How to navigate through the multi-GAAP reporting maze during an IFRS conversion*

An IFRS publication

*connectedthinking

PRICEWATERHOUSECOOPERS

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The heart of the matter

The need for a dual-reporting environment.

Oftentimes, before a company can embed IFRS as its primary financial reporting standard, it must go through a dual-reporting period during which IFRS and US GAAP financial statements are reconciled. The ability to meet challenging multi-GAAP reporting requirements largely depends upon the magnitude of the IFRS and US GAAP differences, other GAAP and/or regulatory reporting requirements, the capabilities of the company's information systems and the agility of its processes. There are complex issues to address and critical decisions to be made, so the time to begin getting the jump on a smooth conversion to IFRS is now.

To minimize costs and realize the upside of change, management should make smart strategic and tactical decisions *early* in the conversion. That means being quick off the mark to establish a real-world timeline, and taking steps up front to understand the information systems implications. It means recognizing and planning for the complex layers of interdependency between an IFRS conversion and other company-wide projects and regulatory initiatives. And it means exploring the potential multi-GAAP reporting solutions to select the one that best fits your company's specific needs during the dual-reporting period and, where necessary, for a period of time thereafter.

From where we stand, most multinationals should not find it necessary to make wholesale changes in their financial reporting systems to accommodate multi-GAAP reporting requirements. With careful planning and analysis, there is likely a manageable solution with the company's existing systems—or at least a transition strategy that you can implement in conjunction with other broader systems upgrade needs.

The first step in finding that sustainable solution is a thorough analysis of both the as-is state—the modules in use, the level of system customization, reliance on spreadsheets or manual calculations, the complexity of the company's financial business processes and the extent of its organizational structure—and a gap analysis against requirements for both IFRS and other business needs. We recommend evaluating and weighting the pros and cons of each option within your ERP and/or consolidation system to determine the most feasible option for both the short- and long-term solution.

The experiences of companies that have already been through an IFRS conversion have shown that making strategic decisions early in the project prevents duplication of effort, changes in direction and cost overruns at a later stage. For example, many companies that converted to IFRS in the past used a top-side approach. Today, these companies are finding themselves truly embedding IFRS as the primary financial reporting language into their processes and systems. The path to successful conversion does contain some pitfalls to avoid, but they go hand-in-hand with opportunities to improve, streamline and/or standardize financial reporting and supporting business processes and systems.

An in-depth discussion

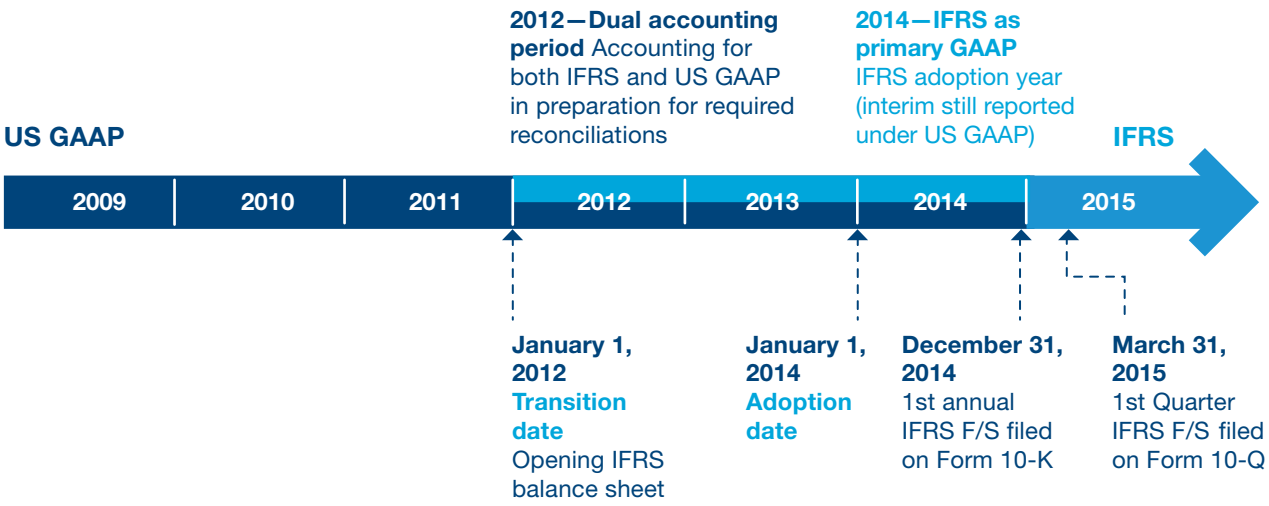
Establishing your adoption date and conversion timeline.

The IFRS adoption date you select serves as the foundation for your conversion timeline and strategic decision-making. So, what might a conversion timeline look like?

On November 14, 2008 the Securities & Exchange Commission (SEC or the "Commission") published its "Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards (IFRS) by U.S. Issuers" (the proposed Roadmap). The SEC will reconvene in 2011 to make a decision on the mandatory use of IFRS by US issuers. Assuming a decision in 2011 to mandate IFRS for US issuers, the proposed Roadmap contemplates a phased transition to IFRS beginning in 2014 for large accelerated filers, 2015 for accelerated filers, and 2016 for remaining public companies. The proposed Roadmap also provides an opportunity for certain qualifying issuers to adopt IFRS as early as fiscal years ending on or after December 15, 2009. While the SEC's requirements are not yet set in stone, for purposes of this example, let's assume you were planning an IFRS adoption date of **December 31, 2014**. In that case, you might be required to prepare statements of income, cash flows and shareholders' equity for the three most recent fiscal years and a balance sheet for the two most recent fiscal years (including an opening balance for the earliest period presented).

Using the year ending December 31, 2014 as your first year of adoption, you would need comparative income statements for **2013** and **2012**, as well as a comparative balance sheet for December 31, 2013 and an opening balance sheet as of **January 1, 2012**. When you publish your first set of IFRS financial statements, some of these comparative periods must be reconciled to US GAAP. The transition period timeline would look like this:

Sample real-world timeline using an adoption date of 2014



Note: Some companies may have a longer multi-GAAP reporting period for other regulatory reasons—for example, those with subsidiaries in other parts of the world that might be reporting under local GAAPs.

With an adoption date of 2014, it may seem as though there is plenty of time for a conversion but, as the transition timeline shows, many companies should be thinking about approaching IFRS in a thoughtful, measured and strategic manner. This is especially true since an IFRS conversion is not just a technical accounting exercise; rather, it impacts the entire organization.

Understanding the impact on information systems. The business as a whole will be impacted by an IFRS conversion, including the processes, controls, data and systems used to facilitate or accommodate the new IFRS accounting policies. In addition, broader business issues related to contract terms, covenants, management reporting and more will likely result from the change to IFRS as the new financial reporting language. As a significant enabler of the business, information systems will obviously be affected by the adoption of IFRS, including changes in configuration settings as well as data mappings during the dual-reporting period and the longer-term to embed IFRS into the business.

The impact of IFRS on Information Systems—two examples:

- In certain sectors, SOP 81-1 and completed contract method of accounting for revenue recognition is used. However, under IFRS, completed contract accounting is not allowed, and revenue must be recognized based on the rights in the contract using either a percentage of completion method or a "recoverable cost" method. As a result, contract terms and conditions may change, requiring sales staff to be more specific about recoverable cost or milestone points; sales staff may require training on the contractual differences and how they sell to their customers; systems may need to be redesigned to capture, process and report different information as it relates to revenues and costs; controls may have to be revamped to handle the changes in the systems and process; and so forth. An accounting policy change will affect related processes and systems, and management should consider in advance how the new policy elections will be operationalized during the company's decision-making process.

- IAS 16 requires that "each part of an item of property, plant and equipment (PP&E) with a cost that is significant in relation to the total cost of the item shall be depreciated separately." Although some US companies may already capture their PP&E at this level and depreciate accordingly, many capitalize PP&E in aggregate (e.g., capitalizing an entire building rather than segregating the major components such as HVAC system, elevators, etc.), or capitalize an entire production line rather than separately identifying the injection molding component from the rest of the line. Once a company converts to IFRS, it should be identifying the material components of PP&E and capitalizing those components separately. This change in accounting policy may drive relevant changes in systems, including enhancements that would allow companies to: track PP&E by component and in aggregate, track cost and depreciation values for both income tax and financial reporting purposes, or track differences in asset depreciation for purposes of reporting under multiple GAAPs. In addition, processes around the purchase and recording of PP&E may need revision, including training of relevant personnel such as capital purchasing staff, PP&E clerks, and tax staff. Finally, companies that perform, or want to perform, cost segregation studies to accelerate depreciation for income tax purposes may find that componentization can lend efficiency to their data collection processes.

It is important that management fully understand the impact of IFRS on the company's information systems—both in the short term to meet immediate demands for versatility and over the long term when there is likely to be a need for more permanent changes. To achieve cost- and time-effective solutions, leading companies are taking a company-wide approach—tying their information systems strategies to their business goals to tackle current information systems challenges and, at the same time, planning for the future state.

Recognizing and managing interdependencies and synergies. In today's dynamic environment, there is never going to be just one change to manage. Typically, management has to cope simultaneously with a mix of regulatory forces, technology advancements, and company-wide initiatives to improve business performance and increased demands from stakeholders. Best-in-class companies will take into consideration all of those different elements, whether external or internal, and overlay IFRS in such a way as to identify and play off interdependencies to gain synergies.

For example, many companies, such as those who use SAP and Oracle, will be upgrading their systems at least once before IFRS becomes mandatory. It makes sense to analyze the company's IFRS needs at the time of the upgrade, in search of opportunities to prepare for or accelerate certain changes, reducing the need for rework and a second potentially expensive initiative later on.

To succeed in effectively managing IFRS conversions that may impact many elements of the business, while ensuring that the implementation is sustainable, it is important to:

- Act now to create and execute a strategy to get you to the future state.
- Go beyond merely focusing on accounting to appropriately scope all impacted elements of the business and include those within the project.
- Examine all significant initiatives for potential synergies with the IFRS conversion, and leverage them to design optimal, robust and sustainable financial reporting and support business processes and systems.
- Recognize that the move toward a single, global set of accounting standards provides an unprecedented opportunity to reduce costs through standardization of financial reporting processes and systems. Seek innovative ways to enhance standardization, including shared services, outsourcing, and moves to a common platform.

Process and Systems Implications

To minimize costs and realize the upside of change, management should make critical decisions early in the conversion process—particularly those related to embedding IFRS as the primary reporting GAAP and selecting multi-GAAP reporting solutions. That means taking steps up front to understand the information systems implications. It means recognizing and planning for the complex layers of interdependency between an IFRS conversion and other company-wide projects and regulatory initiatives. And it means exploring the potential multi-GAAP reporting solutions to select the one that best fits your company's specific needs and challenges during the dual-reporting period and, where necessary, for a period of time thereafter. It also means selecting the optimal multi-GAAP reporting solution in order to make the future changeover to IFRS as the primary reporting GAAP as efficient as possible.

Developing a big-picture approach to an IFRS conversion. There are many issues—both strategic and tactical—to consider during the IFRS conversion process, for example:

- Determining the multi-GAAP reporting solutions and planning to embed IFRS as the primary reporting GAAP
- Standardizing financial reporting systems and processes
- Determining data requirements and using information systems to facilitate the collection, processing and reporting
- Coordinating with regulatory and statutory reporting requirements

By looking at the big picture in terms of company size, industry, business goals, people competencies/skill sets, etc.—planning ahead to meet both short- and long-term needs and making decisions accordingly early in the conversion process—management can take steps to reduce the financial costs inherent in gearing up for the IFRS conversion.

Determining multi-GAAP solutions and embedding IFRS as the primary GAAP. As discussed, multi-GAAP reporting will be a necessity for many companies for a period of time, especially during the dual-reporting period where IFRS will need to be reconciled to US GAAP, for certain periods and certain financial statements, in the first set of published IFRS financial statements. Depending on the company's existing technology platform for financial reporting, there could be several methods of handling multi-GAAP reporting, but there is no silver-bullet solution. As management is thinking through the various issues around multi-GAAP reporting—for example, the level at which it should happen (i.e., general ledger or consolidation level)—they should also be thinking about the current state of the accounting systems and processes in terms of what it will take to arrive at the future state, including how the financial systems will have to change to make the cut-over to IFRS as the primary reporting GAAP. *In all likelihood, this will entail source system changes, data mappings, data-quality exercises, and designing and implementing controls.*

Standardizing financial reporting processes and systems. Management may take the IFRS adoption process of standardizing accounting policies as an opportunity to standardize financial reporting processes and systems throughout the global organization. For example, a US multi-national company with subsidiaries around the world may have historically maintained books and records and prepared statutory financial statements using dozens of different GAAPs. With the move to IFRS globally, including the US, the number of GAAPs can be reduced significantly. When a US corporate entity establishes and communicates the IFRS accounting and reporting policies, it may be a prime time to standardize the accounting and reporting processes and systems where IFRS is required (or permitted) in the various countries in which its subsidiaries are registered. *This standardization of processes and systems is not an overnight process, and careful thought is needed to plan and execute in order to achieve cost efficiencies.*

Determining data requirements and using information systems to facilitate the collection, processing and reporting. IFRS will present additional and changed information and disclosures for financial reporting purposes. For example, information contained in the MD&A today regarding risk management strategies and sensitivity analyses may need to be included in the core set of financial statements and subject to audit. Alternatively, account information as it relates to financial instruments may be a new reporting item that must be added to the Chart of Accounts. When a company identifies the data gaps (e.g., the information and disclosures that were not previously reported under US GAAP or subject to the same rigor of controls), management will need a plan to modify processes and systems in order to collect, process, record and report the new information and disclosures, subject to a well-controlled environment. In order to embed IFRS into the organization, management may look to the information systems as the solution, versus developing a topside Excel spreadsheet to deal with the data gaps. *Thoughtful planning is needed when redesigning/configuring systems to handle the new data requirements.*

Coordinating with regulatory and statutory reporting requirements. The number of international regulations pressuring companies today is escalating. IFRS is just one of many issues facing management today; whereas management faced another significant reporting requirement over the last several years—compliance with the Sarbanes-Oxley Act of 2002 (SOX). With these and other significant regulatory reporting requirements combining to place stress on a company's information systems, IFRS conversion projects cannot be considered in a vacuum, but rather, viewed in the context of the big picture.

This is especially true for large multinational companies that must take into account the complex layers of *interdependencies* between an IFRS conversion and other company-wide projects and regulatory initiatives—looking at the whole gamut of regulatory requirements and assessing the overall impact |

on their systems. To cite one instance, when performing an IFRS conversion, SOX compliance will play a significant role in order for management to ensure effective internal control over financial reporting is in place. Using complex spreadsheet models outside of the systems environment, for example, can often pose a control problem.

On the other end of the spectrum, it's risky when changes are made to the systems to handle IFRS without investing sufficient effort in designing and testing the appropriate level of internal control. As IFRS changes are made to impacted systems and processes, they should follow the protocols established by many companies in their sustainable SOX compliance programs.

Resolving the challenges—Reaping the rewards. Management must make decisions about new accounting policies under IFRS *while* keeping control of the other GAAP requirements relevant to the group. This "multi-GAAP" view of the world certainly adds to the complexity of financial reporting. At the same time, an IFRS conversion also brings significant opportunities to seize and rewards to reap.

Multi-GAAP reporting considerations

Many groups throughout the EU and elsewhere have found themselves reporting in local GAAP and preparing group financial statements in IFRS. When IFRS is either optional or mandated, many companies in the US will find themselves in a similar situation. US GAAP reporting may still be required for a period of time for multiple reasons:

- It is expected that companies will be required to provide a reconciliation from IFRS to US GAAP for certain periods and certain financial statements within their first set of published IFRS financial statements.

- Companies may want US GAAP reported financial statements for purposes of management reporting or budgeting and forecasting until they are comfortable with how to interpret the IFRS financial statements.

- Contractual arrangements may require the use of US GAAP financially reported information. For example, debt covenant agreements typically require financial covenants to be calculated using US GAAP. Until those agreements are modified, companies may continue to produce US GAAP financial statements.

- Companies with subsidiaries in countries that do not allow the use of IFRS will still find themselves with a multi-GAAP reporting situation to manage.

- When multi-GAAP reporting on a regular basis is required, there are many options to be considered (both in the general ledger and consolidation system)—each with advantages or disadvantages—in order to arrive at and develop a well-controlled solution.

It is reasonable to expect that most financial reporting systems already in use by large, complex, multinational entities should be able to handle the multi-GAAP reporting for an IFRS conversion. However, the ease of transition may depend on the ERP and/or consolidation system version currently in use and on decisions made at the time of a systems implementation or most recent

upgrade. Another key factor is whether the company intends or needs to give the conversion effect at the general ledger level or in consolidation.
Not surprisingly, we have observed that the major software vendors have introduced improved, more flexible options in anticipation of IFRS becoming more widely accepted. The key, then, is for each company to analyze its as-is state and determine the best path to conversion. Three possible approaches are outlined below:

- **Using an accounts approach.** Many general ledger and consolidation systems allow for the creation or modification of accounts in order to record adjustments in arriving at an alternative GAAP, (e.g., IFRS). For example, new accounts are added for which IFRS adjustments are made and, when combined with the pre-existing US GAAP accounts, produce a set of IFRS financial statements. Alternatively, accounts are modified with a tag of "IFRS" and those accounts are chosen to produce a full set of IFRS financial statements. This approach has the advantage of being possible within virtually all major financial reporting systems, even very early versions. Its many disadvantages include complexity of account structure, parallel maintenance of balance sheet and income statement structures, and a greater risk of error due to the need for manual postings to two sets of accounts. Furthermore, it is difficult to accommodate differing fiscal reporting periods for statutory purposes.

- **Using an entity-based approach.** As an alternative to the accounts approach, some companies may choose to change or modify the entity structure within the general ledger or consolidation system in order to produce multi-GAAP financial statements. For example, one may create an "IFRS Company" in which adjustments are recorded and, when combined

with all other entities, produce a set of IFRS financial statements. Depending on the company's organizational structure, there may be a single IFRS conversion entity or many. This approach, like the accounts approach, can be implemented in most systems with relatively low initial effort. However, it, too, requires additional manual effort to maintain and may be more prone to error. Detective controls should be designed and implemented to mitigate this risk.

- **Using a "mirror" ledger approach.** In some technology solutions, including the most recent versions of widely used financial reporting packages, a second ledger mirrors the primary ledger (e.g., US GAAP) and, either based on automated pre-defined rules or manual input, the second ledger is used to produce an alternative GAAP set of financial statements (e.g., IFRS). This method provides the cleanest separation of US GAAP and IFRS, with less complex postings, and can best accommodate differing fiscal reporting periods for statutory purposes. For many companies, this approach is more difficult to implement, but it is the most sustainable over time.

These are just a sample of generic options available in the most widely used ERP and consolidation systems today. Although they may sound fairly easy to implement, each has its own set of benefits and complexities for management to consider before making a decision to move forward.

Moving and reconciling between GAAPs—Critical during the dual-reporting period! The company's ability to isolate the build of an audit trail from original data capture through to final result—and to drill down on reconciling or adjusting entries—should give management the confidence that their information is complete. Similarly, from a management perspective, the system should have the capability to compare and contrast key performance

indicators between any GAAP and IFRS during the dual-reporting period. A vital requirement of an IFRS-compliant consolidation model is the ability to roam between results in different GAAPs and report them side by side, together with the reconciling differences between them. In practical terms, this means that any of the chart-of-account lines can, if required, be analyzed to any of the applicable GAAPs. The whole consolidation model then becomes completely self-contained and amenable to change.

Also, each IFRS-related change to data stores should be analyzed both for unintended impacts to internal reporting and for possibly beneficial opportunities to carry the changes over to management reports in order to align with IFRS.

Multi-GAAP reporting—Part of a much bigger challenge and opportunity

All stakeholders – both internal and external – should understand the impact of IFRS on performance management and KPIs. Forward-looking statements of performance based on IFRS must be consistent with budgets captured in the operational GAAP. Reporting tools and dashboards must be sufficiently versatile to allow management to monitor, understand and report performance in whatever GAAP or language is desired. In a compliance-oriented culture, where good governance equates to superior management capability, nothing *short of complete oversight of performance and risk* is acceptable.

When considering the multi-GAAP reporting environment, management should ask, and *answer*, these questions in order to better achieve their final goal:

- Are you aware of the current multi-GAAP ERP and consolidation systems solutions? Can your systems provide for the multi-GAAP strategy you want?
- Have you identified the level at which to make systems changes?
- How will you ensure consistency and compliance – especially if your company is global?
- Will your reporting systems effectively cope with new requirements?
- Do you have the right people with the right skills to complete the transition and embed the changes within your company?
- Are you prepared to seize the upside of the change, in terms of increased standardization of systems and processes?

Why it’s important to start planning now.

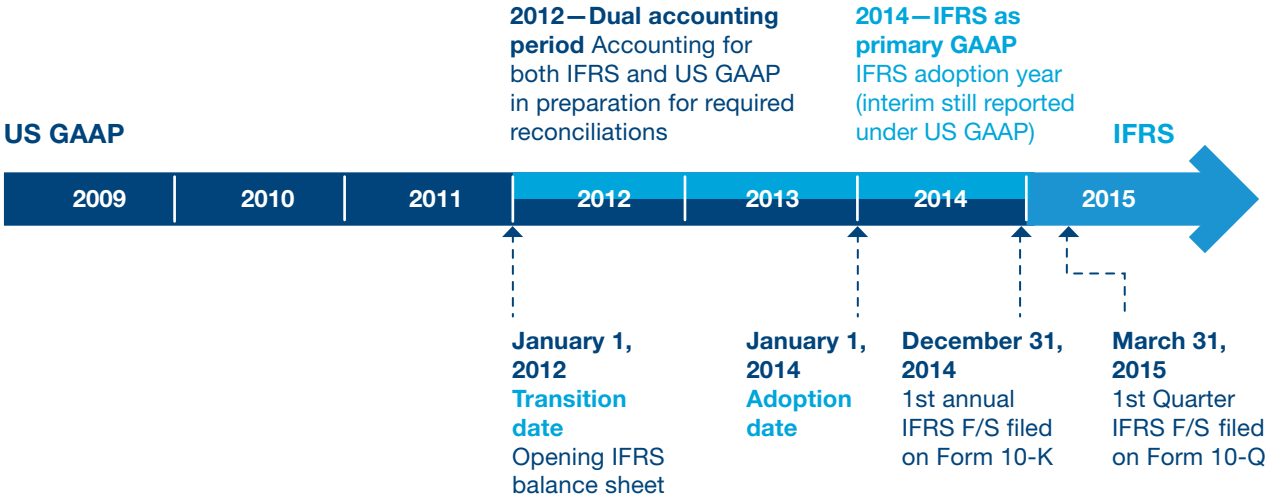
Time matters!

Those companies that are quick off the mark to make critical strategic and tactical decisions early in the process in relation to their adoption date, and that put the right systems and processes in place to support a smooth transition period, are the companies that will be the first to scale the barriers and reap the rewards that can go hand-in-hand with an IFRS conversion.

Looking again at our sample timeline that assumes an adoption date of December 31, 2014, it would seem as though you have the time to back-burner this for a bit to focus on other pressing business issues and initiatives. Not true. The timeline is tighter than it looks at first glance, and being complacent now can cost you down the road.

Now is the time to assess your existing systems capabilities and the efficiency of your processes, and to begin making decisions around enhancing or changing them to handle the requirements during the dual reporting period and thereafter.

Sample real-world timeline using an adoption date of 2014



Action steps for a smooth conversion

Finding the right solution and the right option within it. From our perspective most multinationals should not find it necessary to make wholesale changes in their financial reporting systems to accommodate multi-GAAP reporting requirements. With careful planning and analysis, we believe you can find a manageable solution within the company's existing systems—or at least a transition strategy that can be implemented in conjunction with other broader systems upgrade needs.

- **Perform a thorough systems analysis.** Evaluate both the as-is state—the modules in use, the level of system customization, reliance on spreadsheets or manual calculations, etc., the complexity of the company's financial business processes and the extent of its organizational structure—and a gap analysis against requirements for both IFRS and other business needs. It is also important that you consider the future direction of your ERP system, especially if you are using an older version. We recommend evaluating and weighing both the pros and cons of each option within your ERP and/or consolidation system to determine the best feasible option for both the short- and long-term solution.

- **Be diligent.** Exploring the various ERP and systems consolidation tools, and the options offered within each, takes time. But putting in the forethought and investing enough time and effort to getting this right will help to prevent poorly controlled solutions at the back end that could lead to potential reporting issues and costly rework at a later date.

- **Tie your systems strategy and solutions to your company's structure and business strategy.** Not only will your conversion to IFRS be smoother, but you will also benefit from process and cost efficiencies across the board. There may be fewer accounting errors and, at the end of the day, your financial statements will be *sustainable and auditable*.

Sounds great—but you're not done yet! There are other challenges to contend with and other tasks to be carefully considered and planned for before you ultimately make the switch to IFRS as your primary reporting GAAP and achieve standardization. Short-term fixes will need to be replaced with longer-term solutions, system changes may continue to be implemented over time, and controls will likely need to be strengthened as you move forward. Stay tuned for our next paper, where we will address those issues.

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