Ascending to new heights with IFRS

A Look at Accounting Changes and Beyond for the Process & Industrial Products Industry

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The role of the finance function in today's globally competitive marketplace is much more than being a good steward of accounting. Finance is expected to be strategic, aligning finance's objectives and operations with the business's direction and being a catalyst for positive organizational change. Fulfilling this role is important since IFRS will not only have a significant impact on your company's accounting processes and procedures, but could also provide a strategic opportunity for those who act early and thoughtfully.

So, the question is not just "How can we plan to implement IFRS with as little disruption as possible?" but also "How might we take advantage of this opportunity to improve the way we conduct business in a global marketplace?"

The challenge is two-fold: continue operating your business while simultaneously considering the implications of IFRS; and then identify the requirements needed to adopt IFRS and integrate the actions needed into multi-year initiatives that may already be underway (such as "finance transformation" or an ERP program). By aligning the transition to IFRS with other initiatives, you may achieve efficiencies and prevent rework at the end of the day. The bottom line: You need to start thinking about IFRS now.

Strategic Considerations

For process and industrial products (P&IP) companies, many of the challenges in adopting IFRS – as well as the opportunities – will be affected by specific, significant trends and competitive realities of the industry. Your understanding of the interaction of IFRS with these trends and realities will, in turn, determine the benefits you can derive from the adoption of the new standards. What's the strategic advantage of a fair-value-based accounting system? You'll need to know for your own business. Here are some key issues and potential impacts you may need to consider in planning for the transition to IFRS.

Finance Transformation

For years, companies in the P&IP industry have tried to cut costs to remain competitive. As a result, relatively little investment was made in finance organizations since these were considered "back-office operations" and not strategically important. But now, the trend in the P&IP industry is to increase top-line revenue by driving global growth. This global growth forces P&IP companies to handle greater transaction volumes, new transactions, and new reporting standards that differ by country; for many, existing legacy systems and processes are simply inadequate. This has necessitated a consideration of the need to transform the finance organization.

Undergoing finance transformation could reduce global finance costs and improve financial reporting quality. But if you're planning a finance transformation, it probably won't be complete without considering IFRS; if you're planning an IFRS implementation, it won't be complete without thinking about some of the broader impacts. Consider these questions:

- Is a shared services model part of your finance transformation efforts or plans? If so, where might resources be located for optimal leverage?
- How might you find and keep people with skills in IFRS, while potentially reducing global headcount at the same time?
- How would IFRS change your disclosure and data requirements? What systems and processes would enable finance to satisfy these new and likely more complex needs?
- How might you consolidate external, statutory, and management reporting to streamline overall efforts within your company's design of controls?

Capital Management

Chemical, metal, and paper companies maintain extensive investments in manufacturing facilities, back-end processing, and distribution operations. In fact, because they are asset-intensive, P&IP companies require access to large amounts of capital to fund their expansion, to replace obsolete operations, or to deploy new process technologies. In today's global marketplace, a P&IP company increasingly competes with companies already using IFRS.

In today's global capital markets, banks, creditors, and rating agencies look for comparability among companies. Therefore, implementing IFRS could enable your company to conform and compete in a global landscape, while possibly improving access to foreign capital markets by providing foreign investors greater insight into your company's financial performance. You'll likely be able to optimize the availability of capital due to expansion of access across multiple geographies.

Yet, conversion to IFRS may also introduce increased earnings volatility and may affect leverage and capitalization metrics. As a result, you may need to evaluate the impacts on debt covenants, especially while considering current and future financing plans.

Growth through Mergers and Acquisitions

Because of the often prohibitive cost of developing new products or of expanding legacy operations geographically, many P&IP companies may opt to grow globally through merger and acquisition (M&A) activity or through establishment of joint ventures (JV). For example, many chemical and metal manufacturers are increasing their global footprints by acquiring operating capacity or securing needed raw material sources and commodities.

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The challenge is due diligence: increasingly U.S. companies are finding that IFRS has become the *lingua franca* of financial statements; a foreign suitor may ask, "What does the U.S. business look like under IFRS?" In addition, IFRS should be considered as part of a company's post-merger integration plan. Experience suggests that post-merger synergy capture depends on the success of integration efforts. If IFRS adoption is not part of the "end state" vision for the combined enterprises, the value of the M&A transaction may be less-than-optimal, not only on Day One, but ever after. Furthermore, the requirement within IFRS for consistency of accounting methods and policies throughout an enterprise (which, it should be noted, is also required under U.S. GAAP) may compel management to reconsider many of the systems, policies, and procedures put in place following an acquisition. Reworking systems and processes to become IFRS-compliant after the fact is likely an unnecessarily costly proposition.

For a joint venture, the importance of IFRS is two-fold:

1. These endeavors may result in complex contractual agreements with regard to cost/revenue sharing or other metrics. Since IFRS affects many aspects of financial accounting, particularly revenue recognition, you may need to evaluate an international JV opportunity through an IFRS lens.
2. As you adopt IFRS for your whole business, you'll likely need to review and perhaps reconsider or renegotiate existing contracts because of the requirements of the new standards. IFRS may trigger changes in the necessary financial accounting information to be supplied from or to the joint venture.

Supply Chain Efficiencies

A measure of success for P&IP companies is their ability to source materials from suppliers, coordinate shipments to production locations, and distribute finished products to distribution centers and to end customers. In P&IP industries, an effective and efficient supply chain is a strategic imperative. A supply chain executive was recently overheard saying, "It's not hard doing business in China. It's hard doing business between China and the U.S." Understanding, coordinating, and integrating supply and demand are difficult and complex supply chain requirements.

Differences exist between IFRS and U.S. GAAP relating to the tax accounting treatment of intercompany cross-border transactions. Since accounting methods and tax methods are closely related, you'll want to reconsider tax strategies for a post-IFRS world, especially with regard to global tax planning and the redesign/enhancement of information systems to make sure they capture all the new and necessary data. If IFRS is planned for properly, the tax function can be stronger and even more value-added after the implementation.

IT Infrastructure and Investment

Many P&IP companies are encumbered with disparate legacy information technology platforms as a result of under investment in the past. In some cases, these systems are already challenged to meet the needs of today's business and finance function. When IFRS is adopted, the demands on IT will be new and complex: you may need new functionality and different data available for transaction reporting and will need to harmonize accounting methods and practices.

As companies invest in new or enhanced enterprise systems, the IFRS-driven capabilities should be on the "must have" list. Adding this functionality after the fact may result in a less efficient and effective investment of time, money, and talent.

Aging Workforce

Many P&IP companies find themselves with an aging workforce, and with this phenomenon comes greater pension liabilities and costs. P&IP companies are challenged to understand the potential changes and impacts of IFRS as it relates to the accounting for some aspects of pension liabilities.

The Business Case for IFRS

In time, virtually every country in the world will allow or require IFRS.

Recent events suggest that reporting under IFRS will be allowed or required for most public companies in the U.S. and around the globe within the next few years. On November 14, 2008, the SEC issued its long-awaited proposed IFRS "roadmap" outlining milestones that, if achieved, could lead to mandatory transition to IFRS starting in fiscal years ending on or after December 15, 2014. The roadmap also contains proposed rule changes that would give certain U.S. issuers the early option to use IFRS in financial statements for fiscal years ending on or after December 15, 2009. The SEC believes that "the use of a single, widely accepted set of high-quality accounting standards would benefit both the global capital markets and U.S. investors by providing a common basis for investors, issuers and others to evaluate investment opportunities and prospects in different jurisdictions." The roadmap also notes that IFRS has the potential "to best provide the common platform on which companies can report and investors can compare financial information." The SEC is seeking comments on numerous questions raised in the proposed roadmap. The comment period is expected to run until mid-to-late February 2009.

The proposed roadmap outlines seven milestones. Milestones 1–4 discuss issues that need to be addressed before mandatory adoption of IFRS:

1. Improvements in accounting standards.
2. Accountability and funding of the International Accounting Standards Committee Foundation.
3. Improvement in the ability to use interactive data for IFRS reporting.
4. Education and training on IFRS in the United States.

Milestones 5–7 discuss the transition plan for the mandatory use of IFRS:

5. Limited early use by eligible entities: This milestone would give certain U.S. issuers the option of using IFRS for fiscal years ending on or after December 15, 2009.
6. Anticipated timing of future rule making by the SEC: On the basis of the progress made on milestones 1–4 and experience gained from milestone 5, the SEC will determine in 2011 whether to require mandatory adoption of IFRS for all U.S. issuers. Potentially, the option to use IFRS could also be expanded to other issuers before 2014.
7. Implementation of mandatory use: The roadmap raises many questions, including whether the transition to IFRS should be phased in. According to the roadmap, large accelerated filers would be required to file IFRS financial statements for fiscal years ending on or after December 15, 2014, then accelerated filers in 2015, and nonaccelerated filers in 2016.

Under the proposed roadmap, U.S. issuers that meet both of the following criteria would be eligible to use IFRS earlier in financial statements for fiscal years ending on or after December 15, 2009:

- The U.S. issuer is globally among the 20 largest listed companies worldwide in its industry, as measured by market capitalization.
- IFRS, as issued by the IASB, is used as the basis for financial reporting more often than any other basis of accounting by the 20 largest listed companies worldwide in the U.S. issuer's industry, as measured by market capitalization.

An issuer that meets these criteria and chooses to use IFRS (an "IFRS issuer") must prepare its financial statements in accordance with IFRS as issued by the IASB. Issuers electing to file IFRS financial statements with the SEC would be required first to do so in an annual report and would not be able to file IFRS financial statements with the SEC for the first time in a quarterly report, registration statement, or proxy or information statement.

Investment companies; employee stock purchase, savings, and similar plans; and smaller reporting companies, as defined by the SEC, are excluded from the definition of an "IFRS issuer" in the proposed roadmap and therefore would not be eligible to early adopt IFRS.

For more information on the SEC's action, visit www.deloitte.com/us/ifrs.

But if 2014 seems a long way off, think again. A conversion effort that is both sane (in the sense of avoiding the fire-drill type atmosphere that characterized compliance with Sarbanes-Oxley and the Y2K computer issue) and successful (one that can stand up to the scrutiny of regulators, analysts, and your independent auditor) will require a lengthy runway. In mid-2008, the American Institute of Certified Public Accountants announced that it considered a 3-5 year timeline to be reasonable for transition to IFRS. Other organizations have made similar determinations.

The Business Case

In building a business case for IFRS, these "talking points" can be very helpful:

Global positioning: "We do business globally; our brand is international; we are expanding into new markets. Our financial reporting should be a reflection of this operational reality."

Cost savings: "We are currently reporting under multiple standards — U.S. GAAP, local GAAPs, and IFRS. Consolidating to a single reporting standard and eliminating a large number of reconciliations will yield potentially significant savings."

Inevitability: "IFRS is coming. If we start soon, we can implement a phased, efficient, and orderly process and avoid the chaos that has typified other major projects."

Alignment: "We are already undergoing a major [ERP/finance transformation/systems] initiative. If we integrate our IFRS conversion effort with this project, we can make better use of our resources while ensuring an optimal end result for everyone."

Internal control: "Accounting policies and procedures will be refreshed and harmonized during an IFRS conversion project; the number of financial reporting standards used and reconciliations required will drop dramatically. The net result will likely be improved accuracy and timeliness of financial reporting."

Chart the Course

If you take only one action after reading this document, we suggest it be this: begin to develop an IFRS implementation roadmap. To kick off this effort, ask yourself and your team a few preliminary questions to gauge the potential impact of IFRS on your company:

- Have we inventoried our current IFRS reporting requirements, if any?
- How many local generally accepted accounting principles (GAAPs) do we report under?
- Do any of our business units already prepare IFRS financial statements?
- How might our access to capital be impacted by an IFRS conversion?
- How many of our competitors have converted to IFRS? Is there an expectation that they would switch to IFRS, if given the choice in the U.S.?
- Do we have a major ERP or finance transformation project in the works?
- Are we involved in or considering a major acquisition?
- What is the level of IFRS knowledge within the company, both domestically and globally?
- What would be the impacts on our company of a possible IFRS requirement in the U.S.?
- Have we assessed the cost and benefits of adopting IFRS?

Of course, your IFRS implementation roadmap should be more detailed than just the answers to these few questions. For example, you would likely use the roadmap to assess the impact on many departments, including finance, human resources, tax, legal, information technology, and investor relations. Also, you may choose to involve several stakeholders, including the board, audit committee, shareholders, and your external auditor. Through your roadmap, you can independently validate perceptions, dispel misconceptions, and justify your decisions.

By determining your costs, benefits, and timing up front, you can avoid a rushed approach (and unnecessary expense). And the roadmap-making exercise itself should expose the value of having standardized and centralized statutory reporting activities/controls, greater consistency of accounting policy application, and possibly core finance transformation.

The Right Approach

Generally speaking, two approaches to IFRS conversion predominate: all-in or tiered.

All-in is characterized by a relatively short timeframe, the simultaneous conversion of all reporting entities, dedicated project teams, and the commitment of significant resources. Tiered is conducted over a more extended period, with a phased conversion of reporting entities, with at least some personnel retaining their "day job" duties, and with a spreading out of project costs.

When the European Union converted to IFRS in 2005, it was, for most companies, an all-in effort driven by the tight timelines imposed by the European regulators. As a result, most companies were forced to rush through the process, leading inevitably to some inefficiencies and ineffectiveness (see the section, The European Experience).

A tiered approach – staged, rational, and measured – to IFRS conversion likely provides better results. This comes with a seemingly self-contradictory caveat: You'll have to act fast if you want to go slow. That is, if you want to reap the potential benefits of phasing in your conversion, you'll need to start planning soon.

Companies that choose a tiered strategy should consider staggering their conversions on a country-by-country or region-by-region basis. As each group moves through the stages (Chart A), the processes developed and lessons learned are applied to the next group.

Technical Accounting Issues for P&IP Companies

U.S. GAAP and IFRS differ in key ways, including their fundamental premises.

At the highest level, U.S. GAAP is rules-based, while IFRS is principles-based. This distinction may prove vexing because, as a rule, the application of IFRS principles calls for more judgment than many U.S. accountants might be accustomed to. IFRS can also present particular technical accounting challenges for P&IP companies.

In this section, we summarize the differences and implications between the two sets of standards (see chart B for an overview of potential impacts by accounting area) and then discuss a few of the most salient issues in more detail.

Property, Plant, and Equipment

As asset-intensive businesses, P&IP companies make large investments in PP&E. One significant difference between IFRS and U.S. GAAP is asset componentization. Under IFRS, the major components of large assets must be separated and depreciated over their useful lives. Identifying the significant components of closely integrated fixed assets represents a major challenge.

For chemical, paper, and steel manufacturers that require periodic plant turnarounds, associated costs may present particular accounting challenges, as some of the associated costs may be capitalized while others can be expensed. In general, turnaround costs that do not involve the replacement of components or the installation of new assets should be expensed when incurred.

P&IP companies that convert to IFRS can expect a complex and potentially lengthy process to inventory their property, plant, and equipment, to reclassify their assets under componentization rules, and to adjust the depreciation calculations of fixed assets.

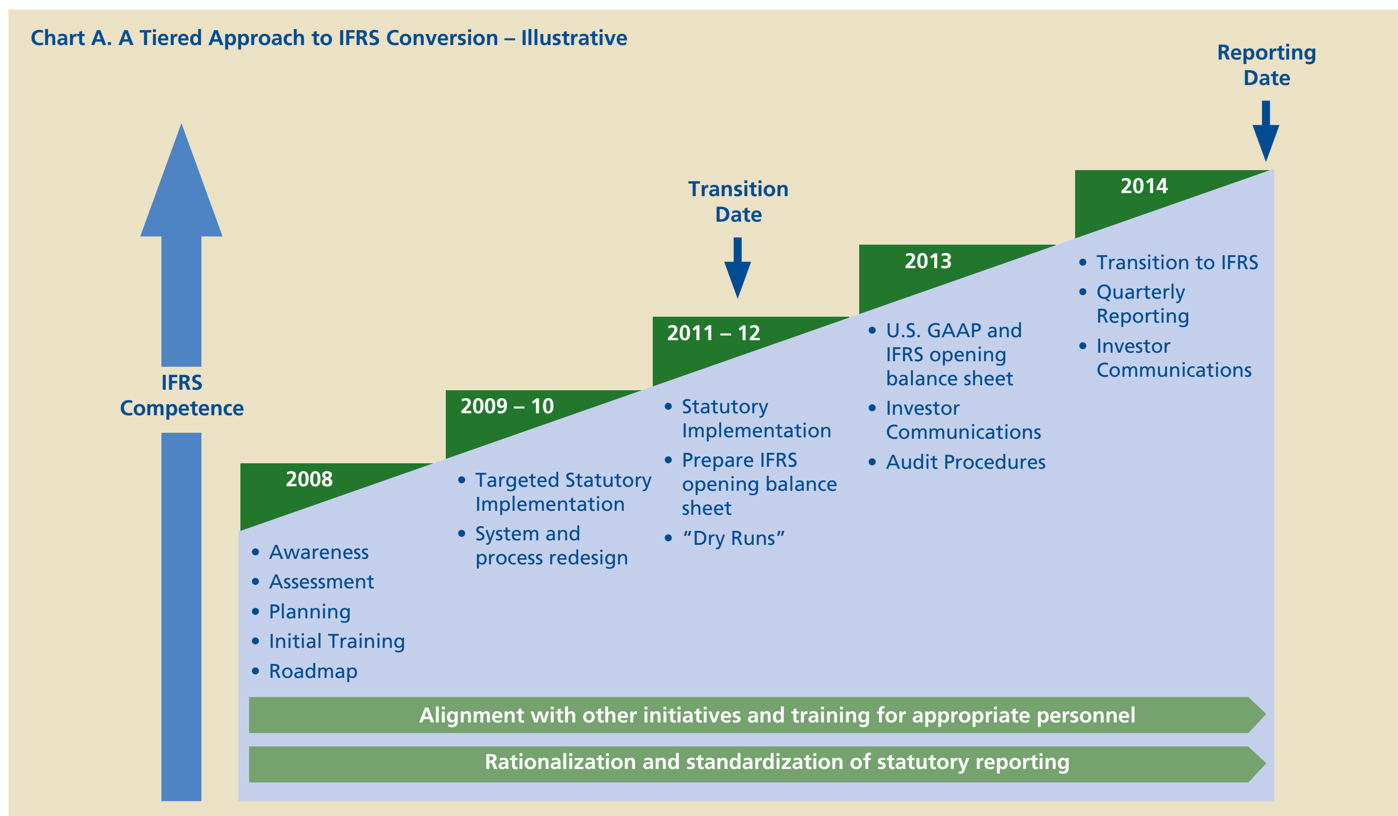

Chart B: U.S. GAAP/IFRS differences for the P&IP industry

Potential Differences	Potential Implications		
	Financial Statements	Process/IT	Other Issues
Revenue recognition			
Revenue recognition	As compared with IFRS, US GAAP has highly specific and specialized revenue recognition guidance, IFRS lacks specific guidance related to certain issues or industries.	May result in potential changes to revenue or gain recognition systems/processes.	Lack of specific rules around revenue recognition could result in changes in future contract development.
Construction contracts	Under IFRS completed contract method is prohibited.	Current systems might require modifications to perform calculations.	
Assets			
Property plant & equipment	IFRS requires componentization approach; major maintenance expense treatments may differ.	Systems modifications may be necessary to track components and separate depreciation amounts.	May cause potential difficulty in initial componentization exercise depending on age of assets, previous acquisitions. Also, may have potentially significant tax implications.
Property plant & equipment revaluation	Historical costs or revalued amounts may be used under IFRS unlike U.S. GAAP where only historical costs are used.	Current systems might require modifications to perform fair value calculations.	May be difficult to determine the fair value of individual class of assets. Increased efforts/resources may be necessary.
Asset impairment	IFRS has a one-step impairment test based on recoverable amount. IFRS impairment losses may be reversed if recovery occurs.	Will require changes in impairment analysis and system modifications to measure and track impairment amounts.	Will lead to increased focus on periodic assessments and possibility of more frequent triggers for reassessment.
Internally generated intangible assets	Difference in recognition of intangibles resulting in possible deferral of expenses.	Current systems might require modifications to processes and data capture to perform calculations.	May need increased monitoring of development cost incurred. Increased efforts/resources.
Inventory	IFRS does not permit LIFO.	May result in potential changes to inventory valuations and associated systems. Need to establish process around impairment reversal.	May have tax considerations relative to different inventory valuation and related tax deduction amounts.
Expenses			
Share based payments – expense recognition	Under IFRS, payroll tax liability is recognized on accrual basis.	Current systems might require modifications to perform calculations as well as changes to cost tracking and allocations.	Human resources and budgeting.
Employee benefits – actuarial gains& losses, valuation date	Under IFRS measurement dates may vary from US GAAP, and actuarial gains and losses may be deferred.	May need to develop process around asset ceiling test as well as judgment around actuarial gains and losses.	Change in funding requirements as well as tax implications.
Liability			
Provisions – general	Criteria under IFRS prescribes recognition of liability when it is "more likely than not" versus probable as higher threshold for US GAAP.	Current systems might require modifications to perform calculations.	More focused approach would be required in determining the probability of outflow of resources.
Re-structuring liability	Under IFRS recognition can be made based on announcement/ implementation of detailed formal plan. Recognition based on this sole criteria is prohibited under US GAAP.	Current systems might require modifications to perform calculations.	Human resources and budgeting.

Asset Impairment

The overall approach to impairment under IFRS holds several stark contrasts to U.S. GAAP. For example, IFRS requires that under certain conditions, a previously-recognized impairment (other than those relating to goodwill) may be reversed up to the otherwise depreciated original value of the asset. Thus it is necessary under IFRS to track any asset impairment to determine the amount of future reversal. Under U.S. GAAP, reversals of previously recognized impairment to long-lived assets are not permitted.

Another significant impact is on the evaluation of impairment of long-lived assets. U.S. GAAP considers an initial undiscounted cash flow recoverability test to determine whether impairment should be recognized; IFRS uses discounted cash flows and current fair values for purposes of assessing and measuring impairment losses.

Differences can also arise in areas such as determination of cash generating units for impairment analysis and the determination of fair value.

Inventory

As P&IP companies acquire raw materials and convert these through the manufacturing process into finished goods, they need to maintain significant amounts of raw, work-in-process, and finished inventory. It is common for these inventories to be maintained on a LIFO basis. So, for P&IP companies, the LIFO "conundrum" is particularly important.

Under U.S. GAAP, companies can apply LIFO rules to their inventory balances. In periods of rising commodity prices, this accounting method leads to higher recognized costs of sales and, thus, reduces taxable income. But LIFO accounting is not allowed under IFRS, so companies will need to recast recorded inventory balances under either weighted average or FIFO rules for financial reporting purposes. Current tax law requires companies reporting inventories on a LIFO basis for tax purposes to also report inventories on a LIFO basis for financial reporting purposes. As a result, the adoption of IFRS could result in a violation of this conformity requirement and, under current law, a significantly higher tax bill.

Consequently, companies with substantial LIFO reserves may be reluctant to convert to IFRS. Some analysts speculate that the U.S. Congress and the Internal Revenue Service will be compelled to address this issue should IFRS be mandated, perhaps by offering a one-time conversion opportunity that limits the tax liability or by removing the requirement for book and tax conformity. But with billions in tax revenue at stake, there will be enormous pressure on all sides of the issue, making final resolution difficult to predict.

A P&IP company should closely monitor developments in this area or actively explore options, from a tax planning standpoint.

Pension Costs

Although many of the differences between IFRS and U.S. GAAP accounting for pension benefits have been eliminated, there continue to be narrow differences which can affect the timing and amount of costs recorded upon transition to IFRS, including differences relating to the recognition of actuarial gains and losses as well as the differences in connection with pension plan amendments and past service costs. Any differences in this area can also add complexity to tax calculations. Also, the tax impact of any contemplated action such as termination of a pension plan, including paying out the existing liability, in relationship to the funding status of the plan must be considered.

More than Accounting and Financial Reporting

Without question, IFRS will impact the general ledger and financial statements. But in a relative sense, the accounting aspects of adoption may be the easy part. How you handle the nonfinancial aspects of the conversion may be a far more accurate predictor of your ultimate success. Among the areas warranting your attention are human resources, legal, tax, treasury, contract management, and technology.

Human Resources

As noted, IFRS involves much more than reorganizing the chart of accounts; its potential impacts cascade well beyond accounting to include people as well. Consequently, human resources can be a major concern. A conversion project will likely place great demands on your people – demands that may come at a time when you are least able to handle them.

As a result of past years' efforts to streamline their operations through reduced hiring, layoffs, and attrition, finance talent availability may be particularly challenging for P&IP companies. What this might mean is you might not have the resources to successfully prepare for and implement IFRS.

To further augment this challenge, attracting the right new talent may be difficult, particularly because U.S. college accounting programs – an important pipeline for keeping finance functions staffed and operating – are just beginning to develop comprehensive instruction on IFRS.

This issue might be addressed through company or industry training programs. Transferring IFRS-capable individuals from non-U.S. locations should also be considered.

Legal

To reduce supplier costs, many P&IP companies are reducing/consolidating vendors; those remaining often become "strategic suppliers." The ripple effects of conversion to IFRS will surely be felt by your legal department, as many supplier contracts will need to be re-examined and some agreements renegotiated and restructured. Also, the legal department will need to take a fresh look at the contracts behind joint ventures, profit-sharing agreements, and other collaborative arrangements. Finally, education and retraining will also come into play, as the legal team needs to understand IFRS principles and associated guidance from the Securities and Exchange Commission.

Tax

The tax considerations associated with IFRS are complex. The analysis of tax issues must go beyond an assessment of key tax accounting differences between FAS 109 and IAS 12 and include the impact of pre-tax accounting changes on tax methods, the impact on global planning strategies, and the evaluation of the information systems in place to capture all the necessary data. If it is properly planned for and approached, a conversion to IFRS has the potential to strengthen the tax function within an organization by providing an opportunity for a detail review of tax matters and processes.

It is important to evaluate the impact of pre-tax differences between IFRS and US GAAP and the related impact on tax methods. If there is a change in the accounting method used for financial reporting purposes, companies must consider the tax effects, in particular:

- Is the new financial reporting standard a permissible tax accounting method?
- Is the new book method preferable for tax reporting purposes?
- Is it necessary to file changes in methods of accounting?
- Will there be modifications in the computation of permanent and temporary differences?
- Do planning opportunities exist?
- How will reporting in accordance with IFRS impact the computation of taxable earnings and profits, foreign source income, and investments in subsidiaries?
- How will a change to IFRS impact local country statutory reporting and tax payable?

A process company may be faced with the requirement to book assets using the component approach and the option to revalue assets. By answering the questions above, the tax department should begin to understand the tax impact of the financial accounting methods. These differences may also have systems implications. Though companies are accustomed to having book-tax differences related to fixed assets, most systems are not designed to track revaluation of existing assets.

But it isn’t all bad news. One unexpected outcome of addressing the componentized asset approach relates to cost segregation studies. Historically, these studies were of value only to the tax department wanting to maximize accelerated depreciation deductions by identifying shorter lived assets. Under IFRS, such studies will also a benefit the financial accounting department. Therefore, organizations may be more likely to have studies performed, as a result maximizing tax benefits.

And don’t forget the potential impact on tax planning, which has long been driven by its impact on the effective tax rate. For example, the requirement to book current and deferred taxes on intercompany cross-border transactions will have a significant impact on transfers of intellectual property and supply-chain structuring. Process companies are involved in sourcing of materials and component parts sourcing and cost sharing arrangements in tax favorable jurisdictions. Under U.S. GAAP, current and deferred taxes are not recognized related to these intercompany cross-border transactions. Conversely, IFRS requires a company to book current and deferred tax attributes on these transactions even when the transaction is eliminated in consolidation. This may create an effective tax rate impact and cash tax implications for the traditional methods previously employed for the transfer of intercompany inventory and intellectual property.

A key to an effective conversion to IFRS is planning. Tax issues such as those discussed above need to be addressed before a conversion. If a company waits until after, the process will likely be very difficult and the potential benefits in accounting choices, systems enhancements, and planning opportunities may be sub-optimal.

Treasury

Moving to a global financial reporting model may open up access to new sources of capital. Many global lenders, global private equity firms, and international exchanges require or prefer IFRS reporting because of its increased transparency and comparability to other investments or companies. Thus, these sources potentially become new avenues for capital funding, particularly in the current U.S. dollar environment.

Note, however, that greater use of fair value may create more volatility in your company’s access to capital. That is, while IFRS might open up access to additional capital in a favorable fair value environment, it could also limit access in an unfavorable environment.

Furthermore, with reporting or disclosure under fair value, management will likely need to understand, evaluate, and manage the expected market reactions to the possible volatility of reported values new territory for most U.S.-headquartered P&IP companies.

Here are additional potential impacts of IFRS on the treasury function:

- Companies that choose to present fair value may need to lower their leverage models to ensure that market fluctuations can be adequately absorbed by equity. This may be challenging since P&IP companies tend to be capital-intensive and often require debt to support this need.
- Companies may need to consider and revise existing debt terms for covenants based on U.S. GAAP metrics or financial results that don’t make sense or are no longer attainable under IFRS.
- The clearer view that lenders get of the fair value of collateral (whether presented on the balance sheet or disclosed in the footnotes) may alter their evaluation of creditworthiness and may impact the terms of new debt instruments related to collateral values and covenants.

Contract Management

An IFRS conversion will potentially impact your existing contracts with suppliers and customers. Consider involving your legal team as part of the remedy for issues like these:

- Many contracts may need to be reviewed to make sure the proper accounting treatment is followed under IFRS. To improve the efficiency of this process, a contract database could be created (if not already in place) to monitor the IFRS conversion and tracking of effects.
- Many P&IP companies participate in joint ventures, contracts, and other agreements that they don’t directly control. Thus, it can be difficult to obtain all the necessary information to accurately convert to IFRS. For example, trying to identify the components of a plant that was funded — but not built — by your company may prove vexing. In such instances, you may want to reassess (and potentially revise) your requirements for financial and accounting information from the joint venture.
- The IFRS conversion may trigger the need to amend contracts with financial institutions and joint venture partners in regards to financial accounting information to be supplied by your company. You may have to reword certain sections to address regulatory or third-party requirements to replace U.S. GAAP information with IFRS information.

Technology

IFRS is expected to have wide-ranging impacts at different levels of the IT systems architecture (chart C). For P&IP companies this will be a challenge, since many are either operating with disparate technology platforms or undertaking significant ERP projects to address this condition. You'll want to give early consideration to the potential demands that IFRS will have on either existing or planned systems. Virtually all applications and interfaces in a system's architecture could be affected, from the upstream or source of data to the farthest end of the reporting tools. As such, time and resource needs may be significant.

As you plan changes to your IT systems, you will need to take into account external factors such as local and international regulations, financial consolidation of subsidiaries, stock markets, and external auditors. The business transformation should not be considered a one-step project. It may be necessary to implement short-term initiatives strategically designed to institute an effective long-term solution for the organization.

The European Experience

U.S. based companies have a unique opportunity to learn from the efforts of European companies to adopt IFRS. In July 2002, the European Parliament passed legislation requiring listed companies to convert to IFRS by 2005. The short timeframe and extensive reach of the directive had many companies scrambling to comply. Anecdotal reports from the field suggest that the conversion placed significant resource pressure – human and financial – on finance teams and their companies at large.

A more tangible measurement of the effort can be found by comparing European companies' 2004 (local GAAP) and 2005 (IFRS) financial statements. The latter averaged more than 50 percent longer than the former; in some instances, reports doubled in length. Much of the increase can be attributed to an increased level of disclosure in the financial statements in areas such as judgments made and assumptions used.

Chart C. Potential Technology Impacts

Upstream Source Systems and Transformation Layer	General Ledger and Financial Applications	Reporting Data Warehouse Planning and Calculation Engines	Downstream Reporting Capabilities
Differences in the accounting treatment between current accounting standards and IFRS will create a need for new input data.	Differences in the accounting treatment between current accounting standards and IFRS will likely drive changes to general ledger design, chart of accounts, as well as sub-ledgers and feeds.	IFRS has much more extensive disclosure requirements, requiring regular reporting and usage of financial data that may not be standardized in current data models.	The differences that arise in the accounting treatment between current accounting standards and IFRS will create a need for changes in reporting.
Data and transactions that are captured, stored and ultimately sent to the financial systems may not have all the needed attributes or qualities.	Multinational companies may ultimately realize a need to re-develop general ledger platforms or additional sets of books to ensure compliance with multiple financial reporting requirements.	Increased need for documented assumptions, sensitivity analyses; potential factors that could affect future development may expand the scope of information managed by financial systems.	Assumption changes from period to period can introduce significant volatility and require detailed support for derivation and rationale for changes, requiring design of additional reports.
Sub ledgers within the ERP may have additional functionality to support IFRS that is currently not being utilized but could be implemented.	Multi-ledger accounting functionality within newer releases of ERP's may be considered for long-term solutions.	Reporting warehouse feeds to calculation engines may need to be adjusted in a standardized way to support reporting processes.	External reporting templates will likely require revisions to reflect IFRS requirements.
Transformation layer not likely to have been designed with IFRS in mind; data sender/receiver structures may need to be adjusted.	Changes to IFRS will likely necessitate redesigned accounting, reporting, consolidation, and reconciliation processes, which may impact configurations of the financial applications.	Data governance functions and meta data repositories (potentially including data dictionary, ETL & business intelligence tools) may need to be adjusted to reflect revised data models.	Increased disclosures such as sensitivity tests and roll-forwards may require additional ad hoc query capabilities.
Over time the potential for acquisitions of companies using IFRS will increase; altering source systems and Extract, Transform and Load (ETL) tools to provide all needed data elements will make integrations significantly more efficient.	Differences that arise in accounting treatment between current accounting standards and IFRS may create a need for new expense allocations and other calculations.	Current valuation systems may not have functionality to handle IFRS requirements.	

Certain accounting issues proved especially vexing during the transition, including asset impairments, financial instruments, and lease accounting.

Among the lessons learned from the European experience were the following:

- **The effort was often underestimated.** The original perception that conversion was solely an accounting issue was replaced with a growing realization that the initiative was much larger and more complex.
- **Projects often lacked a holistic approach.** Because of the limited view cited above, companies frequently did not take the collateral effects into consideration, such as the impacts on IT, HR, and tax.
- **A late start often resulted in escalation of costs.** Those few companies that anticipated conversion and took steps to prepare for it were in much better shape than those that did not. Companies that delayed their response paid a price for it, in terms of higher costs and greater diversion of resources.
- **Many companies did not achieve "business as usual" state for IFRS reporting.** The highest quality financial data is obtained when companies fully integrate IFRS into their systems and processes. The compressed timeframes precluded this possibility; instead, first-year financials were often produced using extraordinary, labor-intensive, and unsustainable measures.

Several companies are only now starting to explore benefits from IFRS implementation. Due to multiple constraints, the first-year effort in the EU was focused more on "getting it done." Potential benefits in terms of reducing complexity, increasing efficiency, and decreasing costs had to be deferred.

Smoothing the Transition

If you decide an accelerated IFRS conversion is desirable, here are a few considerations for smoothing implementation:

Leverage existing projects

If you are already going through — or recently completed — an enterprise resource planning (ERP) or finance transformation project, now may be the time to consider IFRS adoption. Recent versions of major ERP systems are designed to accommodate IFRS, which can be mapped in, usually with significant cost savings.

Conduct a trial run

Implementation might be easier if you take a bite-sized approach starting with a single country or reporting entity. Use existing reporting requirements and local country IFRS requirements to your advantage. For example, subsidiaries in countries adopting IFRS over the next 3 years may be good candidates for your trial run. Learn from this initial conversion exercise, and apply the lessons learned to your global rollout down the road.

Consider shared services centers

IFRS might provide a compelling reason to establish shared services centers and to consolidate dozens of local GAAPs into a single reporting standard. Geographically-dispersed finance offices could be reduced or even eliminated in favor of a central finance function, strategically located to take advantage of tax incentives, payroll savings, and facilities cost reductions. In many cases, this concept is already aligned with the strategic direction P&IP companies have taken or are currently considering relative to their finance function.

Strengthen controls

IFRS offers the opportunity to implement standardized frameworks and processes to enhance the overall control environment across external, statutory and management reporting.

Refresh your policies

Conversion to IFRS drives a need to revisit revenue recognition, impairment, share-based payments, cost capitalization, and other accounting policies. In other words, IFRS provides a refresh exercise for accounting policy implementation, with the aim of more accurate and timely financial reporting.

Improve your access to capital

Capital is migrating away from the U.S. for a number of reasons, including the weakness of the dollar, the credit crisis, and the growth of foreign financial centers in Europe and Asia. Regardless of the cause, when it comes to raising capital, trends are clearly global. IFRS can potentially improve liquidity and access to capital by offering greater transparency, in the form of full and better disclosure, to investors.

Access to capital may also be enhanced by virtue of aligning with a common standard. Markets and investors have been demanding a common standard for years, and IFRS has increasingly served that need. As such, companies reporting under IFRS may have an improved ability to access other capital markets that have adopted the standard.

Time for Leadership

You are in an enviable position because you possess knowledge that many others in your organization may not: the movement toward IFRS is inexorable and the initiative involves multiple corporate functions, not solely finance.

So you have a choice: either sit back and wait for it to happen (with all the attendant uncertainty and risk) or mobilize your company to attempt to extract every possible benefit and dodge every avoidable obstacle.

In other words, it's time for leadership.

By starting now, you will likely spread out your costs, get the jump on your competition, and reel in scarce talent before it vanishes. You can avoid the fire-drill atmosphere that characterizes most last-minute projects. You can improve your processes and systems. You can integrate with other initiatives, such as an ERP upgrade or a merger or acquisition. Most important, you can do it on your own terms, at a pace that suits your company and its circumstances.

As noted previously, P&IP companies are faced with addressing several strategic drivers that are placing significant demands on their financial and human resources. An IFRS project cannot be a distraction from the primary activities of your business. It must be integrated, coordinated, and aligned. It starts now with some preliminary questions and a carefully drawn roadmap. And it ends somewhere in the next decade when you report for the first time under a single unified standard. Whether the journey from here to there is rocky or smooth may be entirely up to you.

Resources

As a result of our thousands of IFRS-experienced professionals in our global network, Deloitte can provide a comprehensive array of services related to IFRS. As a multidisciplinary organization, we can help companies address a wide range of the issues that IFRS will challenge them with.

Deloitte offers companies assistance with:

- Evaluating the potential impacts of IFRS
- Assessing readiness for IFRS conversions
- Implementing IFRS conversions, providing support with technical research, project management, and training
- Addressing the implications of IFRS in such areas as tax, finance operations, technology, and valuation

Deloitte's U.S. Process & Industrial Products Practice:

For more than 100 years, Deloitte and its predecessor firms have served the Process & Industrial Products industry. In fact, Deloitte currently serves 95% of the Process & Industrial Products companies included in the 2008 Fortune 500 list of companies. We continue to assist chemical, metal, paper, and industrial products manufacturers develop and execute growth strategies, streamline processes, improve cost structures, improve productivity, and achieve profitability, allowing them to remain flexible and competitive in an ever changing marketplace.

Deloitte's Online Resources:

For a wealth of online resources related to IFRS, visit www.deloitte.com/us/ifrs. Available materials include newsletters, whitepapers, pocket guides, timelines, webcasts, podcasts, and more.

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