How to Adopt IFRS in Five Steps

By Joseph M. Langmead, CPA; Gloria Phillips-Wren; Jalal Soroosh, CMA; Hong Zhu; Kenneth A. Kelly, Jr., CPA; and Kenneth S. Thomas

If you work for a public company, you're likely discussing—and perhaps actively gearing up for—the substantial changes associated with adopting or endorsing International Financial Reporting Standards (IFRS) and converging them with U.S. Generally Accepted Accounting Principles (U.S. GAAP). In February 2010, the Securities & Exchange Commission (SEC) published a "Work Plan" related to IFRS adoption. In this document, the SEC committed its staff to "analyze" the impact on companies' accounting and related systems and procedures before deciding whether to adopt IFRS as the required accounting model for U.S. public companies. That decision is expected any day now, with implementation beginning as soon as 2015. The Work Plan also committed the SEC staff to assess the impact on corporate contracts and governance requirements, among other things.

This raises several questions: How might such analyses and assessments be made? What factors should be considered? How can they be communicated to all of the internal departments that will be affected? We'll probe these questions because of their obvious urgency in light of the SEC's scheduled time frame.

Much has been written in recent years with regard to the anticipated adoption of IFRS. For example, the authors examined differences between IFRS and GAAP—both overall and for specifically relevant standards, such as IFRS 1, "First-time Adoption of International Financial Reporting Standards," which covered defined accounting considerations in the first year of adoption. (For more on this topic, see "International Financial Reporting Standards: The Road Ahead," *The CPA Journal*, March 2009, and "Planning Ahead for IFRS 1: Initial Adoption of IFRS by U.S. Public Companies," *The CPA Journal*, October 2009, by Joseph Langmead and Jalal Soroosh.) Others have embraced broader considerations of the impact on affected organizations, especially in areas such as financial information systems. Some literature seeks to identify all the various organizational components that may be affected and describes a project approach broad enough to embrace the numerous, multifaceted implications of an organization's conversion to IFRS. Larger accounting firms, in fact, have made a number of such materials available through their websites and other communications. Our interest is in evaluating the readiness of organizations in the broadest practical terms but without losing focus on how all organizational activities and information systems will be impacted.

A Rational, Methodical Approach

In the face of a relatively high-speed convergence process and an imminent SEC assessment of what can be characterized as organizational readiness for IFRS, it would be helpful to have a tool that frames readiness in sufficiently universal terms as to be useful for all U.S. public companies. Such a tool, if designed and structured appropriately, could serve a second objective: as a survey instrument for accounting researchers and SEC staff for querying such companies regarding their readiness. Our staged approach provides the basis for developing such an assessment instrument.

The approach we'll describe can't be effective, however, without buy-in from the CEO and board of directors (usually through its audit committee). The tool reflects the primary role of the CFO and controllership from the beginning and throughout the process, as well as the commitment of the CEO and board.

We can't overstate the potential implications of IFRS for both financial and nonfinancial information systems. Financial information systems are often integrated within wider enterprise-level information systems, sometimes as part of an integrated design, sometimes less formally through ad hoc interfaces. Therefore, information systems (IS) leaders should be included in the change process from the earliest evaluation stage. That's because all of the business processes that may be affected by the switch to IFRS are feeders to the information systems and its databases. For some organizations, then, IS may need to partner with the operations center responsible for business process engineering and reengineering.

The bottom line of the aggressive adoption agenda is this: U.S. companies don't have the luxury of a five-year planning period for a 2015 event—they are facing a multiyear event with potentially significant implementation requirements as early as *this year*.

Five Stages of Change

Although a transition plan to IFRS can be divided into phases in a variety of ways, let's consider as an example a medium-to-large U.S. company with a number of overseas activities. We've identified five stages designed to achieve IFRS readiness across the organization and pegged them to seven key responsibility centers within the organization. We've tentatively assigned tasks to the most relevant centers, with each center participating at some level in each of the five stages. Furthermore, for the controllership tasks, the more significant likely IFRS differences are itemized along with the additional IFRS considerations in the first year of adoption.

As we describe each stage, we include a table summarizing the most significant tasks and subtasks for each of the seven centers. Taken together, the five tables form a kind of checklist to serve as a process tool that can be adapted to specific organizations. Those with differing structures and responsibility centers should be able to adapt the

Table 1: Stage 1—Initial Assessment

RESPONSIBILITY CENTER	PRINCIPAL TASKS	KEY SUBTASKS
Controllership	Initial identification of current differences	Survey of relevant literature and expertise Review of non-U.S. operating segments already familiar with IFRS
CFO	Initial assessment of implications, including strategic implications	Survey of relevant literature and expertise
Tax Department		Survey of relevant literature and expertise
Human Resources		Survey of relevant literature and expertise
Information Systems	Initial familiarization with possible implications	Survey of relevant literature and expertise Identification of in-house and vendor expertise
CEO	Familiarization with nature of tasks and implications, including strategic implications	
Board of Directors	Familiarization with nature of tasks and implications, including strategic implications	

tables to their own needs quite readily. Note, however, the early and pervasive involvement of IS as well as the extensive responsibilities of Human Resources (HR).

Stage 1: Initial Assessment

The first stage encompasses the research appropriate to become familiar with and understand the project's relevant components and effects, and it identifies internal and external capabilities and resources, such as consultants and contractors. It's likely that the CFO or his or her designee will take the lead role throughout an IFRS project, given the concentration of expertise and degrees of impact in areas often under the CFO's direction (such as financial reporting and communications, accounting, and income and other taxes). Naturally, this can vary by organization and structure. The CFO will probably make an initial assessment of the strategic significance and implications of adopting IFRS. The controller/chief accounting officer will be very active in all stages, especially the first and second, where specific differences between IFRS and GAAP must be identified and analyzed for the company as a whole and for its various business segments around the world.

The next most active player in all stages is IS. This center not only should identify its key leader/participant in the project early, but it should be deeply involved from the outset given the typically large implications for IS regarding both financial and accounting applications and the various operational processes with which they interface. Meanwhile, HR leaders should begin to identify the more indirect, yet significant, effects on pensions and compensation contracts as well as the substantial training and communications challenges within the organization (see Table 1).

Stage 2: Detailed Analysis

The second stage is more rigorous in its impact analysis, both in terms of actual likely accounting differences and the effects on compensation agreements, debt covenants, and other contracts directly and indirectly related to accounting metrics. Thus, HR leadership becomes more actively involved, and IS will do its preliminary analysis side by side with the accounting/disclosure analysis, which now needs to consider in detail each of the accounting areas noted in Table 2.

The progress of convergence is of special importance here since convergence efforts are directed such that at least some major IFRS/GAAP differences will be superseded by a converged standard that may become effective earlier than full adoption of IFRS. The tax department,

Table 2: Stage 2—Detailed Analysis

RESPONSIBILITY CENTER	PRINCIPAL TASKS	KEY SUBTASKS
Controllership	Detailed identification of differences and assessment of likely effects of convergence preceding an adoption Consultation with internal and external auditors Preparation of preliminary project budget	First-time adoption issues/options Earlier business combinations Property & equipment valuation Componentized depreciation Foreign currency effects Pension measurements Consideration of likely differences Revenue recognition Financial instruments and valuation Hedge accounting Stock/option compensation LIFO Lease accounting R&D Contingencies Impairment Derecognition of assets/liabilities Consolidation Interim reporting Internal-use reports
CFO	Initial assessment of nonaccounting implications, including debt covenants/ other contracts and business practices/ other finance implications, including related information systems Preliminary cost-benefit analysis	
Tax Department	Assessment of tax implications and related information-gathering processes and systems	LIFO Uncertain tax positions Book-tax differences Deferred tax accounting Tax disclosures
Human Resources	Initial assessment of impact on compensation arrangements and training and communications implications	Employment contracts Stock/option compensation plans Incentive compensation plans based on financial measures Pension/other benefit plans
Information Systems	Preparation of detailed IS analysis	All relevant information systems and related business processes Interfaces with supply chain/customers
CEO	Kept informed	
Board of Directors	Kept informed	

Table 3: Stage 3—Designing the Change Process

RESPONSIBILITY CENTER	PRINCIPAL TASKS	KEY SUBTASKS
Controllership	Impact assessment on consolidation and other financial reporting software/systems; initial assessment regarding related systems (financial management information system/executive information system/ERP system) Further consultation with internal and external auditors	Financial statement presentation Note disclosures Consolidation/equity method investees Separate company statements/filings
CFO	Prepare detailed project budget Design change process, including time-line, and change management structure Full cost-benefit analysis	
Tax Department	Continuing assessment as convergence unfolds	
Human Resources	Begin "familiarity" training at all levels of organization	
Information Systems	Formal IS analysis, including impact on other significant projects	All relevant information systems and related business processes
CEO	Assess risk management and strategic implications	
Board of Directors	Assess risk management and strategic implications	

for instance, often located within the CFO's organization, will initially consider "last in, first out" (LIFO) and other tax considerations related to the switch.

In this stage, the CEO/board should receive a preliminary budget and cost-benefit analysis coordinated and summarized by the controller with the input of IS. IS leadership will have extended its analysis to interfaces with suppliers and customers. Both the internal and external auditors should be fully informed of progress in this stage since they'll be required to concur with all accounting conclusions.

Stage 3: Designing the Change Process

In the third stage (Table 3), all significant relevant information has been gathered and analyzed. The organization now understands the scope of the effort, its costs, and its benefits. The formal change management process, including a timeline, can be designed and staffed. Training can begin in all relevant segments of the company for financial and operational managers and key personnel. Internal and external auditors will have concurred with both accounting conclusions and

Table 4: Stage 4—Managing the Change Process

RESPONSIBILITY CENTER	PRINCIPAL TASKS
Controllership	Manage change process, including simulations/parallels
CFO	Draft relevant internal and external communications
Tax Department	Perform continual assessment as convergence unfolds
Human Resources	Continue implementation training
Information Systems	Begin systems- and program-level change/conversion process as convergence unfolds Collaborate with relevant departments/resources on related business process redesigns
CEO	Monitor change management process and convergence developments
Board of Directors	Monitor change management process and convergence developments

the impact on internal controls over financial reporting.

Stage 4: Managing the Change Process

The fourth stage includes all changes to information flows and processes, both manual and automated, in anticipation of the conversion dates. Thus, changes are made and tested, but at least some aren't yet made operational. Implementation training continues. The CFO's office drafts appropriate external communications, such as investor relations (see Table 4). Also noteworthy at this stage is the need to coordinate the IS change process with changes already embedded in the management of the software development life cycle.

IFRS Readiness at a Food Company

McCormick & Company, an international food industry leader, has been monitoring IFRS developments in the U.S. and around the world for several years. Planning efforts have been led by the corporate controller, and more recently the chief information technology officer has joined to form a coordinated effort. The company has formalized its readiness planning around a time-phased plan organized into five stages that are similar in many key respects to the approach we've outlined.

The company began by assessing the potential benefits of IFRS in relation to its own accounting and reporting processes and its access to global capital markets. It also considered the benefits of a uniform set of global reporting standards in terms of a better way to benchmark itself against its competitors here and abroad.

Key controllership personnel began identifying the more important potential accounting and reporting differences and have been actively monitoring the convergence process. Organizational briefings and discussions at the executive and board levels, as well as at operational management levels, have ensued. Key information systems implications are now actively included in the planning process. Alternative implementation models have been considered that range from incremental integration to full implementation and integration into systems, processes, and controls. In-house and potential outside resources have been evaluated, too.

Implementation-stage planning includes a parallel processing strategy, with the full expectation that both U.S. GAAP and IFRS information may be needed for several years during the transition to IFRS.

McCormick's staged approach culminates in a post-implementation review process.

If the SEC makes IFRS mandatory for U.S. public companies, as is likely, McCormick believes its readiness plan will serve it well. In the meantime, the company's strategy includes a country-by-country IFRS assessment and implementation plan since several of the countries in which it operates and reports have already adopted IFRS or have active plans to adopt or converge with it.

Table 5: Stage 5—Implement and Monitor

RESPONSIBILITY CENTER	PRINCIPAL TASKS
Controllership	Implement all changes
CFO	Communicate with investors/analysts
Tax Department	Implement all changes
Human Resources	Support remaining training and communications tasks
Information Systems	Implement all changes/conversions, and assure quality and accuracy
CEO	Internal and external communications Refresh strategy and risk management assessment
Board of Directors	Monitor implementation and strategy and risk management implications

Stage 5: Implement and Monitor

The fifth and final stage, outlined in Table 5, is full implementation with ongoing testing of quality and accuracy. Remaining communications, internal and external, are completed. Enterprise risk management and other strategic processes are adjusted in light of the new model of measurement and disclosure.

The cost-benefit analysis in the second and third stages can present special challenges regarding measurable benefits. Since IFRS adoption isn't likely to be optional for public companies, the overall project provides for compliance with the new reporting regulations. Measuring benefits under these circumstances can be somewhat academic, especially when the benefits cited in the public policy debate concern efficiencies of global capital markets and don't translate easily into measurable incremental revenues or cost savings at the company level.

Consultation and Collaboration

We identified a major public company with significant multinational complexity to participate in the process of developing and reviewing our staged approach to adopting IFRS. McCormick & Company, based in Sparks, Md., is a global leader in the manufacturing, marketing, and distribution of spices, seasonings, and flavorings. Its size ($3.3 billion in annual revenue) and the scope of its activities globally make it an appropriate surrogate for most public companies, both larger and smaller.

Corporate controllership and information technology executives participated and shared the company's convergence efforts to date and its planned approach for IFRS adoption. These executives have been active nationally and internationally in the study of IFRS-related issues, and one of them has been especially active in developing the converged standards. The company's approach, of course, is specific to its activities and assessment of impact as well as to its particular organizational structure and systems configuration. While the staged approach described here has been developed to assist a wide variety of organizations, it's nevertheless similar in many respects to McCormick's present plan.

McCormick has identified the benefits of IFRS both for its own organization and across the broader economy. It describes a sequenced approach to implementation composed of five stages, beginning with an initial assessment of impact and concluding with a post-implementation review. It identifies the "who" and "what" with regard to specific tasks and involvement at each stage, and it recognizes the particular significance of getting IS management involved early. Thus, McCormick's experience has been a significant source of information for, and validation of, the approach we describe. (See sidebar: IFRS Readiness at a Food Company.)

Moving Forward

The SEC has stated that two of its primary considerations for 2011 are the progress of convergence and the organizational readiness of public companies to implement an IFRS convergence and adoption program. Recently, the

SEC staff also published a description of additional adoption option scenarios combining convergence of certain standards and endorsement of others, which is commonly referred to as "condorsement." The five-stage program that we've outlined can help U.S. companies meet those requirements by assessing the readiness of individual departments and of the organization as a whole. Not only can it help key executives in managing the changes within their firms, but researchers who are interested in assessing organizational readiness, including the SEC staff, can adapt the tool to form a survey instrument.

How do these developments affect you, the corporate management accountant or financial professional? The results of a recent American Institute of CPAs (AICPA) survey said that 76% of CPAs working for public companies are putting their preparations to adopt IFRS on hold until the SEC issues a clear timeline. This may be a shortsighted approach however pliable the timeline may be right now. It would be advantageous for your organization to take the lead as soon as possible to develop an IFRS readiness plan. A good game plan like the one we've described can put your company on an even playing field initially, as well as in the later innings, when real implementation begins. **SF**

Joseph M. Langmead, CPA, is executive in residence in the accounting department at Loyola University in Baltimore, Md. You can contact him at (410) 617-2474 or jmlangmead@loyola.edu.

Gloria Phillips-Wren, Ph.D., is an accounting professor and chair of the Department of Information Systems and Operations Management at Loyola University. You can reach her at (410) 617-5470 or gwren@loyola.edu.

Jalal Soroosh, CMA, Ph.D., is a professor in the Department of Accounting at Loyola University and is a member of IMA's Baltimore Chapter. You can reach him at (410) 617-2543 or jsoroosh@loyola.edu.

Hong Zhu, Ph.D., is an associate professor of accounting at Loyola University. You can reach her at (410) 617-2597 or hzhul@loyola.edu.

Kenneth A. Kelly, Jr., CPA, is senior vice president and controller, and Kenneth S. Thomas is senior director and vice president, global IT operations, at McCormick & Company in Sparks, Md. Both men have been instrumental in developing and guiding the company's IFRS convergence and adoption plan.