

Time to clear up misunderstandings about IFRS convergence

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The timetable for U.S. companies to move from U.S. Generally Accepted Accounting Principles (GAAP) to International Financial Reporting Standards (IFRS) is not set in stone, but such a transition is moving inexorably forward, either through conversion or convergence. Thus far, more than 100 countries worldwide require or permit IFRS, and the differences between U.S. GAAP and IFRS are lessening over time due to converging accounting principles.

As it stands now, a mandatory switch may begin in fiscal 2014 for large accelerated filers, which means affected companies would need to include IFRS comparable data in their operating statements for 2012, 2013 and 2014. By 2016, current guidelines will call for all public companies to report financial results under international accounting standards – that is if IFRS requirements are adopted in 2011. While there is always a possibility that something could derail the conversion time frame, convergence itself will not go away – and is, in fact, already occurring as key standards change one at a time.

While many U.S. companies have taken baby steps toward IFRS, a surprising number have yet to act. Such stasis may be due, in part, to a lot of “fuss” clouding the truth behind convergence. It is time to address those concerns to get clearer bearings on what is involved.

Fuss: IFRS conversion will be enormous, expensive and hard to control

Most companies are unsure about the cost and effort necessary to convert. The way they can overcome such uncertainty is to perform a diagnostic review to determine exactly what a conversion, for them, would entail. That will demystify the scope of the conversion, reduce anxiety and provide a better understanding of the timeline, potential costs and magnitude.

With that knowledge, as companies become more comfortable in their understanding of IFRS, many in certain industries will view a conversion as a chance to present their financial information in a manner that seems more logical than what the rules of U.S. GAAP allow. Because IFRS is considered more principles-based than U.S. GAAP it allows – and requires – more judgment.

Companies may also find that having consistent financial reporting processes around the globe, rather than having to convert back and forth through reconciliation packages and workflows, translates to reduced long-term cost and effort.

Insight from a diagnostic review can also help U.S. companies take advantage of other business process and technology changes that would enable IFRS conversion or convergence as a side effect. For example, factoring in IFRS could sharpen decisions about timing and requirements for a new IT system – some IT systems are very IFRS friendly. Approaching components of the convergence process within other strategic initiatives that are already going on builds toward an accretive change and leverages the cost and effort.

Fuss: There are no protocols in place for a change of this magnitude

On the contrary, companies can draw from past experience – lessons learned from U.S. GAAP changes in recent years, from IFRS experiences overseas and from U.S. Sarbanes-Oxley Section 404 efforts. In Europe, where the conversion process started in 2003, a number of lessons emerged. Chief among them is that top-level sponsorship is essential – not just finance and financial reporting. Successful companies included in the conversion effort senior management and those from tax, treasury, HR, training and lines of business that produce data that drive accounting. Also, many who have done this already say that thorough scoping and planning are as much as half the effort. Companies must be prepared for changes along the way and must impose rigid documentation discipline.

Similarly, planning and scoping were part of the Sarbanes-Oxley transition. We believe one of the lessons from that experience – one that could help companies dodge costly, time-consuming “do-overs” – is having frequent interaction with external auditors to assure general agreement that the transition process is on track. Because IFRS is more principles-based, companies need to be very clear in their own policies and procedures about what they will do from an accounting perspective given a set of facts and circumstances.

Fuss: Under IFRS all our accounting rules, policies, procedures and controls will change

Actually, not every company in every industry will have the same experience or the same operations. The way an enterprise is affected will vary depending on its capital structure and revenue streams. The effort for a company with global operations and one line of business will be different from a company with multiple business lines. While U.S. GAAP allows different timing and policy treatment as long they are disclosed, IFRS requires consistency across all business units in each country, which demands more discipline (and requires more inspection of that discipline) in each reporting entity and more clear guidelines in corporate policies.

Internal audit steps up to the plate

Internal audit (IA) will have a big role to play as a result of the move to IFRS. Given IA's customary role in auditing large events, the conversion – involving high risk, affecting accounting controls and coming at a sizable expense – will probably be one of IA's largest areas of focus in the year of adoption and in the succeeding years in which consistency of application will need to be policed. Sitting at the top of the organization, IA will have a view on the consistency of the application of IFRS as well as a local country view. Auditing the application of “judgment,” as opposed to verifying the adherence to rules, will likely shift the focus of IA's planning and execution processes.

The conversion will have an overall impact on six elements of infrastructure:

- **Strategies and policies** – A critical first step is the determination of accounting policies under IFRS, but keep in mind that conversion impacts more than accounting policies alone.
- **Processes and workflows** – Internal auditors will need to execute a plan that takes into account the time and effort for the business units to update documentation.
- **People and capabilities** – Internal audit groups will need to access or “borrow” people with requisite skills in order to execute their plans.
- **Communications, awareness and training** – IA will need to plan and execute the timely communication of issues with IFRS conversion for internal and external timelines.

- **Data, information and reporting** – IA will need to build plans that respond to changes in the design and testing needs which come from changing sources of data and information flows.
- **Systems and technology enablement** – For many companies, IT may pose the most significant conversion issues. IA groups will need to be able to react to changes in which data passes through systems or human hands and pay special attention to IT change management protocols in the year or years of conversion.

IFRS strategies: Top-down or bottom-up?

How companies approach IFRS will vary. If an enterprise is heavily centralized, corporate can come up with the rules, do all the work centrally and push it down to the organization. Just work with a set of policies and procedures that stipulate: “If XYZ is the fact, follow XYZ everywhere.” The bottom-up approach takes a different direction: “With all subsidiaries using IFRS in its various flavors, let us take stock and pick the best practice, come to a consensus and then push that out to the entire organization.” Naturally, this choice will drastically impact the amount of time and resources required to effect a conversion.

A company could decide to do a top-down “tweak only” (change what needs to be changed, and no more) or take a top-down “full sweep/clean-sheet-of-paper” approach (change everything that you can). It could also do the same thing with a bottom-up approach. Either way, the decisions must be made up front. While it sounds logical, history has shown that this is not the kind of thing you want to decide at midstream.

In the meantime, to avoid missteps it is important to keep in perspective the changes that will be required by the conversion process. Initially, this perspective can be supplied by a diagnostic review that will indicate what it is going to take to get the job done. After that, keeping it in perspective is a matter of basic project management.

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