

# COMPLIANCE WEEK

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## How to Prepare for the IFRS Tsunami

By Tammy Whitehouse — July 1, 2008

Death, taxes—and now, conversion to international accounting standards. It's that real.

David Schmid at PricewaterhouseCoopers says he was frustrated for months by the number of non-believers he confronted. Players in U.S. capital markets simply weren't prepared to accept that the United States would eventually move to adopt International Financial Reporting Standards.



"I couldn't get anyone to listen to me," says Schmid, PwC's leader of a consulting group solely dedicated to IFRS. "Now everyone is listening to me. Our message on the street is that it's inevitable in the United States. It seems like the message has finally taken hold."

Schmid

U.S. Generally Accepted Accounting Standards have existed since the 1930s, rising up from the ashes of the historic 1929 crash that plunged the United States into the Great Depression. By contrast, International Financial Reporting Standards got their start only in the early 1970s. That's when accounting groups from a handful of countries, including the United States, formed the International Accounting Standards Committee (the predecessor to today's International Accounting Standards Board) to begin establishing a global accounting rulebook.

The U.S. capital markets grew in size and complexity for decades following U.S. GAAP—and so, U.S. GAAP grew right along with them.

Still, an increasingly global economy became ever more intrigued with a global accounting standard. By 2005, when the European Commission required international standards for companies listed on European Union exchanges, the United States no longer stood as the largest capital market system in the world.

Now the Securities and Exchange Commission is the tipping point. It already has bent to international pressure to allow non-U.S. companies reporting under IFRS to list on U.S. exchanges without reconciling their financial statements to GAAP. The SEC is widely expected in coming months to make some kind of further determination that if foreign companies can do business in the U.S. following IFRS rather than GAAP, U.S. companies should be allowed the same.



Rudolf

That conclusion, whatever it may allow or require, is expected to begin a cascade of “choices” and eventually requirements that will haul U.S. financial reporting into the IFRS world. “A lot of people think it will be mandatory somewhere in the timeframe of 2013 or 2014,” says Hans-Peter Rudolf, an executive with Crowe Chizek’s assurance and financial advisory services. “It will happen. We just don’t know the form, the extent, or the timing.”

Gary Iliano, partner-in-charge of international and domestic accounting for Grant Thornton, says the accounting and finance professions have never seen a shift as substantial as the one coming. “This is the biggest change ever,” he says. “Before, we would implement a standard or two in a given year, which was hard enough to do. This will be major.”

### **What’s Ahead?**

For corporate finance staff responsible for preparing financial statements, the thought of throwing out the GAAP rulebook in favor of a new system of accounting is daunting at the least. PwC’s Schmid says there’s no time like the present to get started.

“There’s a great opportunity right now in the United States for CFOs and controllers to really take stock of a multiphase conversion project,” he says.

In a number of countries where IFRS is already followed, and especially in the European Union, companies faced deadlines to convert their existing accounting to adapt to IFRS. Schmid says since the move to IFRS seems apparent enough in the United States now, but no date has yet been set, companies have more lead-time to prepare.

“They can go into the process now and be sensitive to the company’s culture, to the strategic arc, personnel, other competing priorities,” Schmid says. “They can set the tone and speed that works for the company, rather than works toward some externally imposed goal.”

And they’ll need that lead-time, according to accounting and IFRS experts from the Big 4 firms and consulting firms. “One of the things seen in the European conversion in 2005 is that it’s a lot like a home improvement project,” Crowe’s Rudolf says. “Whatever your best expectation is regarding the timing required, it will probably take twice as long and twice as many resources as you expect.”



Wright

In the earliest stages, companies need to consider broad and deep issues such as how the financial statements themselves will change, how accounting systems and information gathering should change to support the new requirements, and how people need retraining to learn and understand a new accounting system, says Chris Wright, managing director at consulting firm Protiviti. “Now is a good time to reflect on whether you have the people, the processes, and the technology to do a project of this type,” he says.

Wright contends that a conversion to IFRS would be even bigger than the implementation of the internal control reporting and auditing requirements of Sarbanes-Oxley. But in the case of IFRS, companies have a lot more warning that it's coming.

"Most people think it shouldn't be required for several years because it's not yet truly international," says Wright. "But if you think about how many years of financial statements a public company needs to report, it tends to be three years of financial statements and two years of P&Ls [profit and loss statements]." That means an optional or mandatory adoption, even five to seven years into the future, would require IFRS-processed numbers as soon as three to five years from now.

"It's incumbent upon company executives to begin educating themselves, their boards, and their audit committees now about what this is going to mean," says Danita Ostling, a partner with Ernst & Young and leader of the firm's Americas IFRS group. "It doesn't mean they have to take on any real conversion work yet. But it does mean they need to begin informing themselves and becoming more conversant."

Some accounting firms are advising clients to begin assessments and project planning now, so they won't be caught flatfooted when the SEC maps out a specific conversion path. The exact details of how IFRS and GAAP rules differ will be the easy part, they say; plenty of resources are available to provide side-by-side comparison of the two systems.

Instead, experts say, focus on the assessment or diagnostic process. Rebecca Albarelli, global practice leader of finance operations for Jefferson Wells, says that first step will result in a long list of big issues to consider.

"Financial statement presentation is going to change," she says. "How you account for business combinations, consolidation, inventory, how you value assets and liabilities, leases, taxes—the list goes on and on. Where are the opportunities, and where is the biggest negative impact? Where would the most time be required?"

Aside from the accounting itself, secondary concerns will arise as well, such as contractual agreements based on GAAP measures, loan agreements, debt covenants, employment contracts, and even performance metrics embedded in the way a company operates, Albarelli says. And then there's the small matter of internal controls, and how to comply with Sarbanes-Oxley while the whole system of financial reporting is changed.



Munter

Paul Munter, an audit partner at KPMG, says companies will want to think about training people in IFRS, but they'll want to move cautiously. "If you train a large number of people then don't use that training for a significant period of time, that's not the most cost-effective way to do it," he says. "But you need some people with significant knowledge of IFRS to help in the gap analysis and to be leaders of the project team."

Larger companies may already have staff in other countries who are up to speed in IFRS and can help with the U.S. transition, while medium or smaller companies may have to think about using outside resources.



Osnoss

As with any major undertaking, it all starts with tone at the top, says Joel Osnoss, a leader with Deloitte & Touche's global IFRS group. "Let's face it. People are 150 percent busy," he says. "We don't have a lot of time to focus on IFRS now. Even when the SEC comes out with a timeframe and it's potentially five to six years before anyone is required to adopt, it's always going to take a back-burner position unless you set the tone at the top.

"Companies on the cutting edge of this are forming steering committees with people at virtually the highest levels of the organization," says Osnoss. "You don't want to wait for the SEC edict on this."

#### EXPERTS SPEAK ON IFRS

**Below is an excerpt from a KPMG report summarizing the views of various parties that participated in Europe's move to adopt IFRS.**

- **Implementation fury reversed.** While IFRS implementation was widely criticized when it was introduced, many now believe it has gone more smoothly than expected. As a result, non-Western regions such as Asia are introducing the standards.
- **Complexity more understandable.** There has been much debate over the complexity of IFRS and compromised understandability. However, many believe that the standards reflect the complex nature of the transactions they report on and provide more transparency.
- **Rules versus principles unresolved.** There is a difference of opinion between professionals who advocate the 'rule-book approach' to the standards and those who prefer a more 'principles-based' system which allows for judgments to be made. These inevitably lead to inconsistencies.
- **Waiting for the Securities and Exchange Commission.** A major issue for U.S. listed companies was their obligation to report separately to the SEC in addition to their IFRS reporting. It is hoped that once the SEC understands IFRS, reconciliation between the two standards will occur decreasing the reporting burden on companies.
- **The downside of convergence.** Bringing reporting rules together around the world (convergence) has the advantage of removing the risks to international investment, but there are disadvantages. Is the information produced useful to the general public? Absolutely consistent interpretation and strict enforcement is required. Conceptual issues also arise.
- **Concern over fair value.** One of these conceptual issues concerns accounting for fair value. Under IFRS the boundaries are considered unclear and too theoretical.
- **Uncertainty on interpretations.** Different regimes may interpret IFRS differently,

with local regulators becoming involved in interpretations when only the standard-setters should. Some feel interpretations should be left to the CFOs.

- **Warning to regulators.** Regulators require certainty but, in their efforts to achieve this, they can undermine IFRS. Regulators can demand restatement if a company uses one method when the regulator prefers another.
- **The role of auditors.** It is felt that IFRS puts responsibility back on the auditors, but some felt that they still had much to learn and that advice regarding standards was slow in coming from some auditors. Others feel that auditors were instrumental in the smooth adoption of IFRS. It is important that auditors be consistent on a worldwide basis.
- **Investors.** It is felt that there is more information under IFRS for investors but also that that data is more complex and requires more detailed analysis. Global investment is advantaged through the use of a global language for numbers. Some, however, are concerned that the owners, employees and the wider public have become secondary to the investors as users of the accounts.
- **Importance of narrative reporting.** One way to deal with complex numbers is to have more narrative reporting such as the Operating and Financial Review, and the Management Discussion and Analysis. These management commentaries will become more critical to explain actions and give information beyond that encapsulated in the numbers.
- **The future.** Generally, professionals are optimistic about the future for IFRS. Many believe it will bed down and continue to be adopted by more countries. It is believed by some that the issues will be 'ironed out' and that eventually one global standard will be accepted worldwide. However, some thought that there could be a situation where there was a European IFRS and a US IFRS. Some thought that the state of flux could continue.

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### Source

KPMG: International Financial Reporting Standards (IFRS).

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