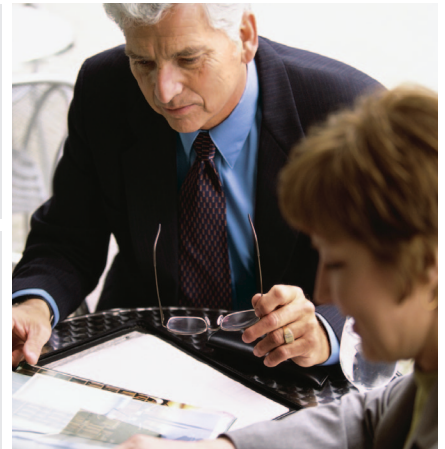


IFRS: OPPORTUNITY OR NIGHTMARE?



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By almost all accounts, the transition from U.S. generally accepted accounting principles (GAAP) to international financial reporting standards (IFRS) is inevitable.

The U.S. Securities and Exchange Commission (SEC) has established a roadmap for transitioning U.S. filers from U.S. GAAP to IFRS. The difficult question for filers is, how soon should I begin to implement IFRS?

While a theoretical debate has swirled around this topic, companies need to roll-up their sleeves and begin to consider the question practically - what does IFRS mean to my organization? Is this a chance to build a better finance function or is it merely a compliance activity? Does this initiative represent a real opportunity or an impending nightmare?

BACKGROUND

Pressure for the adoption of IFRS in the U.S. is coming from two major sources.

First, the U.S. stands alone as the last major financial market to set a date for IFRS adoption. Europe, Canada, Japan, China, Australia and over 100 other countries either are currently reporting financial results pursuant to some form of IFRS or have committed to do so by 2011. While the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have devoted time and energy to convergence, the process

has taken longer than expected. Many U.S. companies perceive the delay as a barrier to competing in the global financial markets.

Second, until recently, the U.S. has accepted financial statements prepared under IFRS, as long as the foreign private issuer reconciled to U.S. GAAP in filings with the SEC. At its November 15, 2007, meeting, the SEC voted to eliminate the reconciliation requirement, and a recent flurry of activity by the SEC is a signal to many that IFRS is no longer just an issue for foreign private issuers. Since the SEC accepts IFRS as a "high quality" accounting standard, many U.S. filers simply argue that if IFRS is good enough for foreign private issuers, it should also be good enough for U.S. companies.

THE OPPORTUNITY

The transition to IFRS can be thought of as a set of staged activities that place a company in the position to take advantage of improvements sooner and minimize negative financial factors later. This enables companies to match financial reporting and financial market benefits to a company's readiness to implement. In addition, moving down the IFRS pathway enables entities to begin building a solid foundation for a global finance function.

Most accelerated filers approached year-one of Sarbanes-Oxley (SOX) compliance with a "whatever it takes" mentality

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that left them cleaning up messes and streamlining processes in the ensuing years. Beginning an orderly, staged approach to the transition to IFRS allows companies to take advantage of the time available for implementation. By starting now, they can control the timelines, resources and decision-making processes, avoiding an “under-the-gun” approach that made SOX such a negative experience.

Companies should begin with a series of assessments – the impact on the financial statements, organizational readiness, policy consistency, etc. Based on that information they can devise plans to train staff; develop and implement global policies, procedures and processes; and convert specific entities before making a final transition to IFRS for SEC reporting. The results of a recent survey by the Corporate Executive Board’s Controller’s Leadership Roundtable support this approach. According to the survey, 85 percent of respondents found that implementing IFRS for internal reporting before filing externally was a useful practice. In the United States, United Technologies Corporation, DuPont, Eaton, PepsiCo and Proctor & Gamble have all begun to assess the impact of IFRS and prepare for its eventual adoption.

Companies can begin to streamline processes that lay the groundwork for the ultimate transition to IFRS, converting when they are fully prepared and mandated for their organization. More importantly, in the end, preparing and transitioning to IFRS provides the opportunity for multinational companies to implement a truly global finance function.

THE IMPACT ON FINANCIAL RESULTS

The impact of IFRS on financial results must be assessed on a company-by-company basis. Given that the United States has industry-specific carve-outs to

IFRS: EVALUATING THE IMPACT

Recently, a Jefferson Wells client, transitioning from U.S. GAAP to IFRS, identified Research & Development as an area of difference affecting its financial statements. Under U.S. GAAP, R&D expenses are not capitalized, while IFRS permits the capitalization of development costs in certain circumstances.

By investing time researching prior labor and other expenses, the client was able to capitalize these development costs under IFRS – affecting both the balance sheet and earnings.

core GAAP principles, accounting effects will be driven by specific accounting treatments in specific industries.

While the IASB and FASB have been working on convergence of their respective standards, significant differences remain. For example, U.S. technology companies find IFRS recognition rules that allow them to recognize revenue sooner under typical technology contracts extremely attractive. In addition, companies that rely heavily on fair values – particularly financial services companies that depend on asset values to support regulatory capital – need to note the different definitions and uses of fair market valuations. Even companies whose balance sheets favor fixed assets can be affected, as IFRS allows the option to report property, plant and equipment using fair value.

In addition, IFRS 1, *First-time Adoption of International Financial Reporting Standards*, requires companies to recognize, derecognize and re-measure assets and liabilities at the date of transition – beginning with the earliest financial year for which comparative information is presented. In general, the effects of changes in accounting policies are recognized in equity in the opening IFRS balance sheet. IFRS 1 does allow a number of optional exemptions that will need to be assessed for their impact on the specific company. Depending on the company’s approach, its key balance sheet ratios and metrics could look substantially different the first time IFRS is implemented. Operating under a dual IFRS and U.S. GAAP system for a period of time will give companies time to evaluate and manage these factors and prepare for the final transition to IFRS.

Given that a transition to IFRS will affect the balance sheet and earnings, companies should include related debt covenants, financing arrangements and compensation plans in their assessments. Contracts and other arrangements should be reviewed, and in some cases modified, to avoid negative operational and cash flow effects. In extreme cases, companies may consider changes to reporting structure and legal entity to either unwind transactions and structures that received favorable treatment under U.S. GAAP or take advantage of reporting under IFRS.

It’s important to remember that contracts a company negotiates today could be accounted for differently under IFRS. Companies should begin reviewing current transactions in this light.

The transition from U.S. GAAP to IFRS will also affect other regulatory and compliance initiatives. For example, the elimination of U.S. last in, first out

(LIFO)-based inventory valuations would change the tax reporting of inventories to the Internal Revenue Service and could cause significant issues for industries that have retained LIFO layers on their books. In addition, financial institution Call Reports will need to reflect changes in reporting standards that support asset valuations. Finally, companies will still have to comply with Sarbanes-Oxley regulations - forcing filers to revisit risk assessments and controls surrounding the additional judgments required under the more principle-based IFRS standards.

Understanding the impact on a company's books and compliance efforts will partially determine when a company needs to start this work. This understanding will also enable companies to begin to alter current transactions - new financing arrangements, acquisitions, contracts, etc. - to position themselves more favorably once IFRS is mandated.

It would be a mistake to focus only on the short-term impact to financial statements. The transition to IFRS presents a tremendous long-term opportunity to streamline processes and improve performance reporting.

THE EFFECT ON FINANCIAL PROCESSES, POLICIES AND CONTROLS

While a transition to IFRS will affect the final financial results, particularly in the transition year, the benefits to profitability and market comparability will quickly be priced into market valuations. Longer-term, a transition to IFRS has the potential to enable companies to make improvements to the internal financial reporting processes and information flow. For the first time, companies can consider the establishment of a truly integrated finance function that supports operations on a global basis.

Initially, companies should examine the differences between policies and controls in its various locations and consider global standardization for policies related to recognition, measurement, presentation and disclosures. Standardization will increase the flexibility of resources and the sharing of deep technical expertise - allowing individuals or work to cross borders. In addition, as IFRS continues its global progression, a truly global market for accounting skills will emerge. By embracing IFRS, companies will reduce the diversity of skills required in the accounting function.

In addition to sharing resources, global policies and procedures make comparing results across

the company far easier. This allows management to gain greater insight into how each unit is operating and compare it to others. This comparability allows senior management to identify leading practices that could be shared or risks that require additional attention. In addition, reporting internal metrics should be simplified, since financial data will be consistent across the company.

Shared policies and procedures will naturally lead to common processes and technology. Common processes enable companies to more rapidly respond to changing regulatory environments as deployment can occur more consistently with less customization. The sharing of policies and processes also enables technology platforms to be designed and deployed consistently - moving closer to the goal of a single, global reporting system. The result should be an enhanced ability to establish shared service centers able to support a broader portion of the company's transaction volume.

As commonality and comparability increases across the company, the finance function may also increase its ability to implement financial controls and monitoring more efficiently. Common policies and procedures reduce the company's number of controls. In addition, common controls support increased use of monitoring to reduce the overall compliance effort. It's easier to assess the effectiveness of a single control by monitoring its operation rather than testing two different controls. The good news is that any investment in streamlining controls in advance of an IFRS implementation will likely produce immediate compliance savings, including SOX and other compliance efforts.

This commonality and comparability of policies, procedures and controls also facilitates streamlined internal and external audits. Fewer disagreements regarding accounting approaches, judgments and increased visibility into consolidations and other financial statement balance roll-ups should reduce the required effort and related fees of auditors. In addition, this enhanced visibility should allow Internal Audit to focus on higher risk events, rather than reviews of different accounting treatments.

Finally, applying IFRS will increase companies' flexibility to purchase or sell business units and entities. Once all jurisdictions are using IFRS, it will be easier to complete due diligence regarding a specific entity and integrate the new entity as its accounting policies and procedures will already be fairly aligned.

As companies initiate their analysis of IFRS, it's important to not only consider what the financial statement balances will look like, but also how IFRS affects the infrastructure used to arrive at those balances. IFRS, and the timeline for implementation, provides finance functions with a reason to re-examine and simplify their accounting policies, processes and technologies across the enterprise. Companies with an eye toward the future can leverage IFRS to build an efficient, flexible accounting infrastructure that streamlines cost, leverages global strengths and enhances enterprisewide decision-making.

ARE YOU READY FOR IFRS?

Efforts of this nature are broad and pervasive – requiring a diverse skill set to implement. Consider the following as you assess your readiness to implement IFRS:

- **Tone at the top set by senior management**

Is senior management committed to taking advantage of the benefits of a truly global finance function or is the implementation of IFRS viewed as just another SEC-driven compliance activity that will divert resources and attention away from the business? Helping top executives understand the operational and decision-making value of implementing IFRS will ensure that appropriate resources are available for the transition effort.

- **Well-documented policies and procedures**

Just as with SOX, if companies have good policies and procedures in place, the amount of streamlining and consolidation work to implement IFRS will be significantly reduced. Good policies and procedures are the foundation for assessing the impact of IFRS on the organization and gaining efficiencies from the globalization of the finance function.

- **Existence of skilled IFRS resources**

Are your employees experienced in working with IFRS? Many multinational companies will have these skill sets in their entities outside of the U.S. Putting in place programs to leverage that experience – for example, rotating employees to roles inside the U.S. for a period of time – could benefit both the individual and the company, while reducing the overall implementation cost by reducing dependence on outside resources. This experience will be key to completing the initial financial statement impact assessment to determine how quickly the organization needs to begin preparing to file under IFRS.

TWO APPROACHES TO IFRS

Consider the examples of two U.S. GAAP-based organizations purchased by a European entity and required to transition to IFRS. The first organization leveraged the IFRS-based policies and procedures of the parent organization – leading to a smooth transition and streamlined external audit. The second organization did not.

The second company struggled. Its U.S.-based controller was unable to appropriately support key accounting judgments and the U.S.-based external audit team – generally unfamiliar with IFRS – expended additional hours resolving disagreements with the European parent over accounting approaches. The controller needed additional assistance to research specific IFRS pronouncements to support policies implemented in the U.S. and resolve disagreements with the external auditor. Like SOX – companies can take advantage of the opportunity to leverage IFRS best practices or IFRS may take advantage of the companies, consuming additional time, money and resources.

- **Existence of IFRS knowledge in key line and operational positions outside of finance**

One risk is that companies focus on training finance personnel on IFRS while business managers are untrained and unable to understand their internal reporting results. Companies should identify the extent to which financial information is distributed within the enterprise and articulate a strategy for preparing key stakeholders to use the financial information.

- **Existence of other key skilled resources**

Do you have the personnel with the breadth of skills necessary to implement IFRS? The implementation will require a broad range of skills – project management, process management, information technology, tax, internal controls, etc. It is wise to pull teams together during the assessment phase to cover the breadth of issues faced.

- **Organizational capacity for making accounting judgments**

Under Sarbanes-Oxley, issuers are limited in the advice they can receive from their audit firms regarding accounting policies and judgments.

These restrictions also apply to the more principle-based IFRS. Companies must either hire staff or partner with a professional services firm that can bring the depth of experience to make and support critical accounting decisions and execute the overall initiative. Locking in those relationships early may prevent resource shortages, audit issues and material weaknesses later.

- **Centralization of operations and complexity of organization**

Companies with centralized finance and control functions that have begun implementing common accounting systems and processes will be substantially ahead of the curve. They will be able to reap the benefits of a faster implementation of IFRS, leveraging the standards to institutionalize this approach further.

More complex and decentralized companies should have increased urgency to assess the implementation effort and establish an underpinning for a common accounting platform. Those steps will often provide immediate benefits in terms of streamlined processes and simplified controls, positioning the companies to move to IFRS.

These decentralized companies may have hidden advantages, as IFRS skills are probably available in foreign subsidiaries. Leveraging those skills, experiences and existing policies and procedures can bring a global organization quickly up to speed on IFRS.

While not a complete list, companies should consider the elements above as they map out their approaches to building global finance functions and prepare to begin filing in the U.S. under IFRS. A broad-based, multi-faceted assessment covering technical accounting issues, financial processes, business performance reporting, internal controls and policy and procedure issues will ensure companies can take advantage of this opportunity, while avoiding another SOX-like compliance nightmare.

RISKS OF IMPLEMENTING IFRS

As with any effort of this nature, companies need to assess their implementation risks. And no plan is complete unless key risks are identified, mitigated and monitored.

IFRS has not been implemented uniformly country to country. Jurisdictional implementations of IFRS could minimize the advantages of comparability

provided by a global standard and require country-specific adaptations to global policies and processes. Companies should evaluate the jurisdictional implications for each operating location and consider how to address any country-specific statutory variations. Establishing an overall global standard with a planned approach to addressing these variations should address this risk.

U.S. GAAP has evolved, with specific rule-based guidance added to clarify and enhance the overarching standards. IFRS does not contain this level of detail – making the determination of appropriate accounting interpretations difficult. One concern is that U.S. standard setters would apply many of the existing industry GAAP rules to the U.S. IFRS implementation, reducing the advantages of moving to a principles-based set of standards and increasing the likelihood of unclear accounting rules that increase the effort to reach appropriate conclusions. Companies will have to implement a robust process for evaluating accounting judgments and escalating key decisions, along with establishing a mechanism to monitor the development of industry-specific accounting treatments over time.

The U.S. accounting industry will need to launch a national program to train and prepare auditors and regulators to implement the new standards. This would likely include updating SEC rules and guidance to reflect IFRS; preparing the Public Company Accounting Oversight Board (PCAOB) staff members for inspections using international standards; updating state certification exams and the implementation of new curriculum at universities. Depending on the rate of implementation of IFRS in the U.S., well prepared, issuers may have a deeper knowledge of IFRS when compared to external audit staff and regulators. Building a robust process for establishing and documenting accounting approaches will support issuers faced with inexperienced auditors or overly aggressive regulators.

CONCLUSION

Companies evaluating the impact of IFRS should assess both the impact to the financial statements and overall operations. While both are important, the market will quickly react to and appropriately value changes to the financial statements.

Transitioning to IFRS provides companies with the opportunity to establish a global finance function – with streamlined operations, policies, processes and controls; consolidated technology;

optimized resources; and improved decision support capabilities. The key is for companies to use the IFRS timeline to make their assessments and turn IFRS into a true opportunity rather than waiting for a nightmare to unfold.

ABOUT JEFFERSON WELLS

Jefferson Wells is a comprehensive solution provider of financial reporting and technical accounting services, including research, documentation, ongoing SEC reporting compliance and knowledge transfer. Because Jefferson Wells does not attest to financial statements, we can support companies in making the transition to IFRS without conflict-of-interest issues.

We provide clients with the full breadth of skills required to assess and implement IFRS - including technical accounting, project management, policy and procedure review and development, tax strategy and implementation, risk management, internal control assessment and implementation, continuous controls monitoring, business performance management, shared service center optimization and financial process improvement.

Experienced Jefferson Wells professionals deliver services in internal audit and controls, technology risk management, tax, and finance and accounting. We serve clients, including Fortune 500 and Global 1000 companies, through highly experienced, salaried professionals working from offices worldwide.