Straight Talk Book No. 11

Buckle up

(On the road to IFRS)

“Revolution is impossible until it is inevitable.”

Leon Trotsky

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Where are you starting from?

Take this quiz to see how urgently you should embrace IFRS.

	NO				YES
We are an accelerated filer.	1				5
We are a public company.	1				5

	DISAGREE				AGREE
We operate globally.	1	2	3	4	5
Our competitors are global—and some are using IFRS.	1	2	3	4	5
Our organization is large and/or complex.	1	2	3	4	5
We're actively involved in mergers and acquisitions.	1	2	3	4	5
We have major systems projects in the works.	1	2	3	4	5
U.S. GAAP has become a little too complicated for our organization.	1	2	3	4	5
We have raised capital abroad—or would like to.	1	2	3	4	5

Scoring:

15 or less: You may not think you need this book. But you will soon.
16–25: IFRS is in your near future. You have time to learn and plan.
26–35: Move this issue to the front burner today.
36 or more: You're probably tackling IFRS already. Aren't you?

Here we go. Again.

In case you haven't noticed, finance and accounting are about to get a makeover. This time it's International Financial Reporting Standards (IFRS). And it's a big deal.

More than 100 countries, including those in the European Union and parts of Asia and Latin America, have already adopted IFRS. More than 7,000 companies are on board in Europe alone. By 2009, some public companies in the United States will have the option of IFRS reporting. Mandatory use of IFRS is likely to begin in 2014.

For many U.S. companies, early conversion to IFRS has appeal. Simplified reporting. Reduced operating costs. Greater transparency and comparability for investors. Improved access to capital. Plus some companies see their competitors already embracing IFRS. That's why momentum toward IFRS adoption has been steadily building, even before it's required.

Today's decisions will determine the direction and speed of your transition. You can make it a smooth ride, a roller coaster, or a train wreck. The choice is yours.

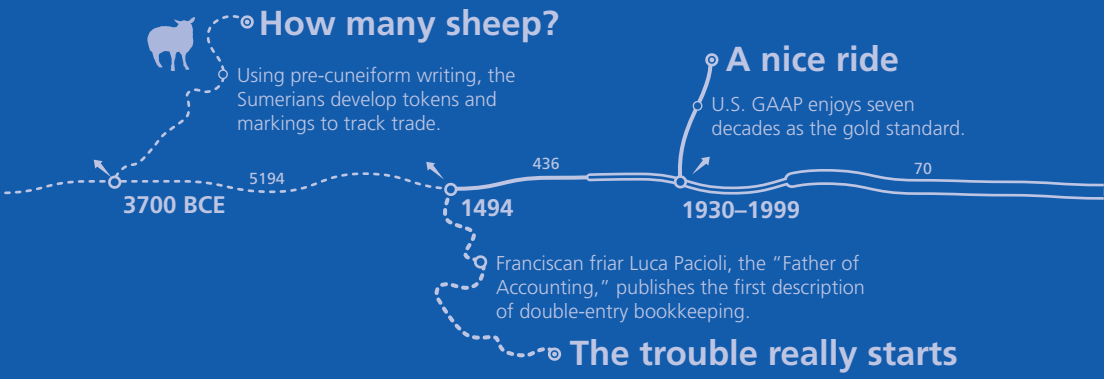
The road to IFRS

Since the 1930s, technical accounting for most U.S. businesses has been governed by U.S. Generally Accepted Accounting Principles. U.S. GAAP contains many detailed rules that dictate how to account for specific transactions and events. If there isn't a rule for a particular transaction, one is usually created. Since 1973, the Financial Accounting Standards Board (FASB) has governed the evolution and interpretation of GAAP in the United States. Other countries have had their own sets of local accounting standards.

As business practices and capital markets have globalized, and with technology enabling capital to rapidly flow around the world, the need for local or country-based standards has diminished. Companies now seek capital without regard to country borders. With this trend, there has been clear movement toward global standards. In 2001, the International Accounting Standards Board (IASB) was created to accelerate the development of a single set of standards—IFRS—that could be used across borders. Today, more than 100 countries use it.

The process of IFRS adoption in the United States is under way. In 2002, the FASB and IASB set in motion convergence—a plan to reduce differences between U.S. GAAP and IFRS. As a result of this and other factors, in 2007 the SEC allowed non-U.S.-based companies to start filing IFRS financial statements without a reconciliation to U.S. GAAP. In 2009, some U.S. registrants will have this option.

Eventually, U.S. GAAP will go away, and IFRS will be the lone standard. This is a historic trend. It is accelerating. And it is inevitable.



To adopt or not to adopt? That is *not* the question.

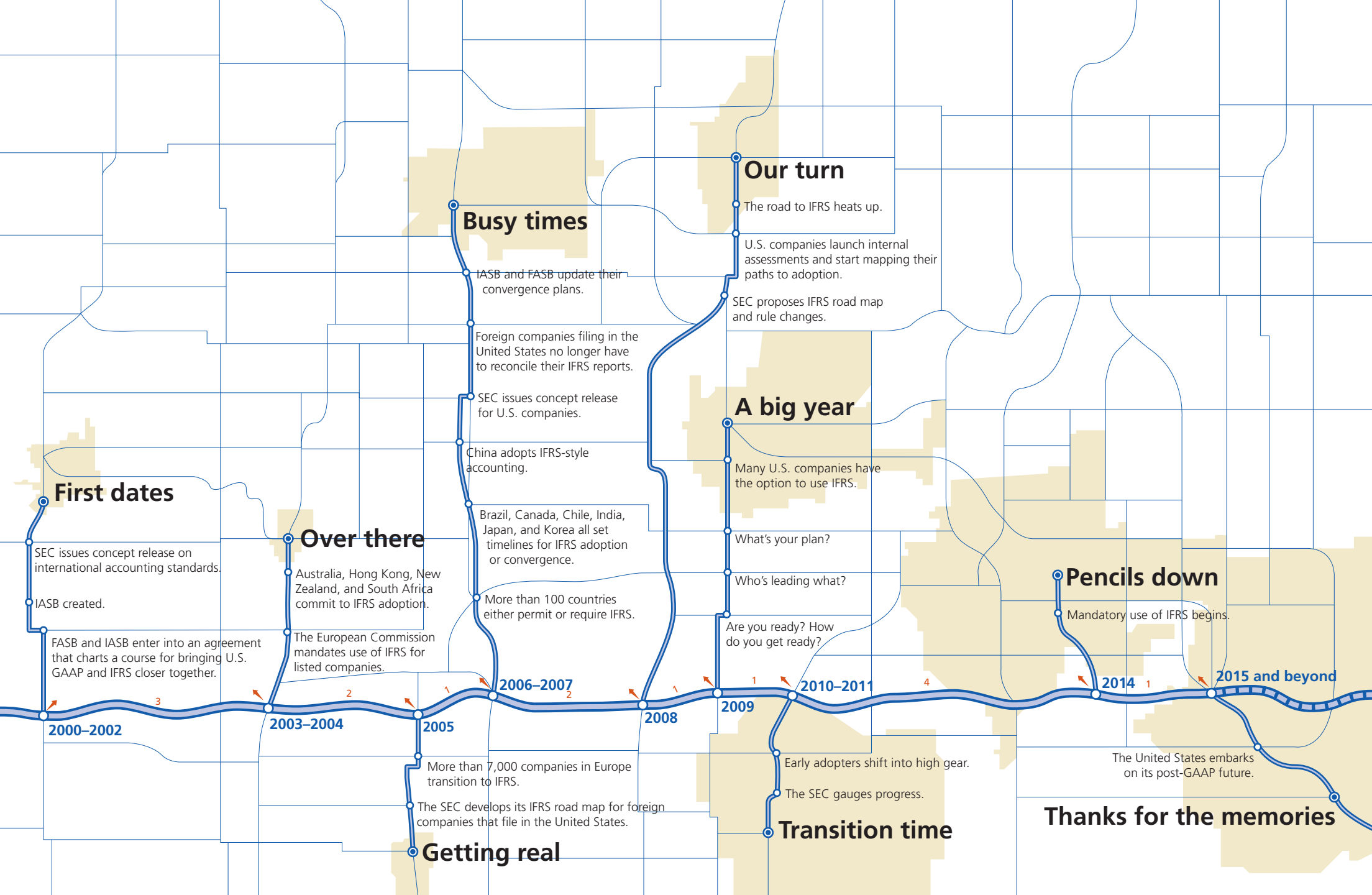
Converting to IFRS is one decision you won't have to make. Every company will eventually be going on this ride. The questions are when and how.

This might feel eerily familiar. Over the past decade, many companies have traveled the Y2K and Sarbanes-Oxley roads. Those experiences offer lessons you'll be able to use with IFRS, but there are important differences, too. For one thing, IFRS is being driven by the globalization of capital markets. Not just by government policy.

This is a unique challenge. If you act as though you've done it all before, you'll run the risk of under-planning and missing opportunities. And if you think convergence will solve this problem, think again.

Important decision points are coming up faster than you may think. Do you want to get ahead of the crunch and ensure a smooth, orderly process? Do you want to move among the early adopters to realize potential benefits before your competitors?

Every business will have a different outlook on IFRS, but no matter what your approach, know this: The full transition will take a well planned effort, requiring leadership and vision. For many companies, it will take at least three years.


First dates
SEC issues concept release on international accounting standards.
IASB created.
FASB and IASB enter into an agreement that charts a course for bringing U.S. GAAP and IFRS closer together.
2000–2002
Over there
Australia, Hong Kong, New Zealand, and South Africa commit to IFRS adoption.
The European Commission mandates use of IFRS for listed companies.
2003–2004
Busy times
IASB and FASB update their convergence plans.
Foreign companies filing in the United States no longer have to reconcile their IFRS reports.
SEC issues concept release for U.S. companies.
China adopts IFRS-style accounting.
Brazil, Canada, Chile, India, Japan, and Korea all set timelines for IFRS adoption or convergence.
More than 100 countries either permit or require IFRS.
2005
Getting real
More than 7,000 companies in Europe transition to IFRS.
The SEC develops its IFRS road map for foreign companies that file in the United States.
2006–2007
2008
Our turn
The road to IFRS heats up.
U.S. companies launch internal assessments and start mapping their paths to adoption.
SEC proposes IFRS road map and rule changes.
A big year
Many U.S. companies have the option to use IFRS.
What's your plan?
Who's leading what?
Are you ready? How do you get ready?
2009
Transition time
Early adopters shift into high gear.
The SEC gauges progress.
2010–2011
Pencils down
Mandatory use of IFRS begins.
2014
Thanks for the memories
The United States embarks on its post-GAAP future.
2015 and beyond

What has to change?

Taking your organization from U.S. GAAP to IFRS will require managing change in multiple areas: technical accounting and tax, internal controls and processes, management and statutory reporting, technology infrastructure, and organizational issues. They're all interconnected, which makes things a bit more complicated than you might imagine.

Your finance organization may become IFRS Central for a while, as others tap into your team's expertise, but this change is bigger than accounting. In fact, IFRS will expand your finance team's communication, coordination, and relationships. That makes it both an opportunity—and a potential headache.

Compared to U.S. GAAP, IFRS relies more on general principles than detailed rules and bright lines. This means your finance people will end up working much more closely with others in the organization to make judgments about accounting based on the underlying economics of transactions.

A flurry of operational changes could be triggered by IFRS as well. You may have to reexamine contracts and debt agreements, treasury policies, employee benefits, education and training, and communications. You may also have opportunities to centralize statutory accounting functions into shared service centers. You may even need to revisit decisions about offshoring, outsourcing, and tax planning.

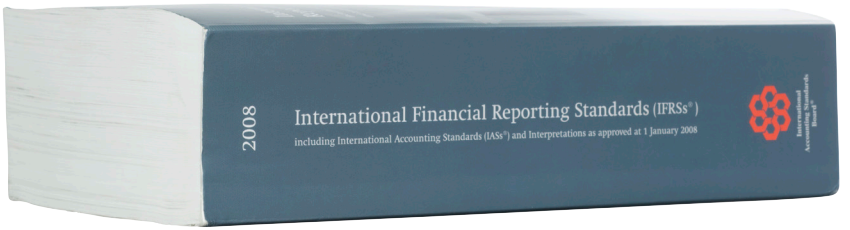
IFRS will also stretch the CFO's job description with new kinds of decisions, new ways of thinking, and plenty of outreach. There's a good chance your colleagues (and board members) don't know a lot about IFRS. You'll have to inform them—and cultivate their support to make it work.

Where the rubber meets the road

IFRS isn't completely different from U.S. GAAP. After all, it's still accounting. But a lot of important things are different, and each can trigger far-reaching changes. Here are some of the key things to look out for—and what CFOs need to do about them.

The topic	The change	The implication
Meet that long-lost relative	**Consolidation policy.** Entities are consolidated based on assessing risks and rewards, as well as governance and decision-making activities.	**More entities may be consolidated.** Entities that may need to be assessed for consolidation include those where there is a significant equity investment, such as joint ventures, special purpose entities, and franchisees.
Are you afraid of commitment?	**Provisions.** Under IFRS, a liability is recognized when an entity has a demonstrable commitment—a different standard from under U.S. GAAP.	**Liabilities will be recognized and measured differently.** Examples include restructuring charges, onerous contracts, uncertain tax provisions, litigation, and asset retirement obligations.
Recognizing the unrecognizable	**R&D.** Internal costs to develop a product must now be capitalized.	**Development costs will be deferred and amortized.** Entities will need to identify and track costs that should be capitalized as assets, assign useful lives, amortize the assets, and evaluate them for impairment.
Is the price right?	**Asset impairment.** Impairments are recognized based on an asset's recoverable amount—the higher of its fair value and value-in-use.	**Impairment charges will be recognized earlier and measured differently.** They are also required to be reversed if the conditions that led to the impairment no longer exist.
Is the value fair?	**Financial instruments.** Fair value measurements may be different and are not always based on exit value. Assets are derecognized based primarily on an assessment of risks and rewards. The debt and equity components of contracts are required to be separated.	**Financial assets and liabilities will be measured differently.** It will be more difficult to derecognize financial assets because qualified special purpose entities no longer matter. Instruments with debt and equity elements will be accounted for differently.
Depreciation isn't simple anymore	**Property.** Assets are depreciated on a component basis, and an asset's residual value is revalued each period. There is also an option to revalue property.	**The computation of depreciation will be more complicated.** Also, the measurement of an asset may be different.
What's 2+2?	**Less guidance.** IFRS is less reliant on bright lines and detailed rules than U.S. GAAP.	**CFOs will need to focus more on the economics underlying transactions and events.** This will eliminate accounting arbitrage and result in more judgment in applying standards. Examples of areas where more judgment is required include financial statement presentation, property, leases, revenue recognition, consolidation policy, provisions, intangibles, and financial instruments.

IFRS
(all of it)



U.S. GAAP
(at least some of it)

Putting principles into action

This won't be easy. Implementing IFRS calls for more complex decisions—and you'll need clear processes for managing them. That will require a judgment framework.

In 2008, the SEC's Committee on Improvements to Financial Reporting (CIFR) issued its final recommendations, including the need for a framework for making financial reporting judgments under IFRS.

Does that mean more work for you? Probably. Different work? Definitely. You'll still focus on areas like transaction analysis, accounting research, and decision making—but you'll find that each area demands a different allocation of your time.

Consider creating a project management office to begin developing your own framework for how judgments will be made. Start with good guidelines. Identify the people who will be responsible for applying them. Then educate your professionals on the company's approach. That will make it easier to understand and trust the judgments made when it's time to sign your name.

Before you go

- Get clear about how IFRS and U.S. GAAP differ. Determine the level of effort required to address the differences.
- Evaluate the impact on accounting policy. Some areas of accounting will require new policies due to clear differences in standards. In other areas, there may or may not be differences, depending on the choices you make.

The judgments you'll make

Judgment area	What it means for you
Transaction analysis CIFR recommended analyzing the business purpose and substance of transactions, and considering all available material facts.	• New need to document processes • Economic substance is paramount—and often involves considerations beyond accounting • Documentation should be contemporaneous
Accounting research CIFR recommended that all relevant accounting research be identified—and alternatives be considered based upon investor needs.	• White papers will be needed to document the assessment • Increased sensitivity to diversity in practice
Decision making CIFR recommended seeking input from multiple individuals with expertise—and emphasized the importance of consistent application of accounting judgments based upon reliable assumptions and estimates.	• The review process should include non-accounting professionals • Increased emphasis on the appropriateness of assumptions • Increased emphasis on disclosure

The time you'll take

What about tax?

When it comes to planning for IFRS, the long-term benefits should be balanced with near-term risk mitigation. Understanding the conversion issues affecting income tax accounting, such as the impact on the effective tax rate and cash taxes, is critical. Do it right, and you could fund your transition.

Differences in accounting for income taxes in areas such as share-based compensation, currency fluctuations for foreign subsidiaries, and intercompany sales could influence your effective tax rate. And just when you thought you had a handle on accounting for income tax uncertainties under U.S. GAAP, accounting under IFRS may result in adjustments to reserve balances that could affect your bottom line.

It may seem that differences in accounting for goodwill, consolidation requirements, or debt/equity classification (for starters) have little to do with accounting for income taxes. Yet they may affect your tax rate and repatriation plans. Planning now for the global tax impact of IFRS will likely put your organization in a more favorable tax position in the future.

You may be thinking: "Surely a change in book reporting won't affect my taxable income as determined by local law." It depends. Some countries rely mostly on book income as the tax base. Others, such as the United States, have more complex rules and offer many alternative tax accounting methods. Regardless, beware of the potential to pay more tax should profits increase under IFRS. Avoid over-paying by adopting the most advantageous tax accounting methods.

And don't forget tax returns. Different countries are moving to IFRS at different times. Even with IFRS in place, many jurisdictions will require a local version of GAAP for tax compliance. The challenge of dealing with myriad global tax regimes isn't going away soon.

Before you go

- Make sure you understand the changing tax issues and how you can capitalize on them. Be prepared for scenario planning and modeling.
- Keep an eye on the long term—but don't neglect near-term risk. Errors can be costly.
- Include the Chief Tax Officer as part of the transition team.

The black box

Many of the benefits of IFRS center on statutory reporting. That means you could soon have a chance to streamline, simplify, and centralize an often cumbersome process.

Statutory reporting isn't a very transparent process in most companies. It's often performed remotely, once a year, in an operational black box. And because it's not done consistently across the globe, it can be harder than you think to know all the resources and standards that are used. IFRS provides an opportunity to shine a light into that black box and make it more efficient.

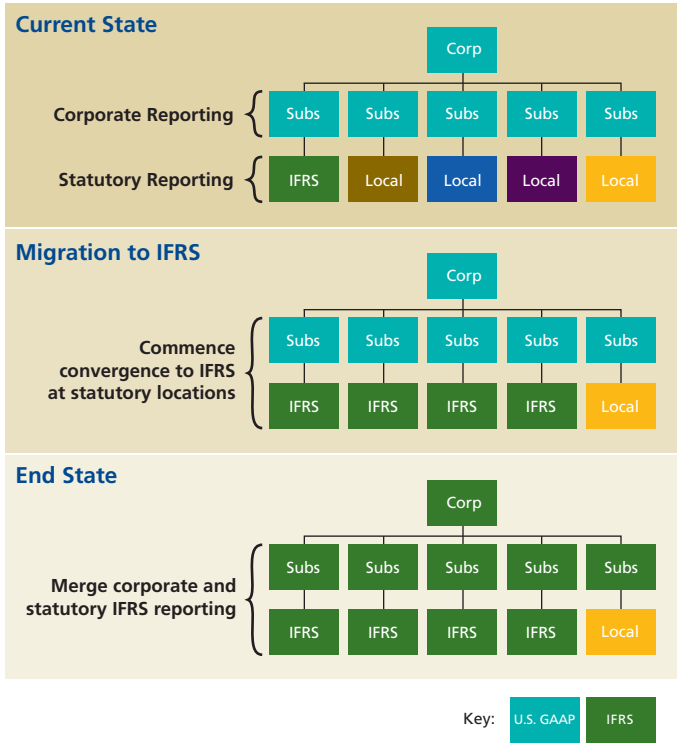
Your statutory reports are a great place to begin working IFRS into your system. Many companies already report under IFRS for various statutory locations—some because they have to, and some because they can. Monitoring and expanding this practice to bring your statutory reports in line with IFRS, where possible, can increase your readiness and help iron out reporting problems before you take on a consolidated conversion down the road. It also avoids potential issues with subsidiaries that are already reporting under IFRS but aren't applying it consistently.

Consider establishing regional centers for IFRS reporting. In the past, shared service centers focused more on transaction processing because statutory reporting varied so widely from country to country. But with IFRS, you should be able to use shared service centers to consolidate operations, drive cost savings, and improve controls.

Before you go

- Inventory your current IFRS reporting requirements and locations.
- Identify resources within your organization to assist in the IFRS effort.
- Assess how consistently IFRS accounting policies are applied at all IFRS reporting locations.

The connection between statutory reporting and consolidated reporting under IFRS



Today your statutory reporting locations may use a variety of standards—either IFRS or the GAAPs of local jurisdictions. If you align these locations with IFRS first, they can be valuable test beds for using the new standard. The end-state vision is a consistent basis of reporting for consolidated and statutory purposes.

Handling the systems side of IFRS
is something you want to do carefully.

Watch your step

Many companies that adopted IFRS in Europe learned systems lessons the hard way. They chose to put a basic IFRS framework in place without thinking through transaction-level details. Now they're paying the price. Their systems can't deliver the detailed information required by regulators. They are trapped in a swirl of spreadsheet workarounds to deliver information that should have been automated.

A more effective approach anticipates the need for transaction details while building out high-level systems. That doesn't mean you take on a gigantic enterprise program all at once. Begin instead with an impact assessment and a piloted rollout.

IFRS could require adjustments to financial reporting systems, existing interfaces, and underlying databases to incorporate specific data to support IFRS reporting. Here are the big impacts:

- *Upstream systems.* Additional reporting requirements in areas such as taxes, financial instruments, and fixed assets.
- *General ledger.* Changes to the chart of accounts. During transition, general ledger reporting will likely need to accommodate ledgers for both U.S. GAAP and IFRS.
- *Reporting data warehouse.* Changes in data models, such as valuation systems and actuarial models.
- *Downstream reporting.* Changes to the number of consolidated entities, mapping structures, and financial statement reporting formats.

Plan on needing several years to work through the issues. If you take shortcuts, your ability to maximize value and mitigate risk could be compromised—and you probably won't end up with a sustainable solution.

Before you go

- Assess the impact of IFRS on your technical infrastructure. Front-end systems, general ledgers, sub-ledgers, and reporting applications may need to be evaluated.
- Identify the impact on current system projects. As new projects are planned, take time to align requirements with the likely impact of IFRS.

The more things change

One of the trickiest things about adopting IFRS is the way changes in one area can affect work in other areas.

Let's say you're in the middle of a new systems implementation that will take several years to complete. If you don't plan ahead, you may find yourself with a system that's not configured for IFRS adoption. That's likely to be true for any business transformation project.

The same can be said of big organizational changes. Companies are constantly fine-tuning their structures. Factoring IFRS into your improvement plans is important to prepare for the future of finance. Even new contracts, such as debt agreements and leases, should be evaluated in light of IFRS.

There will be new processes required, too, as well as solid controls. For example, you'll need to manage the reversal of impairment reserves and the segregation and capitalization of development costs. Your planning, forecasting, and budgeting systems will need to reflect IFRS reporting. If you have regulatory reporting requirements, those may change too.

You can't and shouldn't stop everything to get your IFRS house in order. But if you have large initiatives in progress that will be affected by the conversion to IFRS, try to get things aligned sooner rather than later. That's one of the big lessons learned during the European IFRS experience. Understanding the systems interactions and dependencies helps all the moving parts work together better.

Drivers and passengers

The conversion to IFRS could knock some of your people out of their comfort zones. That's not something you should leave to chance.

For CFOs, the challenge is two-fold. You have to realign your talent and organization to suit the new reality, and you have to keep people happy along the way. The first part requires that you ask the right questions. The second part will take good answers.

The right questions include: Do your people have the technical knowledge they need on IFRS? Do they have the skills and mindset to operate using principles instead of rules? How can you retrain the ones who don't—and get the most from the ones who do? Will IFRS affect how your employees are compensated? If so, how?

Begin a formal assessment of—not a casual look at—the finance talent with IFRS skills already under your roof. Invest in training to position your people to excel as IFRS becomes a reality.

It's natural for people to be apprehensive about what IFRS is and what it will mean for them personally. To keep emotions in check, communicate early with colleagues above, alongside, and below you so they know what's happening. Help them remember that IFRS is not only a challenge, but also an opportunity for career enhancement. If they're informed, included, and prepared, they will feel ownership—and their personal commitment to success just might be contagious.

Your financial reporting function is going to depend more than ever on the judgment of individuals. That's something you can't easily teach. But you can foster, recognize, and reward it.

Before you go

- Identify stakeholder groups affected by IFRS. Assess their current level of understanding of what's ahead.
- Create a plan to address the training and communication requirements for each stakeholder group. Keep people informed through the entire journey. Take time to celebrate success.

Sign here

Your IFRS journey will eventually lead to a certification on your desk—and a pen in your hand. It's all going to happen sooner than you think—and that means it's time to get going.

Begin your transition by fixing your starting point with a thorough assessment. Find out which IFRS or local GAAP requirements currently apply in the different jurisdictions where you report. Understand which specific differences between U.S. GAAP and IFRS will bring the most change—and risk—to your company.

Then develop an internal structure to manage the changes ahead. Involve senior executives who represent the functions that are most affected by IFRS, such as tax, IT, HR, and treasury. Be sure you're taking responsibility for educating your board and audit committee members. You might start by sharing this book with them.

With a structure and plan in place, you can begin to focus on the operational details of your conversion. If you've identified risks, how will you address them? How will your communication plan evolve from simply alerting people to preparing them for change?

Create an IFRS timeline that specifies when you'll begin organization-wide transition to IFRS reporting, when you'll actually file under IFRS, and all the stops along the way.

Targeted implementations in statutory locations can be a smart way to road-test the technology, process, and accounting policy changes that will come with IFRS. From there, you can move on to pilot conversions of whole subsidiaries in areas where IFRS is permitted or will soon be required.

You'll need plenty of runway. You'll have to provide comparative financials during conversion—and deal with all the systems, process, and organizational issues surrounding the transition. It will take time. And it will ultimately require your signature.

Are we there yet?

For many companies, IFRS is here today. For others, it's on the near horizon. It's coming—there's no question about that. And CFOs must decide how to get on top of the new requirements.

Before you do anything else, develop a road map of your IFRS opportunities and risks. That's a good way to lay a foundation for the transition plan you'll need going forward.

Then take a closer look at the changes IFRS implementation is going to require. Think ahead about how you'll engineer each of the changes, and what roadblocks you might encounter.

For you, IFRS is both a challenge and an opportunity—one that will take leadership, vision, and ambition.

For your organization, it's going to be an exciting ride. You're in the driver's seat. Make sure you know where you're going—and how you're going to get there.

Before you go

Here's a checklist of assessments you'll need.

- ☐ Technical accounting impact analysis
- ☐ Tax impact analysis
- ☐ Statutory reporting analysis by country
- ☐ Evaluation of technology issues
- ☐ Analysis of internal controls and process changes
- ☐ Organization readiness and training plan
- ☐ Stakeholder analysis and communications plan
- ☐ Project plan, including budgets, timelines, resources, and risk analysis

About this book

Buckle Up (On the road to IFRS) is the eleventh in a series of books dedicated to helping companies improve performance. To request additional copies of this book or to order previous editions, go to *deloitte.com/straighttalk*.

To receive regular updates on IFRS, please subscribe to our newsletter, *IFRS Insights,* at *deloitte.com/us/ifrsinsights.*

Talk to us

We look forward to hearing from you and learning what you think about the ideas presented in this book. Please contact us at *buckleup@deloitte.com.*

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