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Audit Committee Brief

Making the transition to IFRS: The role of the audit committee

Most countries either have converted to or are converting to International Financial Reporting Standards (IFRS) and U.S. companies are taking notice.

Currently, IFRS is used for public reporting in more than 100 countries throughout the world. Other countries, namely Argentina, Brazil, Canada, Chile, India, Mexico, and South Korea, will follow in the next couple of years. Japan expects to decide by 2012 whether it will mandate the use of IFRS. Shortly, many of these countries will permit or require the use of IFRS for local statutory purposes.

Audit committees have an important role in overseeing the development of a comprehensive IFRS implementation program, including understanding how potential risks surrounding conversion are being addressed and assisting in setting the tone for an effective IFRS implementation program. Indeed, early involvement from the audit committee can help provide the appropriate level of management attention for an IFRS implementation program.

"These developments have re-energized discussions on the future of IFRS in the U.S.," said D.J. Gannon, partner, Deloitte & Touche LLP. "The movement toward a single set of global accounting standards is on the radar of U.S. company executives, who must increasingly evaluate and assess their organizations' preparedness for IFRS adoption."

Market and regulatory signals can change quickly, often prompting questions and considerations for companies. Recent events advancing the IFRS discussions in the United States include:

- SEC Chairman Mary Schapiro and Chief Accountant James Kroeker have said that the proposed IFRS roadmap will be a priority, and indicated that the SEC will address the issue in the fourth quarter of 2009.
- In September 2009, the Group of Twenty (G-20) leaders issued a statement following its summit in Pittsburgh, calling on international accounting bodies to redouble their efforts to "achieve a single set of high-quality, global accounting standards within the context of their independent standard-setting process, and complete their convergence project by June 2011."
- Issued in November 2008, the SEC's proposed IFRS roadmap outlined a timetable and related milestones for mandatory transition to IFRS beginning in 2014 for large accelerated filers. Also included in the roadmap were proposed rules changes that would allow certain U.S. issuers to use IFRS earlier.
- In early November 2009, the IASB and the FASB issued a statement reiterating their commitment to complete major convergence projects by 2011.

"These developments have re-energized discussions on the future of IFRS in the U.S.," said D.J. Gannon, partner, Deloitte & Touche LLP. "The movement toward a single set of global accounting standards is on the radar of U.S. company executives, who must increasingly evaluate and assess their organizations' preparedness for IFRS adoption." The specific path for IFRS adoption in the United States has not been finalized, but additional clarity and next steps are expected from the SEC in the near term.

Steps the audit committee can take

Many audit committees are broadening their knowledge of IFRS issues, deepening their proficiency in the technical aspects, and engaging management on the considerations associated with adoption. Recognizing that compliance with IFRS will be critical and that identifying potential risks and benefits is essential for achieving a cost-effective and well-managed transition, forward-thinking audit committees are taking a closer look at IFRS and what it means for their organizations.

The audit committee, along with other board committees and management, can help develop the company's strategic plan on IFRS. Through insightful discussion, members of the audit committee can clarify and help shape a company's IFRS direction and strategy.

To begin to set expectations for the organization, the audit committee may consider the following actions:

Set the tone. The audit committee can be a leader in establishing IFRS as an important initiative the organization must prepare for and cannot ignore. This helps provide appropriate buy-in from functions and business units. Raising key questions early may ultimately determine the optimal adoption approach and help establish the proper tone at the top.

Determine timing. Audit committee members should be involved early in setting a timeline and budget for transition. Under the SEC's proposed roadmap, if an organization plans to report under IFRS in 2014, an opening balance sheet as of January 1, 2012, will be required. Under this proposal, the infrastructure to facilitate IFRS reporting would need to be developed starting in 2010. The amount of time companies have to prepare may be less than expected.

Refresh policies. IFRS provides an opportunity to reconsider accounting policy elections and implementation. Audit committees must understand and oversee policy elections, with a focus on achieving greater transparency and improved financial reporting. Conversion to IFRS may require a review of fixed-asset componentization, inventories, derivatives, revenue recognition, and other accounting policies. Ask management to identify activities and decisions that need to be reviewed by the audit committee. There are also first-time IFRS adoption elections to consider.

Know what is—and isn't—mission-critical. Consider short- and long-term planning issues to determine what the company needs to do now versus later. Asking questions and consulting with management and board committees can drive the answers to those questions. Be mindful of opportunities in the IFRS conversion process that could translate into longer-term benefits, such as increased standardization and centralization of statutory reporting.

Understand the risks. Be aware of potential risks, including the implications of waiting too long to develop a plan. Also, because IFRS contains fewer bright-line rules and detailed application guidance than U.S. GAAP, it requires the use of more professional judgment. The audit committee should understand how management will ensure that IFRS is applied consistently throughout the organization.

Determine the need for audit committee education. If the audit committee does not have a sufficient understanding of IFRS to exercise the appropriate level of oversight, it could result in the adoption of inappropriate policy elections. The committee should develop a plan that outlines timely education for all members and should consider the implication that IFRS could have on the listing standard's financial literacy requirements. Building proficiency will allow audit committee members to lead a productive dialogue and provide useful insights in IFRS planning discussions.

Use time to your advantage. Positioning the company for obtaining long-term benefits from an IFRS transition starts with early planning. With sufficient lead time, potential problems and issues can be identified and addressed in a cost-effective way.

Considerations for the audit committee

- What educational needs and goals does the audit committee have?
- Has the audit committee considered the implications IFRS may have on the financial-expert designation?
- Does the audit committee have an oversight plan for IFRS adoption, including the implementation process?
- How will the audit committee remain informed about changes and the impacts of the company's IFRS transition?
- How will IFRS adoption affect the duties and responsibilities of the audit committee for internal control and financial statement disclosures?
- Is the audit committee aware of the accounting policy elections and various implications for the organization?
- What are the tax and systems implications of an IFRS implementation?

Steps companies are taking

As U.S. executives await next steps from the SEC, many are preparing their organizations for change and mobilizing around IFRS planning and transition activities. Many companies have undertaken activities to identify potential areas of significant impact. According to a recent Deloitte survey[1], 80 percent of U.S. financial executive respondents said that their companies are involved with an IFRS assessment; half are performing or have performed a high-level IFRS assessment, while the other half plan to perform one.

Given the broader implications that IFRS may have, company executives are finding the need to take a more holistic approach to those assessments—beyond considering solely the technical accounting differences. For example, tax structures may be affected as a result of IFRS being used by subsidiaries for

[1] *"IFRS Survey Results 2009: Update on views and activities," Deloitte Development LLC, September 2009. Survey results are solely the thoughts and opinions of survey participants and are not necessarily representative of the total population of finance professionals.*

statutory reporting purposes, changes in information technology infrastructure may be needed to address such areas as parallel reporting during the transition period, and agreements such as loans and leases may require revisions.

A high-level IFRS assessment generally includes the following:

- **Identifying the affects of IFRS throughout the organization** – Analyzing the potential effects of IFRS throughout the organization, focusing not only on the impacts to accounting and systems, but also in such areas as income taxes, sales contracts, loan agreements, and employee compensation arrangements. Global companies are getting a glimpse of the impact of IFRS in countries where their subsidiaries file IFRS financial statements for statutory purposes.
- **Determining project interdependencies and lead-times** – Mapping the necessary implementation actions and calculating the time needed to complete such actions, as well as considering the interrelationship among activities, both related and unrelated to IFRS. This includes factoring IFRS into current or upcoming systems implementation projects.
- **Estimating resource needs** – Developing an estimate of the time, materials, and cost needed to complete the implementation, based on the previous steps.

The product of a well-executed IFRS assessment is usually a company-specific roadmap that enables an orderly migration to IFRS, while anticipating and mitigating risk and facilitating greater value for the organization.

"Those companies with plans and strategies in place will not only be better equipped to address IFRS-related changes, but they will also reap the benefits of IFRS sooner," said Alfred Popken, principal, Deloitte & Touche LLP.

A well-planned roadmap may allow a company to generate value from an exercise that could otherwise be reactive or compliance-driven. The map may lead to reduced implementation costs, standardization and centralization of statutory reporting activities and related controls, potential tax savings in certain areas, greater consistency of accounting policy application, among others.

In terms of timing, a three- to five-year timeline is considered a reasonable estimate for a transition to IFRS. Those U.S. companies that take advantage of the lead time are better positioned to manage a cost-effective conversion.

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When the European Union converted to IFRS in 2005, many companies experienced an unpleasant journey driven by regulatory deadlines. Without the luxury of time, many European companies were forced to rush the conversion, which led to inefficiencies and ineffectiveness.

Case Study: Statutory Reporting Simplified with IFRS

With limited visibility into the statutory reporting processes and requirements, a large global company with more than 100 subsidiaries in 70 countries was not fully aware of its existing risk exposure at the subsidiary level or opportunities to simplify its reporting. A comprehensive evaluation of the IFRS landscape facing the company and its subsidiaries, as well as an assessment of readiness for an IFRS conversion, enabled the company to identify improvements in its financial tax-reporting processes, its treasury processes, and internal controls.

In helping to streamline the global finance organization, other benefits, including cost savings and opportunities for simplification, were also identified.

Key questions for the audit committee to ask executive management

- Has the company conducted an inventory its current IFRS reporting requirements, if any?
- What is the level of IFRS knowledge in the company, both domestically and globally?
- Are the company's competitors reporting under IFRS? If not, is there an expectation that they would switch to IFRS, if given a choice in the United States?
- How would the company be affected if IFRS were required in the United States?
- Has the company developed a plan for adopting IFRS?

Conclusion

The audit committee's involvement in developing the company's IFRS strategy is essential for meeting its central fiduciary responsibilities of providing effective oversight of regulatory compliance, risk, performance, strategic direction, financial reporting, and considering shareholder interest. Audit committee members can begin contributing to their organization's successful IFRS effort now by serving as a guiding force in positioning the organization to achieve strategic, operational, and economic benefits.

For additional resources please visit the Center for Corporate Governance IFRS page, Deloitte's IFRS Resource Library, and the IAS Plus website.

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