

## International Financial Reporting Standards for U.S. Companies: *Planning for IFRS Adoption*

More U.S. executives—within finance and beyond—are beginning to look closely at the movement toward International Financial Reporting Standards (IFRS) as a basis for financial reporting. This global trend is not easily dismissed: IFRS is here.

Today, the Securities and Exchange Commission (SEC) allows foreign companies in the United States the ability to use IFRS for SEC reporting purposes. In November 2007, the SEC eliminated the longstanding requirement to reconcile financial statements to U.S. Generally Accepted Accounting Principles (U.S. GAAP) for those foreign private issuers that use IFRS, as published by the International Accounting Standards Board (IASB). Now, the SEC is focusing on IFRS for domestic U.S. companies—with further announcements expected soon.

A shift to IFRS here in the U.S is expected to occur through the full adoption of IFRS rather than through a gradual convergence of IFRS and U.S. GAAP—perhaps with the exception of certain long-standing convergence projects. Historically, convergence has involved incremental changes to accounting standards. Given the increased activity around IFRS in the United States, it is likely that the ultimate conversion to IFRS within the next several years will overtake the need for further convergence.

Charged with leading the finance organization, CFOs must keep current on important accounting trends that raise both opportunity and risk for the organization. Developing a response and plan around IFRS implementation is becoming increasingly important to help the organization navigate through considerable change. Having weighed the challenges and benefits associated with IFRS, some companies—especially those with global operations—have taken steps toward developing and implementing an IFRS strategy that positions them for the future.

So, how can company leaders—especially in finance—begin to plan properly for tomorrow's IFRS world?

### Planning for IFRS Implementation: Pre-work

Company leaders need to get familiar with “big picture” issues to fully understand the impact a move to IFRS will have on their organizations. Gaining this perspective will help determine an approach that coordinates key constituents, considers the organization's current state of readiness, and identifies priorities to inform the development of an eventual IFRS implementation strategy. This pre-work is the initial stage for leaders to get a better sense of the type of change the organization can expect when it's time to implement IFRS.

Whether a company ultimately decides to address IFRS from a perspective of minimizing differences with U.S. GAAP or resolves to take a “fresh start” route (preparing to apply IFRS as if it had always used the standards), companies will need to go through initial planning.

Understanding the impact of IFRS on various aspects of a company is important to preparing a successful implementation. The planning process typically includes assessing technical accounting, tax, internal processes and statutory reporting, technology infrastructure and organizational issues. This publication presents an overview for each of these areas followed by practical steps to help executives engage in the planning process today.

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## Technical Accounting

CFOs, controllers, and chief accounting officers should expect technical accounting challenges when moving from U.S. GAAP to IFRS. Companies will need to take into account more than measurable differences between the two sets of standards—it will also be necessary to develop a framework and approach that can be used to determine appropriate accounting. Key considerations include:

- *Principles versus rules.* A move to principles-based accounting will require a change in mindset and approach. In U.S. GAAP, the volume of rules is large—perhaps larger than any other GAAP in the world. However, once the correct rule is identified, there should be a sound accounting outcome. IFRS has fewer detailed rules and more judgment is generally required to determine how to account for a transaction. Under IFRS, there is increased focus on the substance of transactions. Evaluating whether the accounting presentation reflects the economic reality and ensuring that similar transactions are accounted for consistently are important steps to determining the appropriate treatment under IFRS. Public company CEOs and CFOs will be required to make certifications on IFRS financial statements in filings with the SEC. Companies will need to ensure that when judgments are challenged they can sufficiently support them.
- *Application considerations.* Accounting differences between IFRS and U.S. GAAP will vary. Some differences will be significant; others will be seen in the details, or depend on the company's industry. Accounting alternatives should be evaluated from a global perspective – not only for prospective policy-setting, but also in making elections and applying exemptions related to retrospective IFRS application upon initial adoption. Those companies that approach IFRS from a perspective of minimizing differences with U.S. GAAP may record adjustments only where required.

Others that take the “fresh start” will consider adopting new accounting policies in additional areas where the outcome is more representative of the underlying economics. Overall, the technical accounting aspects of IFRS adoption will be challenging.

- *First time adoption considerations.* IFRS 1, *First-time Adoption of International Financial Reporting Standards*, grants limited exemptions from the need to comply with certain aspects of IFRS upon initial adoption, where the cost of compliance could potentially exceed the benefits to users of financial statements. Exemptions exist in many areas, such as business combinations, share-based payments, and certain aspects of accounting for financial instruments. Companies will need to decide which exemptions are the appropriate ones to use.



### Technical accounting action steps for financial executives:

- *Understand key areas of IFRS and U.S. GAAP differences.* There will be many differences between U.S. GAAP and IFRS to assess. Some will require minor modifications and others will have a significant impact on the organization. Identifying these differences and determining the level of effort required by the organization to address these changes is an important step in developing an IFRS conversion strategy.
- *Determine the accounting policy impact of differences.* The differences between IFRS and U.S. GAAP may also impact many current accounting policies. Some areas of accounting will require different policies under IFRS as compared with U.S. GAAP due to a clear difference in standards. In other areas, there will be no differences and in others still, there may or may not be differences, depending on a company's choices under IFRS. Understanding and addressing the necessary policy changes will also be an important step towards conversion.

## Tax

Understanding tax consequences of IFRS will be important for finance and tax executives to consider – if they'd like to help support appropriate tax results for the organization down the road. As with any tax accounting issue, the effort for an IFRS conversion will require close collaboration between finance and tax departments. Key considerations include:

- *Conversion timing.* Consider developments around Financial Accounting Standard No. 109, *Accounting for Income Taxes* (FAS 109). Should the FASB revise FAS 109, changes to the financial reporting of income taxes may occur in two stages: first the adoption of a revised FAS 109 standard for reporting under U.S. GAAP resulting from the convergence project underway by the IASB and FASB; and second the conversion to IAS 12, *Income Taxes*, in place of FAS 109 as a result of a full conversion to IFRS. In the absence of such a revision, adoption of IAS 12 would occur as part of a full conversion.
- *Differences in Accounting for Income Taxes.* Although IAS 12 and FAS 109 have much in common, differences currently exist between the two standards. Many of these differences are expected to be eliminated as a result of the joint IASB/FASB convergence effort. However, some areas of divergence will remain, including, for example, uncertain tax positions, leveraged leases, and deferred taxes related to share-based payments.
- *Tax accounting methods.* Companies that make the most of a conversion to IFRS will approach the undertaking as more than a mere “IAS 12 vs. FAS 109” exercise. It is important to address the tax consequences of the pre-tax differences between IFRS and local GAAP because a conversion to IFRS requires changes to several financial accounting methods. Since the starting point in most jurisdictions for the calculation of taxable income is book income as reported in accordance with local GAAP, companies may need to re-evaluate their existing tax accounting methods.

- *Global tax planning.* Global tax planning may need to be revisited to address the potential changes associated with conversion timetables in all jurisdictions and ultimately a full IFRS global conversion. For example, tax planning in connection with IFRS should consider changes in the global effective tax rate that may arise as a result of the following:
  - The requirement under IAS 12 rather than FAS 109 to recognize both current and deferred taxes on the intercompany sale of inventory and other assets.
  - The requirement under IAS 12 to recognize deferred taxes on exchange rate fluctuations for temporary differences of foreign subsidiaries that use the U.S. dollar as their functional currency.

**Conversion and convergence.** These two words sound alike, but have very different meanings. Conversion is the overall transition to a new set of accounting standards; convergence is the rewrite of one accounting standard at a time. What some people may not realize is that conversion and convergence may come at different points of time. The timeline for U.S. companies to voluntarily convert to IFRS may occur as early as 2011 and as early as 2013 for mandatory conversion. The timeline for convergence or changes to standards for *Accounting for Income Taxes* under IFRS or U.S. GAAP, however, could apply sooner. Thus, companies will need to plan for not only the timing of conversion and convergence, but also the interplay of other standards with their income tax planning.

A conversion to IFRS may also impact the calculation of the parent's basis in its foreign subsidiaries and thereby influence cash repatriation plans.

Proper planning should involve an analysis of the tax results both before and after an IFRS conversion. Also, to the extent the realization of a tax benefit depends on the pre-tax statutory books, consideration should be given to the desirability and timing of conversion for individual legal entities and jurisdictions.

Finally, IFRS conversion is a global phenomenon. As IFRS standards converge with U.S. GAAP, the change impacts all entities in jurisdictions filing under IFRS. To the extent that local tax rules are based on accounting standards, there may be a corresponding impact on the tax attributes of a subsidiary in that jurisdiction. And the U.S. is not the only jurisdiction contemplating convergence with, or conversion to, IFRS standards. Japan is undertaking several projects to converge its standards with IFRS. Any time a local or global accounting standard changes, there is a potential for an impact on tax attributes of the entities in those jurisdictions.

#### **Tax action steps for finance and tax leaders to address:**

- *Determine changes to key tax positions, provisions, processes, and technology.* An IFRS tax assessment is likely to identify tax positions and tax accounting methods that may be impacted by changes to financial reporting standards. Tax professionals should consider performing a high level impact analysis that highlights potential changes to the tax provision in the following areas:
  - Deferred income tax
  - Current income tax on a country-by-country basis
  - Indirect tax (VAT, GST, etc.)

- Based on the results of this analysis, companies can begin to assess the impact of conversion on tax processes and technology.
- *Identify and inventory tax issues and opportunities.* Another important step in a conversion to IFRS involves identification of first-time adoption issues, such as conversion elections available under transitional tax rules and other IFRS accounting standards that may have an impact. Taking an inventory of tax issues and planning opportunities, as well as developing a roadmap to address overall IFRS tax conversion issues, will be important to capture the tax related costs and benefits associated with a conversion. Additionally, a well thought out plan will help prioritize and incorporate significant tax issues into the overall conversion timeline.

## **Internal Processes and Statutory Reporting:**

A move towards a single set of global accounting standards is expected to lead to greater efficiency and internal control improvements for multinational companies. To make this move and to realize benefits, a number of financial reporting processes will likely have to be evaluated and/or fine-tuned. Key considerations include:

- *Close and Consolidation.* A move to IFRS may require changes in charts of accounts to ensure relevant information is captured appropriately. It could involve changing current corporate consolidation processes, or adjusting the existing close calendar.
- *Management Reporting.* It is likely that metrics used as the basis for measuring performance in management reporting will be impacted by a change to IFRS. There may be a need to develop new performance metrics to measure performance and benchmark against competitors.
- *Internal Controls.* A move to a new basis of accounting, including a shift from rules to principles and changes to financial systems, will affect the internal control environment. Documentation will need to be updated and processes put in place to mitigate new risks.
- *Statutory Reporting.* For many U.S.-based multinational companies, IFRS statutory reporting is already a reality at some subsidiaries. Historically, statutory reporting has primarily been accomplished at international locations and has received less attention at a corporate level. However, in an IFRS environment, the potential for adoption of a consistent set of accounting standards at many locations, causes a need for consistent application throughout the organization — it also creates an opportunity for standardizing and centralizing statutory reporting activities.

#### **Internal processes and statutory reporting action steps:**

- *Take an IFRS inventory.* Inventory your current IFRS reporting requirements and locations to understand the extent to which you may already be reporting under IFRS, or where it is now permissible, and identify the resources you have within your organization to assist in the IFRS effort.
- *Review IFRS application.* It is also important to assess how consistently IFRS accounting policies are applied at all IFRS reporting locations.



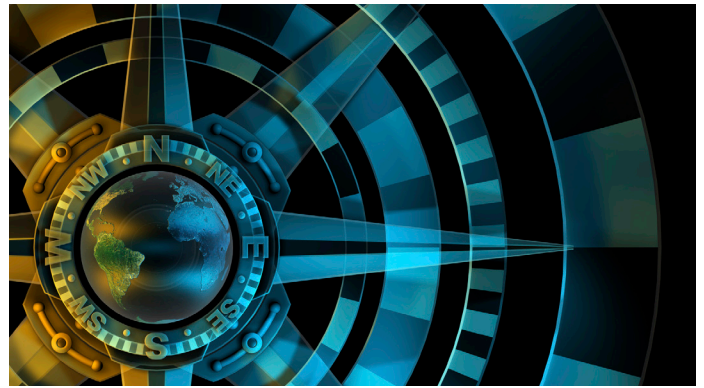
## Technology Infrastructure:

Changes in accounting policies and financial reporting processes can also have a significant impact on a company's financial systems and reporting infrastructure. These changes may require some adjustments to financial reporting systems, existing interfaces and underlying databases to incorporate specific data to support IFRS reporting. CFOs will need to collaborate with their IT counterparts to review systems implications of IFRS. Key considerations include:

- *Upstream Systems.* The transition from local GAAPs to IFRS can often result in additional reporting requirements in complex areas such as taxes, financial instruments, share-based payments and fixed assets, to name a few. Not only may system adjustments be necessary to address these complex areas, but also modifications to the interfaces between these source systems and the general ledger may also be required. In instances where this information is currently being gathered through the use of complex spreadsheets, the adoption of IFRS may serve as a catalyst that some companies may need to bring about long overdue updates to these processes and make critical adjustments for supporting source systems.
- *General Ledger.* IFRS conversions may require changes to the chart of accounts and modifications to capture IFRS-specific data requirements. In addition, during the transition to IFRS, general ledger reporting will likely need to accommodate multiple ledgers (under U.S. GAAP and IFRS) and the maintenance of multiple ledger structures during transition will require planning. In the long term however, conversions can also provide the opportunity to streamline your financial reporting systems by reducing the number of general ledgers previously required under a local GAAP reporting structure.
- *Reporting Data Warehouse.* Current systems may not have the functionality to handle IFRS requirements, so changes in financial information requirements due to IFRS should be identified – and the impact of these requirements on the existing data models should be assessed. Valuation systems and actuarial models will also need to be evaluated to accommodate IFRS changes.
- *Downstream Reporting.* The conversion to IFRS can also result in changes to the number of consolidated entities, mapping structures and financial statement reporting formats, all of which will require adjustments to the consolidation system. External reporting templates will need to be evaluated to identify changes necessary to support increased or different disclosures under IFRS.

### Technology infrastructure action steps for CFOs and IT leaders to discuss:

- *Determine IFRS impact on technical infrastructure.* Once the scope and extent of technical accounting differences have been identified, an important next step is determining the impact on information systems and system interfaces. IFRS can have broad implications on front end systems, general ledgers, sub-ledgers and reporting applications that may all need to be evaluated as part of an impact analysis.
- *Identify the impact on existing system projects.* As new systems projects are scoped and planned, it is important to align these project requirements with the likely impact of IFRS reporting.



## Organizational Issues:

Organizational changes that are this pervasive require planning, communication, and training throughout the organization. Another important aspect of the planning process is considering organizational issues that, when identified up front, can help pave the way and support the eventual IFRS implementation.

Key considerations for human resources and finance leaders to review include:

- *Organizational Readiness.* An important step to assessing the impact of IFRS is to understand the company's current awareness of IFRS and determine what type of education program will be needed. In addition to having an internal communication strategy, other awareness-building activities, such as executive briefing sessions and workshops, should also be considered to help develop consensus regarding IFRS initiatives.
- *Training and Learning.* IFRS training should extend beyond the technical accounting personnel and may pose a significant challenge for organizations. A conversion to IFRS will require stakeholders throughout the company to be trained appropriately. This will require training or workshops to address ongoing learning needs.
- *Stakeholder Communication.* Converting to IFRS also means anticipating the information and communication needs of external stakeholder groups, including the board, shareholders, lenders, and analysts, among others. For example, financial knowledge for board members related to IFRS will need to be supported.

### Organizational action steps:

- *Conduct a key stakeholder analysis.* IFRS can have many impacts on an organization. Identifying target audiences and stakeholder groups impacted by IFRS and assessing their current level of understanding and communication needs is an important step in planning for the impacts of IFRS.
- *Develop IFRS communication and training plans.* Communication and training will be an essential element in effectively planning for and managing the necessary changes resulting from an IFRS conversion. Establishing a proactive plan to address the near and long-term training and communication requirements for each stakeholder group can further support the overall IFRS plan.

## Strategy and Timeline for IFRS Implementation

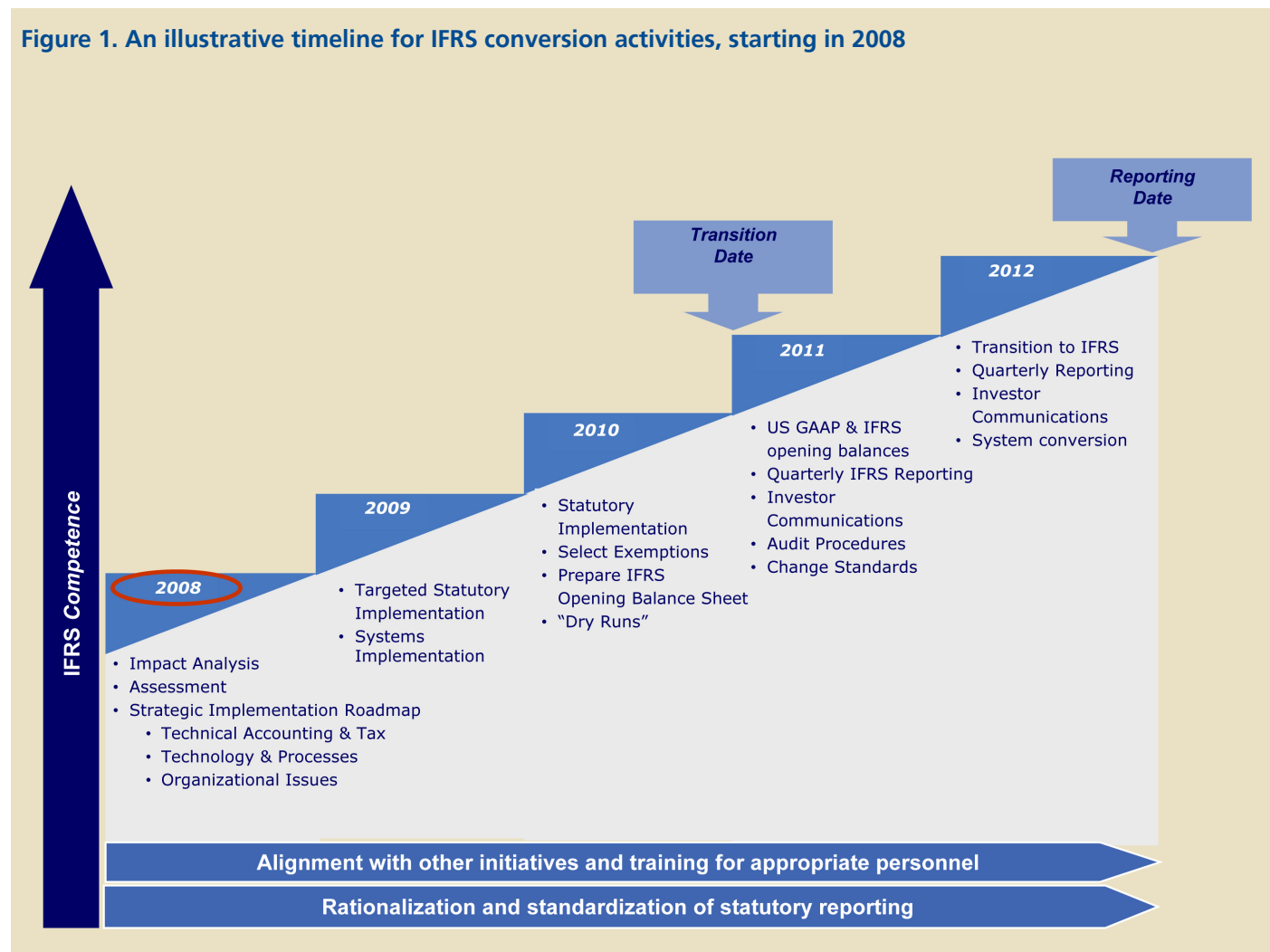
The conversion to IFRS will require an approach and timeline that can accomplish a measured transition to IFRS and ultimately achieve a sustainable IFRS reporting structure. The timeline for IFRS implementation is likely to take longer than many companies initially anticipate, as was seen in the EU experience. Reasons for this include: the comparative financial statements that will be required upon adoption; the retrospective nature of implementation; and the pervasiveness of many of the impacts of IFRS. Ultimately, companies will have to set up a structure to implement IFRS. Developing a holistic plan now can help properly equip the company for upcoming changes.

While conversion to IFRS on a consolidated basis may not be mandated for another few years, companies can start taking advantage of opportunities to convert to IFRS for statutory

reporting purposes now by developing a multi-year strategy for conversion and sustainability (see Figure 1 for an overview of what companies will need to focus on in the next several years, starting with planning efforts today). Many countries already permit the use of IFRS. These provide an opportunity to develop a multi-year strategy and a detailed roadmap for conversion to IFRS. By leveraging the training and experience gained on these statutory conversions, companies will be better positioned to execute a consolidated IFRS conversion in the near future.

Before a company can get to the implementation stage, the CFO, along with leaders from key areas of the organization, will need to proactively confer to: increase awareness of IFRS, assess the company's current capabilities to address IFRS smoothly, and plan the best approach and training needs. Understanding the impact to these areas will help inform the development of the roadmap. Smart planning can provide companies with advantages that global competitors may already have.

**Figure 1. An illustrative timeline for IFRS conversion activities, starting in 2008**



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