



*Actions Are Being Taken to Address the  
Impact That International Financial  
Reporting Standards Will Have on Tax  
Administration*

**September 8, 2010**

**Reference Number: 2010-30-112**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



## HIGHLIGHTS

### **ACTIONS ARE BEING TAKEN TO ADDRESS THE IMPACT THAT INTERNATIONAL FINANCIAL REPORTING STANDARDS WILL HAVE ON TAX ADMINISTRATION**

## Highlights

**Final Report issued on September 8, 2010**

Highlights of Reference Number: 2010-30-112 to the Internal Revenue Service Commissioner for the Large and Mid-Size Business Division.

### **IMPACT ON TAXPAYERS**

One of the Internal Revenue Service's (IRS) goals from its Strategic Plan for 2009-2013 is to enforce the law to ensure everyone meets their obligation to pay taxes. The Large and Mid-Size Business Division's Strategic Initiatives and Fiscal Year 2009 Priorities also included developing a Servicewide strategy to address the consequences of the expected conversion to the International Financial Reporting Standards (IFRS). The IRS is positioning itself to address the impact that the IFRS will have on tax administration and the taxpayer.

### **WHY TIGTA DID THE AUDIT**

The Large and Mid-Size Business Division's Strategic Initiatives and Fiscal Year 2009 Priorities included engaging with tax professionals who provide tax advice on international administrative, technical, and information reporting matters. As part of this strategic initiative, the Large and Mid-Size Business Division planned to identify and monitor emerging issues related to the adoption of the IFRS. This audit was initiated as part of the Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Globalization. The overall objective of this review was to assess the IRS' progress to prepare for the tax issues and implications of converting from United States Generally Accepted Accounting Principles to the IFRS.

### **WHAT TIGTA FOUND**

The IRS is in the process of providing awareness training to IRS employees and managers by introducing them to IFRS concepts and potential issues. It also is providing technical advice and guidance to employees conducting examinations of returns filed based on the IFRS.

The IRS appropriately coordinated with the tax practitioner community to outline IFRS implementation concerns. In addition, the IRS is in the process of developing procedures to address significant issues related to IFRS.

### **WHAT TIGTA RECOMMENDED**

Although TIGTA made no recommendations in this report, IRS officials were provided an opportunity to review the draft report. IRS management did not provide any report comments.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

September 8, 2010

**MEMORANDUM FOR** COMMISSIONER, LARGE AND MID-SIZE BUSINESS DIVISION

**FROM:** *Michael R. Phillips*  
Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Actions Are Being Taken to Address the Impact That International Financial Reporting Standards Will Have on Tax Administration (Audit # 201030040)

This report presents the results of our review to assess the Internal Revenue Service's progress to prepare for the tax issues and implications of converting from United States Generally Accepted Accounting Principles<sup>1</sup> to International Financial Reporting Standards.<sup>2</sup> This audit was conducted as part of our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Globalization.

Although we made no recommendations in this report, we did provide Internal Revenue Service officials an opportunity to review the draft report. Management did not provide us with any report comments.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report findings. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.

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<sup>1</sup> Generally Accepted Accounting Principles are a set of standards and procedures used by companies to prepare and report financial information.

<sup>2</sup> International Financial Reporting Standards are a set of accounting standards used in more than 100 countries that serve as a framework for financial reporting.



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*Abbreviations*

GAAP	Generally Accepted Accounting Principles
IFRS	International Financial Reporting Standards
IRS	Internal Revenue Service
LMSB	Large and Mid-Size Business
SEC	Securities and Exchange Commission
U.S.	United States



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## *Background*

International Financial Reporting Standards (IFRS), which are issued by the International Accounting Standards Board,<sup>1</sup> are a set of accounting standards that serve as a framework for financial reporting. The IFRS are rapidly gaining worldwide acceptance and are now used for public reporting purposes in more than 100 countries, including member countries of the European Union, Hong Kong, Australia, India, and Russia.

In November 2008, the Securities and Exchange Commission (SEC)<sup>2</sup> proposed a “Roadmap” that would potentially require United States (U.S.) domestic issuers of annual reports to the SEC to use the IFRS. U.S. domestic issuers currently prepare financial statements in accordance with U.S. Generally Accepted Accounting Principles (GAAP)<sup>3</sup> as established by the Financial Accounting Standards Board.<sup>4</sup> In comparing the two sets of standards, the IFRS differs from U.S. GAAP in a number of areas. For example, as identified by the Internal Revenue Service (IRS), U.S. GAAP are rules-based, consider historical cost, provide specific guidance, focus on application, and place emphasis on form. In contrast, the IFRS are principles-based, consider value, provide general guidance, focus on results, and place emphasis on substance.

***The SEC established several milestones that, if achieved, could lead to the mandatory use of the IFRS in Calendar Year 2015 at the earliest.***

As capital markets become increasingly global, U.S. investors have a corresponding increase in international investment opportunities. In this environment, the SEC believes that U.S. investors would benefit from an enhanced ability to compare financial information of U.S. companies with that of non-U.S. companies. The SEC has long expressed its support for a single set of high-quality global accounting standards as an important means of enhancing this comparability. The SEC believes the IFRS have the potential to best provide the common platform on which companies can report and investors can compare financial information.

The SEC proposed the “Roadmap” as part of its consideration of the role a single set of high-quality accounting standards plays in investor protection and the efficiency and

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<sup>1</sup> The International Accounting Standards Board, an independent, privately funded organization, is responsible for developing the IFRS and promoting the use and application of these standards.

<sup>2</sup> The SEC’s mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC requires public companies to disclose meaningful financial and other information to the public.

<sup>3</sup> The GAAP are a set of standards and procedures used by companies to prepare and report financial information.

<sup>4</sup> The Financial Accounting Standards Board, a private, not for profit organization, was established in 1973 and was designated by the SEC as the organization responsible for setting standards of accounting that govern preparation of financial reports by publicly held companies in the U.S.



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effectiveness of capital formation and allocation. The “Roadmap” sets forth several milestones that, if achieved, could lead to the mandatory use of the IFRS by U.S. issuers in their filings with the SEC in Calendar Year 2015 at the earliest. The SEC will make its determination in 2011 based on whether the requirement to use the IFRS is in the public interest and for the protection of investors. The milestones to be achieved include:

- Improvements in accounting standards.
- Accountability and funding of the International Accounting Standards Committee Foundation.<sup>5</sup>
- Improvement in the ability to use interactive data for IFRS reporting.
- Education and training related to the IFRS.
- Anticipated timing of future rulemaking by the SEC.
- Implementation of the mandatory use of the IFRS by U.S. issuers.

In 2007, the SEC removed the requirement for non-U.S. companies reporting financial results using the IFRS to reconcile to U.S. GAAP. This rule became effective for periods ending after November 15, 2007.

In a related matter, the International Accounting Standards Board and Financial Accounting Standards Board have embarked on a joint project to develop an improved common conceptual framework that provides a sound foundation for developing future accounting standards. Such a framework is essential to fulfilling the goal of both Boards to develop standards that are principles-based, internally consistent, internationally converged, and that lead to financial reporting that provides the information that investors need to make decisions in their capacity as capital providers. The new framework, which will deal with a wide range of issues, will build on the existing frameworks of both Boards and consider developments subsequent to the issuance of the conceptual framework.

The IRS’ Large and Mid-Size Business (LMSB) Division developed a Servicewide Approach to International Tax Administration<sup>6</sup> that identifies its Strategic Initiatives and Fiscal Year 2009 Priorities. The LMSB Division’s approach to international tax administration follows the IRS Strategic Plan for 2009-2013. In relation to the IRS’ goal to enforce the law to ensure everyone meets their obligation to pay taxes, the LMSB Division’s Strategic Initiatives and Fiscal Year 2009 Priorities included engaging with tax professionals who provide international tax advice on international administrative, technical, and information reporting matters. As part of

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<sup>5</sup> The International Accounting Standards Committee Foundation is the parent entity of the International Accounting Standards Board and is an independent, not-for-profit, private sector organization working to develop a single set of high quality, understandable, enforceable, and globally accepted International Financial Reporting Standards.

<sup>6</sup> Revision 3, dated April 10, 2009.



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this strategic initiative, the LMSB Division planned to identify and monitor emerging issues relating to adoption of the IFRS. The LMSB Division's Strategic Initiatives and Fiscal Year 2009 Priorities also included developing a Servicewide strategy to address the consequences of the expected change to the IFRS.

In early 2009, the LMSB Division began developing plans for strategic and operational activities relating to adoption of the IFRS. It identified that a multi-functional working group, referred to as the IFRS Team, led by the Director of Pre-Filing and Technical Guidance, LSMB Division, would plan and monitor the ongoing activities. Currently, the Pre-Filing and Technical Guidance office maintains an IFRS Technical Guidance Web Site that identifies contacts for the IFRS Team and provides resources related to IFRS accounting and procedures. In terms of training, audit tools, and reference materials, agents are expected to rely on the IFRS Team's technical advisors for case specific guidance until written procedures are provided.

This review was performed at the IRS National Headquarters and the LMSB Division's Pre-Filing and Technical Guidance office in Washington, D.C., and at Pre-Filing and Technical Guidance's Financial Accounting Issues office in New Haven, Connecticut, during the period March through June 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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## *Results of Review*

### ***Internal Revenue Service Employees Are Being Provided With International Financial Reporting Standards Awareness Training and Guidance***

The existing focus of the IRS' IFRS Team is to provide awareness training to IRS employees and managers by introducing them to IFRS concepts and potential issues. The Team is conveying that some companies<sup>7</sup> are already filing returns that were prepared based on the IFRS. As part of the awareness training, employees are encouraged to contact the IFRS Team when conducting an examination of an IFRS-related return. This practice will enable the IFRS Team's technical advisors to provide advice and identify issues that need to be addressed. Because employees are not required to contact the IFRS Team, the Team has also taken a proactive approach to getting involved and providing guidance by identifying current examinations of IFRS-related returns and contacting the related managers. We reviewed documentation indicating the IFRS Team has given more than 20 presentations on the IFRS to IRS employees since September 2008. The IFRS Team has plans to continue making presentations and holding workshops into Fiscal Year 2011. In addition, the IFRS Team will record pertinent training sessions and post the sessions on a training web site for employees to download and review.

The IFRS Team created a general presentation, identified as IFRS 101, that provides information on:

- IFRS background.
- IFRS usage by other countries.
- The potential SEC decision to convert to the IFRS in the U.S.
- Joint Financial Accounting Standards Board and International Accounting Standards Board convergence efforts to resolve key differences.
- Major differences between U.S. GAAP and the IFRS.
- Audit techniques.
- Resources for obtaining additional IFRS information.

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<sup>7</sup> The IFRS Team determined that approximately 220 companies are currently filing returns using the IFRS.



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The presentations are modified to ensure pertinent information is shared with various and/or specific audiences. During this review, we attended two presentations and found the information provided was tailored for each audience. For example, the presentation given to a group of international examiners provided in-depth information on the significant subject matter differences between U.S. GAAP and the IFRS, while the presentation given to the Issue Focus Group only briefly touched on these differences.

***The Internal Revenue Service Appropriately Coordinated With the Tax Practitioner Community to Outline International Financial Reporting Standards Implementation Concerns***

During the early stages of developing plans for strategic and operational activities relating to the IFRS conversion, the IFRS Team reached out to several external stakeholders for their assistance in identifying and outlining IFRS implementation concerns. External stakeholders included the American Institute of Certified Public Accountants, the Big Four,<sup>8</sup> large regional accounting firms, and firms associated with the Dow Jones Industrial Average.<sup>9</sup> The IRS held several teleconferences with the stakeholders and obtained insight on issues potentially affecting the tax community. As a result, various areas of concern were identified that could affect U.S. tax reporting. To further delve into areas of concern, the IRS held separate roundtable discussions with the stakeholders and formed breakout groups to identify potential tax form, publication, and legal issues. The IFRS Team Manager informed us that he does not expect many changes to tax forms or publications, but indicated they will continue to evaluate the need for changes. Since the roundtables were held, the IFRS Team has continued their effort to identify areas of concern.

In addition to the teleconferences and roundtables, the IFRS Team indicated they have given several external presentations and participated on panels with tax professionals. The IFRS Team is currently in the process of gathering information that will assist them in solidifying issues related to IFRS implementation. As issues are solidified and guidance is developed, the IFRS Team will present updated information to the tax community by continuing to engage in external presentations with tax professionals and taxpayer groups. The IFRS Team will also post additional guidance for the tax community to their web site.

In a related matter, the IFRS Team has also had limited indirect contact with taxpayers. The IFRS Team is responsible for monitoring events in the field to provide their guidance and to facilitate the IRS Chief Counsel's guidance for tax issues that arise. When the IFRS Team's technical advisors become involved with existing cases, various activities occur. Specifically, on many occasions, they receive telephone calls where they provide quick answers to the field

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<sup>8</sup> The Big Four is the reference for the four largest international accountancy and professional service firms – PricewaterhouseCoopers, Deloitte Touche Tohmatsu, Ernst & Young, and KPMG.

<sup>9</sup> The Dow Jones Industrial Average is an index that shows how 30 large, publicly owned companies, based in the U.S., have performed during a standard trading session in the stock market.



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employees. In other instances, where the substance of the contacts requires greater attention, the technical advisors make visits to the field sites on these cases. The IFRS Team Manager indicated to us that these case visits are learning experiences for the employee, technical advisors, and also for the taxpayers being audited.

***Procedures Are Being Developed to Address Issues Related to the  
International Financial Reporting Standards***

The IFRS Team is currently overseeing an Issue Focus Group that is addressing issues related to IFRS conversion efforts. The Group consists of the IFRS Team's technical advisors and subject matter experts within the IRS who have been selected to review, in relation to specific issues/topics, the differences between U.S. GAAP and the IFRS. The Group will be responsible for creating guidance, by topic, which will serve as audit aids for IRS employees who conduct examinations of tax returns. The Treasury Inspector General for Tax Administration plans to review the guidance and procedures once the IRS has fully implemented them. The IFRS Team designed a standardized template to assist the Group in creating the audit aids and to ensure consistency in format. The template identifies the sections of information that must be included, as well as the order in which they are to be presented. The required sections include an overview of the issue/topic, a description of the related standards under U.S. GAAP and the IFRS, differences between the standards, the related U.S. tax implications, and suggested audit techniques. Once the audit aids are completed,<sup>10</sup> the IFRS Team will consolidate the guidance into a collective summary referred to as the Issue Matrix Audit Technique Tool.<sup>11</sup> This Tool will provide IRS employees with a single source of information for handling significant issues related to the IFRS.

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<sup>10</sup> The audit aids for some issues are scheduled for completion by August 31, 2010. Completion of other audit aids will take longer for those issues that are more complex or that are subject to change due to convergence efforts of the Financial Accounting Standards Board and the International Accounting Standards Board.

<sup>11</sup> The Issue Matrix Audit Technique Tool is scheduled for completion by August 31, 2011.



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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

The overall objective of this review was to assess the IRS' progress to prepare for the tax issues and implications of converting from U.S. GAAP<sup>1</sup> to the IFRS.<sup>2</sup> To accomplish this objective, we:

- I. Identified the actions taken or planned to be taken by the IRS to prepare and train employees to handle changes resulting from conversion to the IFRS.
  - A. Interviewed IRS management.
  - B. Identified and reviewed related training documentation and evaluated the content.
- II. Identified the actions taken or planned to be taken by the IRS to establish and/or revise procedures to correspond with changes resulting from conversion to the IFRS.
  - A. Interviewed IRS management.
  - B. Identified and reviewed related procedural documentation and evaluated the content.
- III. Identified the actions taken or planned to be taken by the IRS to provide information and support to the taxpayer community (taxpayers and representatives) to handle changes resulting from conversion to the IFRS.
  - A. Interviewed IRS management.
  - B. Identified and reviewed documentation created to provide guidance to the taxpayer community on conversion to the IFRS.
- IV. Identified the actions taken or planned to be taken by the IRS to create and/or revise tax forms and instructions to correspond with changes resulting from conversion to the IFRS.
  - A. Interviewed IRS management.
  - B. Identified and reviewed related documentation and evaluated the content.
- V. Identified the actions taken by the IRS to address the impact of the SEC's removal of the requirement for non-U.S. companies reporting financial results using the IFRS to reconcile to U.S. GAAP.

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<sup>1</sup> The GAAP are a set of standards and procedures used by companies to prepare and report financial information.

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- A. Interviewed IRS management.
- B. Reviewed related documentation.

**Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: sound project management guidelines for planning, executing, monitoring, and controlling project activities. We evaluated these controls by interviewing management and reviewing project documentation.



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**Appendix II**

*Major Contributors to This Report*

Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)

Amy L. Coleman, Audit Manager

Todd M. Anderson, Lead Auditor

Stanley M. Pinkston, Senior Auditor

Melvin V. Thomas, Senior Program Analyst



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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Commissioner, Small Business/Self-Employed Division SE:S  
Deputy Commissioner, Large and Mid-Size Business Division SE:LM  
Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Deputy Commissioner, International SE:LM:IN  
Director, Pre-Filing and Technical Guidance, Large and Mid-Size Business Division  
SE:LM:PFTG  
Chief Counsel CC  
National Taxpayer Advocate TA  
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