

Complying with International Financial Reporting Standards (IFRS)

Getting your systems ready to meet financial
consolidation and reporting requirements

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The heart of the matter

Getting your financial consolidation and reporting systems ready for IFRS conversion.

There's no getting around it. IFRS is coming, and it will impact the majority of organizations, their people, their processes and their technology.

One of the critical technology issues facing today's companies is how to best support their financial consolidation and reporting needs in order to achieve IFRS compliance. This is the unavoidable technology change around the transition to IFRS. The good news is that, with sufficient planning, companies can embed many IFRS requirements into their general ledger and subsystems, thereby removing the need for manual adjustments in their consolidation and reporting system and minimizing compliance risk. This reduces the scope of required updates to the consolidation and reporting system—where the focus should be on adoption of IFRS specific consolidation rules and report layout.

Technology is a key enabler in the transition to IFRS, and the financial consolidation and reporting process in particular. Companies can look at the technology impacts of an IFRS transition in three layers: 1) Financial Consolidation and Reporting, 2) General Ledger, and 3) Subledgers or Subsystems. In this white paper—the first in a series of three—we focus on *Financial Consolidation and Reporting*.

Since most organizations will undergo a phased embedding process to convert from US Generally Accepted Accounting Principles (GAAP) to IFRS, the planning for IFRS systems-readiness has become a burning issue. Many organizations already have a technology road map and may soon be performing upgrades or conversions—undertakings that they should coordinate with their planning for IFRS. Coordinating the transition to IFRS with the technology road map can be challenging, and management is apt to underestimate the amount of time and resources that a successful conversion project requires. Companies in Europe, Asia, and Australia have learned this the hard way. Historically, underestimating the challenge has led some of them to rush this complex process—giving rise to increased risk of errors and/or the need to outsource more work than necessary. This has driven up costs, weakened their control environment and hindered their efforts to embed IFRS knowledge within the company.

That said, conversion brings a one-time opportunity to comprehensively reassess financial reporting, taking a clean-sheet-of-paper approach to financial policies and processes and the technology that supports them.

Given the length of time it takes to change an organization's people, process and technologies, and to adopt governance practices globally, now is the time to assess and plan for the impacts of an IFRS transition on your organization. Those companies that act now to get the jump on IFRS requirements—putting in place an effective methodology supported by people, processes and tools to help them understand the transition impact on their organization—will be among the first to benefit from the adoption of IFRS. Early action will allow companies to control costs, understand and manage the challenging scope of implementation, and allow for a smooth transition plan.

An in-depth discussion

Considerations— Effecting a smooth transition to IFRS.

Most of the world already talks to investors and stakeholders about corporate financial performance in the language of International Financial Reporting Standards (IFRS). All signs suggest that the US will soon follow. By acting now, well in advance of IFRS conversion deadlines, US companies have an opportunity to make time work for them—positioning themselves to gain control over costs, understand and manage implementation challenges, and achieve a smooth transition.

The time frame—shorter than it appears. The recent publication of an IFRS road map by the SEC proposes that 2014 could be the first year that the SEC would allow US-registered companies to file in an IFRS format in the US (with an early adoption in 2009 for companies that qualify). With the current requirement for companies subject to SEC regulations in the US to prepare opening balances plus two years of comparative statements, the first year that comparable IFRS statements would need to be produced is 2012. For companies that only operate in the US, and that have no overseas subsidiaries nor any need to raise capital or debt in overseas markets, a more measured approach to IFRS transition may be appropriate. However, with multiple countries at different stages in the adoption process, organizations should assess how best to time the internal adoption of IFRS accounting standards, and the governance of those standards, as well as the ability to present IFRS statements to the US markets.

Given the length of time taken to change an organization's people, processes and technology, along with the global adoption governance issues, now is the time to assess the impacts of an IFRS transition, and plan to embed IFRS accordingly into the day-to-day operations.

Multi-GAAP reporting—it's not just an accounting exercise! The need to produce financial statements in IFRS format for the capital markets does not eliminate the need to continue to have other financial statement formats on an ongoing basis for tax and other purposes. Thus the concept of multi-GAAP reporting is not only a transition issue but also an ongoing part of doing business. History bears this out. In 2002, when organizations in the European Union embarked on the process of moving from local GAAP to IFRS reporting for an effective date of 2005, many companies did not immediately recognize that this was more than an accounting exercise. As a result, there was a very late response to understanding and effectively managing the impact to an organization's people, processes and technology.

“There's much more disclosure in the year-end reports and accounts, and it took a lot of time to get the data.”

Source: “Our survey says: FDs deliver their judgment on IFRS,” by Sarah Perrin, published by *Financial Director*, May 2006

Due to the lack of long-term planning, many companies only had time to address ways of posting journal entries into their consolidation and financial reporting system. They were unable to address embedding those into the general ledger transaction system and the subledger and subsystems until much later.

However, US companies that plan ahead will be able to adopt leading practices designed to help them achieve a smooth, efficient and effective transition, and to actively deploy technology to facilitate the process.

The fact that this paper looks at impacts on the financial consolidation and reporting system does not imply that this should be considered the only embedding step by organizations. Rather, it is an important first stage.

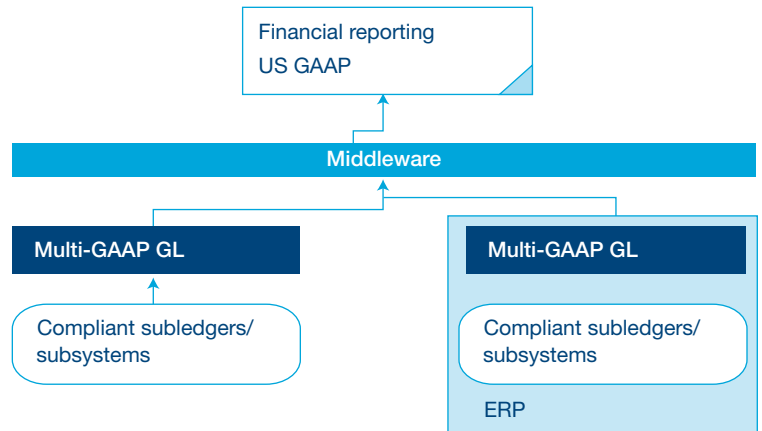
A simplified model of the financial reporting transition process. The following simplified illustrations show a three-stage transition process for the technology supporting the IFRS transition.

“The new financial reporting model is more complex and less understandable. Narrative reporting is needed by shareholders because it provides important information that is not in financial reports.”

Source: “Our survey says: FDs deliver their judgment on IFRS,” by Sarah Perrin, published by *Financial Director*, May 2006

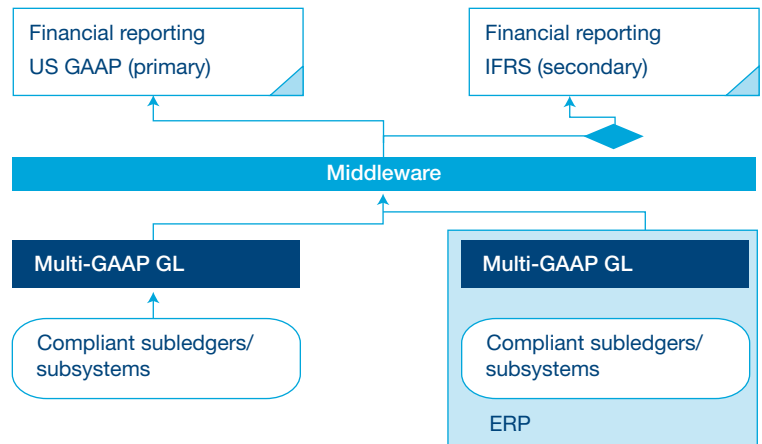
Stage 1:

In the first stage, the current state, the organization is reporting in US GAAP format from its supporting general ledger (GL) and subsystems.



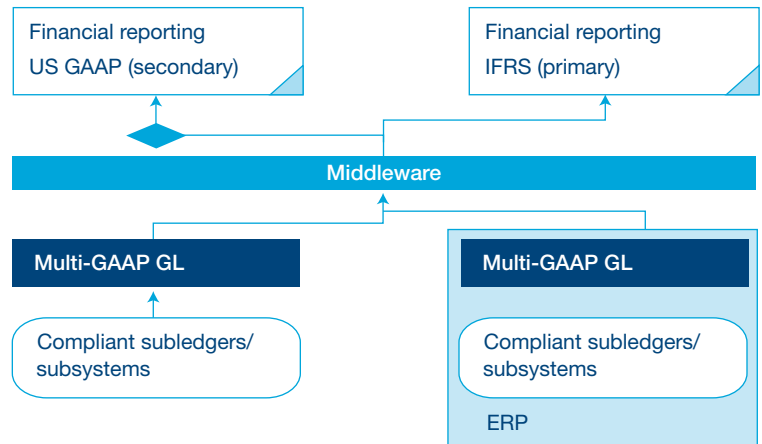
Stage 2:

In the second stage, the same sources of information are being used, however the consolidation and reporting system is now being used to create IFRS compliant financial statements, along with US GAAP statements. Some of the IFRS changes have been embedded into supporting transaction systems (GL level and subledger/subsystems); however, there are some manual adjustments being made within the consolidation system to prepare the IFRS financial statements.



Stage 3:

Over time, the IFRS requirements will be more fully embedded into the supporting transaction systems (GL level and subledgers/subsystems). As this happens, the need to make adjusting entries to prepare the IFRS financial statements will be reduced or eliminated. It is possible that adjusting entries will be needed to prepare US GAAP financial statements (or other statutory, tax or regulatory reporting) as the primary GAAP becomes IFRS and the people, process and technology efficiencies are focused around IFRS. The SEC has established a road map for adoption, but the internal switch to IFRS as the primary accounting language could happen before or after the SEC-proposed date.



Existing financial reporting applications. Technology employed for financial reporting differs widely between organizations, ranging from commercially available consolidation and financial reporting applications to homegrown solutions typically based on Excel spreadsheets. The key aspect to examine in the context of IFRS is whether your application is ready and able to absorb the changes demanded by the adoption of new reporting standards. Look at how and where the existing US GAAP rules have been configured in your existing systems. Have they been hard-coded? Is there scope to add new IFRS rules in parallel without breaking or risking the accuracy of the current reporting environment? Are the rules easy to change? Can they even be changed? How easy would it be to handle two different consolidation scopes—one IFRS and one US GAAP—should additional entities need to be consolidated under IFRS?

Flexibility is key. Many legacy commercial consolidation applications have limited scope for this kind of change. Typically implemented many years ago, they were often significantly customized through scripting. While this will still do the job for US GAAP reporting, adapting such legacy applications to a dual-reporting scenario, encompassing both US GAAP and IFRS, may prove extremely challenging. In our experience, the conversion process is much harder wherever there is significant need for manual intervention, data enrichment (for example, adding additional coding detail to transactions after the fact) or subledger reconciliation.

Modern consolidation and reporting applications, which were explicitly designed with multiple reporting scenarios in mind, offer out-of-the-box infrastructure to manage the dual-reporting process where US GAAP and IFRS rules can be configured in parallel and with ease. Such flexible applications may be easily adapted, leading to a streamlined reporting process and agile reporting, including reconciliation reporting between US GAAP and IFRS (and other reporting requirements if needed). Applications such as SAP® Business Objects™ Planning and Consolidation are already well suited to the transition to IFRS.

Also consider the way in which legacy consolidation applications have been implemented. Are those people that performed the design and configuration still with the organization? Is the intellectual property (IP) still in the business?

In summary, is your existing system capable of taking on the challenge of IFRS reporting in parallel to the US GAAP based reporting performed today—and of doing so without adding unnecessary risk or introducing compliance issues? How much does this cost, and could it be addressed more efficiently through a dedicated, single-reporting solution?

Coping with multiple frameworks through the transition process. Enterprises will not be able to simply switch off US GAAP reporting one day and turn on IFRS the next. There will be a period of transition, and there will be tax and other reporting needs (such as debt covenants) that may continue to be in US GAAP (for a period of time) and other statutory reporting GAAP formats.

For companies subject to SEC regulations in the US, under the current proposal there will be a need for opening balances, plus two years of comparative financial statements. That means organizations must consider not only how to adopt the new IFRS regulations, but also how to navigate through the transition phase (i.e., the period in which the entity is still reporting US GAAP financial statements while developing IFRS financial statements)—and to do so well in advance of the expected mandatory timetable so as to be able to provide the required comparatives. If this were not enough, some international entities will be further challenged by ongoing requirements to produce local GAAP-based reporting in different countries, along with an increasing use of IFRS-based reporting. Finally, individual industry groups (e.g., Utilities, Aerospace/Defense, and Financial Services) have specific additional reporting requirements that must continue to be satisfied through the transition process.

Historically, the challenges have been many. Experience in Europe (where IFRS was mandated for publicly listed companies in the EU in 2005) indicates that the transition process is likely to introduce additional challenges beyond mere multi-GAAP reporting. For example, there will be a need to produce reconciliation reports that explain differences between the reporting frameworks to stakeholders, additional disclosures and commentary will be required, and the volume of data collected from subsidiaries will increase, which could introduce delays in closing and reporting cycles.

So how can companies ready their financial consolidation and reporting system to handle these challenges? One viable approach will be where the consolidation and reporting application takes the strain off of multiple frameworks. Given the scope of transactional and GL systems in day-to-day operations, as well as the significant differences between US GAAP and IFRS (for some companies), this option will be far easier to implement than some of the other alternatives. That said, consolidation applications are unable to conjure up accounts from thin air. You must examine your GL and enterprise resource planning (ERP) systems to ensure that they are analyzing transactions in such a way that all of the base information needed by the consolidation and reporting application is available, not only to report in US GAAP but also to perform the necessary IFRS reporting.

In cases where all of the IFRS changes have not been embedded, the financial consolidation and reporting system must be able to hold the data in US GAAP format and also to hold a number of sets of manual journal entries that can be applied to the base data in order to produce the required reports for IFRS. In order to save time when producing reports in multiple frameworks, the system should be able to automate the calculation and storage of as many of the adjustments as possible. This data should all be held in a single database. The longer-term objective will be to embed the IFRS needs into transaction systems and the general ledger and reduce/eliminate the need for manual journal entries.

Coping with multiple frameworks in this way requires a system that has sufficient dimensions to store the information, the ability to perform complex calculations, the ability to perform and store multiple consolidations, and to report in different formats. Applications such as

SAP BusinessObjects Planning and Consolidation are well-suited to the task as they inherently support multiple reporting frameworks and the associated challenges, and are also able to work with any of the underlying GL and ERP systems.

Data collection and consistency. Since IFRS will change the accounting language of the organization, it is important that the accounting function and others—such as legal, IT, HR, etc.—are aware of the new IFRS language. As financial information is aggregated within the organization, additional descriptive information may be required along with the financial values.

In systems terms, you will need to make sure that the GL and other source systems are amended to include the necessary account lines.

Where complex GL subsystems are already in place and difficult to change—such as those in manufacturing—consider a “loose coupling” strategy during the transition process. Rather than modifying these systems up-front, make the necessary changes in the corporate consolidation and reporting application instead via manual journal entries. Then put a longer-term plan in place for the embedding of IFRS into the GL and subsystems. This allows the organization to adopt IFRS today without any short-term impact on the transactional systems.

From where we stand, achieving and maintaining ongoing consistency is easiest if all of the information is in a single application. When using the consolidation approach, it is important to avoid storing some of the IFRS adjustments in Excel spreadsheets while the consolidation data is in a specialist application, as this generates additional work. Doing so makes compliance more challenging because it increases the risk of errors and the danger that inconsistencies will creep into published financial statements.

Issues around providing different reporting formats. There are a number of systems issues around the need to produce reports in more than one format during the transition phase—especially since the changeover may require several years of running IFRS parallel with US GAAP.

The prescribed formats for IFRS reporting are different from those in US GAAP (and, for that matter, other statutory reporting GAAPs). In some cases, the same number can be described in different ways in IFRS as compared to US GAAP. For example, IAS 7 (Cash Flow Statements) does not require a reconciliation of net cash flow to movement in net debt.

How easy is your report writer to use? Some systems require Visual Basic programs to be written to create reports, which require specialist skills for changing existing reports and creating new ones. Other applications—SAP BusinessObjects Planning and Consolidation, to name just one—have flexible and powerful end-user reporting functionality that enables the head office consolidation team to create and change their own reports.

Examples of IFRS potential impacts

Under IAS 16, differences in asset componentization guidance may result in the need to track and account for property, plant and equipment at a more disaggregated level. Greater disaggregation may in turn trigger earlier disposal or retirement activity when portions of a larger asset group are replaced.

The IAS 39 model does not permit many securitizations to qualify for de-recognition. Most securitization transactions include some ongoing involvement by the transferor that causes the transferor to retain some of the risks and rewards related to the transferred assets—a situation that may preclude full de-recognition under IFRS, but not under US GAAP.

Because the use of LIFO inventory costing is precluded under IAS 2, companies that utilize the LIFO-costing methodology under US GAAP may experience significantly different operating results as well as cash flows under IFRS.

More instruments will qualify as derivatives under IFRS. Some instruments, such as option and forward agreements to buy unlisted equity investments, are accounted for as derivatives under IFRS, but not under US GAAP.

Also consider how easy it is to create XBRL (eXtended Business Reporting Language) instance documents from the consolidation and reporting application in order to support the electronic communication of business and financial data to regulators. In recent years, this has become an increasingly important aspect of the financial consolidation and reporting process worldwide—nowhere more so than in the US following the US SEC’s mandate that, under a three-year phase-in period, the largest public companies are required to begin submitting XBRL-formatted financial information for periods ending on or after June 15, 2009. The SAP BusinessObjects XBRL Publishing application by UBmatrix enables financial business users to leverage data in SAP Business Suite software and SAP BusinessObjects enterprise performance management solutions and prepare XBRL documents.

Finally, does your system support assigning different names to a single account? If so, then you will be able to use the account names in the database for reporting in the different formats. (Some tools, such as the SAP BusinessObjects Planning and Consolidation application, can do this.) However, if your system is not capable of doing this, then you must hard-code descriptions in your reports, making them more difficult and time consuming to maintain.

A framework for moving forward. It is important to calibrate the organizational situation and your company’s appetite for change. But where do you start?

The pace of transitioning from US GAAP to IFRS in an organization’s technology, particularly the degree of embedding into the GL and below to the sub-ledgers, will in turn determine how robust the reporting system needs to be during transition.

IAS 1 (Presentation of Financial Statements) requires different balance sheet headings to those currently used under US GAAP for some items such as Stock being recorded as Inventories and Fixed Assets being classed as Property, Plant, and Equipment. This is simple to do using the SAP BusinessObjects Planning and Consolidation application.

Some questions to ask yourselves when assessing your technology:

- Can the current technology support the transition?
- Can it support the various reporting standards that will be required?
- Does it integrate planning and consolidation?
- Can it be loosely coupled to the transaction systems through middleware, so that changes elsewhere in the systems environment do not disrupt financial reporting?
- Does it offer an accelerated approach or toolset for building IFRS financial statements?

But looking only at your technology will not give you the big picture of your organization and its readiness for IFRS adoption. It is important to look beyond the technology itself to these other considerations. Ask, and answer, questions such as these:

What is your organization's degree of change agility? Different organizations respond to change differently and have varying appetites and capacity for change. Do you know what your appetite for change is? Consider the cultural aspects of the organization. Does the enterprise have sufficient agility and a desire to be proactive in effecting a rapid technology change in the immediate term—before mandatory IFRS reporting becomes necessary? For example, would it consider replacing an existing legacy consolidation application with a combined US GAAP and IFRS dual-reporting system all in one go? This may make sense for organizations with relatively straightforward reporting structures and a single ERP, whereas other less nimble organizations may prefer to adopt a more progressive approach—perhaps maintaining existing legacy systems for US GAAP and, in parallel, implementing a new and separate IFRS-only environment alongside it. In this case, you may want to consider leveraging Business Intelligence reporting tools to perform reconciliation reporting between the two systems.

Clearly the former approach involves higher risk but has the advantage of addressing the challenge rapidly, whereas the latter approach is more measured, represents less project risk, and allows the organization to take one step at a time. However, it is prone to creating additional reconciliation issues.

Does the enterprise have sufficiently skilled resources to implement the new technology? Are end users aware of the change and equipped with the appropriate knowledge and skills to use the new systems? For example, is there a dedicated team in the organization who fully understands the requirements of IFRS and is charged with systems implementation, or is there a need to source this talent externally? Have end users been communicated to about the technology change and received adequate training to effectively perform their roles using the new systems? What additional support and resources

are available to help end users make the transition and embed the technology change (e.g., help desk, job aids, super user network)? Ideally, all of these elements should be considered as part of the overall change strategy and plan.

What is your history in terms of structural development? Another aspect that may impact how and when it is best to approach the adoption of IFRS is the volume and frequency of change in the organizational structure, and therefore the reporting scope. IFRS can bring additional entities within the consolidation scope. Enterprises that are experiencing rapid growth with a significant emphasis on business development via acquisition face particular challenges when it comes to financial reporting. For example, as new subsidiaries are acquired, it is necessary to rapidly integrate those into the existing financial reporting framework.

It is equally challenging to ensure that dispositions are dealt with appropriately. The key requirement for such organizations is flexibility—the ability to evolve reporting scope on a continual basis, and to easily perform simulations during the planning phase. In fact, such organizations are constantly in the planning phase, so there is a major benefit in integrating the financial planning and financial reporting processes, ideally using a single application. Mature enterprises that are relatively static in nature may find it easier to transition to new reporting standards, simply because there is less development “noise” going on.

How well does your organization cope with the complexities of technology? The complexity and diversity of source GL and ERP systems across the enterprise can impact the ease of transition to IFRS. Depending on the size and scope of the enterprise, source systems can range from a single instance GL that has been implemented consistently throughout the enterprise to an organization with a myriad of different GLs.

Enterprises that are experiencing rapid growth with a significant emphasis on business development via acquisition face particular challenges when it comes to financial reporting. For example, as new subsidiaries are acquired, it's necessary to rapidly integrate those into the existing financial reporting framework.

Certain global organizations—for example, those in certain European territories—may already have subsidiaries that report locally according to current IFRS standards. In such cases, the transition process may need to be coordinated. The ability to leverage this local information often depends on whether or not corporate financial consolidation and reporting systems can easily be adapted to new, different and (during the transition phase) parallel data sources. Determine if appropriate financial information management applications are already in place. Applications such as SAP BusinessObjects Financial Information Management permit flexible finance business-user mapping (and subsequent re-mapping) of accounts, yet are also fully compliant—thus offering a complete, automated audit trail. If such systems are not already present, consider whether the addition could provide extra flexibility during the transition phase—especially for those reporting units that are able to provide source data in dual US GAAP and IFRS formats.

Given the need for a smooth and reliable transition from US GAAP to IFRS over the coming years, it may be necessary to adopt the IFRS changes into the consolidation and reporting system faster than they can be embedded into the general ledger and subsystems. If that is the case, you can leverage financial information management and consolidation applications during the transition phase to map and adjust information at the corporate level, then progressively change the source applications as time and resources permit.

The clock is ticking... and there are many things to consider. Don't underestimate how long all of this takes. If you want to get it right, this is the time to determine specifically how IFRS will impact your company, and to start planning and executing your strategy accordingly.

What this means for your business

Reaping the benefits of early action.

IFRS is already affecting many US multinational companies through statutory or other reporting by their foreign subsidiaries and, from where we stand, it's only a matter of time before it has a major impact on most US companies—on their people, on their processes and on their technology. Indeed, one of the most critical—and unavoidable—technology challenges facing today's executives centers on how best to support the IFRS financial consolidation and reporting requirements.

Here are some key considerations around the financial consolidation and reporting aspects of an IFRS transition:

- This is the unavoidable technology change around the IFRS transition. In addition, you may need to make additional technology changes within the GL and subsystems to support IFRS.
- With sufficient planning, the detailed IFRS requirements can be embedded into the general ledger and subsystems, thus avoiding the need for IFRS to be achieved only through manual adjustment in the consolidation and reporting system. However, for most organizations, embedding will be phased.
- Systems must support the ongoing need for reporting in US GAAP, IFRS and other reporting standards (if applicable).
- Accounting standards, along with tax and other financial reporting needs will evolve over time, and a system that is capable of dealing with that evolution will minimize the ongoing need for technology changes.
- IFRS does not change the fact that a company will still need internal control over financial reporting. Relying on large volumes of manual adjustments, established in desktop tools, may create new compliance/controls issues.
- The good news: an important benefit of converting to IFRS is the opportunity to centralize and streamline financial reporting functions through use of a single set of IFRS accounting policies.

In short, for all these reasons, systems readiness has become a burning issue. Recognizing the complexities involved, many companies seeking guidance in “getting it right” are conferring with advisors who bring a depth of specialized knowledge in IFRS conversion.

Getting it right takes time. While the transition period appears distant on the calendar, the reality is that it is closer than it seems. The time to begin strategizing on how you plan to handle the transition to IFRS is now.

Leading companies understand the importance of getting the jump on IFRS requirements early on. They're planning their conversion strategy. They're taking steps to implement an effective methodology backed up by the people, processes and tools to help them understand the transition impact on their organization. And they're acting now to ready their systems to meet the multi-GAAP reporting challenge. Early action will allow these proactive companies to control costs, understand and manage the challenging scope of implementation, and allow for a smooth transition plan.

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