The IT implications of IFRS

A Grant Thornton article for publicly listed companies

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Will new international accounting rules affect your technology systems?

Canada's publicly accountable entities are well aware of the looming deadline to convert to international financial reporting standards, or IFRS—companies with a December year-end need to report under IFRS for the 2011 fiscal year. They must also issue comparative financial statements for the preceding year under IFRS. This means many public companies will need an IFRS-compliant opening balance sheet starting as early as January 1, 2010.

This issue affects each organization differently, depending on the complexity of its business structure, and accounting and reporting systems. For instance, capital intensive organizations with large investments in property, plant and equipment face significant choices under IFRS. Conversely, some industries, such as financial services, already adopted regulations that bring their reporting in line with IFRS, which may result in less extensive compliance efforts.

As companies implement their strategies, however, they often neglect to consider the full impact of IFRS conversion on their IT systems. Overlooking these issues can result in significant compliance challenges as the year wears on. To avoid underestimating the work effort, advanced planning is essential.

Making hard choices

A good starting point for assessing the implications of IFRS is identifying the differences between the accounting policies you currently follow under Canadian generally accepted accounting principles (GAAP) and those that apply under IFRS.

In conducting this scoping exercise, it's important to realize that the conversion to international standards is far from straightforward. In many cases, you can select from several alternatives related to both your organizational and industry-specific needs. For instance, under IFRS, capital asset valuation can take place at market value (fair value). However, it can also be applied on a cost basis, using rules similar to those that apply under Canadian GAAP today.

Each of these determinations will affect your IT systems differently—and that's true even in the first year of conversion. Consider: as you work to meet the 2011 IFRS conversion deadline, 2010 will likely become the last year for which you report under existing Canadian standards. At the same time, you still have to generate IFRS-compliant comparative financial statements for 2010. This means you may need to run two parallel financial statements during the year of your conversion.

If this scenario applies to your organization, consider the following questions:

- Can your systems handle parallel processing?
- Do you have storage and memory capacity to retain all the financial information required?
- Does your finance department have the capacity to enter data into two systems?
- Does your finance department have access to the level of data required to run financial statements using divergent accounting standards?

If the answer to any of these questions is "no," you need a strategy for mitigating these challenges.

Beyond year one

In the rush towards timely compliance, many companies are focusing their IFRS transition strategies on identifying the risks, and setting timelines, for adopting necessary financial statement changes. Yet this focus may be too narrow, as it fails to take into account the broader implications of conversion. Specifically, as you begin to implement new processes and potentially new systems to accommodate international standards, these changes trickle down to your staff responsibilities, internal controls and enterprise systems.

Companies that have engaged in system migrations or modifications often discover these projects entail a corresponding change in the way information feeds into their systems. As you convert to IFRS, consider the following IT implications:

- **New data requirements.** Compared to Canadian GAAP, IFRS frequently mandates more detailed disclosures. For example, under Canadian rules, corporations currently depreciate capital assets such as buildings over an average anticipated life span. Under IFRS, however, buildings are not seen as standalone assets. Instead, companies must depreciate the individual significant assets that comprise a building, such as its roof, its elevator system or its HVAC system. To capture this level of detail, you need IT systems capable of tracking more granular information across a range of new data fields.

- **Data storage and retention.** Despite transitioning to new accounting standards, you still need access to your legacy financial systems to comply with data retention requirements. This raises questions around your company's ability to effectively store and retrieve mass amounts of older financial data. It also has implications around the retrieval of data for comparative purposes, benchmarking and other business decisions that involve comparing data prepared under Canadian GAAP vs. IFRS.

- **Application level controls.** Any migration to a new financial reporting system will alter the way in which your company processes transactions. In addition to mandating revised business process controls, this shift will result in the need to amend your general application environment to ensure security, authentication and access control mechanisms remain sufficiently robust to meet regulatory requirements.

- **Implications on business intelligence and decisioning systems.** Another area you must consider is the way in which data is shared across your enterprise-wide operational systems. Although your core financial reporting system will be affected most by conversion, changes of this magnitude trigger spillover effects from both an operational and regulatory perspective. As your financial data input evolves to comply with IFRS, the information that feeds into your operational systems may shift as well. Companies may find that they have to amend key inputs into the systems responsible for such things as forecasting and budgeting, performance management, incentive-based compensation, decision-support tools or tax-related reporting. Similarly, companies that electronically file compliance forms with regulators may need to amend their reporting processes to ensure they continue to provide the information required.

Assessing the options

Given the wide range of IT implications presented by IFRS, you must understand the magnitude of the changes you may face upon your own conversion. Only in this way can you determine the best course of action for your organization. For instance, companies that do not need to make significant changes upon converting to IFRS may choose to simply tweak their processes rather than engage in a wholesale system modification. In this case, it may make sense to simply use existing systems to process IFRS financial statements, and manually journal any differences at the end of the reporting period.

That said, this type of approach can be unduly labour intensive, particularly if you process high volumes of transactions subject to IFRS implications. Aside from being error prone, manual record adjustment can require a tedious analysis of financial spreadsheets that cover potentially thousands of journal entries. At the same time, these adjustments would need to be made without jeopardizing adherence to already tight reporting deadlines. Given these detractions, this approach generally makes sense only for companies with very straightforward accounting requirements.

Other companies may prefer to modify their existing programs to enable more granular information capture. They can do this by either modifying their systems internally or by upgrading their applications to the most recent versions, which are likely to be more compliant with IFRS.

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If you are considering this course of action, it's important to ensure your software vendors have in fact modified their applications to accommodate your specific IFRS requirements. Vendors with a significant installed base of customers in countries that have already converted to IFRS (such as the UK, Australia, New Zealand and South Africa) will likely have upgraded their systems sufficiently. Conversely, systems targeted primarily to American customers or whose install base is quite small may not be sufficiently robust to support your conversion to IFRS.

If tweaking existing systems or system modifications won't bring your company into compliance, you may have to consider the need to implement a new financial reporting system. Although this will not be necessary in many cases, you can only identify the right solution for your organization by understanding the IT ramifications of your conversion in advance.

Avoiding common traps

Without question, each company's conversion to IFRS will require unique effort.

However, advanced planning can help you avert common conversion pitfalls. To make sure your company remains on track throughout its conversion, take steps to

- **Conduct a detailed analysis of the impacts of IFRS on your IT systems.** Whether you conduct this assessment internally or work with third-party advisers, be sure to document the differences between Canadian GAAP and IFRS as they pertain to your company, and rank their IT impact from low to high.

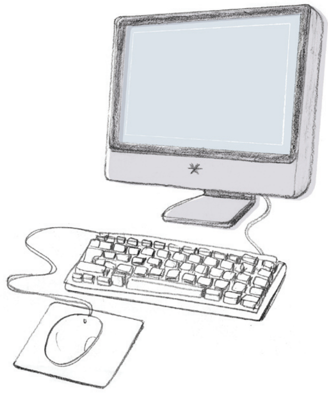
- **Carefully assess your software choices.** Although newer versions of many financial reporting applications comply with IFRS, not all systems are created equal. If you must modify your existing systems or migrate to a new system, be sure to get unbiased advice about the various software options available to you.

- **Bolster your project management capabilities.** In today's constantly evolving regulatory environment, companies frequently engage in multiple compliance projects simultaneously. Given the system-wide implications of adopting IFRS, it's essential to engage experienced project managers capable of ensuring each initiative is completed on time, on budget and according to specification.

- **Model international best practices.** Although converting to IFRS can be complex, Canadian companies have the advantage of other countries' examples. To streamline your conversion, solicit input from other companies in your industry that have already adopted IFRS in their own countries. In addition to providing you with insight into both pitfalls and best practices, these companies can let you know how well their software systems accommodate industry-specific IFRS requirements.

As the IFRS conversion deadline approaches, the timelines are getting tighter for companies that must still conduct a scoping analysis, identify the IT implications of their conversion and select the appropriate solution for their organization. To safeguard your company from common conversion errors and ensure you're ready to hit the ground running in a post-conversion environment, the time to start planning is now.

For more information, visit www.GrantThornton.ca



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