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# Public Accounting, International Standards, and You: A Closer Look on the Impact of IFRS and GAAP Convergence

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Public Accounting, International Standards, and You:  
A Closer Look on the Impact of IFRS and GAAP  
Convergence

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## **Abstract**

The convergence of US GAAP and IFRS has been significant for the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) over the decade. Due to major differences such as with the consolidation model and the special entities (i.e. Research and Development), there are concerns of how the convergence will affect the accounting practice. The US GAAP is known to have more industry-based details than the IFRS, and so it is essential to know what kind of issues lie from industry to industry. Here, our focus is within the life sciences. More specifically, this paper examines the financial statements of the top 10 firms in the pharmaceutical industry for both the United States and Europe. By analyzing and comparing the documentation, we can see the similarities and differences of using either the GAAP or IFRS. With these results, the impact of the convergence of the US GAAP and IFRS on the industry and as a whole will be concluded.

## **Introduction**

Public Accounting has faced many obstacles with the two different accounting standards used in the United States and Internationally. With different standards, two oversight groups were established, Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). Thus, in September 2002 the IASB and the FASB agreed to work together, in consultation with other national and regional bodies, to remove the differences between international standards and US GAAP. This decision was embodied in a Memorandum of Understanding (MoU) between the boards known as the Norwalk Agreement.<sup>1</sup>

The FASB's mission is to improve U.S. financial accounting standards for the benefit of present and potential investors, lenders, donors, creditors, and other users of financial statements. The FASB believes that pursuing convergence – making global accounting standards as similar as possible – is fully consistent with that mission. Investors, companies, auditors, and other participants in the U.S. financial reporting system should benefit from the increased comparability that would result from internationally converged accounting standards. More comparable standards would reduce costs to both users and preparers of financial statements and make worldwide capital markets more efficient.<sup>2</sup>

On the other hand, the IASB's goal is to develop a single set of high quality, understandable, enforceable and globally accepted International Financial Reporting Standards (IFRSs) through its standard-setting body, the International Accounting Standards Board (IASB), as well as, promote the use and rigorous application of those standards.<sup>3</sup>

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<sup>1</sup> "Convergence between IFRSs and US GAAP." IFRS. <<http://www.ifrs.org/Use-around-the-world/Global-convergence/Convergence-with-US-GAAP/Pages/Convergence-with-US-GAAP.aspx>>.

<sup>2</sup> "International Convergence of Accounting Standards - Overview." FASB. 25 Apr. 2014 <<http://www.fasb.org/jsp/FASB/Page/SectionPage%26cid%3D1176156245663>>.

<sup>3</sup> "About the IFRS Foundation and the IASB." IFRS. <<http://www.ifrs.org/The-organisation/Pages/IFRS-Foundation-and-the-IASB.aspx>>.

Convergence will move U.S. accounting from a detailed, rules-based approach to a more principles-based approach, and every aspect of operations will be affected. This makes the rules more difficult to apply initially, because it offers few clear-cut answers to accounting questions. This difference will require companies to more strongly focus on the definition of their accounting policies, resulting in increased transparency of financial reporting and improved consistency across businesses, industries and countries.<sup>4</sup>

Strict guidelines found under GAAP will no longer be followed if there is a change to IFRS. Thus, allowing organizations to their revenue recognition policies to make their financial statements look better. This will be good because of the discretion that managers can use to better recognize their revenues within their company. With more choice comes less comparability even between companies with similar operations. The disclosures under IFRS will help maintain some of the comparability because managers have to explain why they choose a particular method of revenue recognition.

Why is this topic important? Many factors including Globalization, the Sarbanes-Oxley Act, the SEC adoption of international standards, and the economic and financial meltdown in recent years have been exerting pressure on a number of countries, including the United States, to eliminate the gap between the International Financial Reporting Standards (IFRS) and the U.S. Generally Accepted Accounting Principles (GAAP).<sup>5</sup> And it is a necessity to analyze the impact these changes may have on current and future employees in the accounting industry.

Are we in need of a convergence of IFRS and GAAP? What will be the impact of the decided change to IFRS on major public accounting firms? What actions will these firms take to

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<sup>4</sup> "What companies need to know about the impending switch to IFRS." Smart Business. 7 July 2011. <<http://www.sbnonline.com/2011/07/what-companies-need-to-know-about-the-impending-switch-to-ifrs/>>.

<sup>5</sup> "The Impact of Combining The U.S. GAAP And IFRS." Investopedia. 15 Jan. 2014 <<http://www.investopedia.com/articles/economics/12/impact-gaap-ifrs-convergence.asp>>.

adjust to the change? How will this affect public accounting within the next 5 years? More precisely, when looking at the pharmaceutical industry, what kind of impact could we expect for other industries? This paper will explain the differences between GAAP and IFRS, in order to understand why there is differences in revenue recognition and intangible assets, which are two major changes to occur in the pharmaceutical industry.

### **GAAP vs IFRS**

The overarching difference between the two accounting standards is US GAAP is rule based and IFRS is principle based. The difference between these two approaches is on the methodology to assess an accounting treatment. Under U.S. GAAP, the research is more focused on the literature whereas under IFRS, the review of the facts pattern is more thorough. However, the professional judgment is not a new concept in the U.S. environment. The SEC is addressing this topic in order to find the right balance between the “educated” professional judgment, that is acceptable, and the “guessed” professional judgment.<sup>6</sup>

The IFRS project is the first step at trying to internationalize global accounting standards to be used by all companies both inside and outside the United States. Presently, United Kingdom companies are governed by IFRS issued by the International Accounting Standards Board (IASB). Effective in 2005, all companies listed on European stock exchanges (approximately 8,000) adopted IASB standards. As of 2010, approximately 120 countries required or allowed their companies to adopt the new international standards including the U.K., Australia, Japan, and New Zealand. Chile and South Korea adopted IFRS in 2009, Brazil in 2010, Canada and India in 2011, and Mexico adopted starting in 2012. Japan will decide in 2012

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<sup>6</sup> "Is IFRS That Different From U.S. GAAP?" AICPA | [www.ifrs.com](http://www.ifrs.com). 16 June 2008. <<http://www.ifrs.com/overview/General/differences.html>>.

about an adoption in 2015 or 2016. A total of more than 12,000 companies are now using IFRS worldwide.<sup>7</sup>

With such a project, there have been many supporters. For example, CEO of Speed Tax, Anton Donde, stated I support the creation of a single set of global accounting standards -- and truly believe IFRS is way overdue. A single set of standards will not only simplify the way companies conduct themselves, but encourage 100 percent adoption of ethical behavior. In addition, any time somewhat-disparate regulatory bodies can come together for a common cause -- even though the rules may be somewhat complicated to follow in the short term -- the public will appreciate the effort because it builds long-term trust and a much stronger economy.<sup>8</sup>

### **Pharmaceutical Industry Analysis**

The pharmaceutical industry has four major processes in its value chain — discovery, development, manufacturing, and marketing and sales. Each of these processes is vital for the success of a pharmaceutical company. In some cases, a large, vertically-integrated pharmaceutical firm carries out a lot of these functions. Sometimes, however, certain activities are contracted or outsourced to other firms. The trend of outsourcing has grown over the past decade. Outsourcing of drug development to contract research organizations (CROs), or manufacturing to contract manufacturing organizations (CMOs), is common and has led to the development of a new industry known as contract research and manufacturing services (CRAMS). The pharmaceutical industry environment is complex, and requires pharmaceutical companies to balance various aspects of their business. The Pharmaceutical industry is

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<sup>7</sup> Top accounting issues for 2013: CPE course. Chicago: CCH, 2013.

<sup>8</sup> "IFRS - Convergence or Adoption?" Accounting Today News. 14 Sept. 2010.

<<http://www.accountingtoday.com/news/IFRS-Convergence-Adoption-55554-1.html>>.

characterized by significant research and development spends, heavy regulations surrounding research, clinical trials, drug manufacture and sales and marketing practices and pricing.<sup>9</sup>

Below is a list of global pharmaceutical companies and the accounting standard that they follow:

Company	Standard Used	Company	Standard Used
Actelion	US GAAP	Genetech, Inc.	US GAAP
Amgen	US GAAP	GlaxoSmithKline	IFRS
AstraZeneca	IFRS	Roche	IFRS
Allergan	US GAAP	Johnson & Johnson	US GAAP
Bristol Myers Squibb	US GAAP	Merck & Co., Inc.	US GAAP
Celgene	US GAAP	Novartis	IFRS
Elan Corp.	IFRS	Pfizer	US GAAP
Eli Lilly	US GAAP	Sanofi-Aventis	IFRS

Using this information, the annual reports for the top pharmaceutical companies within the US and Europe were analyzed for differences between revenue recognition and intangible assets. As these are two important areas that have shown major variances, it is important to see the impact of these areas between the different companies.

#### *Johnson & Johnson<sup>10</sup>*

The Company recognizes revenue from product sales when goods are shipped or delivered, and title and risk of loss pass to the customer. Provisions for certain rebates, sales incentives, trade promotions, coupons, product returns and discounts to customers are accounted for as reductions in sales in the same period the related sales are recorded.

Product discounts granted are based on the terms of arrangements with direct, indirect and other market participants, as well as market conditions, including prices charged by competitors.

Rebates, the largest being the Medicaid rebate provision, are estimated based on contractual

<sup>9</sup> "Accounting and Auditing Update" KPMG. July 2010.

<sup>10</sup> Johnson & Johnson. Annual report 2013. <<http://www.investor.jnj.com/secfiling.cfm?filingID=200406-14-33>>



terms, historical experience, trend analysis and projected market conditions in the various markets served. The Company evaluates market conditions for products or groups of products primarily through the analysis of wholesaler and other third-party sell-through and market research data, as well as internally generated information.

Sales returns are generally estimated and recorded based on historical sales and returns information. Products that exhibit unusual sales or return patterns due to dating, competition or other marketing matters are specifically investigated and analyzed as part of the accounting for sales return accruals. Sales returns allowances represent a reserve for products that may be returned due to expiration, destruction in the field, or in specific areas, product recall. The returns reserve is based on historical return trends by product and by market as a percent to gross sales. In accordance with the Company's accounting policies, the Company generally issues credit to customers for returned goods. The Company's sales returns reserves are accounted for in accordance with the U.S. GAAP guidance for revenue recognition when right of return exists. Sales returns reserves are recorded at full sales value. Sales returns in the Consumer and Pharmaceutical segments are almost exclusively not resalable.

Promotional programs, such as product listing allowances and cooperative advertising arrangements, are recorded in the year incurred. Continuing promotional programs include coupons and volume-based sales incentive programs. The redemption cost of consumer coupons is based on historical redemption experience by product and value. Volume-based incentive programs are based on estimated sales volumes for the incentive period and are recorded as products are sold. The Company also earns service revenue for co-promotion of certain products. For all years presented, service revenues were less than 2% of total revenues and are included in

sales to customers. These arrangements are evaluated to determine the appropriate amounts to be deferred.

During the fiscal first quarter of 2013, the Company adopted the Financial Accounting Standards Board (FASB) guidance and amendments related to testing indefinite-lived intangible assets for impairment. Under the amendments in this update, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to determine the fair value. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test. An entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. This update became effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The adoption of this standard did not have a material impact on the Company's results of operations, cash flows or financial position.

#### *Pfizer*<sup>11</sup>

Pfizer records revenues from product sales when the goods are shipped and title passes to the customer. At the time of sale, we also record estimates for a variety of sales deductions, such as sales rebates, discounts and incentives, and product returns. When we cannot reasonably estimate the amount of future product returns and/or other sales deductions, we record revenues when the risk of product return and/or additional sales deductions has been substantially

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<sup>11</sup> Pfizer. Annual report 2013. < [http://www.pfizer.com/investors/sec\\_filings](http://www.pfizer.com/investors/sec_filings)>

eliminated. We record sales of certain of our vaccines to the U.S. government as part of the Pediatric Vaccine Stockpile program; these rules require that for fixed commitments made by the U.S. government, we record revenues when risk of ownership for the completed product has been passed to the U.S. government. There are no specific performance obligations associated with products sold under this program.

These acquired assets are recorded at cost. Intangible assets with finite lives are amortized on a straight-line basis over their estimated useful lives. Intangible assets with indefinite lives that are associated with marketed products are not amortized until a useful life can be determined. Intangible assets associated with IPR&D projects are not amortized until approval is obtained in a major market, typically either the U.S. or the European Union (EU), or in a series of other countries, subject to certain specified conditions and management judgment. The useful life of an amortizing asset generally is determined by identifying the period in which substantially all of the cash flows are expected to be generated.

*Merck & Co., Inc.*<sup>12</sup>

Revenues from sales of products are recognized at the time of delivery when title and risk of loss passes to the customer. Recognition of revenue also requires reasonable assurance of collection of sales proceeds and completion of all performance obligations. Domestically, sales discounts are issued to customers as direct discounts at the point-of-sale or indirectly through an intermediary wholesaler, known as chargebacks, or indirectly in the form of rebates. Additionally, sales are generally made with a limited right of return under certain conditions. Revenues are recorded net of provisions for sales discounts and returns, which are established at

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<sup>12</sup> Merck & Co., Inc. Annual report 2013. < <http://www.merck.com/investors/financials/annual-reports/home.html>>

the time of sale. In addition, revenues are recorded net of time value of money discounts if collection of accounts receivable is expected to be in excess of one year.

Acquired intangibles include products and product rights, trade names and patents, which are recorded at fair value, assigned an estimated useful life, and are amortized primarily on a straight-line basis over their estimated useful lives ranging from 3 to 40 years. Merck periodically evaluates whether current facts or circumstances indicate that the carrying values of its acquired intangibles may not be recoverable. If such circumstances are determined to exist, an estimate of the undiscounted future cash flows of these assets, or appropriate asset groupings, is compared to the carrying value to determine whether an impairment exists. If the asset is determined to be impaired, the loss is measured based on the difference between the carrying value of the intangible asset and its fair value, which is determined based on the net present value of estimated future cash flows.

*Novartis*<sup>13</sup>

Revenue is recognized on the sale of Novartis Group products and services and recorded as "Net sales" in the consolidated income statement when there is persuasive evidence that a sales arrangement exists, title and risks and rewards for the products are transferred to the customer, the price is determinable and collectability is reasonably assured. When contracts contain customer acceptance provisions, sales are recognized upon the satisfaction of acceptance criteria. For surgical equipment this occurs when title and risk and rewards are transferred after installation and any required training has been completed. For surgical equipment leased to customers, revenue representing the net present value of the minimum lease payments is recognized at the commencement of the lease term if the lease term is for the major part of the

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<sup>13</sup> Novartis. Annual report 2013.

<<http://www.sec.gov/Archives/edgar/data/1114448/000104746914000415/a2217883z20-f.htm>>

economic life of the asset or if the payments represent substantially most of its fair value, even if the legal ownership is not transferred. If products are stockpiled at the request of the customer, revenue is only recognized once the products have been inspected and accepted by the customer and there is no right of return or replenishment on product expiry and cost of storage will be paid by the customer on normal commercial terms.

Cash discounts are offered to customers to encourage prompt payment and are recorded as revenue deductions. Wholesaler shelf-inventory adjustments are granted to customers based on the existing inventory of a product at the time of decreases in the invoice or contract price of a product or at the point of sale if a price decline is reasonably estimable. When there is historical experience of Novartis agreeing to customer returns or Novartis can otherwise reasonably estimate expected future returns, a provision is recorded for estimated sales returns. In doing so the estimated rate of return is applied, determined based on historical experience of customer returns or considering any other relevant factors. This is applied to the amounts invoiced also considering the amount of returned products to be destroyed versus products that can be placed back in inventory for resale. Where shipments are made on a re-sale or return basis, without sufficient historical experience for estimating sales returns, revenue is only recorded when there is evidence of consumption or when the right of return has expired.

Intangible assets available for use are amortized over their estimated useful lives on a straight-line basis and evaluated for potential impairment whenever facts and circumstances indicate that their carrying value may not be recoverable.

Acquired research and development intangible assets, which are still under development and have accordingly not yet obtained marketing approval, are recognized as In Process Research & Development (IPR&D). IPR&D assets are only capitalized if they are deemed to

enhance the intellectual property of Novartis and include items such as initial upfront and milestone payments on licensed or acquired compounds. IPR&D is not amortized, but evaluated for potential impairment on an annual basis or when facts and circumstances warrant. Any impairment charge is recorded in the consolidated income statement under "Research & Development". Once a project included in IPR&D has been successfully developed it is transferred to the "Currently marketed product" category.

*Sanofi*<sup>14</sup>

Revenue arising from the sale of goods is presented in the income statement under Net sales. Net sales comprise revenue from sales of pharmaceutical products, vaccines, and active ingredients, net of sales returns, of customer incentives and discounts, and of certain sales-based payments paid or payable to the healthcare authorities. Revenue is recognized when all of the following conditions have been met: the risks and rewards of ownership have been transferred to the customer; the Group no longer has effective control over the goods sold; the amount of revenue and costs associated with the transaction can be measured reliably; and it is probable that the economic benefits associated with the transaction will flow to the Group, in accordance with IAS 18 (Revenue).

Intangible assets are initially measured at acquisition cost or production cost, including any directly attributable costs of preparing the asset for its intended use, or (in the case of assets acquired in a business combination) at fair value as at the date of the combination. They are amortized on a straight line basis over their useful lives. The useful lives of intangible assets are reviewed at each reporting date. The effect of any adjustment to useful lives is recognized prospectively as a change of accounting estimate.

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<sup>14</sup> Sanofi. Annual report 2013.

<[http://en.sanofi.com/investors/news/financial\\_publications/financial\\_publications.aspx](http://en.sanofi.com/investors/news/financial_publications/financial_publications.aspx)>

Amortization of intangible assets is recognized in the income statement under Amortization of intangibles with the exception of amortization of acquired or internally-developed software, which is recognized on the relevant line of the income statement according to the purpose for which the software is used. The group does not own any intangible assets with an indefinite useful life. Intangible assets are carried at cost less accumulated amortization and accumulated impairment, if any, in accordance with IAS 36

*GlaxoSmithKline*<sup>15</sup>

Revenue is recognized in the income statement when goods or services are supplied or made available to external customers against orders received, title and risk of loss is passed to the customer, reliable estimates can be made of relevant deductions and all relevant obligations have been fulfilled, such that the earnings process is regarded as being complete.

Intangible assets are stated at cost less provisions for amortization and impairments. Licenses, patents, know-how and marketing rights separately acquired or acquired as part of a business combination are amortized over their estimated useful lives, generally not exceeding 20 years, using the straight-line basis, from the time they are available for use. The estimated useful lives for determining the amortization charge take into account patent lives, where applicable, as well as the value obtained from periods of non-exclusivity. Asset lives are reviewed, and where appropriate adjusted, annually. Contingent milestone payments are recognized at the point that the contingent event becomes certain. Any development costs incurred by GlaxoSmithKline and associated with acquired licenses, patents, and know-how or marketing rights are written off to the income statement when incurred, unless the criteria for recognition of an internally generated

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<sup>15</sup> GlaxoSmithKline. Annual report 2013. <<http://www.gsk.com/investors/corporate-reporting/annual-report.html>>

intangible asset are met, usually when a regulatory filing has been made in a major market and approval is considered highly probable.

Acquired brands are valued independently as part of the fair value of businesses acquired from third parties where the brand has a value which is substantial and long-term and where the brands either are contractual or legal in nature or can be sold separately from the rest of the businesses acquired. Brands are amortized over their estimated useful lives of up to 20 years, except where it is considered that the useful economic life is indefinite.

The costs of acquiring and developing computer software for internal use and internet sites for external use are capitalized as intangible fixed assets where the software or site supports a significant business system and the expenditure leads to the creation of a durable asset. ERP systems software is amortized over seven to ten years and other computer software over three to five years.

The US based pharmaceutical companies compared to the European pharmaceutical companies show two difference consistent approaches to revenue recognition and intangible assets. The following sections will elaborate on differences found using GAAP and IFRS.

### **Revenue Recognition**

Revenue is a crucial number to users of financial statements in assessing an entity's financial performance and position. However, revenue recognition requirements in U.S. generally accepted accounting principles (GAAP) differ from those in International Financial Reporting Standards (IFRSs), and both sets of requirements need improvement. U.S. GAAP comprises broad revenue recognition concepts and numerous requirements for particular industries or transactions that can result in different accounting for economically similar transactions. Although IFRSs have fewer requirements on revenue recognition, the two main



revenue recognition standards, IAS 18, Revenue, and IAS 11, Construction Contracts, can be difficult to understand and apply.

Revenue recognition guidance under IFRS is provided principally by International Accounting Standard (IAS) 18 Revenue. IAS 18 provides guidance on revenue recognition for the provision of both goods and services. IAS11 also provides guidance but specifically in relation to construction contracts and will usually not be applicable to most agreements encountered in the pharmaceutical and biotechnology industries. Its requirements are, however, applied by analogy through IAS 18.21. Under IFRS, revenue is recognized when it is probable that future economic benefits will flow to the entity and those benefits can be measured reliably. Revenue on sales of goods is only recognized when, inter alia, the significant risks and rewards of ownership have been transferred to the buyer and the seller does not retain either control of the goods, or continuing involvement, to the degree associated with ownership. For services, evidence is required that a service has been delivered by requiring the seller to be able to measure reliably the stage of completion of the transaction. In the pharmaceuticals industry it is important to assess whether the selling entity has actually delivered something – either transferring the risks and rewards of goods or other assets (e.g. licenses) or by providing service to the buyer.<sup>16</sup> Differences between US GAAP and IFRS under revenue recognition is as follows:

	US GAAP	IFRS	Major Difference
<b>Sale of Goods</b>	SAB 104, Revenue Recognition, requires the risks and rewards of ownership have been transferred (delivered).	Revenue is recognized when risks and rewards of ownership have been transferred and	Under GAAP, revenue is not recognized prior to delivery. While, IFRS may recognize prior to

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<sup>16</sup> "International Financial Reporting Standards." PwC. July 2012

		the buyer has control of the goods.	delivery if risks and rewards have been transferred to buyer.
<b>Research and Development &amp; Services</b>	Service revenues is recognized in accordance to SAB 104.	Revenue may be recognized with long term accounting. Thus, consideration for stage of completion is needed to determine revenue and costs reliably.	Revenue is not recognized until service is completed under GAAP. IFRS recognizes upfront revenue.

### **Intangible Assets**

Research & Development (R&D) activities are critical to the success of the life sciences industry. Life sciences companies invest a significant amount of capital to research, discover and clinically test new drug candidates in the hopes of generating future revenue. Accordingly, life sciences companies must carefully consider whether any US GAAP-IFRS differences exist relating to the accounting for intangible assets, including R&D costs. Some of the more significant GAAP differences may include the accounting for internal development costs and (ii) payments made to separately acquire or license intangible assets (for example, in a collaboration arrangement).<sup>17</sup> Some significant differences found in intangible assets can be seen below:

	<b>US GAAP</b>	<b>IFRS</b>	<b>Major Difference</b>
<b>Development Costs</b>	Costs are expensed as it is incurred.	Costs are capitalized as long as specified criteria is met.	Under IFRS, development costs will be recognized over multiple periods, where it does not under GAAP
<b>Payments (i.e. Milestone or license)</b>	Payments for rights to a product not yet received regulatory approval is expensed.	Payments should be capitalized as intangible assets.	Intangibles may be more accurately stated under IFRS.

<sup>17</sup> "US GAAP vs IFRS: The Basics: Life Science." EY. June 2009

	Payments for rights to a product that has received regulatory approval is capitalized.		
<b>Advertising Costs</b>	Costs are either expensed as incurred or expense when it occurs for the first time.	Costs are expensed as it is incurred.	IFRS allows for prepayments to be recognized as well, if there is access to goods.
<b>Revaluations</b>	Revaluation is not allowed.	Revaluation to fair value as an intangible asset is a permitted accounting policy.	Intangibles may be more accurately stated under IFRS.

## **Implementation**

### *Revenue Recognition*

Current plans suggest a consistency in revenue recognition regardless of the industry. Organizations will be required to disclose quantitative information about contracts with customers, including disaggregation of revenue, contract balances and changes in those balances, remaining performance obligations and information about assets recognized from the costs to obtain or fulfill contracts with customers; and qualitative information about revenue contracts including significant judgments involved in applying the revenue guidance.

In addition, reporting organizations will be required to assess the goods or services promised to a customer, identify performance obligations on the basis of whether the goods or services are distinct, and recognize revenue when (or as) each performance obligation is satisfied. Companies will be required to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer. Variable consideration will be included in the transaction price to the

extent it is probable that a significant revenue reversal will not occur. Consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties, or other similar items.

For public companies, the new guidance will be required for annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. Early application is not permitted. For nonpublic companies, the new guidance will be required for annual reporting periods beginning after December 15, 2017, and interim and annual reporting periods after those reporting periods. A nonpublic entity may elect early application, but no earlier than the effective date for public entities. For companies reporting under IFRS, the new guidance will be required for reporting periods beginning on or after January 1, 2017. Early application is permitted.<sup>18</sup>

With such changes, it is necessary for a delayed effective date because of the various organizations that will be affected. These changes will also have a significant effect on other areas of their financial statements that are tied to revenue recognition. Time is needed in order to adjust to these changes.

### *Intangible Assets*

FASB and IASB have no longer made intangible assets a priority, even though the convergence was mentioned in the “Memorandum of Understanding” (MOU) in 2006. Nonetheless, it was mentioned in the 2008 MOU that there is a possibility for a new project to eliminate differences in the accounting for research and development costs. Thoughts are formulated that the IAS 38 will be adopted in the future.

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<sup>18</sup> "Revenue Recognition." FASB, Financial Accounting Standards Board.  
<[http://www.fasb.org/jsp/FASB/Page/BridgePage%26cid%3D1351027207987#section\\_6](http://www.fasb.org/jsp/FASB/Page/BridgePage%26cid%3D1351027207987#section_6)>.

In March 2009, the FASB's Emerging Issues Task Force tentatively concluded in EITF 09-2 Research and Development Assets Acquired in an Asset Acquisition that research and development assets acquired in an asset acquisition should be capitalized. While the Task Force is in the early stages of its deliberations on the Issue, it could result in convergence for certain aspects of accounting for intangible assets that are significant for life sciences companies (for example, payments to acquire or in-license intangible assets, such as through R&D collaboration arrangements, would be capitalized, which is consistent with the accounting under IFRS).<sup>19</sup>

### **Conclusion**

In summary, the accounting challenges in a pharmaceutical industry continue to be centered around revenue recognition (upfront vs. deferral), accounting for research and development (capitalize vs. expense) and intangible assets (amortize and carry forward vs. impair). Adoption of IFRS around the world is expected to introduce homogeneity in accounting practices and permit international comparability and thereby accelerate cross border transactions.<sup>20</sup>

As a result many benefits will be seen. By converging the US GAAP and IFRS, businesses will be able to present financial statements among foreign relations and it will allow for easier comparisons. Also, tying back to globalization, as many companies have subsidiaries in other countries, it allows for a consistent accounting standard to be used worldwide, instead of confusion within the company. To accommodate for the impact the changes may have, a steady gradual convergence is necessary. Nonetheless, the change will not be taken lightly by upper management who are thinking about cost effectiveness. It will also impact investors, stock markets, accounting professionals, and the accounting standard rule setters.

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<sup>19</sup> "US GAAP vs IFRS: The Basics: Life Science." EY. June 2009

<sup>20</sup> "Accounting and Auditing Update" KPMG. July 2010.

The program of converging accounting standards between the Financial Accounting Standards Board and the International Accounting Standards Board is nearing an end after more than a decade. Along the way there have been some bumps and differences in view between FASB and IASB, but this unique standard-setting partnership has resulted in converged or substantially converged standards on a number of major subjects, including accounting for business combinations, employee stock compensation, fair-value measurements, and segment reporting.<sup>21</sup>

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<sup>21</sup> Herz, Robert. "End of Convergence Brings Challenges and Opportunities." Compliance Week. 27 Aug. 2013. <<http://www.complianceweek.com/end-of-convergence-brings-challenges-and-opportunities/article/307946/>>.

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