Preparing for International Financial Reporting Standards

An Opportunity for Finance Transformation

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To understand how companies view the International Financial Reporting Standards adoption journey, Accenture commissioned a survey of 208 executives at companies with a minimum of US$1 billion in annual revenues. Executives represented all major industries, and 75 percent of respondents were from companies with greater than US$5 billion in revenue. The Internet-based survey was conducted in December 2008.

A Google search on "IFRS" yields close to 5 million hits, with content available from accounting firms, government agencies, accounting trade groups, the business media and management consulting firms. Indeed, the International Financial Reporting Standards (IFRS) are arguably the most widely discussed accounting topic of the moment among businesses in the United States (US)—in particular, what is involved in adopting the standards. The volume of discussion has only intensified since November 2008, when the US Securities & Exchange Commission (SEC) proposed a roadmap that would allow some US companies to adopt IFRS as soon as 2009 and require adoption by all companies by 2014, 2015 or 2016, depending on the company's size and filing status.

To date, more than 100 countries, including the United States, require or permit the use of IFRS or are converging with the standard. Between 2009 and 2011, the Financial Accounting Standards Board (FASB) will be converging several key aspects of its US Generally Accepted Accounting Principles (GAAP) standards—including such critical and broad-reaching elements as revenue recognition and fair value—into greater convergence with IFRS. Most recently, the SEC extended the comment period on its proposal and SEC Chairman Mary Schapiro has used more cautious language regarding the current proposal. Yet, regardless of the mandated timing for formal IFRS adoption, many elements of accounting are already converging, meaning the key question surrounding IFRS for US companies is no longer "if" but "how and when."

Yet in Accenture's view, IFRS should be about more than just accounting standard compliance. Instead, companies should approach IFRS conversion as an opportunity to strengthen their distinctive capabilities, which Accenture's High Performance Business research reveals is a building block of high performance. Indeed, companies that use IFRS adoption to drive improvements in key areas such as finance and supporting Information Technology (IT) applications—in essence, investing in vital areas of the business during the current economic downturn—will be better positioned for competitive advantage and high performance than those that approach IFRS conversion simply as a compliance initiative.

To better understand how US companies view IFRS adoption, as well as how they are preparing for it, in December 2008 Accenture conducted a survey of more than 200 executives from a cross-section of industries. In particular, we set out to understand how large companies and executive professionals viewed IFRS and its associated challenges and opportunities. Three-quarters of our respondents represented companies with greater than $5 billion in revenue, and one out of five respondents was a chief financial officer (see Figure 1). Notably, our research was conducted after the SEC had proposed its IFRS roadmap so respondents were aware of the increased relevance of the issue.

In Accenture's view, IFRS should be about more than just accounting standard compliance. Instead, companies should approach IFRS conversion as an opportunity to strengthen their distinctive capabilities.

Our survey found that 64 percent of companies either are currently engaged in an IFRS initiative or will be within 12 months, and an additional 15 percent will begin within 24 months (see Figure 2). Large companies appear to be further along than smaller enterprises: companies with greater than $5 billion in sales are 2.5 times more likely to say IFRS is already a priority than smaller companies.

At a high level, our research uncovered four main findings:

- **IFRS's impact will be much larger and broader than anticipated**, affecting many areas outside of finance including human resources, IT, business operations, external stakeholders and customers. Furthermore, survey participants expect IFRS will add substantial complexity to a variety of initiatives they currently are pursuing, such as new enterprise information systems implementation, mergers or acquisitions and expansion of global operations.

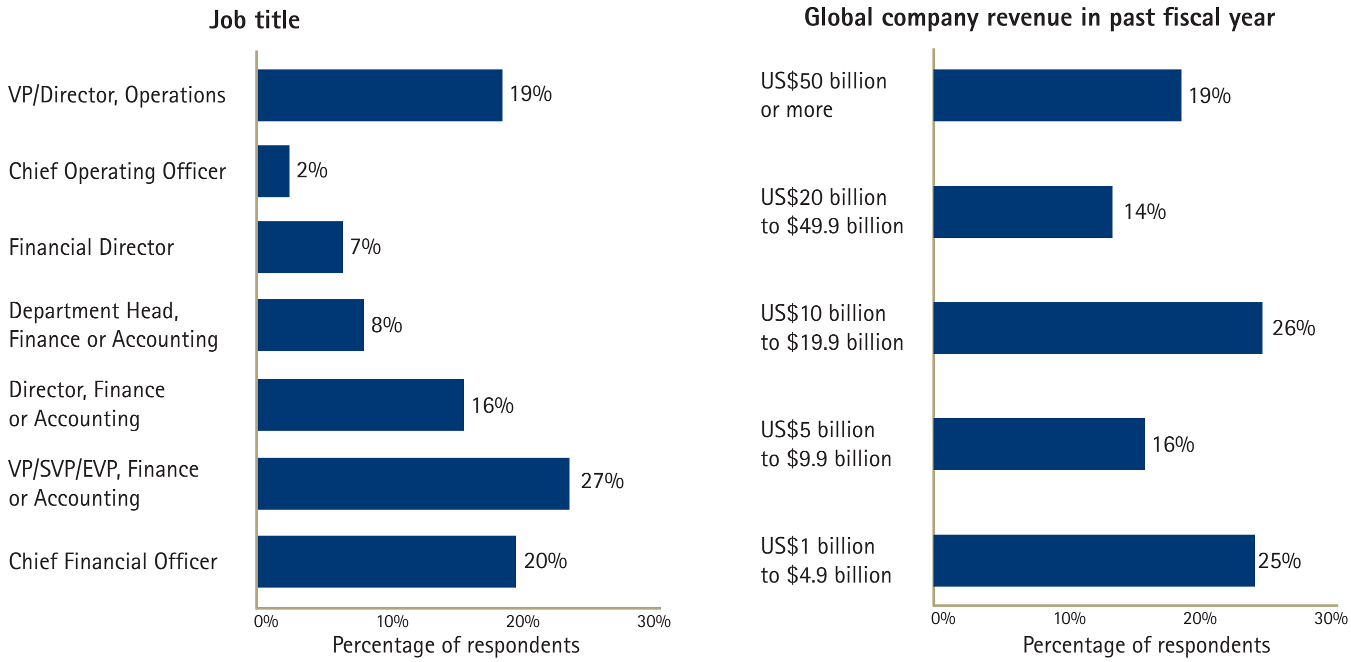
- **IFRS provides companies with a significant opportunity to achieve broader transformational change and drive business benefits beyond compliance.** In particular, survey participants see IFRS adoption as an opportunity to transform the finance function. But they also acknowledge that the shift could help them reduce their risk exposure from dealing with different statutory reporting methods, more smoothly integrate their global operations and expand into new geographic markets, and improve financial reporting and transparency.

- **Chief Financial Officers (CFOs) perceive the impacts and opportunities of IFRS differently from other constituents in finance and outside of finance.** For example, they were more likely than other respondents to believe IFRS will introduce complexity into ongoing corporate initiatives, affect functions outside of finance, and cost more to adopt. But CFOs also are much more apt to see the potential of IFRS to drive a major change in the way the finance function does business.

- **IFRS's impact on enterprise performance management capabilities will be significant**, and many executives are making substantial investments in key related processes and technologies to deal with the impact. Target setting, planning, forecasting and management reporting are among the capabilities executives believe will need to be improved to deal with the changes and volatility IFRS likely will introduce in the flow of revenue and costs.

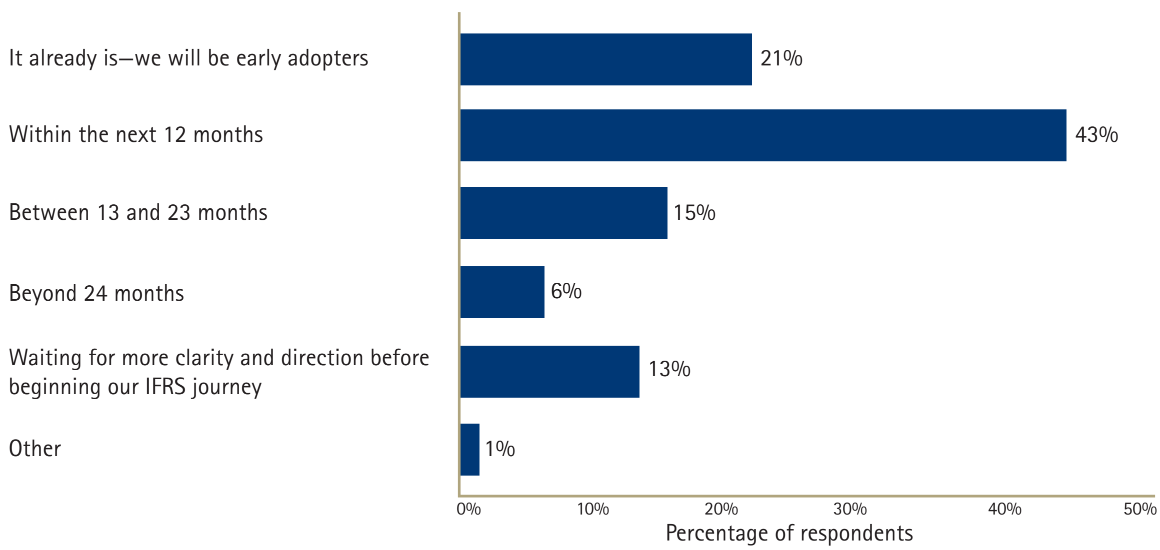
In this report, we explore these findings in more detail, discuss the implications of our research for executives preparing to undertake this significant and important initiative, and provide guidance on how enterprises can use an IFRS conversion as a springboard to achieving high performance.

Figure 1. Survey participants' titles and the revenues of the companies they represent



Source: Accenture 2008 IFRS Survey
Note: Figures may not total to 100 percent due to rounding.

Figure 2. When companies expect IFRS adoption to become a priority



Source: Accenture 2008 IFRS Survey
Note: Figures may not total to 100 percent due to rounding.

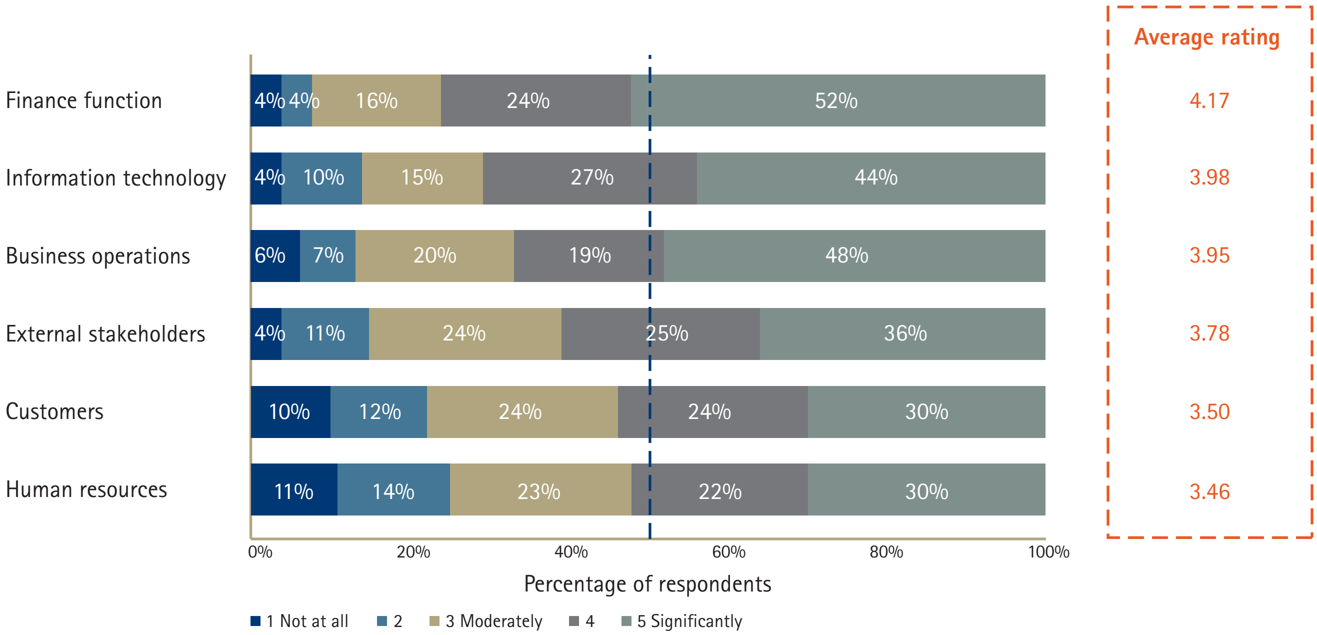
The impact of IFRS will be much larger and broader than anticipated.

Although it is widely known that IFRS is more than an accounting change, the breadth and depth of the potential IFRS impacts may surprise many executives. According to our survey, adoption will affect people, processes and technology in vital areas across the enterprise. Indeed, although executives aware of IFRS generally know the new standards represent a major change for the accounting function, those participating in our survey see it as much more than that. In fact, more than half of all respondents said that most major functions of their business—including IT, business operations, external stakeholders, customers and human resources (HR)—will experience a significant impact from IFRS (see Figure 3). Additionally, a large majority of respondents think IFRS adoption will add complexity to other planned initiatives, including mergers, enterprise resource planning (ERP) and other IT implementations, geographic expansion and outsourcing or shared services implementations (see Figure 4).

Further reflecting the significant scope of this change is the fact that executives expect IFRS adoption to require a substantial investment. More specifically, recent studies on European IFRS conversions estimate one-time conversion costs at an average of .05 percent of revenue.

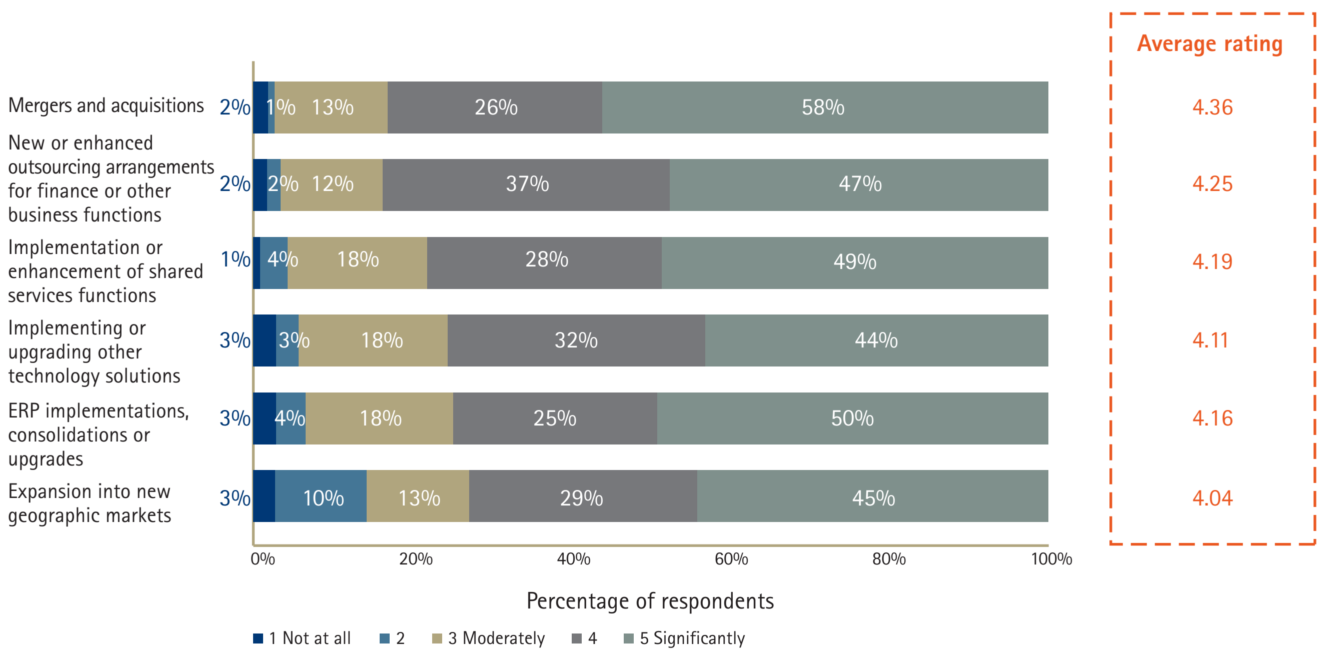
However, Accenture's own research reveals that while an average can give some guidance on spend, companies need to more fully understand how the conversion relates to their specific circumstances. For instance, as illustrated in Figure 5, the anticipated spending on IFRS conversion among our survey sample, as a percent of revenue, varies substantially by the size of the enterprise. In fact, as the figure shows, smaller companies

Figure 3. Extent to which IFRS will impact other business functions



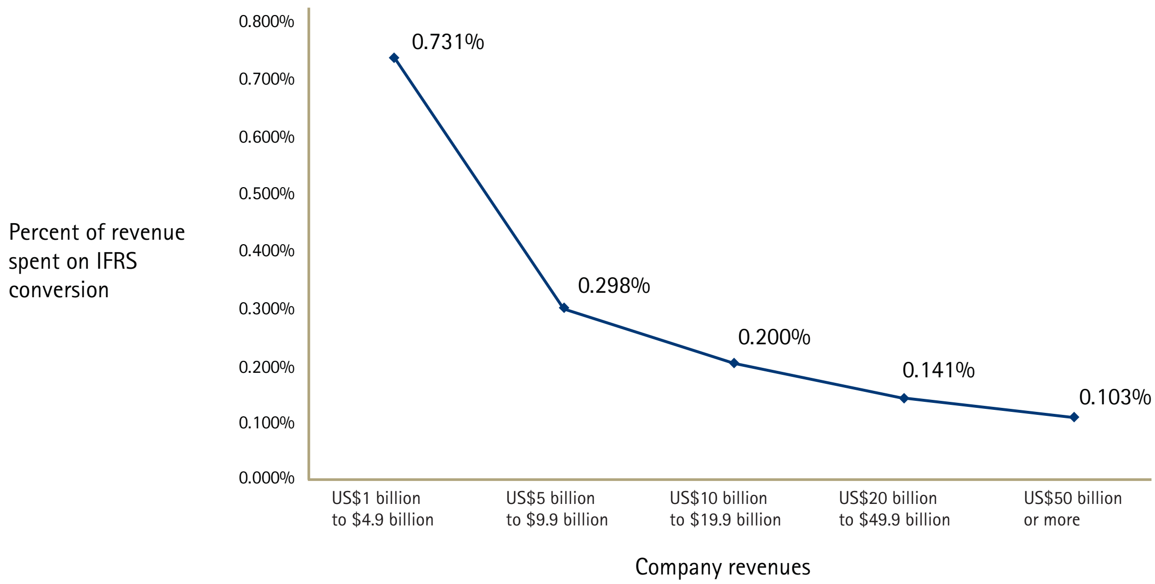
Source: Accenture 2008 IFRS Survey

Figure 4. Extent to which IFRS will add complexity to these initiatives



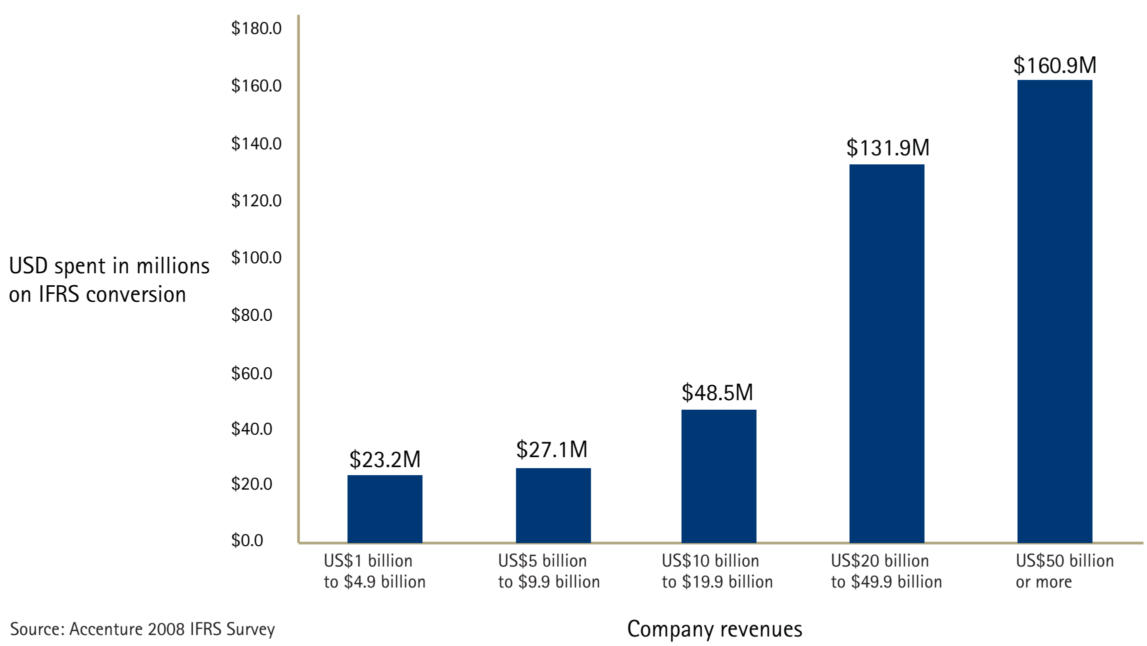
Source: Accenture 2008 IFRS Survey

Figure 5. IFRS conversion spend by size of company



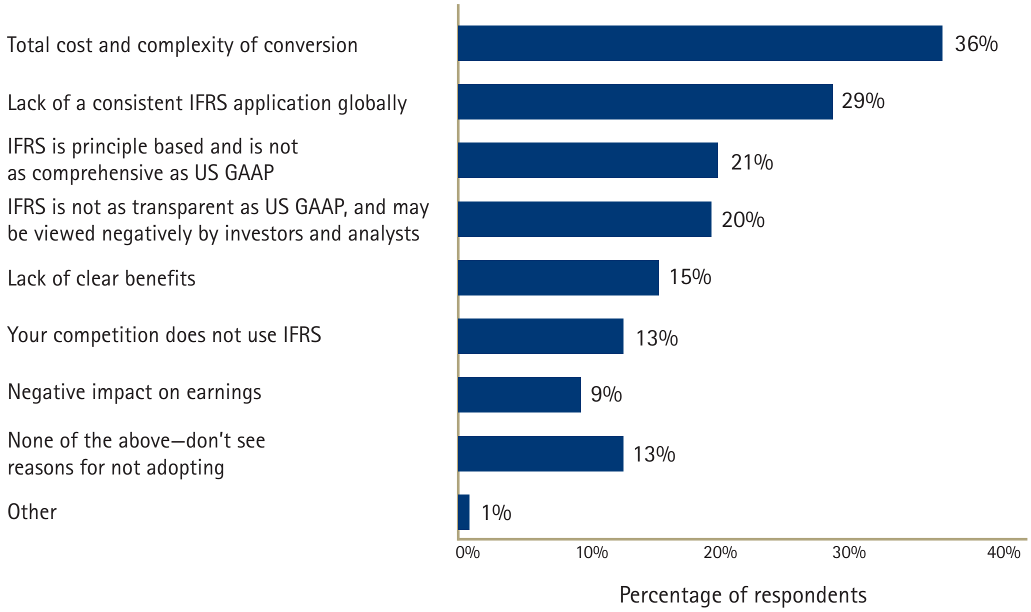
Source: Accenture 2008 IFRS Survey

Figure 6. Average IFRS conversion spend by size of company



Source: Accenture 2008 IFRS Survey

Figure 7. Obstacles to IFRS conversion



Source: Accenture 2008 IFRS Survey

will be disproportionately affected because regardless of size, there is a minimum amount of spend needed to comply with IFRS. And not surprisingly, large companies expect to spend substantially more as measured in total dollars (see Figure 6).

But it is important to note that the amount of estimated spending on IFRS varies widely within each category of company size, with some companies in the same size category expecting to spend far more than their peers. For example, among companies with $50 billion or more in revenue, 43 percent expect to spend less than $25 million while 30 percent anticipate spending more than $100 million. The point is that every company's spend will differ depending on its size, complexity, existing finance capabilities (talent, processes and supporting technologies), accounting policies and industry. Thus, it is important for executives to avoid relying on simple averages when budgeting for the conversion and, instead consider their specific circumstances. Conducting a strategic assessment prior to the launch of a conversion initiative can be an effective way to understand the magnitude of change—and, consequently, the investment—that will be necessary to successfully make the shift.

Given the preceding, it is not surprising that total cost and complexity was the most cited obstacle to IFRS conversion in the United States, especially among larger companies (see Figure 7). In our experience, the higher degree of cost and complexity in the United States is attributable to four major factors.

The need for parallel accounting approaches. Unlike companies in other areas of the world, US companies converting to IFRS will be forced to operate dual accounting approaches to remain compliant with both US GAAP and IFRS while the SEC deliberates on when and how to fully convert to IFRS.

The extent of change required. European country accounting practices were more similar to IFRS in many areas, which made the transition easier. This is different in the United States, where US GAAP is substantially more complex and prescriptive than IFRS in a number of key aspects. As a result, the extent of change necessary in the United States to "bridge the gap" is more considerable. In addition, restatement periods were more limited and the impacts of the following two factors were not felt in as significant a way as they will be in the United States.

Blending of regulatory and statutory reporting. In the European Union (EU), IFRS adoption has been somewhat simplified by the option to separate regulatory and statutory reporting in a number of countries. For example, in the United Kingdom (UK), IFRS is used for reporting of companies listed in an EU/European Economic Area securities market, while UK GAAP could be elected as the basis for tax reporting. However, in the United States statutory and regulatory reporting (e.g., FAS 71 for regulated industries like public utilities) has been blended to a higher degree, adding complexity to IFRS adoption.

Presence of a "control" environment. When European Union companies converted to IFRS, they did not have to contend with an additional set of overriding controls mandated by legislation such as Sarbanes-Oxley. Additional work will be required in the United States to ensure that compliance with Sarbanes-Oxley is embedded in the IFRS conversion, including revalidation of controls and procedures.

The extent to which companies can manage the preceding factors will help determine the overall approach, cost and duration of IFRS conversion.

The total cost and complexity was the most cited obstacle to IFRS conversion in the United States.

IFRS presents a significant opportunity for broader transformational change.

Despite the challenges IFRS conversion poses, our survey reveals many companies view the initiative as an opportunity to make broader transformational changes and drive business benefits beyond simple compliance. In other words, these organizations intend to use IFRS conversion as the impetus to strengthen their distinctive capabilities that enable them to out-execute the competition and achieve high performance.

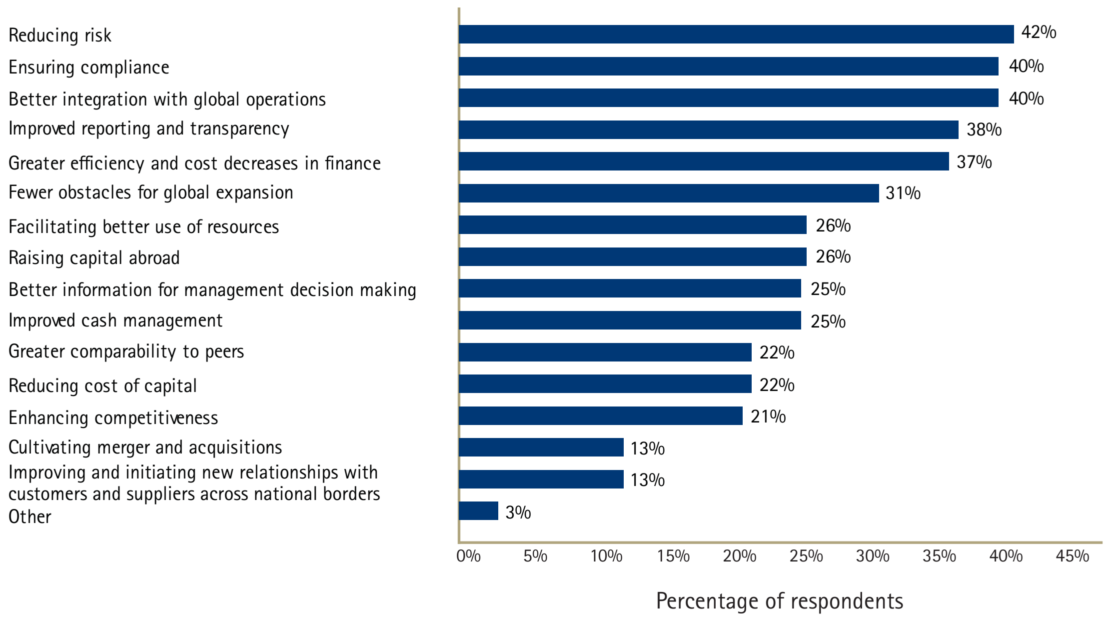
To be sure, IFRS is a mandated change meant first and foremost as a benefit to investors, and does not come with a business case for strong return on investment. However, executives we surveyed do believe IFRS will generate a number of benefits beyond compliance—the most significant of which is reducing the risk exposure of multiple statutory reporting methods, a critical issue for companies operating in a complex global market. In fact, reducing such risk was cited by 42 percent of respondents as an anticipated benefit (see Figure 8).

Beyond reducing statutory reporting risk, executives identified several other business benefits. These include better integration with global operations, enhanced reporting and transparency and fewer obstacles to global expansion. Executives also believe their finance organizations will especially benefit from IFRS: 83 percent view adoption as an opportunity to drive broader transformational change within this function.

Finally, to help reduce the expense impact of the transition to IFRS, one out of two respondents are seeking and finding cost synergies between IFRS adoption and other ongoing initiatives. More specifically, 21 percent of organizations surveyed are integrating IFRS conversion with finance systems implementations, while another 25 percent are combining it with finance transformation programs. More than half of the respondents recognize the enterprise implications to getting this right and as such, are combining multiple initiatives which would have IFRS implications so as to ensure they are addressed together, synergistically, and that the transformative value to the organization is maximized.

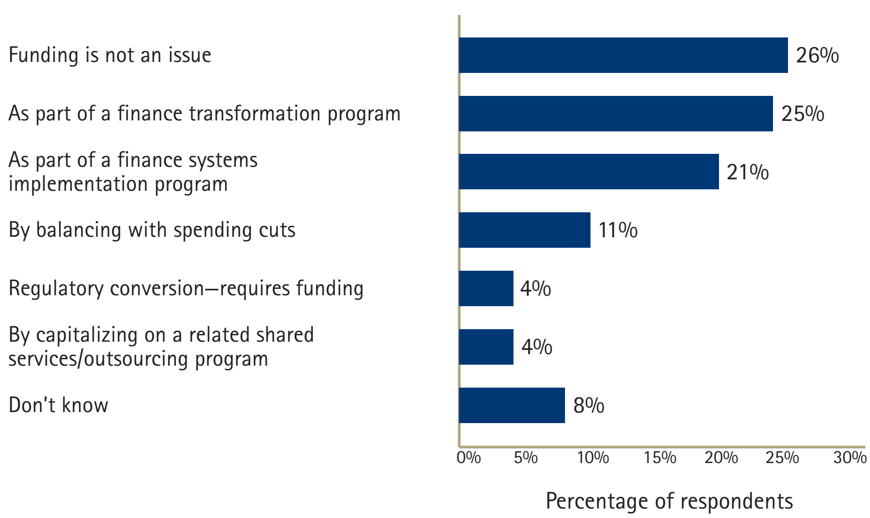
In short, if companies think creatively about dovetailing their IFRS initiatives with other efforts where appropriate, and recognize the “downstream” efficiencies and other sustainable business benefits IFRS eventually will generate, they will be able to more easily justify the cost of adoption and use the initiative as a way to help them take strides toward achieving high performance (see Figure 9).

Figure 8. Benefits of IFRS



Source: Accenture 2008 IFRS Survey

Figure 9. How companies will fund their IFRS conversion



Source: Accenture 2008 IFRS Survey

Note: Figures may not total to 100 percent due to rounding.

CFOs have a distinct perspective on IFRS impacts and opportunities.

When it comes to both the impacts and opportunities inherent in adopting IFRS, our research shows that CFOs take a very different view than other executives. Indeed, while all respondents acknowledged the complexity of IFRS, CFOs see the task as more challenging, are more optimistic about its results and are more prepared to act fast.

For example, more than two-thirds of CFOs predicted IFRS conversions would add significant complexity to executing other enterprise initiatives, versus less than half of other respondents. Across the board, CFOs also are more likely than other respondents to believe IFRS adoption will have a significant impact on all functions: a minimum of 60 percent of CFOs voiced this sentiment, compared with a range of 21 percent to 47 percent for other respondents. This difference likely explains why CFOs also are more apt than others to recognize the importance of change management. In fact, 64 percent of CFOs, versus only 30 percent of other respondents, plan to emphasize change management and communication as part of their IFRS initiative.

CFOs also think IFRS adoption will be more costly: 67 percent of CFOs, compared with only 37 percent of other respondents, believe conversion will cost more than an estimated $25 million. On the positive side, while two-thirds of CFOs "very much see" IFRS as an opportunity to drive broader transformation change within the finance function, only 30 percent or less of other executives expressed the same level of enthusiasm.

Finally, CFOs appear much more ready to act. While 15 percent of directors of finance and accounting are waiting for more clarity and direction before beginning their IFRS projects, less than 5 percent of CFOs believe they need more insight to proceed.

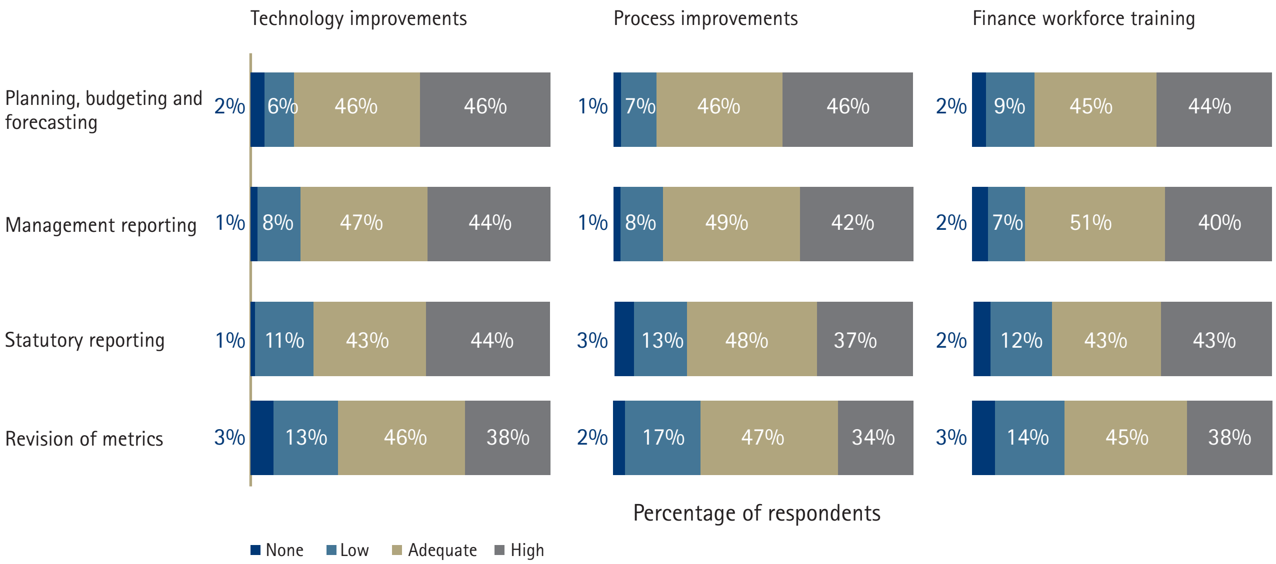
IFRS will require a significant change to enterprise performance management capabilities.

When they do press ahead with their projects, executives believe the impact of IFRS on enterprise performance management capabilities will be significant. For instance, IFRS will directly affect how earnings, compensation, tax liability and other key aspects of the business are accounted for and reported. In fact, many European companies experienced a material change in earnings after adopting IFRS—something 60 percent of respondents to our US survey also expect to encounter. Such changes, in turn, will require companies to substantially alter their performance management processes, including target setting, planning and management reporting.

The accounting implications of IFRS for enterprise performance management can be viewed from two primary perspectives: those driven by the timing of cost and revenue recognition, and those that are the result of real changes in asset and liability value.

In terms of timing, IFRS will affect when and how companies recognize various costs—that is, as a one-time hit or amortized over several years. Such changes, in turn, could materially affect earnings. One example is capitalizing development costs for intangible assets—taking a cost that was expensed as incurred under US GAAP and for finite assets amortizing them over their useful life. Such an action does not change the actual cost, but only the timeframe in which the cost is recognized. Timing-related issues such as this could have major implications for innovation-dependent industries, especially in industries like pharmaceutical.

Figure 10. Investments in EPM capabilities



Source: Accenture 2008 IFRS Survey
Note: Figures may not total to 100 percent due to rounding.

In addition, by mandating the use of fair value, IFRS will cause companies to assess the value of their assets and liabilities periodically to determine their actual current value. This requirement can have implications for earnings if major reductions in asset value or increases in liability value are found. Furthermore, IFRS allows for the periodic revaluing of property, plant and equipment and any resulting decrease in value would be expensed. Additionally, IFRS permits companies to reverse inventory write-downs in certain situations, whereas US GAAP does not.

These impacts will not simply be felt by the company on its balance sheet; they also will hit close to home among employees for whom some portion of their compensation is variable and incentive based. More specifically, sales people paid on commission may find their compensation affected if recognition of the revenue from sales is deferred to comply with IFRS. Similarly, employees who are rewarded in part based on the company's achievement of certain targets linked to earnings could find their compensation affected by IFRS impacts on how earnings are stated.

In short, because revenue and cost flows are likely to be more volatile under IFRS, companies will need to be able to plan and reforecast in such a way that avoids surprising investors and that maintains management credibility. And enterprises will have to understand and address potential effects these changes could have on the motivation and morale of employees with earnings- or sales-based incentives.

These potential impacts are driving executives to invest at least as heavily in planning, budgeting, forecasting and management reporting and underlying metrics as they are in the revision of statutory reporting. In fact, approximately 40 percent of respondents in our survey described their level of investment as "high" in technology, processes and workforce training related to planning, budgeting and forecasting and management reporting; just over one-third of respondents gave the same rating to their level of investment in those areas related to the revision of metrics. These investment levels are very similar to the investments being made in technology, processes and training related to statutory reporting requirements—which one might presume to be a much higher priority given IFRS's emphasis on external reporting (see Figure 10).

Clearing the way for IFRS adoption.

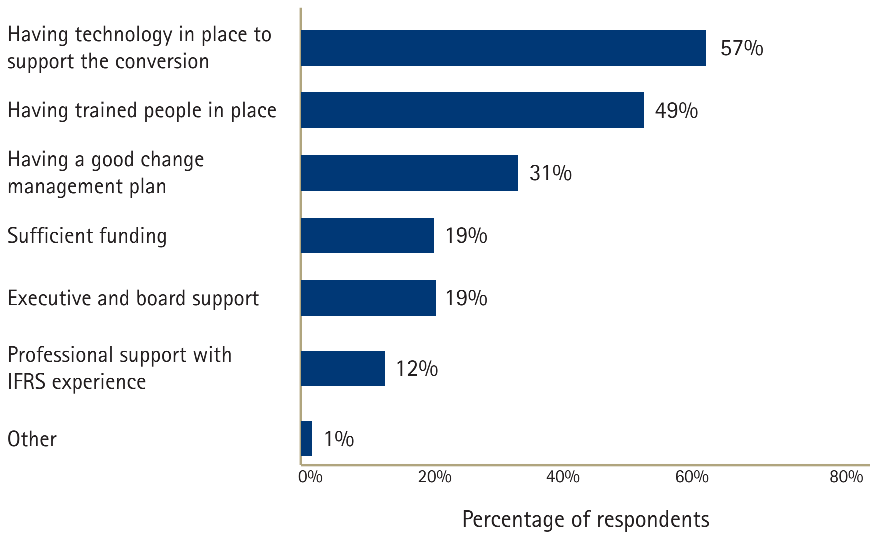
There is no question that IFRS conversion will be a major challenge; however, it also stands to offer companies a number of compelling business opportunities and benefits. The key concern, thus, becomes what companies should do to keep their IFRS initiatives on track and generate the greatest possible benefits.

According to our survey, information technology is most commonly seen as a key to the success of an IFRS initiative, fact cited by just less than 60 percent of executives surveyed. Not far behind in the minds of survey participants are trained people, cited by just under half of the respondents. And, given the scope and extent of IFRS's impact on an enterprise, it is no surprise that approximately one-third of executives view change management as a critical success factor (see Figure 11).

Accenture's experience in IFRS conversions has revealed additional and related insights into the factors for success. For example, we have learned that it is critical to get started early, which the large companies in our survey are in fact doing. And as discussed earlier, the scale, scope and complexity of the initiative can be significant, so it behooves companies to take advantage of the time they have to tackle the challenge.

Second, we have found that a strategic assessment is invaluable for defining how adoption will impact each specific organization, and in particular how the chosen IFRS policies will affect people, processes, data and technology. Conducting such an assessment will enable companies to have a more effective timeline for preparation and implementation, and will allow them to understand potential synergies with other company initiatives.

Figure 11. Key success factors for IFRS conversion



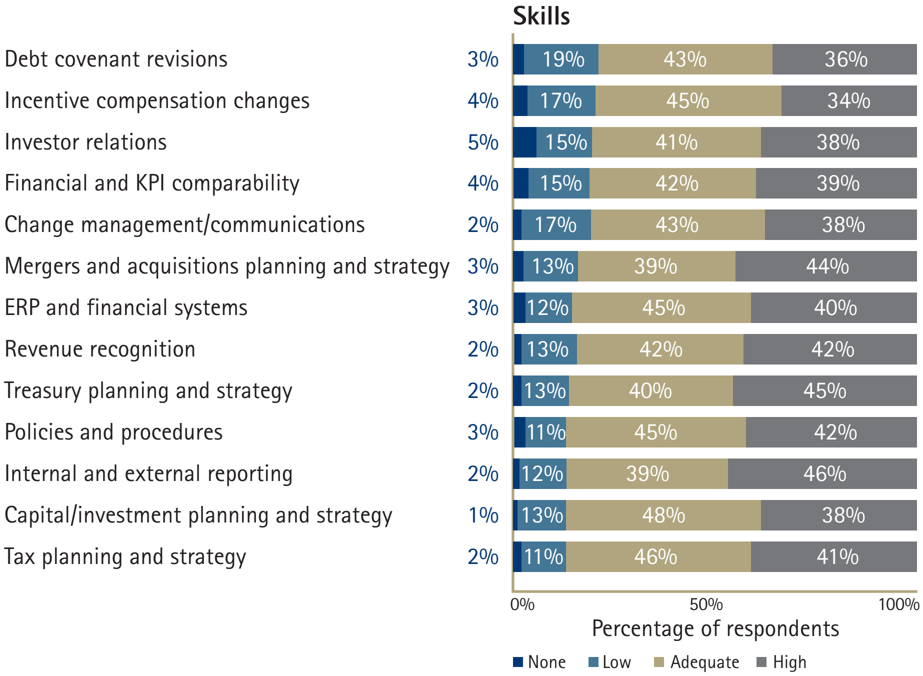
Source: Accenture 2008 IFRS Survey

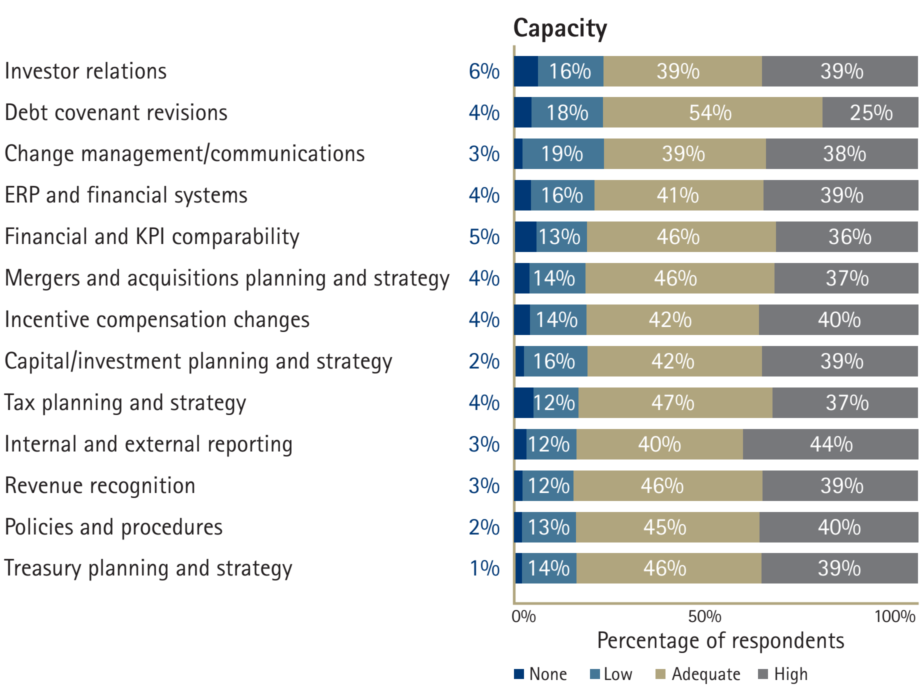
For example, a company designing and implementing an ERP system should consider how their chart of accounts and general ledger design and configuration would have to change to accommodate the parallel accounting required by IFRS. Doing so would allow them to embed those changes in the new system while it is being developed, instead of having to implement costly changes down the road when the conversion to IFRS is made.

Another example relates to training: companies generally understand that the finance function will have to undergo extensive training to make the shift to IFRS. However, as mentioned earlier, IFRS likely will affect many other areas of the business, and therefore training for employees in functions outside of finance also must be developed and implemented to make the transition to IFRS as smooth as possible.

Given the fact that IFRS could touch many areas of the business, it is also critical to have representatives from across the enterprise involved in the initiative. One way to secure such participation is by creating a cross-functional steering committee—accountable to the audit committee—that includes individuals from human resources, information technology, business operations and finance.

Figure 12. Extent to which companies have skills and capacity to address IFRS conversion impacts





Source: Accenture 2008 IFRS Survey
Note: Figures may not total to 100 percent due to rounding.

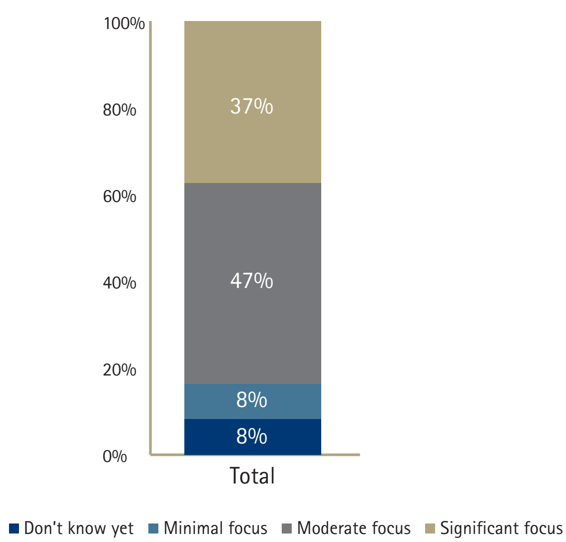
Finally, as is the case with any large-scale change initiative, a comprehensive communication program should accompany the IFRS conversion to inform key stakeholders of what IFRS means for them (and, in the case of employees, how specific elements of their jobs will be affected by conversion). For investors and analysts, communication should focus on how IFRS will affect earnings, as well as the company's assets and liabilities. Employees and business unit leaders also will need to be alerted to what is changing and when, and how those changes will affect their daily jobs (and, as noted earlier, in some cases their compensation).

How are companies faring in these areas? Organizations in our survey are proceeding down the path to addressing these key IFRS success factors, although considerable opportunity for improvement exists. For example, about 40 percent of respondents claimed their companies have a high level of skills and capacity to address IFRS conversion impacts on a variety of areas, including tax planning and strategy, capital/investment planning and strategy, internal and external reporting, mergers and acquisitions (M&A) planning and strategy, and ERP and financial systems. But only approximately one-third gave a high rating to their ability to address IFRS impacts on such areas as investor relations, incentive compensation changes and debt covenant revisions (see Figure 12).

One-third of respondents also said they "very much so" have an adequate number of personnel with sufficient skills and capacity for converting to and maintaining IFRS financial statements; just less than half said they "somewhat" have such skills. However, 20 percent said they either have no such skills in place or don't know the state of their capabilities in this area. And when it comes to change management and communications, just less than half said they expect to have a moderate focus on these areas, while only 37 percent said their focus on such factors will be significant (see Figure 13).

In sum, it appears that for a substantial portion of companies surveyed, the talent and attention focused on IFRS adoption are not as strong as they could be given the magnitude of the initiative they face.

Figure 13. Extent to which companies are focused on change management and communications related to IFRS adoption



Source: Accenture 2008 IFRS Survey

An opportunity for business improvement.

As IFRS continues to gain momentum, it is critical for companies to begin preparing for the change now—once again, something our survey revealed large companies are doing already. And, as our survey also confirmed, IFRS is expected to impact many areas of a company outside of finance, driving a need for substantial changes in enterprise performance management capabilities. This finding, coupled with our data on companies' preparation levels and priorities, suggests organizations could be challenged to allocate the resources required to minimize disruptions to the business and derive the greatest possible benefits from IFRS adoption.

However, the broad reach of IFRS anticipated by survey participants also is expected to provide companies with a rare chance to reevaluate and improve key elements of their business that are critical to organizations' ability to achieve high performance. Now that IFRS—or at the very minimum, convergence on a global set of standards—is coming, companies should strongly consider making improvements to areas of the organization that will be affected by its adoption. In particular, executives believe there are major opportunities for transformation in the finance function as part of IFRS adoption. However, each company also will find challenges and opportunities specific to its industry, accounting policies, systems and business priorities, so a strategic assessment prior to launching an IFRS initiative will help companies understand the magnitude of change necessary and where they can derive the greatest benefits.

Accenture believes companies that approach IFRS with a business-improvement mindset and not solely a focus on compliance will be much better positioned to gain competitive advantage and achieve high performance in today's highly dynamic global economy.

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