2	2	2	2	2	2,3
	Statement of Cash Flow	Nd	2	2	nd	2,3	nd
IFRS 2	**Share-Based Payments/Stock Options**						
	Black-Scholes option pricing model	Y	Y	Y	N***	Y	Y

* nd: no discussion provided nm: the company specified the item is not material
** Increase in equity of Euro 134 (348) million on Jan. 2006 (Dec. 31, 2006)
*** Monte Carlo

APPENDIX 1A: LIST OF IFRS 1 MANDATORY EXEMPTIONS

Item	Standard	Exemptions	Description
1		Accounting estimates	An entity's estimates in accordance with IFRS at the date of transition to IFRS shall be consistent with estimates made for the same date in accordance with previous GAAP, after adjusting for any difference in accounting policy, unless there is objective evidence that those estimates were in error
2	IAS 39	Derecognition of financial assets and financial liabilities	Financial assets and liabilities for which derecognition was achieved before 1 January 2004 under previous GAAP are not required to be recognized again in the opening IFRS balance sheet
3	IAS 39	Hedge accounting	An entity shall not reflect in its opening IFRS statement of financial position a hedging relationship of a type that does not qualify for hedge accounting in accordance with IAS 39
4	IAS 27	Non-controlling interest	An entity shall apply the following requirements of IAS 27 prospectively from the date of transition to IFRS: (a) total comprehensive income is attributed to the owners of the parent and to the non-controlling interests; (b) changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and (c) a loss of control over a subsidiary, and the related requirements of IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

APPENDIX 1B: LIST OF IFRS 1 OPTIONAL EXEMPTIONS

Item	Standard	Exemptions	Description
1	IFRS 3R	Business combinations	An entity may elect not to apply IFRS 3R retrospectively to business combinations that occurred before the date of transition to IFRS
2	IAS 16, 38, 40	Fair value or revaluation as deemed cost	An entity may elect to measure an item of property, plant and equipment at the date of transition to IFRS at its fair value and use that fair value as its deemed cost at that date.
3	IAS 19	Employee benefits (on actuarial gains and losses)	An entity may elect to recognize all cumulative actuarial gains and losses at the date of transition to IFRS, even if it uses the corridor approach for later actuarial gains and losses.
4	IAS 21	Cumulative (foreign exchange) translation differences	An entity may elect that the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to IFRS.
5	IAS 32	Compound financial instruments	An entity needs not separate liability and equity components of a compound financial instrument if the liability component is no longer outstanding at the date of transition to IFRS.
6	IAS 27, 28, 31	Assets and liabilities of subsidiaries, associates and joint ventures	If an entity elects not to apply IFRS 3R, an entity shall adjust the carrying amounts of the subsidiary's assets and liabilities to the amounts that IFRS would require in the subsidiary's statement of financial position.
7	IAS 39	Designation of previously recognized financial instruments	An entity is permitted to make an available-for-sale designation at the date of transition to IFRS. An entity is permitted to designate, at the date of transition to IFRS, any financial asset or financial liability as at fair value through profit or loss provided the asset or liability meets the criteria of IAS 39 at that date.
8	IFRS 2	Share-based payment transactions	An entity is encouraged, but not required to apply IFRS 2 to equity instruments that were granted after 7 November 2002 but that vested before the date of transition to IFRS; and an entity is encouraged, but not required to apply IFRS 2 to liabilities arising from cash-settled share-based payment transactions if those liabilities were settled before 1 January 2005 or before the date of transition to IFRS

9	IFRS 4	Insurance contracts	An entity may apply the transitional provisions in IFRS 4 that restricts changes in accounting policies for insurance contracts, including changes made by an entity
10	IFRIC 1	Changes in existing decommissioning, restoration, and similar liabilities	An entity need not comply with IFRIC 1 for changes in decommissioning, restoration or similar liability liabilities, included in the cost of property, plant and equipment, which occurred before the date of transition to IFRS.
11	IFRIC 4	Leases	An entity may apply the transitional provisions in IFRIC 4 to determine whether an Arrangement contains a Lease. Therefore, an entity may determine whether an arrangement existing at the date of transition to IFRS contains a lease on the basis of facts and circumstances existing at that date
12	IAS 39	Fair value measurement of financial assets and financial liabilities	An entity may apply the requirements of IAS 39 regarding the fair value of a financial instrument, in either of the following ways: (a) prospectively to transactions entered into after 25 October 2002; or (b) prospectively to transactions entered into after 1 January 2004.
13	IFRIC 12	Service concession arrangements	An entity may apply the transitional provisions in IFRIC 12 that requires retrospective application unless it is, for any particular service arrangement, impracticable for the operator to apply IFRIC 12 retrospectively at the start of the earliest period presented
14	IAS 23R	Borrowing costs	IAS 23R requires that all borrowing costs be capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset. The policy election to immediately recognize such costs as an expense has been eliminated effective 1 January 2009 with earlier application permitted. An entity may apply capitalization prospectively to new qualifying assets or retrospectively to assets whose construction, manufacture or production commenced at an earlier specified date
15	IAS 27R	Investments in subsidiaries, jointly controlled entities and associates	If an entity measures investments in subsidiaries, jointly controlled entities and associates at cost, it shall measure that investment at the costs determined in accordance with IAS 27 or the deemed costs (fair values or carry costs) in its separate opening IFRS statement of financial position.

ENDNOTES

[1] These firms remain cross-listed in the U.S., with the exception of Hydro, which was delisted on November 23, 2007.
[2] Prior to this ruling, all foreign companies cross-listed on U.S. stock exchanges were required to reconcile net income and stockholders' equity to what would have been reported under U.S. GAAP via form 20-F. This reconciliation continues for foreign firms that use accounting standards other than IFRS.
[3] Based on the comments received from the roundtable discussions and political pressure on the U.S. market regulators, the SEC had inevitably moved to the direction of requiring U.S. firms to issue financial statements using IFRS with an option for early adoption for selected U.S. companies. The SEC's 2011 IFRS work plan, however, suggests reconsidering this option.
[4] Succeeding Christopher Cox as the SEC Chair on January. 27, 2009, Mary Schapiro, stepped down on December 14, 2012. Mary Jo White was sworn in as the 31st Chair of the SEC on April 10, 2013.
[5] The differing costs for firms of different sizes may be driven by the firms' operating environment or managerial choices. For example, firms electing a greater number of optional exemptions to restatements may experience a less costly transition. Likewise, many smaller firms in the U.S. are not publicly listed and may experience transition costs that are not consistent with firms of similar size in the E.U.
[6] The SEC Roadmap to adopt IFRS has proposed a dual reporting requirement for U.S. issuers who are chosen to adopt IFRS early. The main reasons for this requirement are to make the financial statements of IFRS early adopters and other U.S. issuers comparable and to facilitate a conversion back to U.S. GAAP if the SEC decides not to adopt IFRS.
[7] The titles of such sections include 'Explanation of transition to IFRS', 'Transition to IFRS - IFRS 1 elected exemptions', 'Explanation of transition to IFRS 1 exemptions', 'Basis of transition to IFRS', and 'Transition to IFRS: first-time application of IFRS'.
[8] IAS 36 requires that goodwill must be allocated to the cash-generating unit or groups of cash-generating units that represents the lowest level within the company at which goodwill is monitored for internal management purposes. In contrast, SFAS 142 requires that goodwill must be allocated to the reporting unit that is an operating segment or a component.
[9] IAS 36 uses a one-step goodwill impairment test based on the discounted present value of future cash flows of the cash-generating unit or groups of cash-generating units. In contrast, SFAS 142 uses a two-step impairment test for goodwill, first comparing the sum of undiscounted future cash flows of the reporting unit to its carrying amount and then measuring goodwill impairment using the implied fair value of goodwill.
[10] Under IAS 19, the threshold for the corridor approach is exceeded if cumulative actuarial gains or losses exceed 10% of either Pension Benefit Obligations (PBO) or the fair value of plan assets.
[11] Amended IAS 19 eliminates the corridor approach and requires that all actuarial gains or losses be directly taken to other comprehensive income.
[12] This exemption also applies to any equity instruments that were granted after November 7, 2002 but were vested before either the date of transition or January 1, 2005, whichever is later.

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