

CFO insights: IFRS: Are Your ERP Systems Ready?

Accounting standards worldwide are shifting to or converging with International Financial Reporting Standards (IFRS). For enterprises affected by this shift, it will likely require changes and modifications to the existing Enterprise Resource Planning (ERP) systems used to collect and report financial data. The movement to IFRS can impact key processes and systems in treasury, payroll, general ledger, financial instruments and asset management, to name a few. If companies have started — or are about to start — an ERP or finance transformation project, now could also be the time to factor in IFRS considerations. Recent versions of major ERP systems have been designed to incorporate IFRS. Thus, a finance transformation project conducted in conjunction with an IFRS assessment that effectively maps IFRS-related changes into the ERP can yield efficiencies for both initiatives, which could be significant depending on the facts and circumstances.

Convergence or Conversion: Understanding Emerging ERP Requirements

Accounting policies still remain in flux and the convergence agenda continues to gain momentum. But whether regulators ultimately converge with or convert to IFRS, it is important to evaluate the likely impacts on ERP under both scenarios. Given the lead times for system changes, it is better to understand the capabilities of current ERP systems in meeting emerging accounting policies than waiting until every detail has been finalized.

The convergence of U.S. Generally Accepted Accounting Principles (GAAP) with IFRS has the potential for immediate and significant impact on ERP systems in areas such as revenue recognition and leases (see a recent CFO Insights paper on IFRS convergence). Companies using “percentage of completion” for revenue recognition and bundling different types of revenue together in the same billing document may have to make system and process changes to comply with new requirements (e.g., “unbundling” of service revenue). Convergence to IFRS on lease accounting also reinforces demands on ERP systems to correctly track leases. Under IFRS, substantially more leases are likely to come onto balance sheet. ERP — or related systems — will have to support the need to track how these leases are capitalized and amortized, and how specific lease terms are interpreted and measured. Thus, if a company has a significant number of leases, the ERP or related systems will have to accommodate any impact resulting from the changes in lease accounting.

Future conversion to IFRS would entail further changes to ERP systems. Two areas for consideration that could require significant change include:

- **Accounting for research and development (R&D)** — Under IFRS, certain costs related to the development phase of a project would now be capitalized and amortized. The major ERP systems will need to support this accounting change. For example, consider a global manufacturing company with distributed R&D operations consisting of about 4,000 engineers. With a conversion to IFRS, the company will have to design a process to capture the engineering activities, and determine whether those activities constitute “research” or “development,” with any development-related costs being capitalized and amortized. Typically, this means that engineers may be



required to track their time against a specific project or program. The burden exists for the finance team to make sure these engineers understand how to charge their time to different products and programs. Finally, prior to the date of IFRS conversion, finance will have to evaluate and determine the opening balance for specific programs.

- **Fixed assets** – IFRS often leads to a greater componentization of the assets. Consider the example of a chemical company with multiple plants where one plant may cover over 250 acres. Trying to figure out what the components are in each part of the plant might prove to be a challenging task. Thus, CFOs and the finance and accounting organization need to decide what components should be capitalized per the IFRS rules. These decisions then need to be reflected in information systems so that expense and capitalization information is correctly captured.

Both convergence and conversion efforts potentially require significant changes to systems. The above examples only illustrate some of the critical areas for CFO consideration.

Dual Reporting: The Systems Challenge

If the Securities and Exchange Commission (SEC) decides to mandate the use of IFRS for public companies, an overarching systems issue arises around dual reporting. SEC reporting requirements require three years of audited U.S. GAAP income statements and statements of cash flows for public issuers. If the SEC applies this requirement to the adoption of IFRS, this would create a requirement for “dual” or “parallel” accounting and financial reporting during a transition period. To illustrate, if IFRS is required for the years ending on or after December 15, 2015, a calendar year company would report using IFRS for the years ending December 31, 2013, 2014, and 2015 in its December 31, 2015, financial statements even though it previously prepared U.S. GAAP financial statements for the years ending December 31, 2013, and 2014.

To meet such a requirement, ERP systems will need to support the ability to produce U.S. GAAP and IFRS statements simultaneously during this period. For most companies, this will likely require some combination of refinements at the consolidation level, general ledger level, and within specific sub-systems, and each of these refinements will need to be planned, integrated and tested, to be sure that the dual reporting requirements can be met.

Action Points to IFRS Adoption

The first step to dealing with the systems implications of IFRS is to assess how convergence or conversion will impact information and system requirements beyond existing ERP capabilities. What are the major areas where financial statement reporting will require new information and process changes? If a finance organization team is undertaking IFRS convergence/conversion assessments, an evaluation of the needed information and system changes should generally be part of their assessment agenda.

The next step is to define the accounting policies the company will implement to be consistent with IFRS. While there could potentially be a range of permissible interpretations of new accounting standards, companies should apply their judgment to best interpret these principles and convert them to policies. For example, as discussed earlier, the level of componentization that a company will choose in addressing fixed assets is an important determination. These choices should drive the design of ERP system refinements.

Following a framing of accounting policies, CFOs would then choose how to adapt systems to meet needs arising from IFRS. Are separate systems to support IFRS convergence cheaper and more effective than fully integrating the changes now or later into an ERP system? At what level should the integration occur and what are the related cost-benefit tradeoffs? Guidance for these choices has to come from how to implement and execute new accounting policies. Similarly, IFRS can be supported by mapping from the U.S. GAAP general ledger to IFRS and “layering” adjusting journal entries – but this may not be the ideal approach due to the incremental reconciliation considerations that will typically exist in such a situation.

While IFRS generates new systems requirements, CFOs can use the shift to IFRS to examine the level of information they have today and if there is potential value in getting more detailed information to support the finance clients in the business units. The move to IFRS can be used as a lever to drive a more comprehensive improvement in management information systems or to consider shared service solutions to reduce costs. Savvy CFOs will use IFRS as a catalyst for implementing meaningful change and performance improvements in their organizations.

Convergence with or conversion to IFRS is already underway in many countries. Given the lead times required to adapt systems, CFOs are well advised to consider how best to prepare for IFRS. This could include forming a core team to look closely at how existing system capabilities address IFRS, frame the company's accounting policies that drive information requirements, and decide their level of commitment to change existing systems. This includes deciding whether to use IFRS as a catalyst for transforming and improving management information systems, or only making minor changes to existing ERP infrastructures. Regardless of the choices, it is critical for CFOs to play the role of a catalyst in a transition to IFRS, and for finance to substantively contribute to managing the transformation of key systems and processes.

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