

It's not the actor, it's the role that counts—How Internal Audit can leverage IFRS

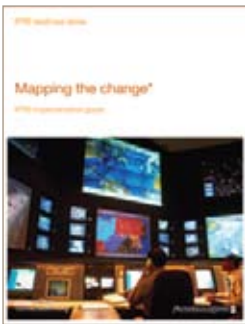
US businesses possess a strength and flexibility not just to weather change, but to lead in efforts to develop pathways forward and to prosper.

—**Dennis M. Nally**
Chairman and Senior Partner
PricewaterhouseCoopers

Internal audit perspectives.

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IFRS Implementation Guide



10Minutes on Transitioning to IFRS

Is Internal Audit (IA) up to the challenge? Among the changes on the horizon is IFRS, which has started to illuminate corporate radar screens during the worst financial downturn in US history. The adoption of IFRS provides IA with an opportunity to get involved in their company's accounting conversion now and stay involved throughout the process.

IFRS is fast becoming the global accounting reporting standard, with more than 100 countries using it or about to adopt it as their global financial reporting framework.¹ The transition to IFRS is not just an accounting exercise. It is a business transformation that goes beyond debits and credits, one that requires an integrated, enterprise-wide approach. The stakes are high, as management's judgments on interpreting IFRS and applying its accounting policies can influence reported results. What's more, implementation challenges will reach far beyond the financial statements and reverberate throughout the enterprise.

IA can be an integral player from the beginning, and chief audit executives should not be shy about demonstrating their skills and experience to assist their organizations through broad change. IA's knowledge of the business and the manner in which data flows into the financial statements make IA personnel ideal members of an IFRS conversion team. In addition to affecting the numbers, IFRS may have a significant impact on company processes, people, and technology. For example, changes to existing disclosures under IFRS may require additional controls over financial reporting. The need to bring additional systems and data within the financial reporting control, primarily due to increased disclosure requirements, could result in a significant amount of changes to the existing Sarbanes-Oxley (SOX) framework and documentation.

IA has already worked with process owners to review and update SOX documentation in many companies and could serve as a valuable resource during an IFRS conversion.

Many businesses overseas, having already implemented IFRS, know the significant impact an IFRS conversion has had and the related challenges their companies have faced during this process. Based on our experience, we see the need for businesses to focus on establishing appropriate and effective means of realigning operations and processes, including accounting, tax, budgeting, internal controls, and training, among many others.

IA can play a valuable role in helping companies work effectively toward a smooth and efficient transition while leveraging the lessons learned from those companies that have already converted to IFRS, thus avoiding the common pitfalls. IA can bring a process, people, and technology mindset to the IFRS conversion effort, helping the organization focus on the implications of what can serve as an opportunity to address other necessary broader organizational change that may be needed.

What's the rush? An IFRS conversion, if mismanaged, can lead to inaccurate and inefficient financial reporting. A well managed IFRS conversion will successfully move a company from rules-based US GAAP to principles-based IFRS. Those companies that undergo an IFRS conversion now may also enable the company to streamline merger and acquisition activity; gain efficiencies in human capital and procurement; and more. But the proper planning in advance of the conversion is critical to realizing these and other potential benefits.

¹ Primarily pertains to listed companies; non-listed companies expected to transition to IFRS for statutory reporting purposes at a later date.

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Starting now The IFRS timeline may fluctuate, but the time to start strategic planning for the crossover is now, so that your company will understand the resource and budget commitment to convert and IA will be prepared when the Audit Committee begins to ask questions. An early assessment can help position the company for a smooth IFRS conversion at a pace that works for the business. Here are key steps that should be taken now to achieve that goal:

- Consider the broad implications for the company's financial and business processes, and any subsidiaries that might adopt IFRS before the parent does.
- Consider the IFRS implications for long-term customer and supplier agreements and for IT enhancements, such as the potential need for maintaining a multi-GAAP environment during the conversion period and—for some companies—the impact on other IT initiatives underway such as new ERP systems.
- Maintain an open dialogue with corporate accounting and finance staff, and business unit finance staff as necessary, to understand the company's plans. Stay abreast of the regulatory developments of IFRS and confirm that management is staying informed and that they have a plan.
- Serve as a resource at the enterprise level by providing updates on IFRS developments to the Audit Committee. Also consider providing information as to the potential broad implications for the business during an IFRS conversion and IA's role.
- If the company should make the decision to convert, IA should get involved in the development and monitoring of a realistic timeline, including the necessary milestones, taking into account key interdependencies on IFRS with other areas (i.e., financial data, accounting changes, and people, process and systems requirements).
- Consider serving as a project management resource to assist the IFRS conversion team. Help the team assess where IFRS may already be in use at foreign subsidiaries and confirm the activities at these subsidiaries are incorporated into the overall conversion plan.

- Assess management's rationale on whether to take an aggressive or conservative approach to the IFRS conversion, and then through the audit process verify that the individual entities within the global organization stay within the boundaries the company has established.

Going forward PwC's *IFRS Implementation Guide* provides a suggested three-phased approach to an IFRS conversion, highlighting objectives, timelines, and key considerations. Based on insights gained through our deep experience with IFRS conversions in dozens of countries, the guide can be used to help management navigate the adoption of IFRS.

Phase 1—Preliminary study

Our experience indicates that a valuable first step is to perform a preliminary study of the broad impact of an IFRS conversion. During this phase, the goal is to gain a high-level understanding of the business impact of IFRS including accounting issues, key ratios and other potential impacts to the business related to process, people and systems. IA should become a key contributor to the IFRS conversion during this phase.

- Understand the goals and objectives of the preliminary study and get involved with project planning. Become a part of the IFRS team from the start.
- Assist with defining the scope of the preliminary assessment and key milestones and deliverables.
- Assess the potential impact on operations, at a high-level, including financial reporting processes, systems, people and information as well as tax and budgeting implications.
- Review diagnostic questionnaires and other tools that may be deployed to facilitate the preliminary assessment.
- Review the organization's IFRS workplan and high-level estimates of resources and costs. Monitor plan progress on an ongoing basis.

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Key questions to consider:

- Does every significant stakeholder have a seat at the table and are they fairly represented?
- Is the right level of project management and reporting in place to keep the Audit Committee and relevant stakeholders informed?
- Has a high-level IFRS conversion road map been established?
- Does the company understand at a high-level, how changes to its accounting policies will impact its people, processes, systems, and operations?
- Has an adequate assessment of the impact of IFRS on the financial statements, including its bearing on required disclosures and tax reporting, been completed?
- Has an assessment been performed to identify the projects and other areas in which IFRS could have an impact now and going forward?
- Have differences between IFRS and US GAAP, such as technical issues and available policy options, been identified?
- Have the change readiness and resiliency of the financial staff to take on IFRS conversion been evaluated?

Phase 2—Project set up, initial conversion, component evaluations, and related issue resolution

The objective of Phase 2 is to establish IFRS policies and prepare the initial IFRS financial results, including designing and implementing an IFRS reporting process during the transition period. During this phase, IA should be proactive in staying involved in the IFRS conversion, assessing the results and progress against the timeline, and communicating their independent assessment on the overall status to its key stakeholders (e.g., Audit Committee).

Key questions to consider:

- Has the proper governance and project management structure, including project team members' roles and responsibilities, been defined and established?

- Does the right level of reporting exist for all IFRS stakeholders (such as the audit committee and senior management)?
- Has the company established adequate plans for training and knowledge transfer?
- Have IFRS policies and procedures been thoroughly vetted across the organization to ensure they will make sense early on and going forward—or is the business in jeopardy of getting locked into decisions that would not make sense after the conversion?
- Has the right data been obtained, mapped to the chart of accounts, and a gap analysis performed to allow for accurate and complete disclosure? Are the necessary controls in place to ensure the data is reliable?
- Have necessary IFRS adjustments for each business unit been analyzed, and issues resolved using standardized policies where possible?
- Have process and system change requirements been identified and prioritized appropriately?
- Does the company's plan for managing dual financial reporting during the transition period make sense? Has a set of financial reporting instructions been developed and communicated to the business units?
- What controls does the company have in place for initial IFRS conversion and where do new controls have to be implemented? What impact will these changes and new controls have on the existing SOX framework?
- Have the post-IFRS adoption Accounting and Financial Reporting processes been tested and compared to expected results by benchmarking an approved draft of annual/quarterly IFRS statements against peers?
- Has an IFRS consolidation and reconciliation to US GAAP been prepared for all required periods?

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Phase 3—Integrate change

The goal of Phase 3 is to ensure that IFRS policies and the changes implemented to systems and processes (i.e., financial reporting, tax and other operational areas) have taken hold within the business to support IFRS as the primary accounting language. IA should stay actively engaged with its stakeholders and ensure that the global business is following the IFRS policies that have been applied.

Key questions to consider:

- Has the company's IFRS conversion been effective?
- Have process and control changes been successfully embedded in the organization in a way that promotes long-term sustainability?
- Have the new requirements regarding data, business, system and related configuration requirements been documented and communicated to the business units?
- Do the company's contractual agreements and financial covenants reflect the new accounting requirements?
- Were pre- and post-implementation tests performed on the new process, controls, and systems?
- Has project progress been monitored and reported accurately to relevant stakeholders?
- Have lessons learned been collected and communicated?

² Securities and Exchange Commission (SEC), International Accounting Standards Board (IASB), and Financial Accounting Standards Board (FASB).

When you wake up tomorrow Help the company begin to develop its strategy for moving forward. A full IFRS conversion may not start today, however you should not wait to begin planning for what will likely happen in the future. Here's what you should be doing now:

- Make sure you are staying abreast of developments at the SEC, IASB, and FASB² concerning adoption of IFRS by companies in the US.
- Begin to develop an IFRS implementation team and develop their training.
- Review the company's IFRS plans and goals and ensure that IA has a role within the overall plan.
- Get involved in the dialogue early and stay involved throughout the process.

Your next move: Read more to know the score. Your source for more information.

PwC has published a series of comprehensive thought leadership on IFRS, including the *IFRS Implementation Guide* and *10Minutes on Transitioning to IFRS*. Other publications related to the tax impacts; multi-GAAP reporting and specific industry implications are also available at www.pwc.com/usifrs.

Contact information

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