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IFRS will bring new challenges to the customs and trade function

by Mark Ludwig

Since 2005 when first deployed by the International Accounting Standards Board (IASB), International Financing Reporting Standards (IFRS) have been steadily supplanting various forms of Generally Accepted Accounting Principles (“GAAP”) and other national accounting standards. To date, more than 110 countries, including all of Europe, have adopted IFRS and all major economies have established time lines to converge with or embrace the standards in the near future. Argentina, Canada, Korea and India, for example, join the list in 2011, and others such as Mexico the year after. For its part, the United States has agreed to a target date for substantial convergence with IFRS in 2011.

On one level, the adoption of IFRS is viewed by many as a positive event that will facilitate greater transparency while reducing information costs among countries. As such, IFRS is expected to encourage international trade flows and investments. On another, more complex level, the scope and scale of the required adjustments are so significant that IFRS should not be viewed as just a matter for accountants. Indeed, most tax, IT and supply chain professionals with any international exposure are coming to appreciate that IFRS will forever change their companies, the way they do their jobs, and even the way they are measured and possibly compensated.

Connecting the dots

But what about IFRS and the customs and international trade professional? If the new rules are going to encourage international trade flows, are there not important elements that this type of specialist needs to consider? Certainly, there are. At this moment, however, it appears that there is little widespread understanding or appreciation of the potential impacts of IFRS on the customs and international trade function.

To help facilitate some broader consideration of the topic, below are some key issues related to the adoption of IFRS that customs and international trade professionals may wish to investigate further. To frame the discussion, it's important to keep in mind that, perhaps above all, IFRS impacts the underlying accounting of the costs of goods and services. Therefore, any small difference in the manner in which cost is accounted for – above or below the operating income line – under IFRS vs. GAAP can have a major impact on financial results.



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Inventory value

In the U.S., the prevailing accounting standard today is U.S. GAAP which uses “historical cost” (i.e., cost as if there had been no change in value since the date of acquisition) for valuing inventory. U.S. GAAP does not allow revaluation of inventory. With IFRS, inventory value needs to reflect the current market price and, consequently, permits revaluation. For companies whose products experience slow inventory turns and/or are subject to significant price swings, the move to IFRS could present challenges in claiming drawback – especially given the U.S. drawback program’s multi-year allowances for importing, exporting and filing claims.

Closely related to this matter is GAAP’s Last-In, First-Out (“LIFO”) inventory accounting method. For various reasons (including certain income tax advantages that it offers) many companies presently use LIFO. It’s also one of the approved GAAP methods for U.S. duty drawback accounting and can be used for tracking originating and non-originating merchandise under certain U.S. trade agreements such as CAFTA-DR. Under IFRS, LIFO is permanently out – that is, it’s not a permitted inventory accounting method. As such, those companies using LIFO for drawback and/or trade agreement qualification accounting may need to transition to an IFRS-permitted method. This could prove to be a potentially challenging migration from one accounting method to another, perhaps giving rise to unexpected issues such as loss of preferential market access under trade agreements.

Contracts and agreements

The forthcoming standards require the separation of the party that has ownership of an item from the party that has the responsibility, risk, and beneficial use of that item. As such, certain agreements that have been negotiated with suppliers and customers prior to IFRS adoption may need to be reviewed, reworked and possibly renegotiated. This may impact, among others, consignment, lease and long-term supply agreements – core arrangements of many of today’s global value chains. Any changes that are made to accommodate IFRS may affect the underlying contractual obligations of the parties involved and possibly the transfer, costs and prices of the subject goods and services. Thus, the customs and international trade function will need to help ensure that what the company declares to customs authorities prior to IFRS implementation either is, or is not, the same as what will be declared after IFRS implementation, depending on the reconfiguration of certain contracts and agreements.



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What's more, IFRS-driven changes in the accounting of costs, profits and thus, income taxes associated with intercompany (i.e., related party) transactions may impact agreements related to intellectual property rights. Many companies establish their royalty rates, license fees and cost-sharing agreements based on many factors, including required/desired inter-company income results. Transfer pricing analysis is usually prepared to both determine and defend the costs and profits of these inter-firm arrangements. Depending on their structure (among other considerations), intercompany payments related to such arrangements may be considered "additions to the price paid or payable" under applicable customs laws. Consequently, IFRS-driven changes to royalty, licenses and cost-sharing agreements may create additional work to ensure the proper customs appraisal of imported merchandise.

IFRS change = customs opportunity

As the broader "value" chains of many of today's global corporations are increasingly intertwined with those of their suppliers, customers and third-party service providers/stakeholders (e.g., customs authorities, customs brokers, logistics- and warehouse-service providers), the requirements within IFRS should be considered for their potential to impact customs and international trade matters and functions. While the full scope and exact timeline for IFRS implementation in the U.S. is not completely settled, experience in other countries informs that IFRS is much more than just an accounting issue. As such, preparing for the changes that IFRS will bring presents an opportunity for the customs and international trade function to add even greater value to the company, today and tomorrow.

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