

# BDO Tech

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## The Big Picture

### THE TECH GAAP

U.S. COMPANIES MAY DISCOVER SOME UNINTENDED CONSEQUENCES AS OVERSEAS RIVALS ADOPT INTERNATIONAL FINANCIAL REPORTING STANDARDS

By Jay Howell



**This article was originally published in the November 19, 2007 Tech Sector Spotlight edition of The Deal, all copyrights apply. Since publication, the SEC voted unanimously to drop the requirement that foreign companies with U.S. listings reconcile their financial results to U.S. accounting rules.**

To attract more investment opportunities and stock listings to U.S. exchanges, this past summer the Securities and Exchange Commission proposed allowing foreign companies to file financial results using international financial reporting standards without reconciling the figures to U.S. generally accepted accounting principles. While well-intentioned, this proposal may have unintended consequences, especially for U.S. technology companies.

IFRS is generally principles-based, compared with U.S. GAAP — which, particularly for revenue recognition, is more rules-based and prescriptive. Under U.S. GAAP, there is typically more specific and restrictive guidance about when and how to record revenue. Many of the U.S. GAAP rules were written to address perceived abusive practices and to help achieve consistent application among companies. The differences in revenue recognition accounting standards could allow a foreign competitor to recognize revenue sooner than a U.S. company following GAAP. In some cases this timing difference could be significant in magnitude.



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## The Big Picture

# THE TECH GAAP (CONTINUED FROM PAGE 1)

By its nature, this issue tends to impact technology companies more than other types of businesses, for two reasons. First, technology companies are more likely to have complex sales transactions that include multiple products and services, and this is one of the particular areas of U.S. GAAP that is more restrictive. Second, for technology companies, investors often place greater importance on top-line revenue growth as an indicator of value than for other industries. This could result in a significant competitive disadvantage for U.S. companies, since international competitors using IFRS have more leeway in structuring sales transactions without adversely affecting the timing of revenue. Earlier recognition of revenue may allow international competitors to show faster growth in revenue, and, as a result, they might be perceived by potential customers and investors as being more successful.

For example, technology companies often sell complex products and license rights that also require some level of ongoing customer support services. Under U.S. GAAP, this is considered a multiple deliverable sale containing both a product and ongoing services. If prescriptive rules for this type of transaction are not met, U.S. GAAP might require the product revenue to be deferred and recognized pro rata over the term of the related support services. IFRS in this situation is not as prescriptive, and a company using IFRS would more easily be able to report the revenue from the product sale when the product is shipped and would have more flexibility to negotiate favorable terms and pricing without jeopardizing the accounting treatment. As a result, in a competitive situation, a U.S. company might need to choose between providing the customer special terms in order to be

competitive and having to defer the revenue or refusing to make concessions so as to maintain a favorable revenue-recognition model to meet investor expectations.

While an astute investor might be able to determine from financial statement disclosures that potential differences in the accounting exist as a result of a foreign company's use of IFRS instead of U.S. GAAP, investors typically would not be able to quantify the effects of these differences, absent specific requirements that companies disclose this information. Currently, foreign companies that are listed on U.S. exchanges are required to quantify differences between the application of IFRS and U.S. GAAP; however, the SEC is proposing to eliminate this requirement.

Another potential rule change that could level the playing field would be to allow U.S. companies to adopt IFRS in lieu of U.S. GAAP. The SEC issued a Concept Release asking for comments on this idea. This change, if it were to occur, has its own issues, including a lack of accountants in the U.S. that have expertise in IFRS.

To address this currently, technology companies that compete internationally can discuss differences between IFRS and U.S. GAAP with their accounting firms and stay abreast as much as possible regarding international competitors' sales practices. This up-front homework could make the difference in closing a competitive sales deal.

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## Did You Know...

According to **CIO Magazine's Outsourcing and Innovation Study**, Forty-four percent of IT execs are unhappy with the innovation provided by offshore outsourcers (compared to 21% for domestic IT service providers)...

There have been 49 technology IPOs this year (20.2% of all IPOs), more than any other industry, according to **IPOhome.com...**

At 10.5 percent, banks and financial services companies spend the biggest part of revenue on technology, followed by the government (7.8%) and education (6.2%) sectors, according to **CIO Magazine...**

Online advertising spending is expected to reach \$36.5 billion by 2011 (totaling \$16.4 billion in 2006), according to **eMarketer...**

Two-thirds of companies on the InformationWeek 500 list of business technology innovators say they do offshore IT outsourcing, up from 43% in 2004, according to **InformationWeek...**

Total worldwide spending on technology M&A transactions in 2007 is projected to increase 67% compared with last year, according to **Innovation Advisors.**

## Mark Your Calendars...

The following is a list of upcoming conferences and seminars of interest for technology executives:

### JANUARY 2008

- January 16**                    **Information Technology Association of America (ITAA)-IMPUT-Software & Information Industry Association (SIIA) Software as a Service/Government '08 Conference**  
The Ritz-Carlton  
Washington DC
- January 27-31**                **Technosium 2008 – Global Conference & Expo**  
Santa Clara Convention Center  
Santa Clara, CA
- January 28-30**                **DEMO (The Launchpad for Emerging Technology) 2008**  
Desert Springs Marriott Resort & Spa  
Palm Desert, CA

### FEBRUARY 2008

- February 17-22**              **The Data Warehousing Institute (TDWI) World Conference – Winter 2008**  
Caesar's Palace  
Las Vegas, NV

### MARCH 2008

- March 3-6**                    **Association for Information and Image Management (AIIM) Conference & Expo**  
Boston Convention and Exhibition Center  
Boston, MA
- March 16-20**                **Wilshire Meta-Data Conference & Data Management Association (DAMA) International Symposium -the world's most authoritative data management conference**  
Sheraton Hotel San Diego  
San Diego, CA
- March 27**                    **Argyle Executive Forum – Strategic Partnering in Information Technology**  
Location TBD  
New York, NY

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