Managing the Transition to

IFRS-based Financial Reporting

Lisa Weaver

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A Practical Guide to Planning and Implementing a Transition to IFRS or National GAAP which is Based on, or Converged with, IFRS

Lisa Weaver

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CONTENTS

Chapter	Title	Page No.
	List of Tables	vii
	List of Figures	ix
	List of Case Studies	xi
	Foreword	xiii
	Preface	xv
	Disclaimer	xvii
	Acknowledgements	xix
	About the Author	xxi
	Introduction	xxiii
	I: Understanding the Framework of Performing a Transition to IFRS-based Financial Reporting	**1**
1	International Financial Reporting in Context	3
2	The Conceptual Framework of IFRS, Accounting Policies and the Presentation of Financial Statements	25
3	IFRS 1 First-time Adoption of IFRS	43
	II: Planning and Implementing a Transition Project	**67**
4	Establishing the IFRS Transition Project	69
5	Assessing the Accounting Impacts of IFRS Transition	105
6	Wider Transitional Issues – Systems, Internal Audit and the Audit Committee, and Commercial Implications	129
7	Training, Communication and Change Management	163
	III: The Way Forward – Developments in Selected Countries	**187**
8	The Transition to New UK GAAP	189
9	The Way Forward – The Move Towards IFRS in the US and Selected Other Countries	207
	Appendix 1: IASB Standards	223
	Appendix 2: Useful Reference Material and Further Reading	225
	Appendix 3: Summary of IFRS Transition Planning Considerations	229
	Bibliography	231
	Index	237

LIST OF TABLES

Table 2.1	Chapters of the Framework	27
Table 2.2	XYZ Group: Statement of Financial Position as at 31 December 20X4	33
Table 2.3	XYZ Group: Statement of Profit or Loss and Other Comprehensive Income for the Year Ended 31 December 20X4	37
Table 2.4	XYZ Group: Statement of Profit or Loss for the Year Ended 31 December 20X4	38
Table 2.5	XYZ Group: Statement of Profit or Loss and Other Comprehensive Income for the Year Ended 31 December 20X4	38
Table 2.6	General Concepts of IAS 1	42
Table 3.1	Examples of Changes in Accounting Policies That May be Required on Transition to IFRS	48
Table 3.2	Mandatory Exceptions and Optional Exemptions	52
Table 4.1	Top Tips for Planning an IFRS Transition Project	76
Table 4.2	Risks and Benefits of IFRS Transition	77
Table 4.3	Typical IFRS Reporting Options in a Group	84
Table 4.4	Specific Planning Matters to be Considered	87
Table 4.5	Areas of Involvement of External Advisors	92
Table 4.6	An Illustration of the Costs of Transition for a Selection of Companies	97
Table 4.7	Typical Costs of Transition by Type of Cost	98
Table 4.8	An Overview IFRS Transition Action Plan for XYZ Co	100
Table 4.9	IFRS Transition Detailed Action Plan for XYZ Co	101
Table 5.1	Examples of Documentation to be Evaluated When Performing an Accounting Impact Analysis	108
Table 5.2	Example High-level Accounting Impact Analysis	111
Table 5.3	An Example of a Specific Accounting Impact Assessment on Non-current Assets	112
Table 5.4	IFRSs Including Accounting Choices	124
Table 5.5	Current Status of IFRS Work Plan Focusing on Major IFRS Active Projects	126
Table 6.1	An Example of the IT Consequences of Changes to the Accounting Treatment of Non-current Assets	136
Table 6.2	Examples of Operational, Financial Reporting and Compliance Risks	139
Table 6.3	The Potential Business and Commercial Implications of the Transition	155
Table 7.1	Training Methods and their Advantages and Disadvantages	166
Table 7.2	Key Communication Messages	170
Table 7.3	Impact of IFRS Adoption on Ratios and Key Performance Indicators	173
Table 7.4	An Example of the Timing and Detail of IFRS Communications	182
Table 8.1	Accounting and Wider Impacts of Moving to FRS 102	198
Table 9.1	Main Differences Between IFRS and US GAAP	212

LIST OF FIGURES

Figure 3.1	Identifying the Date of Transition to IFRS	46
Figure 4.1	SWOT Analysis of an IFRS Transition	78
Figure 4.2	Establishing the Transition Project Team	83
Figure 4.3	A High-level Overview of a Transition Project	86
Figure 4.4	External Auditor Involvement in IFRS Transition	96
Figure 5.1	An Overview of the Stages in Assessing and Responding to Accounting Impacts on Transition	106
Figure 6.1	Typical Stages in the IT Conversion Process	130
Figure 7.1	A Proposed Timescale for Communicating Externally	175
Figure 8.1	Reconciliations Required on Transition to FRS 102	203

LIST OF CASE STUDIES

Case Study 1.1	BSkyB Plc's Reconciliation of Profit on Transition to IFRS	18
Case Study 1.2	Centrica Plc's Reconciliation of Profit on Transition to IFRS	18
Case Study 1.3	BSkyB Plc's Reconciliation of Equity on Transition to IFRS	19
Case Study 1.4	Centrica Plc's Reconciliation of Equity on Transition to IFRS	19
Case Study 2.1	An Irish Company Presenting Other Comprehensive Income for the First Time	36
Case Study 2.2	How a UK Company Decided on the Presentation of its Financial Statements on its Transition to IFRS	40
Case Study 3.1	An Illustration of Accounting Policy Changes on First-time Adoption of IFRS	49
Case Study 3.2	An Example of Applying IFRS 1 to Accounting Estimates	53
Case Study 3.3	An Illustration of the Reconciliations Required by IFRS 1 with One Comparative Period Presented	58
Case Study 3.4	An Illustration of the Reconciliations Required by IFRS 1 with Two Comparative Periods Presented	59
Case Study 3.5	An Example of the Presentation of an Equity Reconciliation at the Date of Transition to IFRS	61
Case Study 3.6	Deciding on the Presentation of the Reconciliations and Supporting Information – An Example from a Canadian Energy Company	62
Case Study 4.1	A Positive Impact of Transition – Improved Dialogue with Industry Peers	75
Case Study 4.2	A Positive Impact of Transition – Improved Controls Over Financial Reporting	75
Case Study 4.3	A Positive Impact of Transition – Improved Asset Management Control in the Public Sector	75
Case Study 4.4	The Use of External Project Management Specialists	81
Case Study 4.5	An External Consultant Advising on Canadian Transitions	93
Case Study 4.6	An External Auditor's Involvement in Irish Companies' Transitions	95
Case Study 4.7	Auditor Involvement in IFRS Transition for a Small Listed UK Company	95
Case Study 4.8	External Auditor Involvement in the IFRS Transition of a Large Canadian Company	96
Case Study 5.1	An Example of an Onerous Accounting Implication of IFRS Adoption – Holiday Pay Accrual in a Public Sector Entity	107
Case Study 5.2	The Problem of the Lack of Documentation in Identifying the Accounting Impacts of Transition	108
Case Study 5.3	Problems Where Previous GAAP Did Not Require Detailed Documentation to be Maintained	109
Case Study 5.4	The Issue of Lease Accounting for UK Companies Moving to IFRS	115
Case Study 5.5	Streamlining Accounting Policies on the Transition to IFRS in a Group	117
Case Study 5.6	Volatility Caused by the Move to IFRS in the Oil and Gas and Airline Industries	121
Case Study 5.7	An External Auditor's View on Assisting with Disclosure Notes	125

Case Study 6.1	IT Implications of IFRS Transition for a Technical Facilities Management Company	134
Case Study 6.2	An External Auditor's View of the Importance of Setting the Correct Tone at the Top	138
Case Study 6.3	Wider Business Implications of IFRS Transition for a Systems Manufacturer Operating in the Aerospace Industry	161
Case Study 7.1	IFRS Training Programme Implemented in a Large Utility Company	167
Case Study 7.2	Difficulties in Getting the IFRS Message Across – A Public Sector Example	168
Case Study 7.3	Internal Communication Methods in a Global Logistics and Postal Services Company	170

FOREWORD

When the IASB came into existence, only a handful of countries used International Accounting Standards (IASs). The 2002 announcement by the European Commission that the new International Financial Reporting Standards (IFRSs), which incorporated the inherited IASs, should be used in the consolidated accounts of listed European companies and the Australian decision a month later to adopt the standards gave the world, for the first time, a standard setter with global reach. Within the next few years major economies such as Brazil, South Korea and Canada switched to IFRSs, while Japan allowed the standards to be used by domestic listed companies. Now over 120 countries, including two thirds of the G20 economies, require or permit the use of IFRSs.

For many countries, especially for those where financial reporting was influenced by taxation considerations or where companies sought bank loans rather than equity finance, the change was dramatic. A new objective of transparency and a fair presentation of profit or loss and financial position replaced tax minimisation or competitive secrecy as the goals of financial reporting. For companies in other countries used to reporting to equity investors, change was still substantial. Some accounting policies that had been used for decades were now banned. Other policies, while continued, had different nuances. The transition to IFRS for all companies involved careful study both of the new standards and of the transitional reliefs allowed in the first year of adoption.

Countries and companies are continuing to transition to IFRSs. As they do so they can benefit from the experiences of those that have gone before them. This book provides an important bridge for those treading that path. It provides, for the first time, a comprehensive guide to making the transition to IFRSs by addressing both the technical and commercial dimensions of the challenge in the context of the experiences of those who have already made the transition in many different parts of the world.

While the book provides useful background to the IFRS world of financial reporting, its real value is in the practical advice it offers. In particular, it shows how to apply project management principles to the transition process and uses case studies to illustrate the application of the main themes being developed. We commend the book to those setting out on the transition journey and those who wish to understand the implications of a reporting entity moving to this new global financial reporting framework.

Warren McGregor, Former Member, IASB
Sir David Tweedie, Former Chairman, IASB
April 2014

PREFACE

This book provides a guide on planning and implementing a change in the financial reporting framework applied in the preparation of financial statements, and specifically the move to International Financial Reporting Standards (IFRSs). The book will be of use to a wide audience who wish to understand the implications of moving to follow IFRS, or a financial reporting framework that is substantially converged with, or based on, the principles of IFRS.

While a plethora of publications exist covering the topic of IFRS and their application, there is little guidance available on the transition process itself. The professional accounting firms, of course, provide advice on planning a transition to IFRS to their clients, and have some documentation available on their websites. This is the first book to provide a comprehensive guide on planning and implementing a transition that also covers the wider commercial implications and puts the transition into a project management context.

It is anticipated that as well as preparers of the financial statements who wish to plan their transition effectively and communicate the relevant facts to external parties in an understandable way, interested readers will include investors, analysts, lenders, employees, suppliers and customers who need to understand the implications of a reporting entity moving to IFRS. The implications also need to be understood by board members, non-executive directors and other members of management within an organisation planning its transition, and this book serves as a useful source of information to this user group.

The book is also useful for students both at undergraduate and postgraduate level who wish to understand more than just the financial reporting rules and their application. The discussions in the chapters presented in this book focus on the practical implications of IFRS-based financial reporting, a topic that is very important but often overlooked by those both teaching and learning about the subject.

The content should be accessible to readers with an interest in financial reporting armed with some prior knowledge of accounting principles, but it is not necessary to have studied accounting or work in a finance function to appreciate the main themes presented and discussed. There is only one chapter that is very technical, Chapter 3, which explores the specific requirements for accounting and disclosing financial information in the first IFRS financial statements. The other chapters do cover technical issues, but in a way that a reader who has some knowledge of accounting principles will be able to digest easily. This book is therefore neither a text that will teach basic accounting nor a detailed study of IFRS requirements and their interpretation, but sits in the middle, as a text that deals more with the practical points that need to be considered when preparing to adopt IFRS.

The comments made in this book represent the author's own opinions based on personal experience and the results of research interviews and questionnaires conducted with a range of individuals who have experience with IFRS transition in many countries.

Lisa Weaver
October 2013

DISCLAIMER

This book should not be used as a substitute for obtaining professional advice and input when planning a transition to IFRS. The content of this book is generic and while suggestions are made on planning matters, readers are encouraged to contact a professionally qualified IFRS specialist to obtain advice and support specific to their circumstances.

The brief summaries of IFRS requirements and principles should be read as outline information only, and for detailed information readers should refer to the IFRSs as promulgated by the IASB, which are copyrighted by the IFRS Foundation. This book does not contain advice on accounting treatments and does not consider the particular legal or other regulatory requirements of specific countries or jurisdictions.

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Extracts from the financial statements of Centrica plc and BskyB plc are reproduced with the permission of those companies, for which I am grateful.

I am grateful to my colleagues and friends at Aston Business School for their support and I also extend my appreciation to Jane Mulligan of NUI Galway for her help with editorial matters and to Helen Milner for input on technical details.

Finally, this book would not have been possible without the encouragement and patience of my family and friends who have been extremely supportive of my efforts during the last year, and who have reminded me of the achievement of completing this book when at times I have felt encumbered by the scale of the project.

ABOUT THE AUTHOR

Lisa Weaver is a professionally qualified accountant and a Fellow of the Institute of Chartered Accountants in England and Wales. After working in audit for several years, she moved into training and education and has lectured on financial reporting, audit and governance topics in the UK and Ireland, the Caribbean, and in Hong Kong and China. She has worked on Continuing Professional Development programmes for many companies, including multinationals, and has been involved in training and consulting for a variety of organisations implementing IFRS for the first time.

Lisa is currently a Teaching Fellow in Accounting at Aston Business School, part of Aston University in the UK, and she is also involved with developing educational materials on IFRS and related subjects. Lisa works with training providers to deliver courses to non-accountants as well as senior qualified professionals, and she contributes to the work of several professional bodies in the field of financial reporting.

INTRODUCTION

SCOPE AND KEY THEMES OF THE BOOK

The transition to International Financial Reporting Standards (IFRS) has been an increasingly significant feature of financial reporting across the globe in the last few years. At the time of writing, more than 120 countries and jurisdictions require or permit the use of IFRS, or financial reporting standards substantially based on, or converged with, IFRS, by some or all of their reporting entities. The International Accounting Standards Board (IASB), the body charged with setting IFRSs, is confident that the use of IFRS, or national accounting standards that are based on IFRS, will grow in the next decade. Hans Hoogervorst, the IASB Chair, stated recently that there is almost universal support for IFRS as the single set of global accounting standards (Hoogervorst, 2013), and organisations including the World Bank, the G20 and the International Organization of Securities Commissions (IOSCO) support the concept of harmonisation of corporate reporting.

Thousands of companies, public sector entities and other organisations have gone through a transition to IFRS-based reporting in the last decade, and many more thousands will do so in the next few years. The huge advantage that relatively late adopters of IFRS-based reporting have is that they can learn from the experience of those that have already gone through the transition. It is fair to say that for reporting entities that were early adopters, there was a significant learning curve for all involved, and one of the aims of this book is to capture some of those experiences of early adopters and explain how to capitalise on them in terms of developing an appropriate transition strategy.

In short, the book aims to show how to apply project management principles to the transition, ensuring that all possible benefits are accrued and that the transition is as smooth as possible. Poorly planned transitions can be inefficient and incur unnecessary costs, and turn into a process of survival rather than an appropriately managed business transformation.

Some transitions are very complex and take years to plan and execute. In transitions like these there may be a large number of material adjustments made to the financial statements on the first-time application of IFRS. Other transitions are much simpler and require minimal restatements of financial information. The key issue is that no two transitions are the same, even for entities of a similar size operating in the same industry, so a bespoke planning and implementation process is needed. All transitions need to be carefully planned for. The planning phase may well justify that only a small number of accounting adjustments are needed, but the time must be spent to perform that detailed impact analysis to prove that that is the case.

The transition should be approached as a significant business project, as it has potentially far-reaching consequences and is definitely not “just an accounting issue”. Many entities that have gone through transition report that they significantly underestimated the time that it would take, the amount of planning that was required, the wider implications away from the accounting function, and the importance of training and of an effective communication strategy. The transition project, therefore, needs to be viewed holistically and should involve personnel from a range of business functions. The involvement of external consultants should also be considered.

This book focuses on the requirements and principles of the IFRSs as issued by the IASB. However, it is important to note that in many jurisdictions it is not strictly the IFRSs as issued by the IASB that are required or permitted for use. In many cases, national or regional authorities make amendments to IFRSs before endorsing them for use. An example is in the European Union, where the IFRSs go through a due process of endorsement before being adopted for use in the EU, and sometimes changes are made to the standards to reflect local conditions. In other jurisdictions IFRSs are not adopted per se; instead, national financial reporting standards are converged with IFRS, so that while based on similar principles, reasonably significant differences remain between local GAAP and IFRS. Due to the generic nature of this book it is not possible to discuss the amendments made to IFRS by a multitude of local authorities or to consider the variety of local GAAPs that have been converged with IFRS. The term IFRS-based financial reporting is used to cover situations ranging from the wholesale adoption of IFRSs as issued by the IASB to the convergence of national GAAP with the principles of IFRS. In any eventuality, for reporting entities moving from previous GAAP to IFRS-based reporting, there needs to be careful planning of the transition to ensure that all impacts have been identified and appropriate decisions made.

It should be noted that not all transitions to IFRS-based financial reporting are complex or difficult. In jurisdictions where there is minimal difference between previous GAAP and IFRS there are less likely to be major adjustments to make to the financial statements or accounting systems. However, even where transitions on first glance would seem not to be problematical, there is still a need for detailed planning, particularly of accounting impacts, because unexpected transitional implications can arise. It is sometimes necessary to conduct a detailed impact assessment just to demonstrate that there are no significant impacts.

AN OVERVIEW OF THE BOOK

The book is in three parts. The first part puts IFRS into context, providing a framework for approaching a transition-planning project. The first chapter contains a discussion of the history of global financial reporting standards and the status of IFRS, the relevant regulatory framework, and the reasons behind international harmonisation, including benefits and drawbacks. The IFRS standard-setting process is summarised, and the current position of convergence around the world, focusing on major economies, is also included. A short section covers the IFRS for Small and Medium-sized Entities, which is relevant to a large number of companies.

Chapter 2 provides an introduction to the fundamental principles of IFRS in terms of the presentation of financial information and the key factors that should be considered in developing IFRS-compliant accounting policies, outlining key concepts such as the qualitative characteristics and the elements of the financial statements. This chapter looks at the key elements of financial statements and their presentation under IFRS.

The third chapter focuses on the specific requirements of IFRS 1 *First-time Adoption of IFRS*, a detailed accounting standard, which has to be applied in the first financial statements of a company that are prepared and presented under IFRS. This chapter provides a discussion of the measurement and presentation rules, the specific disclosure requirements for the notes to the financial statements, and the exemptions that are available in preparing the first IFRS financial statements. Case studies are used to illustrate the accounting and disclosure issues relevant to first-time adoption of IFRS. This is the most technical chapter in the book, and

IFRS transition planning tips are included at regular intervals to bring the technical discussion back to the main theme of the book; in other words, how to plan and manage the transition.

The second part of the book deals with planning and executing the transition to IFRS-based financial reporting. This is a practical section containing suggestions on matters such as project management techniques, devising a communications strategy, dealing with IT changes and recruitment and training issues, as well as accounting implications. Chapter 4 contains a discussion of the potential scale of the IFRS transition project and why project management techniques need to be used to manage and coordinate the project. This chapter introduces the key concept that IFRS transition is not just an accounting issue but involves many different areas of a business, so planning and coordination is essential to ensure a smooth and cost-effective transition. This chapter outlines the main tasks in establishing the transition project and considers the personnel that are typically involved in planning and implementing IFRS transition, and how to bring the team together. The stages of the transition project are outlined, and some of the impact assessments that should be performed are introduced, such as assessing the impact on financial reporting, the need for changes in systems and controls, the non-financial aspects such as legal and stakeholder education, and how the project will be resourced. A potential action plan is suggested to show how the project can be scoped out with realistic milestones put in place.

Some companies will not have the resources to plan and implement the project in-house and will rely on external advisors such as auditors, systems designers and tax advisors. This chapter explores the ways that external advisors may be able to provide much of the resource needed to plan and carry out the IFRS transition. The problems of relying on external advisors are explored, with issues including cost, loss of control of the project, and ethical issues if the company's auditor is asked to help with the transition. The typical costs that are incurred in the transition are discussed and the importance of budgeting is emphasised. The IFRS transition project can be very costly. Chapter 4 analyses the typical costs involved and considers how best to plan for these costs based on the experience of companies that have already gone through the transition.

The next chapter discusses how organisations can determine the impact that the transition to IFRS will have on their financial statements. The accounting impact assessment is crucial to the success of the transition project and an example of a typical impact assessment is provided. The importance of performing a detailed line-by-line analysis is stressed, with guidance on how to prioritise the impacts that are identified. The matters that are typically considered in developing new accounting policies are discussed in some detail, and the issue of dealing with IFRSs that offer a choice of accounting treatment is explored. The importance of disclosure of certain items in the notes to the financial statements will also be covered, as for many companies the additional disclosure under IFRS is a significant planning issue.

Chapter 6 looks at wider implications of the transition. The move to IFRS reporting is likely to mean that changes to accounting systems will be necessary, for example to capture new information needed for disclosure, or to record entirely new balances that were not required under previous GAAP. Systems will need to be robust and controls over financial reporting information systems may need to be improved. This chapter explores systems-related planning issues and considers the role of IT specialists as well as internal audit and the audit committee. It is important that IFRS is not seen as a "one-off" project, especially if much of the work is

delegated to external advisors. This chapter will discuss why it is important for the company to take ownership of the project, even if external advisors carry out much of the planning and implementation. It will also explore the ways that IFRS can become embedded, and therefore part of day-to-day operations, rather than something that has to be considered only at the year-end when the financial statements are being prepared. Many companies underestimate the wide-reaching impact that the transition to IFRS can have within a business. There will potentially be knock-on effects on procurement policies, employment benefits, contract negotiations, customer relationships, and on shareholders and other stakeholders. The IFRS transition project should include consideration of all of these issues and more, and this chapter will discuss how these impacts can be identified and planned for.

Chapter 7 deals with training, education and communication. Most stakeholders will not understand the impacts that IFRS transition will have on the financial statements that are presented. For example, IFRS transition often leads to changes in profitability, which users of the financial statements may mistake for a change caused by business practices rather than caused purely by changes in how balances and transactions are accounted for. Care must be taken to ensure that all users of the accounts have enough information to understand the impact of IFRS properly. This chapter will look at how stakeholders can be educated effectively. This chapter also examines how the first IFRS-based financial statements should be presented and explained to stakeholders, and also considers the importance of providing information to external parties throughout the transition process, leading up to the publication of the first IFRS financial statements. Using the experience of companies that have already moved to IFRS, different methods of presentation will be explored, including the use of presentations to groups of stakeholders, information packs on companies' websites, and press releases. Education and training issues are also discussed, with a key message being that IFRS skills are often in short supply, so an organisation must ensure the training needs of its staff are met, and may need to bring in external knowledge where necessary.

The third and final part of the book considers future developments in IFRS-based financial reporting in a selection of countries. Chapter 8 outlines developments in the UK and Ireland, where the implementation of "new UK GAAP" will see many companies changing their financial reporting frameworks, and with a greater emphasis on IFRS-based financial reporting even while remaining under UK GAAP. Planning points will be considered, with the key theme that the transition to new UK GAAP can be planned and approached in a similar way to a transition to IFRS. Chapter 9 looks at the move to IFRS-based financial reporting in the USA, Brazil, China, India and Russia, focusing on how these countries have markedly different approaches to the harmonisation of their financial reporting standards and yet are all, to a greater or lesser extent, converging with IFRS.

Appendices are included for ease of reference on key information. Appendix 1 is a summary of all extant IFRS and Appendix 2 contains a list of reference material, further reading and e-learning resources. Appendix 3 is a useful collation of all of the IFRS planning action points that are included in the main text, and can be used as a checklist to ensure that all major planning considerations have been factored into the transition project.

INFORMATION SOURCES

Much of the content of this book draws on the past experience of reporting entities that have gone through the transition to IFRS-based financial reporting.Their experiences give rise to

valuable insights and provide learning points for entities that are yet to go through transition. Information sources that have been used to collate transition experiences include:

- Academic research in connection with, for example, costs of transition, impacts on share price, comparability of information;
- Professional body reports, for example, on transition issues faced in certain countries or in particular business sectors;
- Company websites – many companies have placed material on IFRS transition issues on the investors' sections of their websites;
- Press articles – these provide anecdotal evidence of transition issues that companies have faced.

In addition to the research based on these information sources, the author conducted face-to-face interviews with a range of individuals who have been involved with transitions in many different countries and from different perspectives. These interviews have provided themes, examples and case studies that are used in the book. In addition, a large number of other individuals provided detailed written responses to the interview questions and thought provokers that were used in the face-to-face interviews. The author's own experience of working with companies during their IFRS transitions has also provided material used in the book.

Throughout the book, and especially in the second part, case studies have been used to illustrate application of the themes being discussed. The case studies are based on the interviews conducted, and on the author's own experience. The case studies are all based on real reporting entities going through the transition to IFRS but the names of the interviewee or the reporting entity have not been included. This is largely at the request of interviewees who have provided their comments and opinions about the transitions they have been involved with but do not necessarily wish to reveal the reporting entity's identity.

Readers should note that there is much more information available on transition-related matters in certain jurisdictions than in others, and for that reason much of the discussion focuses on the situation in the EU, North America and Australia, which are the most researched areas. Wherever possible the discussions have been extended to include other jurisdictions, but unfortunately this has not often been possible. Hopefully, the lack of research and published material on transitions in other countries, especially in less developed economies, is a problem which will be corrected in the not-too-distant future, and subsequent editions of this book will be able to take discussions in a truly global direction.

In summary, the book provides an overview of how to plan and carry out a transition to IFRS-based financial reporting, and it discusses the wider implications within the organisation and to those external to it. Its content is unique in that it draws on personal experiences as well as professional and academic studies. It will help with decision making for those planning a transition, as well as providing essential information to individuals analysing financial information prepared under IFRS, and will also be useful for students of financial reporting who wish to understand the commercial implications of financial reporting matters.

I UNDERSTANDING THE FRAMEWORK OF PERFORMING A TRANSITION TO IFRS-BASED FINANCIAL REPORTING

1 INTERNATIONAL FINANCIAL REPORTING IN CONTEXT

Financial reporting is essentially a method of communication whereby a reporting entity presents financial information to interested external parties. As with any communication process, there need to be in place mechanisms for ensuring that the information being communicated is understandable and pertinent to the needs of users.

It was not until the mid-twentieth century that significant thought was given to how financial reporting should be regulated. The first part of this chapter considers how the international community began to debate the benefits of international harmonisation of financial reporting standards, and the steps taken to achieve that goal.

When the move towards an international financial reporting framework gathered momentum, a new regulatory framework began to develop, leading to today's environment in which the IFRS Foundation, through the International Accounting Standards Board (IASB), aims to develop a single set of high quality, understandable, enforceable and globally accepted International Financial Reporting Standards. The second part of this chapter summarises the role and status of the IASB and IFRSs, including a discussion of the main features of the standard-setting process.

The final parts of this chapter look at the current state of harmonisation with IFRS around the world, and given that more and more countries are adopting or converging with IFRS (a distinction that will also be explored), there is a preliminary discussion on the main accounting impacts that may arise when a reporting entity moves to follow the requirements of IFRS. It is important to note that both the accounting and non-accounting impacts of the transition vary greatly between reporting entities, even those operating in the same industry and in the same jurisdiction, and one of the themes running through this book is that the impact of IFRS must be assessed at the level of an individual reporting entity. However, it is useful in this first chapter to look at some examples to illustrate the type of accounting impacts that can take place, and the magnitude of them, as this helps in understanding the importance of planning the transition process properly.

1.1 THE DEVELOPMENT OF INTERNATIONAL FINANCIAL REPORTING

This section explores how international financial reporting has developed in the last 60 years or so, beginning with the development of national accounting standards. As economies expanded and companies and other organisations grew in size and status, individual countries tended to develop their own accounting rules, which were entirely appropriate to their own needs but arguably became less relevant with growth in international business and cross-border investment. The response to this was a demand for an international set of financial reporting standards, and this section will describe the development of the first stage of the international financial reporting regime, namely the International Accounting Standards Committee (IASC).

1.1.1 The Initial Development of Accounting Guidance and Reasons for, and Problems Caused by, National Differences in Accounting Requirements

In the late 1940s and the 1950s there was an unprecedented increase in international trade, leading to the formation and growth of multinational corporations. During this time barriers to international trade were lessened, which encouraged direct investment overseas, with the United Kingdom and United States being major contributors to the flow of capital around the world (Camfferman and Zeff, 2007). Economies encouraged international trade through the creation of international trading blocs; for example, the European Economic Community (EEC) was created by the Treaty of Rome of 1957, and through many stages evolved into the European Union, which has played a significant part in shaping the harmonisation of financial reporting. A major objective of the EEC was to promote the flow of capital between member countries, fuelling the movement of funds, people and goods between countries.

At the same time as the increase in cross-border investing and the development of multinational organisations, different jurisdictions were creating their own local financial reporting rules. National standard-setting bodies were established to oversee the development of accounting and financial reporting rules and regulations, leading to discrepancies in the accounting treatment of transactions and balances between different jurisdictions.

Regional accountancy bodies had been established, such as the American Institute of Certified Public Accountants (AICPA), the Institute of Chartered Accountants in England and Wales (ICAEW), the Canadian Institute of Chartered Accountants (CICA) and multinational organisations such as the Confederation of Asian and Pacific Accountants (CAPA). At conferences held in the 1950s and 1960s, discussions relating to the standardisation of accounting practices took place and the first calls for a harmonisation of accounting practice were heard. There were already inconsistencies in accounting treatments in different countries. An example of an early study into this issue found that some countries were very rules-based, while others allowed more flexibility in accounting practices; factors shaping the way a country developed its own accounting standards included the influence of the political and economic structure of the country, whether inflation was an issue, the influence of taxation policy, and the organisation of accounting and audit firms within the country (Kollaritsch, 1965).

There are many reasons for national differences in financial reporting, which include:

- Whether providers of finance are primarily creditors or equity holders – for example in countries such as the UK and USA, shareholders traditionally provide a significant proportion of finance, whereas in Germany, France and Spain, finance tends to be from external sources including banks or the state.
- The basis of the legal system including whether law is based on a common law or a code law system – for example in China the existence of code law creates a very different framework for business activity and financial reporting than in other countries where common law prevails.
- The relationship between taxable income and accounting income and how tax liabilities are determined, with this often helping to shape whether the financial reporting framework is more prescriptive or principle-based in nature – for example, in Japan a combination of code law and reporting primarily for tax reasons led to the development of a very prescriptive accounting regime.

- Cultural differences, such as attitude to secrecy of financial information and language and whether there is state control or professional regulation of financial reporting – this is discussed with relevance to Islamic finance principles later in this chapter.

One of the main problems with the development of different accounting regulations in different countries is that it acts as a barrier to the movement of funds between countries. A comparison between financial statements issued in different jurisdictions becomes problematical due to a lack of consistency in preparation and disclosure requirements, hindering cross-border investment. Hence, the move to an international regulatory framework, making comparability easier, should encourage both individuals and companies to invest overseas, having confidence in their analysis of financial statements which, though prepared in a different jurisdiction, follow familiar accounting principles and disclosure requirements.

For preparers of financial statements of multinational reporting entities, the lack of consistency when not using an international set of accounting rules means that time is spent preparing multiple sets of accounts using different principles and rules, and reconciliations between the different sets of accounts may be necessary. International harmonisation should allow the accounting processes of the individual components of a group to become streamlined, improving the efficiency of the accounting function and making consolidation a smoother process. It follows that there should be a reduction in the costs of preparing the financial statements and having them audited.

There are, of course, many commentators who argue that moving to IFRS does not necessarily lead to lower costs, and indeed the costs of transition itself can be significant. Others argue against the use of a global set of financial reporting standards and that individual jurisdictions should continue to play an important role in determining the financial reporting framework. However, the pace of harmonisation has gathered momentum over the last few decades, and the rest of this section will look at the development of the international regulatory regime for financial reporting.

1.1.2 The International Accounting Standards Committee

In 1973 the International Accounting Standards Committee (IASC) was formed. As discussed in Section 1.1.1, there had been a growing opinion in the accountancy profession that an international approach should be considered in the development of accounting standards. The aim was to develop accounting standards, to be called International Accounting Standards (IAS), with a general objective of promoting international harmonisation of accounting treatments.

The IASC was based in London and in its early years was a small organisation that met several times a year. Its members were representatives of national standard setters who contributed on a part-time basis to the work of the IASC (Kirsch, 2012). The national accounting bodies of the UK and Ireland, the United States, the Netherlands, Australia, Canada, France, Germany, Mexico and Japan were invited to join the IASC (Zeff, 2012). Each member body agreed to promote the use of IAS in their countries, but it is worth noting that many countries, in particular the UK and the US, continued to invest in the development of a robust set of national accounting standards. It was mainly developing nations that adopted IAS as their own financial reporting framework.

The IASC existed for 27 years and during that period its membership grew, with representatives from countries such as South Africa and Nigeria joining the committee, increasing the geographical spread of the organisation. A major event in the development of the IASC occurred in 1987 when the International Organization of Securities Commissions (IOSCO), of which the US Securities and Exchange Commission (SEC) had recently become a member, discussed with the IASC the possibility of IOSCO endorsing IAS for use on the securities markets of its members. The IASC worked on producing a set of core standards that would be submitted to IOSCO and this was a lengthy process. The IASC's first attempt at developing a core set of standards was the "Comparability/Improvements" project, which culminated in 1993. IOSCO did not endorse the IAS standards at this time, leading to the IASC developing a revised work programme called the "Core Standards Program".

A further driving force encouraging the IASC to develop its core standards was the increased appetite for a European capital market, the achievement of which it was believed would be helped by the use of international accounting rules. In addition, by the late 1990s the SEC had hinted that, subject to the core standards being of "high quality" and meeting certain criteria, their acceptance in US capital markets would be debated further. The SEC and AICPA were particularly critical of the many permissible accounting treatments of IAS (Kirsch, 2012), and the Core Standards Program looked closely at eliminating choice in the standards.

1.1.3 The Formation of the International Accounting Standards Board, and Endorsement of IAS by IOSCO and the EU

The membership of the IASC had grown in the 1990s, yet it was still essentially a relatively small organisation faced with an ever-increasing number of projects to deal with. The IASC issued 41 IASs during its existence, as well as numerous Standing Interpretation Committee documents, a Conceptual Framework and other guidance.

There was concern that high quality standards to meet the demands of a global set of stakeholders could not be developed realistically within the existing structure of the IASC. In particular there were calls for input from a wider geographical perspective, for more formal liaison with national standard setters, and for those appointed to deliberate and decide on financial reporting standards to have appropriate technical expertise. In May 2000 the IASC's member bodies, numbering 143 at the time (Zeff, 2012), approved the formation of the International Accounting Standards Board. The first chairman was David Tweedie, the former chair of the UK's Accounting Standards Board. Members of the IASB's board included representatives from a range of countries comprising the UK, USA, Australia, Canada, France, Germany, Japan, South Africa and Switzerland. Some of the members had a responsibility to liaise with national standard setters. The IASB was to issue accounting standards known as International Financial Reporting Standards (IFRSs) and adopted the IAS issued by the IASC.

One of the main objectives of the IASB in its early years was to agree with the US Financial Accounting Standards Board (FASB) a programme of convergence. In October 2002 the two bodies issued a Memorandum of Understanding (MoU), which became known as the Norwalk Agreement. The MoU's main objective was to start a series of projects that would ultimately remove differences between US GAAP and IFRS, a process that would involve the revision of existing standards and the development of new standards. The MoU has been revised periodically, and while there have been many success stories in terms of the alignment of US

GAAP and IFRS, at the time of writing full convergence has not been achieved and remains a controversial issue.

Several key events, which were to be fundamental to the international harmonisation of financial reporting, occurred at the start of the twenty-first century. Firstly, in May 2000, at the same time as the formation of the IASB, IOSCO endorsed the core IAS standards that had been developed by the IASC, recommending that its members permit incoming multinational users to use the standards for cross-border offerings and listings. This was a big step in establishing the credibility of IAS globally and was seen as a landmark decision for improved financial reporting at an international level.

Secondly, in June 2002 the European Commission announced that as part of its strategy towards a single capital market across its member states, EU listed reporting entities would be required to prepare financial statements using IAS from 2005. This ruling resulted from a disharmony that had developed in the member states over the previous two decades when accounting rules had been based largely on the fourth and seventh directives on company law issued by the European Commission. The directives had not led to the desired accounting harmonisation across the member states, leading to discussion of whether an alternative approach to harmonisation would be preferable. The directives were legislation and therefore cumbersome to issue, amend and enforce in different countries, and the attractiveness of the IASB's perceived more flexible approach to standard setting grew. In addition, in the 1990s there was a substantial increase in the number of European companies listing on non-European stock markets, notably the New York Stock Exchange, which encouraged the European decision makers to move away from an objective of accounting harmonisation within Europe to one of embracing a more global approach to harmonisation. The EU decision was momentous, as it was the first time that there was a commitment for IAS to be adopted as the primary reporting mechanism for such a large number of reporting entities.

There was, however, a controversial part of the EU policy on adoption of IAS. Part of the EU's strategy on IAS adoption was that the IAS followed by EU listed reporting entities would be those IASs that had been reviewed and endorsed for use in the EU. This led to concerns that the EU would cherry pick from IAS and only endorse those standards that suited implementation in the EU, leaving other less appealing standards un-endorsed. This led to some problems in the transition for EU companies, which will be discussed in subsequent chapters.

1.2 THE REGULATORY FRAMEWORK OF IFRS TODAY

1.2.1 The Overall Governance Structure and Standard-setting Bodies

The key bodies in the regulatory framework of IFRS are the IFRS Foundation, the IASB, the IFRS Interpretations Committee, and the IFRS Advisory Council, as summarised below.

The IFRS Foundation is a not-for-profit, private sector organisation, operating independently with the following principal objectives:

- To develop a single set of high quality, understandable, enforceable and globally accepted international financial reporting standards (IFRSs) through its standard-setting body, the IASB;
- To promote the use and rigorous application of those standards;

- To take account of the financial reporting needs of emerging economies and small and medium-sized entities (SMEs); and
- To promote and facilitate adoption of IFRSs, being the standards and interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs.[1]

The Foundation's trustees oversee the standard-setting process and appoint members to the other bodies. The trustees also review the effectiveness of the regulatory framework, safeguard its independence and are tasked with raising finance for the structure. The trustees come from geographically diverse areas and a range of professional backgrounds. The key objective is to develop a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. The Foundation wants to ensure that the standard-setting process is open and transparent, and that there is full consultation with investors, regulators, national standard setters, business leaders and the global accountancy profession.

The IASB is the independent standard-setting body tasked with developing and issuing IFRSs and the IFRS for Small and Medium-sized Entities (IFRS for SMEs). From July 2012 the IASB has 16 board members drawn from a wide geographical background, and the current Chairman is Hans Hoogervorst, who succeeded David Tweedie in July 2011. IFRS is developed via a consultation procedure known as "due process" which involves a number of stages:

1. **Setting the agenda, planning and research**
   The decision as to whether an item is added to the agenda is driven by the information needs of users of financial statements, in particular investors. Matters such as the possibility of increasing convergence, whether there is existing guidance, and resource constraints are also considered. Planning involves deciding whether to conduct the project alone or to involve another standard setter, and a working group may be formed to conduct the necessary research for a larger project.
2. **Discussion Paper**
   The issuance of a Discussion Paper (DP) is not a mandatory part of due process, but one will usually be issued for larger projects as a way for the IASB to obtain early feedback on the project and gauge the response of interested parties. A DP would normally include an overview of the issue, an outline of possible approaches that may be used including the IASB's views, and an invitation to comment.
3. **Exposure Draft**
   An Exposure Draft (ED) is a mandatory step in due process that describes in detail a proposed accounting treatment, taking the form of a proposed accounting standard (or amendment to an existing standard). An ED will be drafted based on comments from various sources including those invited from a DP (if issued), input from IASB staff researchers, the IFRS Advisory Council, and discussions held at public meetings. As with a DP, an ED includes an invitation to comment.

[1] *Extracted from the IFRS Foundation website at http://www.ifrs.org/The-organisation/Pages/IFRS-Foundation-and-the-IASB.aspx.*

4. **IFRS**
   Comments on an ED are considered by the IASB and, if necessary, the ED is re-exposed. Once the IASB is satisfied that the proposed accounting treatment has been debated appropriately, based on feedback from the ED, the IFRS is drafted and a ballot held. There may be several rounds of comments before this stage is reached if the IASB wishes to re-expose the matter in a series of EDs. After an IFRS has been issued, there will be a post-implementation review, involving meetings with national standard setters and other parties. The IASB aims to understand any practical issues and impacts that may have arisen in the implementation of the new accounting requirements.

The implication of the due process involved in developing or revising IFRSs is that for preparers of financial statements, including those planning a transition to IFRS, they should bear in mind that potential changes to existing accounting rules may influence the selection and development of accounting policies. It is therefore crucial to have an understanding not only of the existing IFRS requirements, but also the changes that may take place over the next few years, as indicated by the existence of DPs and EDs.

The IFRS Interpretations Committee (formerly known as IFRIC) is the IASB's interpretative body. The Committee looks into issues relating to existing IFRS, such as matters that arise on their practical application, and produces interpretations known as IFRICs, often on specific and specialised matters. The IASB approves the Committee's interpretations. The Committee comprises 14 members drawn from a variety of professional backgrounds and geographical areas.

The IFRS Advisory Council is not itself a standard-setting body. It provides advice to the trustees of the Foundation and to the standard-setting bodies and reflects the views of a wide range of interested parties including academics, investor groups, auditors, professional bodies, analysts and preparers of financial statements. The members are appointed by the trustees.

1.2.2 IASB Standards

At the time of writing there are 13 IFRSs issued by the IASB, as well as 27 IASs, which were issued by the IASC and remain effective. There are also many Interpretations and SIC documents which form part of IFRS. Appendix 1 sets out a list of all issued standards and documents.

The standards are published in hard copy annually in the "Red Book", which is the only official printed version of the IASB's pronouncements. As well as containing the full text of the standards, the "Red Book" also contains accompanying documents, such as illustrative examples, implementation guidance, bases for conclusions and dissenting opinions. There is also a "Green Book", which is a guide through the standards, and a "Blue Book", which contains the standards without early application. The IFRS Foundation offers a subscription service that provides access to all relevant IFRS information.

The standards and their technical summaries (but not accompanying documents) can be accessed free of charge on the IFRS Foundation website on registration with the site.

As part of its objective of encouraging the global adoption of IFRS, the IFRS Foundation considers it important that IFRS is translated into different languages. Indeed, it recognises that having IFRS translated into a particular language can have a crucial impact on whether IFRS is adopted by a country using that language. The IFRS Foundation has several policies on translation, including that there is only one translated version of IFRS, and that the translation process involves native speakers who are accounting experts.

The paragraphs contained in an IFRS are either bold type or plain type, and they have equal authority. The bold type paragraphs indicate the main principles of the IFRS. In addition, IFRSs have accompanying guidance which may or may not be an integral part of the IFRS, and if it is integral to the IFRS it is a mandatory part of the standard. Guidance states whether it is integral to the IFRS or not.

1.2.3 The Conceptual Framework

In 1989 the IASC issued the Framework for the Preparation and Presentation of Financial Statements (the Framework) that was subsequently adopted by the IASB. The Framework contains basic concepts that underpin the detail given in IFRS such as definitions of elements of the financial statements, measurement principles and the desired characteristics of useful information.

The Framework principles should be used in the absence of any specific requirements or guidance in financial reporting standards. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires the preparer of the financial statements to use judgement in developing and applying an accounting policy in the absence of any such specific guidance, and in making that judgement, the definitions, recognition criteria, and measurement concepts for assets, liabilities, income, and expenses in the Framework should be considered. These issues are discussed in more detail in Chapter 2.

In 2004 the IASB and FASB agreed to begin work on a joint project to develop a common conceptual framework. FASB has its own conceptual framework contained in documents entitled Statements of Financial Accounting Concepts, which, while containing some similar principles to the IASB's Framework, also contain many areas of difference. Without a common conceptual framework it was difficult to see how the IASB and FASB financial reporting standards could be harmonised. Progress on the joint project was slow for a number of reasons, and it was not until September 2010 that the first phase of the project was completed with the issuance by both the IASB and FASB of Phase A of the revised Framework, dealing with objectives of financial statements and qualitative characteristics. This was the first revision by either Board to their respective conceptual frameworks for several years, making the revisions noteworthy (Pounder, 2010).

Late in 2010 the project was paused while the IASB worked on more urgent projects, and the project was restarted in September 2012, but as an IASB-only project. A Discussion Paper dealing with the remaining chapters of the Framework was issued in July 2013.

The content of the Framework and its relevance to IFRS transition is discussed in Chapter 2. It is particularly important that the Framework principles are adhered to in selecting and developing accounting policies, so for first-time adopters of IFRS a sound understanding of those principles is essential.

1.2.4 The IFRS for SMEs

IFRS was developed to meet the needs of equity investors in companies in public capital markets. IFRS is therefore perceived as a detailed set of rules and principles, requiring comprehensive disclosures in the notes to the financial statements, which may not be entirely suitable for small and medium-sized entities with simple transaction streams and whose users have less need for detailed disclosures. The crux of the issue is that preparers of financial statements of small and medium-sized entities are reluctant, given the choice, to follow IFRS because the cost and effort of preparing IFRS-compliant financial statements would outweigh the benefit provided.

In 2003 the IASB began to deliberate views on a separate financial reporting standard for small and medium-sized entities, with the objectives being to meet user needs while balancing costs and benefits from a preparer perspective. A Discussion Paper was issued in June 2004, and an Exposure Draft in 2007. Field testing of the Exposure Draft was conducted, involving 116 small companies in 20 countries. Following largely positive feedback in relation to the field testing and Exposure Draft, the IFRS for Small and Medium-sized Entities (IFRS for SMEs) was published in July 2009.

The IFRS for SMEs is a self-contained standard of only 230 pages, representing a practical and cost-effective alternative to "full" IFRS. It is available for any jurisdiction to adopt, whether or not it has adopted full IFRS. Each jurisdiction must determine which entities should use the standard and so far, over 80 countries have adopted, or plan to adopt, the IFRS for SMEs.

Compared with full IFRS, it is less complex in a number of ways:

- Some topics are omitted because they are not relevant to typical SMEs.
- Some accounting policy options are not allowed because a more simplified method is available to SMEs.
- Simplification of many of the recognition and measurement principles.
- Substantially fewer disclosures (IFRS Foundation, 2012).

According to the IFRS for SMEs, small and medium-sized entities are entities that do not have public accountability, and publish general purpose financial statements for external users.

Although the title of the standard refers to the terms "small" and "medium", there is actually no size criterion used to determine which entities fall under its scope. Eligibility to use the IFRS for SMEs is largely dependent on whether the reporting entity has "public accountability". Essentially, an entity has public accountability if its debt or equity instruments are traded in a public market or if this is likely to be the case in the near future. The definition means that listed entities irrespective of size may not use it, and it effectively bars most financial institutions such as banks and building societies from being eligible.

It seems that the IFRS for SMEs should remove a potential barrier to harmonisation, as its conciseness, clarity of explanation and simplified accounting treatments have been well received by preparers of financial statements, encouraging those who may have been put off by the burden of full IFRS adoption to move to a more workable version of IFRS. Compliance with the IFRS for SMEs should bring similar benefits in terms of the comparability of financial

statements, and may also improve access to capital from international banks and other investors abroad, who are already accustomed to IFRS (Miller, 2010).

One section of the IFRS for SMEs deals specifically with transition to the standard, which can mean transition from national GAAP, from full IFRS, or a situation where an entity has not previously before published general purpose financial statements.

1.3 THE CURRENT POSITION ON INTERNATIONAL HARMONISATION OF FINANCIAL REPORTING

Earlier in the chapter, the harmonisation of accounting standards was discussed in relation to the history of the IASB. This section will further explore the situation today, and consider whether true global harmonisation will ever be achieved.

1.3.1 Convergence and Harmonisation

Convergence refers to the process of narrowing differences between national Generally Accepted Accounting Practice (GAAP) and IFRS, such that a country retains its own financial reporting standards which become more consistent with the rules and principles of IFRS (Kothari and Barone, 2011). There may be a number of reasons for a country deciding to retain its own GAAP, including political, legal and cultural issues which mean that the wholesale adoption of IFRS in place of national GAAP is not possible. The IASB will help countries following this route, recognising that convergence is a powerful driving force in the adoption of globally accepted financial reporting standards.

Currently the most common route to convergence involves the retention of partially or substantially converged national GAAP at the same time as allowing or permitting the use of IFRS for some reporting entities, for example, in many EU countries listed entities use IFRS (as adopted by the EU) and other entities are usually given the option to use national GAAP or IFRS. Other countries, notably those with no pre-existing national GAAP, may decide simply to adopt IFRS as their own financial reporting regulation. The IASB's Director of International Activities argues that this is "the simplest, least costly and most straightforward approach" (Upton, 2010).

According to the IASB, all major economies have established timelines to converge with or adopt IFRSs in the near future and it has been reported that approximately half of the Fortune Magazine Global 500 companies use IFRS (Danjou, 2013). It cannot be denied that the transition to IFRS has gathered pace in the last decade, and IFRS reporting is now the norm, rather than the exception, for major companies around the world.

As previously discussed, a major boost for harmonisation was the EU regulation requiring that from 2005 all EU listed reporting entities are to publish their consolidated financial statements using IFRS rather than national GAAP. This spurred other countries such as Australia, South Africa, and Hong Kong, amongst many others, to adopt a similar regulation. There then followed a second tranche of countries converging with IFRS, including Argentina, Canada, Mexico, and Russia. At the time of writing many more countries are deliberating convergence and others, for example, Japan and India, are at various stages in the process of convergence.

In June 2013, the IFRS Foundation released information on a survey completed on the adoption of IFRS around the world, which represented the first phase of an initiative to assess the progress

towards global adoption of IFRSs. The work so far completed indicates that IFRS is being adopted on a wide scale, with 95% of the jurisdictions included in the survey having made a public commitment supporting IFRSs as the single set of financial reporting standards suitable for global application, and with 80% having already adopted IFRSs as a requirement for all or nearly all companies whose securities are publicly traded (IFRS Foundation, 2013e).

It is not just the IASB championing the use of globally accepted financial reporting standards. The international convergence efforts of the IASB are also supported by the Group of 20 Leaders (G20) who, in 2009, called on international accounting bodies to redouble their efforts to achieve this objective within the context of their independent standard-setting process. In particular, they asked the IASB and the FASB to complete their convergence project. The fact that the G20 leaders specifically highlighted the issue of US convergence (or lack of) with IFRS indicates that this is seen as a significant problem for harmonisation.

Despite the fact that so many countries require or permit the use of IFRS, some commentators argue that there is perhaps a misconception surrounding this, and that actually the adoption of IFRS is less widespread than is commonly thought. For example, in many jurisdictions the use of IFRS is only required for listed entities, leaving the large number of non-listed entities which commonly make up the majority of companies in a country to use local GAAP or, in some countries, giving them a choice to move to IFRS if they wish to do so (in which case many decide to stay with local GAAP). In addition, some jurisdictions require or permit a locally adapted version of IFRS, for example, in the EU, where listed entities follow EU-adopted IFRS rather than IFRS as issued by the IASB. There are also national factors, which means that when IFRS is adopted, it is applied in different ways in different countries, with the legacy of the previously applied GAAP retaining an influence over the selection and development of IFRS accounting policies.[2]

1.3.2 Convergence of US GAAP and IFRS

As discussed in Section 1.1, from its formation a primary aim of the IASB was to work towards convergence with US GAAP, leading to the Norwalk Agreement and the Memorandum of Understanding (MoU) between the IASB and FASB. Although significant progress has been made, there still remains some uncertainty over how fully converged US GAAP and IFRS will ever become.

Since the MoU was first agreed many joint projects have been completed; the MoU was updated in 2008, and in 2009 the IASB and FASB issued a joint statement reaffirming their commitment to the MoU. In this statement strategies were described, which would ensure the timely completion of projects on financial instruments, consolidations, derecognition, fair value measurement, revenue recognition, leases and financial statement presentation. The completion of these projects would eliminate, as far as possible, the areas of significant difference between IFRS and US GAAP. However, progress has not been as speedy as hoped and several of the projects are not yet complete. Three projects have been earmarked as priorities, namely: leases, financial instruments and revenue recognition.

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[2] *For a more detailed discussion of the actual extent of IFRS adoption across the world, academic literature contains debates on this issue, for example "The continued survival of international differences under IFRS" by Chris Nobes (Nobes, 2013b).*

In 2007 two significant announcements were made by the SEC, which led many to believe that the US standard setters and regulators were very much in favour of convergence. Firstly, the SEC eliminated the need for accounts prepared by foreign private issuers to contain a reconciliation between the financial reporting framework under which the financial statements had been prepared, often IFRS, and US GAAP. Secondly, the SEC announced that IFRS might, in the future, be permitted as an alternative to US GAAP as the financial reporting framework for entities filing financial statements in the US. However, progress towards this has been slow, largely due to the MoU projects taking longer than anticipated to complete.

In May 2011 the SEC issued a staff paper which explored the possible methods of incorporating IFRS into US GAAP. In the paper, the idea of convergence had been replaced with the concept of "condorsement", introducing new terminology into the harmonisation debate (SEC, 2011a). The condorsement framework, combining elements of the endorsement and convergence approaches to harmonisation, involves the retention of US GAAP, with the FASB incorporating elements of IFRS into US GAAP over a period of time, the period discussed in the paper being five to seven years, to achieve convergence of US GAAP and IFRS. The FASB would then endorse IFRSs issued by the IASB and have the ability to amend them before incorporating them into US GAAP.

At the time of writing no further major developments have taken place in respect of the US harmonising with IFRS. In January 2013, the Chairs of both the IASB and FASB reaffirmed their commitment to eliminating areas of difference between US GAAP and IFRS, but it seems that progress will continue to be slow. The specific transition issues relating to the USA are discussed in more detail in Chapter 9.

1.3.3 Harmonisation Challenges – a Cultural Perspective

Despite the growth in the use of IFRS across the world, there are some areas and jurisdictions in which the move to IFRS faces significant challenges. A detailed discussion is beyond the scope of this book, but it is important to highlight at least some of the issues, which mean that IFRS may never be truly globally accepted, and that in some locations local GAAP will remain the main mechanism for financial reporting.

Cultural issues are very important and can create a significant barrier to harmonisation. In many parts of the world, Islamic culture has a significant influence on financial reporting. For instance, under Islamic finance doctrines, interest is not charged on borrowings due to a principle which forbids a fixed rate of return. To cope with these cultural influences, a range of Islamic (Sharia-compliant) financial transactions have developed, such as alternatives to traditional commercial mortgage arrangements, and methods of financing new business ventures that do not rely on interest-bearing finance. This clearly causes issues with the application of some financial reporting rules, especially in relation to financial liabilities and finance charges and means that IFRSs such as IFRS 9 *Financial Instruments* and IAS 18 *Revenue* would be extremely difficult to apply to these transactions. There are also Sharia-compliant insurance arrangements and leasing contracts, to which the application of IFRS principles would be difficult. Another example, relating to disclosure requirements, is from Egypt, where the disclosure of related party transactions is prevented by cultural taboo, making application of IAS 24 *Related Party Disclosures* difficult (Outa, 2013).

Although it would seem that accounting for balances and transactions in a way that complies with both IFRS and Sharia principles is unlikely to be possible, many commentators argue that this is not the case, and indeed many global organisations, including banks, do manage to achieve this. The principles-based nature of IFRS means that there is some flexibility in applying the standards, which eases the situation somewhat.[3]

In response to the specific type of financial arrangements prevalent in Islamic countries, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has developed a series of standards on accounting, audit, governance and ethics, with many of the financial reporting standards focusing on Islamic finance. The standards are followed by organisations that wish to be Sharia-compliant, including some global banks and finance companies (Krom, 2013).

Countries influenced by Islamic culture have responded to the issue of whether IFRS and Islamic principles of conducting business are compatible in different ways. In Malaysia, for example, the Malaysian Accounting Standards Board has issued IFRS-compliant Malaysian Financial Reporting Standards (MFRS) and has an Islamic Technical Unit to address issues of potential difficulty in applying MFRS to Islamic finance transactions and balances. However, in other countries it would seem that the cultural issues are more of a barrier to IFRS adoption, for example in Iran, where a recent study concluded that for a number of factors it would be difficult to envisage a situation where IFRS was fully adopted (Kangarlouei, Agababa, and Motavassel, 2013).

1.4 THE BENEFITS AND IMPACT OF MOVING TO IFRS

There are many advantages to moving to an IFRS-based financial reporting framework, and while the transition itself inevitably has cost and other implications, for many organisations the move to IFRS brings benefits in the long run. The first part of this section discusses the general potential benefits. The discussion then moves on to provide an overview of the impact that transition can have on reported results, looking at performance and financial position and the relevant disclosures in notes to the financial statements.

1.4.1 The Benefits of Moving to IFRS

There are many benefits cited for organisations that use globally accepted financial reporting standards. The first is the greater comparability that using such standards can bring. The idea is that by using IFRS, the financial statements of reporting entities being produced from a consistent framework and set of requirements should be comparable, allowing existing and potential investors, as well as other users of the accounts, the ability to compare more easily their reported results and financial position. This should, in turn, encourage investment. The theory is that for investors the improved information environment creates lower risk investments; for companies there should be better access to capital from a range of investors all over the world, and there should be a reduction in the cost of capital. Much academic work has been performed on the cost of capital issue, some of which concurs with the suggestion that cost of capital does decrease subsequent to IFRS adoption, but overall the results are not overwhelmingly conclusive on this point (Brüggemann, Hitz, and Sellhorn, 2013). However,

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[3] *For a discussion of the application of IFRS to Islamic finance transactions, the PwC report "Open to Comparison: Islamic Finance and IFRS" is a good point of reference (PwC, 2010a).*

from a purely practical point of view it is undoubtedly easier to make comparisons between two sets of financial statements prepared under IFRS than if they were prepared under completely different accounting standards, so the ease of comparability is enhanced even if there is not a marked effect on capital markets.

There are also more direct benefits to businesses. For example, the use of financial reporting standards that are consistent with industry peers across the world can open up business opportunities and make companies themselves more willing to invest overseas, and not just attract an inflow of overseas funding. The use of the same financial reporting framework removes barriers to overseas investment. For instance, an American study suggests that migrating to IFRS-based financial reporting allows even small companies to reduce operating costs when engaging in overseas business and to reduce the risk of investing overseas (Etnyre and Singhal, 2011). And other studies indicate that by using IFRS, companies are able to more effectively contract with customers and suppliers (Hail, Leuz, and Wysocki, 2010).

In addition, there might be actual cost savings in the long run; for example, where there is no longer a need to reconcile financial statements produced under one country's GAAP to that of another in the case of companies with multiple stock exchange listings. Some companies will take advantage of the transition project and build into it other changes that benefit the business; for example, improving information systems or strengthening controls over financial reporting. It then becomes difficult to differentiate the benefits directly consequential to the IFRS transition from the other added-value benefits, but overall it is a positive experience for these companies. For multinational companies there are definite advantages in terms of simpler consolidation processes, and when all accounting staff are IFRS-literate there are benefits of easier labour mobility and economies of scale from standardised financial reporting packages.

However, despite the benefits outlined above, it cannot be denied that for many businesses the transition to a new set of accounting standards is costly, time-consuming and disruptive. When surveyed, many accountants respond that they feel the benefits of moving to IFRS do not outweigh the costs involved. This attitude is hopefully only short term, as in the long run there are definite advantages to companies, especially if they embrace the potential opportunities offered by the transition to engineer business improvements and improve both internal and external communication of financial information.

1.4.2 Impact on Profitability and Performance

There is plenty of evidence available on the impact of IFRS on financial statements, but this is a very difficult issue to generalise, as the nature and significance of impacts will vary depending on factors such as:

- The level and nature of differences between previous GAAP and IFRS – this will affect the impact on a jurisdiction level basis – for example, whether previous GAAP is based on similar principles to IFRS. Research shows that there are big differences in the impact of moving to IFRS on a country-by-country basis.
- The existence of any industry sector factors that necessitate the application of IFRS requirements with particular impacts on certain line items in the financial statements – this includes, for example, financial institutions applying hedge accounting.

- The degree to which organisations are inclined to make changes to accounting policies, i.e., whether they only make absolutely essential changes to comply with IFRS or embrace a wider consideration of their accounting policies.
- The influence of audit firms in the selection and development of accounting policies, and the required level of disclosure in notes to the financial statements.

The specific impacts of moving to IFRS on financial performance and position will depend on matters such as those listed above, and vary from country to country. To provide an example of the impacts seen when companies move to report under IFRS, this section will take perhaps the most significant wave of transitions to IFRS, that of EU transition in 2005, and consider the impacts seen there to illustrate the effect of adopting IFRS. As discussed in Section 1.1, the EU passed legislation in 2002 that mandated the use of IFRS by EU listed groups from 2005. This affected more than 8,000 reporting entities and is the wave of transition that has been most studied by academics, professional firms and regulatory bodies, and therefore provides some important insights into the impact of transition.

Generally, for EU companies, profit was found to increase on the move to IFRS. This is demonstrated in several studies. In an academic study of 241 UK listed companies (excluding banks, insurance and pension firms), it was found that IFRS implementation generally improved profit measures such as operating and net margins, and earnings per share figures also were higher under IFRS than under UK GAAP (Iatridis, 2010).

Another study looked at the impact of IFRS transition on equity for firms in different industries. It showed that the impact varied even within the same industry, indicating that the impact of transition depends largely on the accounting policies of individual companies within an industry sector (Aisbitt, 2006). For example, the research looked at the impact on equity for companies within the consumer services industry when they moved to IFRS reporting. The results showed that for 8 of the 25 companies their equity figure increased under IFRS; for the remaining 17 companies their equity figure decreased under IFRS.

A study by the Institute of Chartered Accountants in Scotland (ICAS, 2008) examined the impact of moving to IFRS on the financial statements of Italian, UK and Irish companies.The average increase in net profit on moving to IFRS was found to be 48.5%. The accounting areas that contributed most to the increased profit were business combinations, financial instruments and investment properties, though there were some accounting areas that tended to reduce profit, namely tax, share-based payment and leases. Similar results were seen in an academic study of companies in the same three countries, which found that business combinations, tax and pensions accounted for much of the reconciling items between previous GAAP and IFRS as disclosed in the first IFRS financial statements (Fifield *et al.*, 2011).

Literature on this topic stresses that impacts will be different for individual companies, but the general trend of increased profit is interesting. To show the magnitude of some profit impacts, example reconciliations from profit as reported under previous GAAP to that reported under IFRS are shown below. For detailed discussion of the accounting policy changes giving rise to the adjustments, explanations are provided in the notes to the financial statements which can be accessed on the company websites. For ease of comparison, the reconciliations have not been taken from the annual reports as published, the data have been extracted and converted to simple tables.

Case Study 1.1: BSkyB Plc's Reconciliation of Profit on Transition to IFRS

	£ million
Profit for the year as reported under UK GAAP	**425**
IFRS adjustments:	
Share-based payments	(13)
Financial instruments and hedge accounting (IAS 21)	(34)
Financial instruments and hedge accounting (IAS 39)	45
Goodwill	148
Intangible assets	8
Others	(1)
Total IFRS adjustments	**153**
Profit for the year as reported under IFRS	**578**

Source: British Sky Broadcasting Group plc website www.corporate.sky.com (Sky Annual Report, 2006). Reproduced by permission.

Comment: BSkyB, like many other UK companies, had a significant adjustment to profit in relation to the non-amortisation of goodwill under IFRS, compared with an annual amortisation charge under UK GAAP. Other adjustments typical of many companies were made for employee share-based payment expenses recognised for the first time, and for financial instruments measured at fair value.

Case Study 1.2: Centrica Plc's Reconciliation of Profit on Transition to IFRS

	£ million
Profit for the year as reported under UK GAAP	**675**
IFRS adjustments:	
Petroleum revenue tax	(48)
Leases	4
Retirement benefits	(41)
Goodwill	119
Other income taxes	1
Employee share schemes	(1)
Discontinued operations	(72)
Total IFRS adjustments	**(38)**
Profit for the year as reported under IFRS	**637**

Source: Centrica Group website www.centrica.com (Centrica, 2005). Reproduced by permission.

Comment: For Centrica, a leading supplier of energy to the UK's national grid, a significant industry-specific adjustment was made to revenue, as well as some adjustments common to most companies in respect of pensions and goodwill, and other smaller adjustments. Unlike many companies, Centrica's overall profit was smaller under IFRS than UK GAAP.

1.4.3 Impact on Financial Position

Studies indicate that equity is generally lower under IFRS than previous GAAP for EU companies. The ICAS survey referred to previously reveals that, on average, the total value of

equity reported under IFRS is 85.6% of its value under previous GAAP (ICAS, 2008). In the EU transition, a significant downwards equity adjustment was often recognised in respect of employee benefits. The reason for employee benefits causing a reduction in equity is related to the fact that at the time when defined benefit pension plans were required to be recognised in the reporting entity financial statements for the first time, many of them were in deficit, resulting in sometimes very significant liabilities being recorded in many organisations' balance sheets. The reasons for the reduction in equity caused by the other accounting issues tend to be more entity-specific.

To show the type of adjustments made to equity, reconciliations of equity as reported under previous GAAP to those reported under IFRS at the date of transition are shown below:

Case Study 1.3: BSkyB Plc's Reconciliation of Equity on Transition to IFRS

	£ million
Equity as reported under UK GAAP at 1 July 2004	**90**
IFRS adjustments:	
Share based payments	24
Financial instruments and hedge accounting (IAS 21)	86
Financial instruments and hedge accounting (IAS 39)	(100)
Events after the reporting date	63
Associates and joint ventures	3
Total IFRS adjustments	**76**
Equity as reported under IFRS	**166**

Source: British Sky Broadcasting Group Plc website www.corporate.sky.com (Sky Annual Report, 2006). Reproduced by permission.

Comment: The largest reconciling item relates to financial instruments, these are mainly foreign currency hedges. The amount shown in the reconciliation is net of a deferred tax asset arising on the recognition of the derivative financial liabilities.

Case Study 1.4: Centrica Plc's Reconciliation of Equity on Transition to IFRS

	£ million
Equity as reported under UK GAAP 1 January 2004	**2,737**
IFRS adjustments:	
Intangible assets	388
Property, plant and equipment	(81)
Joint ventures	61
Deferred tax assets	381
Financial assets	22
Current tax assets	(31)
Trade and other receivables	(39)
Other financial assets	(745)
Cash and cash equivalents	723
Trade and other payables	129
Current tax liabilities	(30)
Bank overdrafts and loans	(3)

	£ million
Bank loans and other borrowings	(326)
Deferred tax liabilities	49
Retirement benefit obligation	(1,108)
Total IFRS adjustments	**(610)**
Equity as reported under IFRS	**2,127**

Source: Centrica Group website www.centrica.com (Centrica, 2005). Reproduced by permission.

Comment: The biggest item in Centrica's equity reconciliation is the reduction in equity attributable to the defined benefit pension plan, in common with many other companies moving to IFRS at this time. This is, to some degree, offset by the increase in equity caused by recognition of more intangible assets, some of which relate to business combinations. Many of the other adjustments shown are purely cosmetic, presentation adjustments, having no overall impact on equity.

The use of these case studies is partly to illustrate the type and scale of IFRS adjustments made, but also to highlight the fact that IFRS adoption will vary for all reporting entities. Even within the same industry and in the same jurisdiction there is likely to be much variety in the impact that IFRS transition has on reported results and on equity. This is why assessing the accounting impact of moving to IFRS reporting is such a crucial exercise when planning the transition. Despite the plethora of information on the differences between previous GAAP and IFRS for most major economies, this information itself cannot determine the accounting issues and required solutions on IFRS adoption – this must be done for each entity moving to IFRS on a line-by-line basis. Even within a group of companies, each legal entity may have very different accounting issues and therefore different issues to consider on the transition to IFRS, so the IFRS impact assessment must be done for each separate legal entity. Chapter 5 covers assessing the steps involved in accounting impact in detail.

1.4.4 Volatility and Fair Value Accounting

It is often assumed that adopting IFRS will lead to more volatile profit and equity figures. This perception is usually linked to the extensive use of fair values in IFRS, particularly the practice of recognising changes in fair value within profit, often referred to as mark to market accounting. This accounting technique is particularly relevant to accounting for financial instruments, and its effects are seen most readily in the financial statements of banking and finance companies, as well as companies in other industries that make extensive use of hedge accounting techniques. Fewer studies have been made on volatility than on the other impacts of adopting IFRS, but one study concludes that while adopting IFRS is likely to increase volatility in book values and reported earnings due to the use of fair value accounting, it does not necessarily mean that an organisation cannot service its debt or will suffer financial distress (Iatridis, 2010). Another study found that companies adopting IFRS for the first time experience statistically significant increases in market liquidity, especially in jurisdictions with a large difference between previous GAAP and IFRS (Daske *et al.*, 2008).

The IASB supports the use of fair value accounting, the rationale being that for financial statements to truly reflect the financial performance of a business, up-to-date values for assets and liabilities must be included, and that changes in value, where appropriate, should be reflected in performance measurement. The IASB recognises that this may lead to volatility

in profit, but argues that volatility reflects economic conditions and commercial reality, and that it is important for users to understand the true performance of the business and the risk profile of the organisation. Fair value measurements also help users to evaluate the timing and amount of future cash flows.

While fair value accounting is used for many items in the financial statements, it is part of a mixed measurement model, and other measurement techniques such as depreciated cost, amortised cost and recoverable amount are just as prominent in the financial statements of many reporting entities. When given a choice, relatively few reporting entities choose to measure at fair value.

Hans Hoogervorst, IASB Chairman, is keen to play down the prominence of fair value accounting in IFRS. In a speech delivered in Tokyo at the opening of the IFRS Foundation regional office in Asia-Oceania in 2012, he emphasised that IFRS favours a mixed measurement approach, and while fair value is relevant for actively traded financial instruments, it is much less relevant to use fair value for assets such as property, plant and equipment (Hoogervorst, 2012).

It seems reasonable to conclude, therefore, that while volatility will be a feature of the financial statements for certain industries, for the vast majority of companies that do not have significant holdings of financial instruments it will not be a significant issue unless an active decision is taken to measure certain items at fair value where that option is permitted.

1.4.5 Impact on Level of Disclosure

A common problem perceived with moving to IFRS is that the level of disclosure required in the notes to the financial statements will increase dramatically. It is true that IFRS is demanding in terms of disclosure and that organisations often underestimate the amount of time and effort that will need to be put into preparing the necessary notes.

A study by Ernst and Young found that the first IFRS financial statements were 20%–30% greater in length compared to the previous year, with the number of pages of notes to the accounts numbering 65 on average (Ernst and Young, 2006). A report by BDO found that first-time adopters of IFRS saw a volume increase of 20–30 pages in their annual reports as a consequence of IFRS adoption (BDO, 2010). And the ICAS study mentioned previously found that for Italian companies there was a particularly pronounced impact on disclosure, with an average of 73 extra pages of disclosure in the first IFRS financial statements (ICAS, 2008).

This illustrates not only the amount of extra disclosure required in the first IFRS financial statements, but also that the application of IFRS and the significance of change that is needed in financial statements to ensure IFRS compliance does vary from country to country.

The disclosures needed in the first IFRS financial statements are extensive, largely down to the one-time requirements of IFRS 1 *First-time Adoption of IFRS* – the application of this standard is discussed in detail in Chapter 3. In subsequent accounting periods, less disclosure specific to the transition will be provided, but it is likely that on an ongoing basis the financial statements will be longer under IFRS than they were under previous GAAP.

Of course, it is not just the quantity but the quality of information that is important to users of the financial statements. If there is no benefit in terms of providing better quality information, then the whole principle of IFRS-based reporting would seem flawed. The quality of information is a subjective matter, but studies have been conducted to try to gauge whether the quality of financial statement disclosures are materially improved on the switch to IFRS. For example, one recent study concludes that moving to IFRS improves the information environment, allowing users of the financial statements to make more accurate forecasts (Horton *et al.*, 2013). A different study also concluded that IFRS adoption leads to better quality of information and in addition that information is more comparable between firms (Yip and Danqing, 2012). Therefore, for users of the financial statements there is some comfort that while they have more information to digest under IFRS, that information should also be more relevant to their needs.

For the preparer of the financial statements, providing all of this additional information can be quite onerous. Anecdotal evidence from those that have gone through IFRS transition indicates that a substantial amount of the transition implementation involves ensuring that the right data are collected for disclosure in the notes. This is particularly the case for companies with complex financial instruments, where a whole standard, IFRS 7 *Financial Instruments: Disclosures*, is devoted to narrative and numerical disclosure requirements. There are also detailed disclosure requirements in many other areas, particularly for defined benefit pension plans, business combinations and segmental reporting, many of which will be new or significantly different in nature and extent to the disclosure requirements of previous GAAP.

As well as disclosures specific to certain accounting issues, companies may be surprised at the extent of general disclosure that is needed in relation to the accounting policies applied, and the areas of significant judgement in the financial statements. While most jurisdictions had some requirement for disclosure of accounting policies in previous GAAP, not all had a requirement specifically in relation to where significant judgement had been applied. It is common to see these disclosures amounting to at least one page of narrative, and often more.

1.4.6 The Influence of National GAAP on IFRS Accounting Policies

It is interesting to note that between countries, the impact of IFRS differed, as some elements of national identity were retained post-IFRS implementation. Financial statements tend to retain legacies of previous local GAAP at the same time as being IFRS-compliant. Evidence shows that companies adopt IFRS by selecting accounting policies that minimise changes from previously applied local GAAP, making the move to IFRS an "easy fix" as far as possible. This is particularly seen in presentation choices. For example, one study looked at how UK and French companies presented statements of changes in equity. The results showed that all French companies surveyed presented a single statement, consistent with previously applied French GAAP; whereas almost all UK companies presented two separate statements, consistent with previously applied UK GAAP (Ernst and Young, 2006). The same review also found that choices relating to the classification of operating expenses by function or by nature also depended strongly on practice under previous GAAP.

Similarly, retention of national identity was seen in a KPMG review which found little similarity in presentation choices between countries, and that the financial statements of different industries within countries were more comparable than those in the same industry but in different countries (KPMG, 2006).

A further academic study provides numerous examples of companies retaining previous GAAP accounting policies where possible under IFRS. The research demonstrates that there is a continuation of national accounting policies and that few companies change their accounting policy where a choice exists between a previously applied policy and a new policy where both are permissible under IFRS. This applied equally to complex matters such as accounting policy choices in relation to pensions, and to more cosmetic presentation differences such as the classification of expenses (Kvaal and Nobes, 2010). This research was updated in 2013 and extended to include the Canadian transition to IFRS, and established that national identity remains a significant determinant of IFRS accounting policies even several years after transition to IFRS (Nobes, 2013a).

CONCLUSION

This chapter has shown how the globalisation of financial reporting has developed over recent decades, beginning with tentative conceptualisations of the benefits of harmonisation, the development of the IASC and IASB, and the IASs and IFRSs, through to the present day, where many of the world's largest corporations report using IFRS-based financial reporting rules. It is clear that IFRS offers a set of principles and rules that are attractive to reporting entities and their stakeholders, and even in countries like the USA, which are more reticent about moving completely to IFRS, there is recognition that a global set of standards is desirable and that there is a risk in being left out of the move to IFRS. In many countries the IFRS for SMEs is a good option for financial reporting in that its simplified rules and disclosure requirements should be relatively easy to implement for smaller organisations.

The final part of this chapter has highlighted the accounting and disclosure impacts of moving to IFRS, focusing on the European experience. The examples used and the results reviewed, and surveys of financial statements post-IFRS implementation indicate that in the case of transition to IFRS, the impacts will differ significantly between reporting entities. This makes the planning of the transition for entities yet to adopt IFRS an extremely important issue. Effective planning can reduce some of the impacts, but where this is not possible, consideration needs to be given to a proper explanation of the impacts, to ensure that they are communicated in an understandable and timely manner.

2 THE CONCEPTUAL FRAMEWORK OF IFRS, ACCOUNTING POLICIES AND THE PRESENTATION OF FINANCIAL STATEMENTS

This chapter introduces the fundamental concepts underpinning reporting under IFRS including the main principles of the conceptual framework, how accounting policies should be determined under IFRS, and the content and presentation of the financial statements. An understanding of the Framework for financial reporting is crucial for anyone wishing to understand the development and selection of IFRS-compliant accounting policies, as its concepts underpin many more specific IFRS requirements.

This chapter will also highlight the use of judgement that is needed when developing accounting policies and the use of estimates, which can play an important part in shaping the overall performance and position of the reporting entity as portrayed in the financial statements. In some jurisdictions there is no equivalent to the IASB's Conceptual Framework for Financial Reporting, in which case many of the principles explained in this chapter will be unfamiliar. Where transitions are being planned in such jurisdictions there will be a significant learning curve for management, especially if the previously applied GAAP was fairly prescriptive in nature.

The presentation of financial statements is also covered in this chapter, and again this may represent a big difference from the presentation requirements of the previously applied GAAP. Preparers of financial statements need to understand the choices they have to make in terms of how items are presented on the face of the financial statements. In jurisdictions where previous GAAP was prescriptive, for example, being based on legislative requirements, the flexibility offered by IAS 1 *Presentation of Financial Statements* may come as a surprise. The users of the financial statements also need to understand the new ways in which financial information may be presented under IFRS, particularly in respect of disclosures that are completely new to them – the requirement to present elements of other comprehensive income being a good example – as it is not required in many GAAPs other than IFRS.

2.1 THE FRAMEWORK

2.1.1 The Purpose and Status of the Framework

The Framework was originally published in 1989 with the full title The Framework for the Preparation and Presentation of Financial Statements. It was reissued in 2010 as the Conceptual Framework for Financial Reporting (the Framework). The Framework contains the fundamental accounting principles that underpin the preparation and presentation of general-purpose financial statements.

The purposes of the Framework are stated as:

(a) to assist the Board in the development of future IFRSs and in its review of existing IFRSs;
(b) to assist the Board in promoting harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by IFRSs;
(c) to assist national standard-setting bodies in developing national standards;
(d) to assist preparers of financial statements in applying IFRSs and in dealing with topics that have yet to form the subject of an IFRS;
(e) to assist auditors in forming an opinion on whether financial statements comply with IFRSs;
(f) to assist users of financial statements in interpreting the information contained in financial statements prepared in compliance with IFRSs; and
(g) to provide those who are interested in the work of the IASB with information about its approach to the formulation of IFRSs (Framework Introduction).

2.1.2 The Content of the Framework

Table 2.1 summarises the chapters and main content of the Framework. Some of the key principles are discussed in more detail in the section following.

2.1.3 General Purpose Financial Statements

The Framework refers to the objective of general purpose financial statements as being to provide financial information that is useful to present and potential equity investors, lenders and other creditors in making their decisions as capital providers. It goes on to state that information that is decision-useful to capital providers may also be useful to other users who are not capital providers (Framework OB2).

It is useful to consider that, although the financial statements are intended for general use, for example, by the entity's customers and employees, and wider user groups including government bodies and the general public, the Framework focuses on capital providers as the key user group.

The Framework emphasises that capital providers need information that will help them to form an expectation about returns, and that this is dependent on being able to assess the amount, timing and uncertainty of future net cash flows. This, in turn, depends on there being information available about the resources of the reporting entity, claims against those resources and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources (Framework OB4).

This is an important point, as it underpins the rationale that users of the financial statements are likely to be primarily concerned with financial position, as this will enable an analysis of liquidity and solvency. Financial position is based around the concept of the reporting entity having resources available (assets), and that there will be claims against the entity (liabilities) – this is the Framework's way of explaining assets and liabilities as the building blocks of financial reporting under IFRS.

Table 2.1 Chapters of the Framework

Chapter	*Key content*
1. The Objective of General Purpose Financial Reporting	Objective of financial statements in providing useful information to a wide range of users. One element of useful information is financial position, i.e., economic resources available, and claims against those resources. Other elements of useful information are concerned with financial performance and prospects for future cash flows.
2. The Reporting Entity	Definitions and discussion of the concept of the reporting entity including the concept of control and whether a portion of an entity can be a reporting entity.
3. Qualitative Characteristics of Useful Information	Relevance and faithful representation are the two fundamental characteristics of useful information. Relevance includes the concept of predictive value and includes consideration of materiality. Faithful representation infers completeness, neutrality and information that is free from error. Comparability, timeliness, verifiability and understandability enhance the usefulness of information that is relevant and faithfully represented. The cost and benefit of providing information should be a consideration.
4. Elements of Financial Statements and Measurement Basis	Going concern is the underlying assumption. The elements of financial statements defined and explained including financial position – assets, liabilities and equity; financial performance – income and expenses. Recognition criteria include assessing the probability of future economic benefit and the reliability of measurement. Different measurement bases are available including historical cost, current cost, realisable value and present value. Concepts of capital maintenance and the determination of profit.

Notes to Table 2.1:
Chapters 1 and 3 were issued in 2010 by the IASB as a result of the joint IASB and FASB project and now form two of the chapters of the Conceptual Framework for Financial Reporting.
Chapter 2 was reviewed as part of the joint IASB and FASB project, resulting in an Exposure Draft in 2010. This part of the Framework, along with Chapter 4, is now under review in the IASB-only Conceptual Framework comprehensive project, and a target date for completing the whole project of 2015.

Users are also interested in financial performance, as this allows the users to analyse the return made on the resources available to the entity. The Framework begins its discussion of financial performance by explaining that changes in economic resources and claims result from financial performance and from other transactions such as issuing equity. Therefore, it is important to see that financial performance, while providing useful information in its own right, conceptually is just one factor that alters the financial position of the reporting entity. Financial performance includes information reflected by accruals accounting and information reflected by past cash flows; hence the need to provide both a statement showing income and a statement showing cash flows as elements of the financial report.

2.1.4 Qualitative Characteristics

It is worth discussing the qualitative characteristics in a little detail, as they are likely to be important when a first-time adopter of IFRS is developing accounting policies and in deciding the level of disclosure to make about certain balances and transactions. As shown in Table 2.1, the fundamental qualitative characteristics are a relevant and faithful representation.

Relevant information helps capital providers to make economic decisions, and it can be confirmatory or predictive in nature. Confirmatory information provides feedback about previous evaluations whereas information has predictive value if it can be used to predict future outcomes (Framework QC8 and 9).

Faithful representation comprises the concepts of completeness, neutrality and freedom from error. Completeness does not simply mean that all balances and transactions have been included in the financial statements. It may also mean that there should be explanations of significant facts about the nature of an item, and a description of the process used to determine the amounts recognised in the financial statements.

Neutrality is the second component of faithful representation. The Framework briefly explains that neutrality means that there is no manipulation to create a certain impression to the users of the financial statements. Neutrality is similar to saying that the balances and transactions should be presented in a way that is free from bias.

Freedom from error is pretty self-explanatory. The Framework acknowledges that freedom from error does not mean perfectly accurate; for example, due to the use of estimates to determine the value of a balance or transaction.

It will be noticeable to some readers that the concept of prudence has not been mentioned. Prudence is not a fundamental accounting concept in the IFRS Framework. The argument behind this is that prudence brings bias into financial reporting, and so creates a potential conflict with the concept of neutrality. This is a controversial issue, and while the IASB has no plans to revise the Framework and "reinstate" the concept of prudence, there are calls for prudence to at least remain in the accounting vocabulary and thought process.

2.2 DEVELOPING ACCOUNTING POLICIES

IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* is relevant to the transition to IFRS. It deals with the criteria for selecting and changing accounting policies, and because the move from previous GAAP to IFRS will inevitably lead to changes in accounting policy, the concepts of IAS 8 should be understood by those planning the transition. Particularly important are the requirements of IAS 8 in relation to determining the new accounting policies to be applied under IFRS. However, it must be emphasised that in the period of transition, the requirements of IFRS 1 *First-time Adoption of IFRS* in relation to accounting policies must also be applied; this is dealt with in Chapter 3.

2.2.1 Definition and Basic Principles of Disclosure

Accounting policies are defined as the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements (IAS 8.5). Typically, accounting policies are developed to determine the recognition, measurement and presentation of balances and transactions in the financial statements.

IAS 1 *Presentation of Financial Statements* contains a requirement that a summary of significant accounting policies is disclosed in the notes to the financial statements (IAS 1.117). The disclosure should assist users in understanding how the reported balances and transactions have impacted financial position and performance. Some accounting policies are required to

be disclosed by the relevant IFRS, but there will be an element of judgement involved in deciding whether some accounting policies are significant enough to warrant disclosure, and if so, how much detail should be given about the policy in the note.

IAS 1 also suggests that an accounting policy may be significant because of the nature of the entity's operations even if the amounts for current and prior periods are not material (IAS 1.121). This may need careful consideration, to ensure that all relevant policies have been disclosed.

The level of disclosure required in respect of accounting policies may be more onerous under IFRS compared to previous GAAP. Care must be taken to ensure that all significant accounting policies have been disclosed, and that the disclosure is sufficiently detailed without going into unnecessary detail, which may detract from the understandability of the disclosure.

2.2.2 Selection and Application of Accounting Policies

The key principle is that if an IFRS specifically applies to a transaction, other event or condition, then that particular IFRS should be applied to develop the accounting policy. As discussed in Chapter 1, IFRSs have accompanying guidance, which may or may not be an integral part of the IFRS, and if it is integral to the IFRS, it is a mandatory part of the standard. Guidance states whether it is integral to the IFRS or not.

It is also important to remember that the definition of IFRS includes Interpretations (SIC and IFRIC documents), which are equal in status to standards. Therefore, in determining accounting policies, the requirements of all relevant IFRSs including all relevant Interpretations must be considered.

Given the range of subject matter covered by IFRS, it is likely that most balances, transactions and other events and conditions that are reflected in the financial statements will be addressed by a specific Standard or Interpretation. But in the absence of any specific IFRS, management will need to develop an accounting policy. IAS 8 states that in developing and applying an accounting policy, management shall use judgement, and develop an accounting policy that results in information that is relevant and reliable[1] (IAS 8.10). To summarise, in developing an accounting policy in the absence of a specific IFRS, management must follow the principles of the Framework to result in information that displays the fundamental qualitative characteristics of reliability and faithful representation that were discussed in the first section of this chapter.

IAS 8 stipulates that when use of judgement is called for, management shall refer to and consider the applicability of the following:

1. The requirements in IFRS dealing with similar and related issues; and
2. The definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework (IAS 8.11).

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[1] *IAS 8 has not yet been updated to reflect the new Framework fundamental qualitative characteristics, and there is a proposal to replace the word "reliable" in the IAS 8 requirement with the phrase "faithfully represent the transaction, other event or condition" to bring about consistency between IAS 8 and the Framework.*

These should be considered in the order as listed above. The first may be particularly relevant for emerging issues in accounting for which a specific IFRS has not yet been developed. There may be an existing IFRS dealing with a similar matter, which can provide guidance on the development of an appropriate accounting policy.

The final sources of guidance suggested by IAS 8 in developing accounting policies in the absence of a specific IFRS are:

- The most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards; and
- Other accounting literature and accepted industry practices (IAS 8.12).

Two points are worth noting about these final sources of guidance. First, IAS 8 does not require them to be considered at all – the wording of the standard is that management "may" consider them (as opposed to "shall" consider them, which is used in the context of a requirement). Second, these non-mandatory sources of guidance should only be considered to the extent that they do not conflict with IFRS and Framework requirements and principles.

The first point listed above means that reporting entities can look to requirements and principles from other GAAPs if guidance is absent in IFRS. For example, some GAAPs including US GAAP contain much more industry-specific guidance than IFRS, and companies may seek to apply that guidance in their IFRS financial statements. This is acceptable, but only if the accounting policy based on a different GAAP that is used does not conflict with IFRS. In this situation management must be very careful that any such conflicts are identified and that inappropriate accounting policies are not used just because they are allowed under a different GAAP.

Where other GAAP requirements or principles are used to develop accounting policies, it is crucial that the resultant policies are consistent with IFRS principles. Procedures need to be put in place to identify and resolve any potential conflicts in the development of accounting policies.

2.2.3 Alternative Accounting Treatments

A final point on accounting policies relates to the IFRSs that contain alternative accounting treatments. There has been a general trend in recent years that alternative accounting treatments allowed in IFRSs have been reduced in number, and there are now only a few IFRSs that allow a choice in accounting policy. However, some important alternative accounting treatments remain, the most significant being in IAS 16 *Property, Plant and Equipment*, which allows an entity to choose between measuring classes of assets using a historical cost policy or a revaluation policy.

The importance of this for IFRS transition is that previous GAAP may have contained very few or no alternative accounting treatments, so management may, for the first time, need to consider the alternatives available and use judgement to determine which of the alternatives to use.

2.3 THE PRESENTATION OF FINANCIAL STATEMENTS

IAS 1 *The Presentation of Financial Statements* applies to all entities reporting under IFRS, including both individual and consolidated financial statements. IAS 1 was originally issued by the IASC in 1997, and it has been revised and amended many times since. Perhaps the

most significant amendments were in 2007 and 2011, when the IASB changed some of the terminology used in presenting financial statements, and introduced the concept of Other Comprehensive Income (OCI). IAS 1 is an important standard for first-time adopters of IFRS, and should be one of the first standards that is looked at in detail, as it prescribes the minimum requirements for presentation of the financial statements including the notes, and contains guidance on the general features of IFRS financial statements such as going concern, materiality and comparative information.

2.3.1 The Complete Set of Financial Statements

IAS 1 states that a complete set of financial statements comprises:

- A statement of financial position as at the end of the period;
- A statement of profit or loss and other comprehensive income for the period;
- A statement of changes in equity for the period;
- A statement of cash flows for the period;
- Notes, comprising a summary of significant accounting policies and other explanatory information;
- Comparative information in respect of the preceding period;
- A statement of financial position as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements. (IAS 1.10)

The financial statements should be shown with equal prominence.

The first issue of importance to first-time adopters of IFRS is the terminology that is used to describe the elements of the financial statements, which may be unfamiliar. For example, in some jurisdictions the term balance sheet is more familiar than "statement of financial position". IAS 1 states that the use of alternative titles is acceptable. This is because the IASB acknowledges that other, more traditional terminology is widely understood. As well as differing terminology for the statements, in some jurisdictions the notes to the financial statements are named differently, for example in the US they are commonly referred to as the footnotes to the accounts.

The second issue facing first-time adopters of IFRS is the form and content of the statements themselves, which may be quite different to the presentation of the statements under previous GAAP. For example, in many GAAPs there is no concept of other comprehensive income, and the statement of changes in equity is often presented differently, and has the status of a note rather than an actual financial statement.

2.3.1.1 The Statement of Financial Position IAS 1 does not prescribe the layout of the statement of financial position. Instead, it gives a minimum disclosure requirement for certain line items, which need to be disclosed when the size, nature or function of the item is relevant to an understanding of financial position (IAS 1.57). Essentially, where a line item is material it warrants separate disclosure on the face of the financial statements. The minimum disclosure line items are:

- Property, plant and equipment
- Intangible assets
- Investment property

- Financial assets
- Investments accounted for using the equity method
- Biological assets
- Inventories
- Trade and other receivables
- Cash and cash equivalents
- Assets classified as held for sale
- Trade and other payables
- Provisions
- Financial liabilities
- Liabilities and assets for current tax
- Deferred tax liabilities and assets
- Liabilities classified as held for sale
- Non-controlling interests, presented within equity
- Issued capital and reserves attributable to owners of the parent (IAS 1.54)

IAS 1 does not prescribe the order in which line items are presented. However, there is a requirement to distinguish between current and non-current assets and liabilities. The general rule is that assets and liabilities are classified as current if they are expected to be sold or consumed (in the case of assets) or settled (in the case of liabilities) in the normal operating cycle of the reporting entity. Assets and liabilities should also be classified as current if they are held primarily for trading, or when they are expected to be realised or settled within 12 months of the end of the reporting period. Assets and liabilities other than those in the categories described are, by default, non-current.

An exception to the current/non-current classification of assets and liabilities exists. IAS 1 permits a presentation based on liquidity if that presentation enhances the qualitative characteristics of the information presented. This could apply, for example, for a financial institution, where a classification based on an operating cycle is less meaningful than one based on liquidity. Where this exception is applied, all assets and liabilities must be shown in order of liquidity. This format is common in the banking sector.

Regardless of the method of presentation used, whether it is based on the allocation of assets and liabilities as current/non-current or based on the order of liquidity, IAS 1 requires that any line items that combine amounts expected to be realised or settled within 12 months, and after 12 months of the end of the reporting period, should be further analysed. Specifically, disclosure is required separating the two elements that have been combined in the line heading.

There are no requirements in terms of totals and subtotals, or in respect of the overall structure of the balance sheet; it can be structured so that total assets and total liabilities and equity are presented, or so that net assets are totalled to equal capital and reserves.

The wording of the line items need not follow that given in IAS 1. The wording can be amended to enhance understandability. Similar items may also be aggregated for the same reason, and additional line items added to the minimum required.

In deciding on how to present the statement of financial position under IFRS, there are many factors to bear in mind, including the terminology to be used, the overall structure, whether a current/non-current split or order of liquidity presentation is more appropriate, and judgement may be needed in deciding which balances need to be shown to meet the minimum

Table 2.2 XYZ Group: Statement of financial position as at 31 December 20X4

	31 Dec 20X4 *$*	*31 Dec 20X4* *$*
ASSETS		
Non-current assets		
Property, plant and equipment	X	X
Goodwill	X	X
Other intangible assets	X	X
Investments in associates	X	X
Available for sale financial assets	X	X
	X	**X**
Current assets		
Inventories	X	X
Trade receivables	X	X
Other current assets	X	X
Cash and cash equivalents	X	X
	X	X
Total assets	**X**	**X**
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital	X	X
Retained earnings	X	X
Other components of equity	X	X
	X	X
Non-controlling interests	X	X
Total equity	**X**	**X**
Non-current liabilities		
Long-term borrowings	X	X
Deferred tax	X	X
Long-term provisions	X	X
Total non-current liabilities	**X**	**X**
Current liabilities		
Trade and other payables	X	X
Short-term borrowings	X	X
Current portion of long-term borrowings	X	X
Current tax payable	X	X
Short-term provisions	X	X
Total current liabilities	**X**	**X**
Total liabilities	**X**	**X**
Total equity and liabilities	**X**	**X**

Source: IAS 1 Implementation Guide

disclosure requirements. It is important to get it right in the first IFRS financial statements, as changing the presentation in subsequent periods, while possible, may be difficult and would have implications for the users of financial statements, especially analysts.

The implementation guide to IAS 1 contains an illustrative balance sheet, which gives an example of how the requirements of IAS 1 can be applied. The format shown in Table 2.2 is based on this example.

2.3.1.2 The Statement of Profit or Loss and Other Comprehensive Income For first-time adopters of IFRS, this is more likely to be different than the statement of financial position in terms of structure and content to previous GAAP. The name itself is a little confusing, as

it is sometimes referred to as the statement of profit or loss and other comprehensive income, sometimes as the income statement, and sometimes as the statement of comprehensive income. The appropriate wording is tied to how the information is presented, as different structures and presentation are allowed in the standard. The same issue applies here as to the statement of financial position, in that alternative wordings are also allowed, with the standard stating that "although this Standard uses the terms 'other comprehensive income', 'profit or loss' and 'total comprehensive income', an entity may use other terms to describe the totals as long as the meaning is clear" (IAS 1.8).

All first-time adopters will be familiar with the concept of providing information in a profit and loss account, or income statement, to show the income and expenses and resultant net profit for a period. This is equivalent to the statement of profit or loss under IFRS. The concept that is less familiar is that of other comprehensive income. A simplified way of explaining other comprehensive income is that it shows items recognised as gains or losses, but outside of profit for the period. Items of other comprehensive income include gains or losses recognised on the change in value of an asset or liability. Typical examples would include a revaluation gain on a non-current asset, gains or losses on the retranslation of certain foreign currency balances, and gains and losses on the re-measurement of certain financial instruments held at fair value. Essentially, gains or losses recognised in equity are disclosed as items of other comprehensive income under IAS 1.

This means that total comprehensive income is made up of two elements – income and expenses recognised within profit or loss, and gains and losses recognised in other comprehensive income.

IAS 1 allows two presentations of this information:

- The profit or loss section and the other comprehensive income section are presented together in one statement, this being normally referred to as a statement of total comprehensive income.
- The profit and loss section and the other comprehensive income section are presented separately, in which case the profit and loss section must immediately precede the other comprehensive income section. The statements would normally be called respectively the statement of profit or loss and the statement of other comprehensive income.

The difference between the two presentation methods can, in one sense, be considered largely cosmetic, as the only difference between them is whether the two elements of total comprehensive income are shown in a continuous list of income and expenses, or whether the profit and loss section is totalled off, with the total carried down as the starting point in the statement of other comprehensive income. However, there are more conceptual arguments for and against, that the preparer of the financial statements may wish to consider in deciding which of the alternative methods of presentation to use, for example, selecting the presentation method that enhances the understandability of the financial statements for the users.

A further issue to be aware of is that following the amendments made to IAS 1 in 2011, entities are required to group items of other comprehensive income according to whether they might be reclassified (recycled) to profit or loss in subsequent periods, and those that will not be reclassified. This was done in response to the growing number of items classified as other comprehensive income, and the need for clarity in the reporting of such items.

If previous GAAP does not require the presentation of items of other comprehensive income, it will be necessary to identify all such items and put procedures in place such that the relevant information necessary for disclosure under IAS 1 is captured. This may be an onerous part of planning for entities with complex balances and transactions involving other comprehensive income, particularly financial instruments.

Turning to the profit or loss section, IAS 1 provides minimum disclosure requirements. In the same way as for the statement of financial position, the line items must be shown on the face of the financial statement. The minimum disclosure requirements for the profit and loss section are:

- Revenue
- Gains and losses arising from the derecognition of financial assets measured at amortised cost
- Finance costs
- Share of the profit or loss of associates and joint ventures accounted for using the equity method
- If a financial asset is reclassified so that it is measured at fair value, any gain or loss arising from a difference between the previous carrying amount and its fair value at the reclassification date
- Tax expense
- A single amount for the total of discontinued operations
- Profit or loss (IAS 1.82)

Some other points to be aware of in relation to the presentation of profit or loss and other comprehensive income for the period include the following:

- An analysis of expenses must be provided, and it is encouraged, but not required, that this be done on the face of the financial statements. The analysis can be by function of expense or by nature of expense. Where expenses are analysed by their nature, typical categories of expenses would include depreciation, employee benefits, transportation costs, purchases of raw materials and advertising costs. Function of expense is the more traditional method of analysis, where expenses are allocated as cost of sales, distribution cost, admin expenses etc. Where this method of analysis is chosen, additional information must be provided on the nature of expenses; for example, to show the depreciation, amortisation and employee benefit expenses.
- There are no specific requirements to present particular sub-totals, though their use is certainly not discouraged, so it may be possible to continue to show the same sub-totals as were used under previous GAAP.
- Additional line items and headings should be used where relevant to enhance the understandability of the financial statements. As above, this may mean that the line items and headings used under previous GAAP may continue to be shown, as long as they do not conflict with IFRS requirements.
- Total profit or loss and total comprehensive income must be allocated between the parent and the non-controlling interest.
- IAS 1 prohibits the presentation of any items of income or expense as extraordinary items. Therefore, if previous GAAP required or permitted the disclosure of extraordinary items, such items will need to be presented differently under IFRS.

- IAS 1 does require that where items of income and expense are material, their nature and amount be disclosed separately. This could include, for example, profit or loss on asset disposal, write downs of inventories or receivables, impairments of assets and litigation settlements.
- The disclosure requirements of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* also affect the presentation of the statement of profit or loss. The specific disclosure requirements in relation to discontinued operations are beyond the scope of this book.
- Listed entities are also required to present, in accordance with IAS 33 *Earnings per Share*, the basic and diluted earnings per share figure on the face of the financial statements. The specific disclosure requirements in relation to earnings per share are beyond the scope of this book.
- Items of other comprehensive income can be presented either net of the related tax effects or before related tax effects with one amount shown for the aggregate amount of related tax.

The implementation guide to IAS 1 provides several illustrative examples of a statement of profit or loss and other comprehensive income. A simplified version is shown in Table 2.3, showing presentation if the statement of profit or loss and the statement of other comprehensive income are combined to present total comprehensive income in one statement, and showing expenses analysed by function.

A second illustration (Tables 2.4 and 2.5) shows the presentation if the statement of other comprehensive income is shown separately from the statement of profit or loss.

Case Study 2.1: An Irish Company Presenting Other Comprehensive Income for the First Time

A privately owned Irish company moved to IFRS in 2010, the decision to move from Irish GAAP to IFRS having been made because management was aiming to achieve a flotation in the next few years. Under IFRS, for the first time the financial statements included a statement of other comprehensive income. It became apparent that some of the shareholders did not understand this part of the financial statements, believing that the gains included were part of profit, would be taxed, and that the gains could be paid out as a dividend. Management had to spend some time explaining to the shareholders that the items disclosed as other comprehensive income were not really part of profit, and that the gains and losses were just being disclosed in a new way. There was no difference in actual profit, and there would be no change in the dividend policy.

This shows that it is important not to assume that the users of the financial statements will understand new disclosures. And even small changes to presentation such as changing the wording of a line item or re-ordering the lines in the financial statements can cause confusion for less financially aware user groups. Any presentation changes should therefore be considered in this light, and where necessary factored into the communications plan that is prepared as part of the transition project.

2.3.1.3 The Statement of Changes in Equity This statement provides a reconciliation of the brought down and carried down components of equity. The basic IAS 1 requirement is that the changes in equity are separated into those resulting from profit or loss, other comprehensive income, and transactions with owners (IAS 1.106). In addition, an analysis

Table 2.3 XYZ Group: Statement of profit or loss and other comprehensive income for the year ended 31 December 20X4

	20X4 *$*	*20X3* *$*
Revenue	**X**	**X**
Cost of sales	(X)	(X)
Gross profit	X	X
Other income	X	X
Distribution costs	(X)	(X)
Administrative expenses	(X)	(X)
Other expenses	(X)	(X)
Finance costs	(X)	(X)
Share of profit of associates	X	X
Profit before tax	X	X
Income tax expense	(X)	(X)
PROFIT FOR THE YEAR	X	X
Other comprehensive income:		
Items that will not be reclassified into profit or loss:		
Gains on property revaluation	X	X
Re-measurements of defined benefit pension plans	X	X
Income tax related to items that will not be reclassified	(X)	(X)
	X	X
Items that may be reclassified subsequently into profit or loss:	X	X
Exchange differences on retranslating foreign operations	X	X
Cash flow hedges	(X)	(X)
Income tax related to items that may be reclassified	(X)	(X)
	X	X
Other comprehensive income for the year, net of tax	X	X
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	X	X
Profit attributable to:		
Owners of parent	X	X
Non-controlling interests	X	X
	X	X
Total comprehensive income attributable to:		
Owners of parent	X	X
Non-controlling interests	X	X
	X	X

Source: IAS 1 Implementation Guide

of other comprehensive income for each component of equity is required. Depending on the number of components of equity that an entity has, the statement of changes in equity can be a lengthy document due to the number of items that need to be presented, and the need for comparative information clearly increases the volume of disclosure that has to be provided. An illustrative example is considered to be outside the scope of this book. Interested readers will find an example in the Implementation Guide of IAS 1.

In some jurisdictions previous GAAP may have required that the information given in the statement of changes in equity be provided in a note to the financial statements, and in many jurisdictions the requirements in relation to disclosing the equity impact of other comprehensive income may not have existed at all. In such situations, the users of the financial statements

Table 2.4 XYZ Group: Statement of profit or loss for the year ended 31 December 20X4

	20X4 *$*	*20X3* *$*
Revenue	X	X
Cost of sales	(X)	(X)
Gross profit	X	X
Other income	X	X
Distribution costs	(X)	(X)
Administrative expenses	(X)	(X)
Other expenses	(X)	(X)
Finance costs	(X)	(X)
Share of profit of associates	X	X
Profit before tax	X	X
Income tax expense	(X)	(X)
PROFIT FOR THE YEAR	(X)	(X)
Profit attributable to:		
Owners of parent	X	X
Non-controlling interests	X	X
	X	X

Source: IAS 1 Implementation Guide

may need to be educated about the contents of the statement, especially if the information is presented in a new way or for the first time.

2.3.1.4 The Statement of Cash Flows The statement of cash flows is part of the complete set of financial statements required by IAS 1. However, unlike the other statements discussed in the previous sections, the requirements relating to the preparation and presentation of a statement of cash flows are found in a different standard, IAS 7 *Statement of Cash Flows*.

Table 2.5 XYZ Group: Statement of profit or loss and other comprehensive income for the year ended 31 December 20X4

	$	*$*
Profit for the year	X	X
Other comprehensive income:		
Items that will not be reclassified into profit or loss:		
Gains on property revaluation	X	X
Re-measurements of defined benefit pension plans	X	X
Income tax related to items that will not be reclassified	(X)	(X)
	X	X
Items that may be reclassified subsequently into profit or loss:	X	X
Exchange differences on retranslating foreign operations	X	X
Cash flow hedges	(X)	(X)
Income tax related to items that may be reclassified	(X)	(X)
	X	X
Other comprehensive income for the year, net of tax	X	X
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	X	X
Total comprehensive income attributable to:		
Owners of parent	X	X
Non-controlling interests	X	X
	X	X

Source: IAS 1 Implementation Guide

There are no exemptions from the requirement for a statement of cash flows; so all entities reporting under IFRS must present one as part of the financial statements. In some jurisdictions, previous GAAP may not require some or all entities to present a cash flow statement. There may be exemptions depending on the size or status of the entity, and whether it is a group member.

If previous GAAP did not require a statement of cash flows to be presented, extra time must be planned in the first IFRS reporting period for the statement to be prepared. Comparatives will also be required, and financial reporting systems must be able to capture the information necessary for the preparation of the statement of cash flows and its related notes.

The first important requirement in terms of presenting the statement of cash flows in accordance with IAS 7 is that the standard requires that cash flows are classified and presented as one of the following:

- Cash flows from operating activities
- Cash flows from investing activities
- Cash flows from financing activities (IAS 7.10)

Previous GAAP may have required cash flows to be classified differently – for example, a greater number of more specific headings may have been required.

There is an element of flexibility and judgement in deciding into which category a cash flow should be classified. For example, interest paid may be considered to be an operating cash flow or a financing cash flow depending on the circumstances in which the transaction occurred. The key issue is that classification should be consistent each year.

A second important issue relating to the preparation of the statement of cash flows is that two methods of presentation are allowed for cash flows from operating activities – the direct and the indirect method. The direct method shows the main categories of cash flows that form part of cash flows from operating activities, for example cash inflows from sales and cash outflows in respect of payments to suppliers and employees. The indirect method takes profit as the starting point and adjusts it for non-cash flows included in profit to generate the cash flows from operating activities.

Finally, IAS 7 requires specific disclosures in relation to cash flows to be made, including those relating to major non-cash transactions and an analysis of cash and cash equivalents. On the other hand, some disclosures required by previous GAAP may not be needed when reporting under IFRS. For example, a reconciliation of net debt to cash flows is required in some GAAPs, but not in IFRS, which may reduce the disclosure requirements on transition to IFRS.

Previous GAAP may have different presentation and disclosure requirements in relation to the statement of cash flows. Management will need to make choices as to the presentation of items in the statement of cash flows, and judgement will be needed regarding the level of disclosure that is necessary.

Case Study 2.2: How a UK Company Decided on the Presentation of its Financial Statements on its Transition to IFRS

The company is a large engineering firm, with operations in many countries and with several overseas subsidiaries. It went through transition to IFRS in 2005, and was one of the first reporting entities to file IFRS financial statements in the UK. In deciding on how to present its financial statements, management reviewed the financial statements of industry peers operating in other countries, there being no other comparable UK companies that had filed IFRS financial statements at that time. Management also reviewed a wide range of IFRS financial statements from a variety of business sectors to build up their knowledge and experience of IFRS financial statements, as this was the first time that many of them had looked at accounts presented under IFRS. Ultimately, management took the view that they did not want the financial statements to look very different to those previously prepared under UK GAAP, and in fact made very few changes to the look of the financial statements other than changing a few pieces of terminology. The format, structure and order of headings were not changed. Management felt it was important that changes to the look of the financial statements were minimised on transition to IFRS.

The interviewee who was involved with this transition commented that the flexibility offered by IAS 1 in terms of presentation choices is very useful, as it does allow most features of presentation to remain very similar, if not the same, as previously reported. The same interviewee has worked on many transitions in the UK and other countries and he felt that companies very rarely change presentation on transition, other than including matters required by IFRS that were not required by UK GAAP, such as the statement of changes in equity as a primary financial statement.

To summarise this section on presentation, a list of the matters that should be considered when deciding on the presentation of the first IFRS financial statements is given below:

General matters:

- Is the objective to minimise changes from presentation under previous GAAP?
- Or, can the move to IFRS be used as an opportunity to review presentation and make improvements?
- How do industry peers present their financial statements?
- If there are any significant changes to presentation, or new information presented, does this need to be explained to the users of the financial statements?

For the statement of financial position:

- Which format will be used, e.g., the trial balance format listing assets in one half and liabilities and equity in the other half, or a format where assets and liabilities are netted to balance with equity?
- Are any terminology changes needed?
- Do headings need to move, e.g., to reflect the order of liquidity?
- Are any new headings needed that were not recognised under previous GAAP?
- Do any balances need to be aggregated or disaggregated?

For the statement of profit and loss and other comprehensive income:

- Will operating expenses be shown on the face of the financial statements or in a note?
- Should operating expenses be classified by nature or by function?

- Are there any exceptional items to be disclosed separately?
- Have all items of other comprehensive income been identified?
- Are any new sub-totals going to be used?
- Are any non-GAAP measures going to be presented on the face of the financial statements?

2.4 FAIR PRESENTATION, GOING CONCERN AND INTERIM FINANCIAL STATEMENTS

2.4.1 Fair Presentation and Statement of Compliance with IFRS

IAS 1 requires that financial statements shall fairly represent the financial position, performance and cash flows of an entity (IAS 1.15). Fair presentation is achieved by compliance with relevant IFRSs, by selecting and applying accounting policies as discussed in Section 2.2.2, and by providing additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to fully understand the financial statements. Non-compliance with the requirements of applicable IFRSs is allowed only in extremely rare circumstances, and must be supported by disclosures describing the reason for the departure. This is similar to the "true and fair override" which is allowed in certain jurisdictions under GAAP.

A further issue relating to fair presentation is the requirement for an explicit and unreserved statement of compliance with IFRS to be made in the notes to the financial statements (IAS 1.16). The financial statements cannot be described as compliant with IFRS unless they comply with all of the requirements of IFRS. This is an important disclosure for a first-time adopter of IFRS, because it means that cherry picking is not allowed, and all IFRSs must be fully complied with in the year of transition to IFRS. This will be discussed further in Chapter 3, when the specific requirements of IFRS 1 *First-time Adoption of IFRS* will be explored, and the importance of the statement of compliance with IFRS will be emphasised.

2.4.2 Going Concern and Other General Features

IAS 1 requires that IFRS financial statements are prepared using various fundamental accounting concepts. These are summarised in Table 2.6. These concepts should be familiar to most first-time adopters of IFRS, as similar concepts are found in most GAAPs.

2.4.3 Interim Financial Information

IFRS does not require interim financial information to be presented, but in many jurisdictions the local regulations require certain entities to present information on an interim basis. For entities reporting under IFRS, the content of interim financial information is governed by IAS 34 *Interim Financial Reporting*. IAS 34 does not prescribe which companies must present interim financial information, but contains requirements on the minimum information that should be presented when interim financial information is a requirement of local regulations.

The detailed requirements of IAS 34 are outside the scope of this book, but essentially IAS 34 requires condensed versions of the statements of financial position, total comprehensive income, changes in equity, and cash flows to be presented, along with selected notes to these condensed financial statements.

Table 2.6 General concepts of IAS 1

Concept	*Main IAS 1 requirements*
Going concern	Financial statements are prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. Material uncertainties that cast doubt over the going concern status are disclosed in the notes to the financial statements. If the financial statements are not prepared using the going concern basis, this fact is disclosed along with the reason, and the basis of preparation used.
Accruals basis of accounting	The financial statements, except for cash flow information, are prepared using the accruals basis of accounting.
Materiality and aggregation	Each material class of similar items is presented separately. If a line item is not individually material, it is aggregated with other items either in the financial statements or in the notes. Specific disclosure required by an IFRS need not be made if the information is not material.
Offsetting	Assets and liabilities or income and expenses are not offset unless required or permitted by an IFRS.

Source: IAS 1.25-32

CONCLUSION

This chapter has discussed the fundamental concepts that must be considered when planning to report under IFRS, i.e., the framework on which accounting policies must be selected and applied, the content of a set of IFRS-compliant financial statements, and the general bases on which those statements must be prepared. Without knowledge of these basic issues it is very hard to begin to plan the transition to IFRS. Transitions will be more challenging for reporting entities in jurisdictions where local GAAP does not contain a conceptual framework, or where the underpinning principles of GAAP are different to those of IFRS.

Presentation of the financial statements is an important planning matter, but is sometimes left until the end of the transition project. This can mean that decisions about presentation are rushed, and possibly the opportunities offered on first-time presentation of IFRS financial statements to make the information as user-friendly and understandable as possible are not taken. Management may well decide that the priority is to make as few changes as possible to the look and feel of the financial statements, as this can be reassuring for the users. But it is likely that some changes or additions will have to be made to make the financial statements IAS 1-compliant, and it is essential that those involved in the transition consider how to communicate and explain any changes made or new information included for the first time. The appearance of new financial information such as that shown in the statement of other comprehensive income means that users of the financial statements will be unsure as to the importance of the new figures presented, or may misunderstand what the information shows. Presentation of financial information is inherently linked with communication with the users, and the reporting entity will need to include in its communications strategy a consideration of how to explain new information provided.

3 IFRS 1 FIRST-TIME ADOPTION OF IFRS

3.1 AN INTRODUCTION TO IFRS 1

The IASB issued IFRS 1 *First-time Adoption of International Financial Reporting Standards* in 2003. The standard contains requirements and guidance to assist in the preparation of an entity's first IFRS financial statements. IFRS 1 has been amended many times to reflect new or revised IFRS requirements, which made the standard complex and somewhat difficult to follow. This led to the standard being restructured and revised in 2008 to make it more understandable, and it has been amended several times since to accommodate requirements of new or revised IFRSs.

The basic principle of IFRS 1 is that there should be a full retrospective adoption of IFRS at the date of transition to IFRS, resulting in a set of financial statements portraying the entity's performance and position as if it had always reported under IFRS.

In the transition to IFRS a reporting entity should do the following in order to implement IFRS 1 successfully:

- Clarify when to apply IFRS 1, i.e., which financial statements fall under the scope of IFRS 1;
- Identify the date of transition to IFRS and prepare an opening statement of financial position at that date;
- Select appropriate IFRS-compliant accounting policies to be applied retrospectively to all periods presented in the financial statements;
- Decide whether to apply any of the optional exemptions from full retrospective application of the new accounting policies;
- Prepare the extensive disclosures required in the notes to the financial statements.

Each of these issues will be discussed in turn. Readers should note that this chapter is the most technically detailed of the book. While the main principles of IFRS 1 are explained, including the exemptions from full retrospective application, the complexities of many of the accounting issues are beyond the scope of this book, and instead the discussion will highlight key issues and practical implications of the exemptions. Similarly, the IFRS 1 requirements in relation to designation of financial assets and liabilities and issues in relation to the deemed cost of certain assets are beyond the scope of the discussion in this chapter.

3.1.1 The Objective of IFRS 1

IFRS 1's stated objective is to ensure that an entity's first IFRS financial statements, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

(a) is transparent for users and comparable over all periods presented;
(b) provides a suitable starting point for accounting in accordance with IFRSs; and
(c) can be generated at a cost that does not exceed the benefits. (IFRS 1.1)

Underlying this objective is the need for information to be presented that explains to the users of the financial statements the impacts that the change in financial reporting framework has had on the entity's reported performance and position.

3.1.2 The Scope of IFRS 1

An entity applies IFRS 1 in its first IFRS financial statements (IFRS 1.2). The first IFRS financial statements are the first annual financial statements in which the entity adopts IFRSs, by an explicit and unreserved statement in those financial statements of compliance with IFRSs (IFRS 1.3). By far the most typical situation in which IFRS 1 is applied is when an entity moves from using national GAAP as its financial reporting framework to using IFRS. IFRS 1 illustrates this and various other situations in which IFRS is being adopted for the first time as follows:

- The entity previously reported using national GAAP, which is not consistent with IFRS in all respects.
- The entity previously reported using national GAAP and the financial statements included a reconciliation of amounts from national GAAP to IFRS.
- The entity previously reported using IFRS but the financial statements failed to contain an explicit and unreserved statement of compliance with IFRS.
- The entity previously reported using IFRS and the financial statements included a statement of compliance with some, but not all, IFRSs.

IFRS 1 also applies where an entity did not present financial statements for previous periods, and in situations where financial statements have been previously prepared using IFRS but for internal reporting purposes only. In other words, the first IFRS financial statements must be those prepared for external use.

It is intended that IFRS 1 should only be used once, and it cannot be applied when an entity's previous financial statements contained an explicit and unreserved statement of compliance with IFRS. This is the case even if the auditor's report on the previous financial statements was qualified (IFRS 1.4).

The relationship between IAS 1 *Presentation of Financial Statements* and IFRS 1 is relevant to the discussion of the statement of compliance with IFRS. IAS 1 requires that an entity whose financial statements comply with IFRS shall make an explicit and unreserved statement of such compliance in the notes (IAS 1.16). Further, IAS 1 suggests that the statement of compliance with IFRS is normally the first note to the financial statements that is presented (IAS 1.114). The note highlights the fact that the financial statements comply with IFRS and that the accounting policies subsequently described in the next note to the financial statements are based on IFRS.

It is important to note that in some jurisdictions there may be specific matters to consider regarding what is meant by the term "compliance with IFRS". For example, in the EU, legislation requires the use of EU-endorsed IFRS for those entities reporting under IFRS,

which is not the same as IFRS issued by the IASB. Therefore, the relationship between local legislation and other regulations that impact on the use of IFRS should be considered when implementing IFRS 1.

3.1.3 Current Developments in Relation to IFRS 1

The current version of IFRS 1 was issued in 2008, and has an effective date of 1 July 2009. IFRS 1 has been amended several times to reflect new or changed requirements of other IFRSs.

At the time of writing the IASB has no plan to change substantially the requirements of IFRS 1. It is important to note, however, that IFRS 1 is revised when necessary for narrow scope amendments that arise from the IASB's Annual Improvements to IFRSs Cycle, the most recent of which was the 2009–2011 cycle, with the effective date of these amendments being 1 January 2013.

3.2 THE DATE OF TRANSITION TO IFRS AND THE OPENING STATEMENT OF FINANCIAL POSITION

3.2.1 Identifying the Date of Transition

The first recognition and measurement rule of IFRS 1 states that an entity shall prepare and present an opening IFRS statement of financial position at the date of transition to IFRS. This date is crucial as it is the starting point for its accounting in accordance with IFRS (IFRS 1.6), and specific disclosures are required to show how the opening statement of financial position was determined.

The date of transition to IFRS is defined as the beginning of the earliest period for which an entity presents full comparative information under IFRS in its first IFRS financial statements (IFRS 1 appendix A).

The date of transition to IFRS will depend on how many years of comparative information are presented. Under IAS 1 only one year of comparative information is required, and the date of transition to IFRS will be at the start of the comparative reporting period. The situation for a typical entity is illustrated in Figure 3.1.

Some entities are required to include more than one year of comparative financial information. For example, under SEC rules public companies in the US typically file two years of comparative information. This means that the date of transition to IFRS for such an entity will be one year earlier than for entities presenting only one year of comparative information. For Company A in Figure 3.1, if it presented full comparative information for the preceding two years in its first IFRS financial statements to 31 December 2014, its date of transition to IFRS would be 1 January 2012. The transition date is three years before the first reporting date under IFRS.

A further complicating factor arises because IFRS 1 requires that an additional comparative statement of financial position be presented in the first IFRS financial statements. IFRS 1.21 states that an entity's first IFRS financial statements shall include at least three statements of financial position, two statements of profit or loss and other comprehensive income, two separate statements of profit or loss (if presented), two statements of cash flows and two

Company A prepares financial statements to a year ending 31 December. It is adopting IFRS for the first time in the financial statements for the year ending 31 December 2014, having previously reported using national GAAP. It presents one year of comparative information.

January 1 2013 | January 1 2014 | 31 December 2014

2013	2014
Financial statements prepared under national GAAP to 31 December 2013 1 January 2013 is the date of transition to IFRS and the opening IFRS statement of financial position is prepared to that date for inclusion in the 2014 financial statements	First IFRS financial statements prepared to 31 December 2014 The 2013 comparatives in the 2014 financial statements are restated under IFRS

Figure 3.1 Identifying the date of transition to IFRS

statements of changes in equity and related notes, including comparative information for all statements presented.

This means that two statements of financial position are presented as comparatives, for the two years preceding the first reporting period under IFRS.

The inclusion of an additional statement of financial position does not bring forward the date of transition. This is because, as discussed above, that date is defined as the beginning of the earliest period for which an entity presents full comparative information under IFRS. The additional statement of financial position does not represent full comparative information, which is part of the definition of the date of transition.

3.2.2 The Opening Statement of Financial Position

IFRS 1 requires that in the opening statement of financial position, the reporting entity must apply accounting policies that comply with IFRSs effective (or available for early adoption) at the end of its first IFRS reporting period. Looking back at Figure 3.1, Company A should develop accounting policies to be used in the preparation of its opening statement of financial position at 1 January 2013 based on IFRSs effective at 31 December 2014. This means that the accounting policies developed to be applied in the opening statement of financial position are applied throughout the financial periods presented.

3.2.2.1 Full Retrospective Application of IFRS The application of the IFRS 1 requirement results in the financial statements being presented as if the reporting entity had always adopted IFRS. This enhances the comparability of the financial information presented,

comparability being one of the qualitative characteristics of the IASB's Framework. The IFRS 1 requirement should ensure comparability over time within the reporting entity's first IFRS financial statements, especially given the extensive disclosure requirements that help to explain how the changes in accounting policies have impacted the entity's performance and position under IFRS compared to that under previous GAAP.

The effect of this requirement is that the first IFRS financial statements should present a complete retrospective application of IFRSs effective at the first reporting date. The IASB recognises that such a complete retrospective adoption can be very time-consuming, costly, and for some transactions and balances, very difficult or impossible to apply. Therefore, there are exemptions to the general rule of full retrospective application. The exemptions, some of which are mandatory and some voluntary, are discussed later in the chapter.

Except when applying the exemptions, IFRS 1 requires that in its opening statement of financial position, the reporting entity shall:

(a) recognise all assets and liabilities whose recognition is required by IFRSs;
(b) not recognise items as assets or liabilities if IFRSs do not permit such recognition;
(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with IFRSs; and
(d) apply IFRSs in measuring all recognised assets and liabilities. (IFRS 1.10)

3.2.2.2 Changes in Accounting Policy A result of this requirement is that there will be changes to accounting policies on moving from previous GAAP to IFRS because changes in recognition, measurement and presentation of transactions and balances represent changes in accounting policy. New assets and liabilities may need to be recognised, and some may need to be de-recognised if they are not allowed under IFRS. There may be reclassifications that affect the layout and format of the financial statements, and there will be changes to how assets, liabilities, and items of income and expenses are measured. Some examples of high-level changes are given in Table 3.1. These examples are illustrative only, and the nature of changes to accounting policy will vary depending on the previous GAAP used by the reporting entity, and the difference between its requirements and those of IFRS. One of the key issues to be considered in planning the transition to IFRS is the changes in accounting policy that will be necessary, this is the subject of detailed discussion in Chapter 5.

This is not intended to be a comprehensive list of all possible changes in accounting policy, as impacts need to be assessed on a line-by-line basis and will differ a great deal even between reporting entities in the same jurisdiction and operating in the same industry. A detailed assessment of accounting policy changes should result in an impact assessment document, which could run to dozens, if not hundreds, of pages for a large reporting entity.

An issue worth noting, as seen in Table 3.1, relates to group accounting. Under IFRS it is possible, even likely, that the group structure will change on the transition to IFRS. This is because IFRS tends to have a wider scope in terms of the investments that meet the definition of a subsidiary, or associate or joint venture, meaning that entities that were previously off-balance sheet now need to be recognised in the group accounts using the appropriate method of consolidation (acquisition accounting for subsidiaries and equity accounting for associates and joint venture companies). This can be an extremely significant issue, as changes in group structure

Table 3.1 Examples of changes in accounting policies that may be required on transition to IFRS

IFRS 1 requirement	*Example change in accounting policy*
(a) Recognise all assets and liabilities whose recognition is required by IFRSs	Recognise additional assets qualifying for recognition under IFRS, for example: • Borrowing costs (IAS 23) • Intangible assets, e.g., internal development costs (IAS 38) • Financial assets, e.g., derivatives (IFRS 9) • Deferred tax assets (IAS 12) Recognise additional liabilities qualifying for recognition under IFRS, e.g.: • Pension plan liabilities (IAS 19) • Deferred tax liabilities (IAS 12) • Financial liabilities, e.g., derivatives (IFRS 9) In a group situation entire entities may need to be recognised that were previously off-balance sheet (IAS 27, IFRS 3, IAS 28, IFRS 11)
(b) Not recognise items as assets or liabilities if IFRSs do not permit such recognition	Derecognise assets and liabilities recognised under GAAP but not qualifying for recognition under IFRS, for example: • Contingent assets and liabilities recognised under GAAP (IAS 37) • Research expenditure capitalised under GAAP (IAS 38) • General provisions allowed under GAAP, e.g., for future losses (IAS 37)
(c) Reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with IFRSs	Reclassify items within the financial statements: • Property, plant and equipment reclassified as intangible assets and vice versa (IAS 16 and IAS 38) • Inventories reclassified as property, plant and equipment and vice versa (IAS 11 and IAS 16) • Property, plant and equipment reclassified as investment property and vice versa (IAS 16 and IAS 40) • Non-current assets held for sale and discontinued operations (IFRS 5) • Financial assets and liabilities have specific classification criteria (IAS 39 and IFRS 9) • Items that were offset under previous GAAP need to be classified separately under IFRS • On a business combination, acquired identifiable intangible assets to be recognised separately from goodwill • Income and expenses reclassified from profit or loss to other comprehensive income
(d) Apply IFRSs in measuring all recognised assets and liabilities	Measure items on a different basis, for example: • Property, plant and equipment and intangible assets cost or revaluation model allowed (IAS 16 and IAS 38) • Inventories – LIFO not permitted as a valuation method (IAS 11) • Financial assets and liabilities – complex measurement rules depending on classification, some at amortised cost, some at fair value through profit, some at fair value through equity (IFRS 9) • Pension assets and liabilities – complex and based on fair value (IAS 19) • Deferred tax – not permitted to be discounted to present value (IAS 12) • Share-based payment – measurement based on fair value (IFRS 2) • Provisions – measurement using best estimate (IAS 37) • Business combinations – detailed rules on measurement of acquired identifiable assets and liabilities (IFRS 3) • Goodwill not amortised under IFRS but is tested for impairment on an annual basis (IAS 38)

can have important wider impacts, such as tax planning consequences, the need for comprehensive and uniform accounting processes across all components of the group, and the development of financial reporting packages to be used by a greater number of separate legal entities.

3.2.2.3 Accounting for the Adjustments on Transition to IFRS IFRS 1 states that the resulting adjustments arise from events and transactions before the date of transition to IFRS. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to IFRS (IFRS 1.11).

This approach is based on the concept that transitional adjustments from national GAAP to IFRS should not impact on the reported profit or other comprehensive income in the first IFRS financial statements. The impacts should be recognised in equity, usually retained earnings. However, some adjustments may result in an impact in a different component of equity. An example would be where a reporting entity makes a transitional adjustment to the valuation of property, plant and equipment in order to measure its assets at a revalued amount. In this case the transitional adjustment would be recognised in a revaluation reserve rather than in retained earnings. Other examples where the adjustment on change in accounting policy would be reflected in a category of equity other than retained earnings include certain remeasurement adjustments made to financial instruments.

Case Study 3.1 illustrates the impact of some changes in accounting policy on transition to IFRS.

Case Study 3.1: An Illustration of Accounting Policy Changes on First-time Adoption of IFRS

Company B identifies that the following changes to accounting policies will be necessary on its transition to IFRS:

	IFRS accounting policy	*Previous GAAP accounting policy*	*Accounting implication*
Development costs	Recognised as intangible non-current assets when certain criteria met	Immediately expensed	$2.5 million development costs that were expensed under previous GAAP to be recognised as non-current assets
Property, plant and equipment	Land measured at revalued amount	Measured at cost	$4 million remeasurement increase in the value of land
Inventories	Measured using first-in, first-out principle	Measured using last-in, first-out principle	$1 million reduction in value of inventories
Borrowing costs	Capitalised when certain criteria met	Immediately expensed	$0.3 million borrowing costs that were expensed under previous GAAP to be capitalised into property, plant and equipment

The impacts on the financial statements will be as follows:

(a) Development costs – increase intangible assets and increase retained earnings by $2.5 million.

(b) Property, plant and equipment – increase non-current assets and increase revaluation surplus by $4 million.
(c) Inventories – reduce current assets and reduce retained earnings by $1 million.
(d) Borrowing costs – increase non-current assets and increase retained earnings by $0.3 million.

Company B is required to disclose the impact of the changes to accounting policies in the notes to its financial statements.

The changes in accounting policy required on transition to IFRS 1 are specifically covered by IFRS 1 and not by other standards. In particular, changes in accounting policy normally are governed by the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, IFRS 1 states that IAS 8 does not apply to the changes in accounting policies an entity makes when it adopts IFRSs or to changes in those policies until after it presents its first IFRS financial statements. Therefore, IAS 8's requirements about changes in accounting policies do not apply in an entity's first IFRS financial statements (IFRS 1.27).

It is also worth noting that there are likely to be deferred tax implications of the changes in accounting policy, especially in relation to certain remeasurements (ignored in the example above). The deferred tax balances arising on the transition, which could be deferred tax liabilities and/or deferred tax assets, are accounted for as part of the package of transitional adjustments, and reflected either in retained earnings or in another element of equity according to IAS 12 *Income Taxes.*

3.2.3 Exemptions and Exceptions from Full Retrospective Adoption

IFRS 1 requires some mandatory exceptions, and permits more optional exemptions from full retrospective adoption. This means that rather than applying IFRS retrospectively to the opening balance sheet, where the exceptions apply and exemptions are taken, IFRS is applied prospectively from the date of transition to IFRS.

These exemptions and exceptions relate largely to accounting issues where the IASB believes that retrospective adoption would be impracticable or impossible due to lack of relevant data, and/or where the use of judgement by management would introduce excessive subjectivity into the accounting treatment. The IASB was also concerned that allowing retrospective application would, in some cases, encourage manipulation of the accounts, with management using the benefit of hindsight to engineer favourable accounting impacts, especially in relation to accounting estimates. A further issue that arises is that of cost–benefit, with the IASB reasoning that the cost of applying full retrospective adoption would outweigh the benefit provided in the financial statements.

To further illustrate this issue, consider the example of a reporting entity that, over the last decade, has acquired numerous subsidiaries. If IFRS 1 required full retrospective adoption of IFRS with no exemptions or exceptions, all of the acquisitions previously accounted for under local GAAP would need to be restated as if the acquisition had occurred under IFRS, meaning that the fair value of identifiable assets and liabilities at the acquisition dates of the various subsidiaries several years ago would need to be established, as required by IFRS 3

Business Combinations. This may be an impossible task, especially if previous GAAP did not require the acquisition to be treated as a business combination, and even if it were possible to estimate the fair value of assets and liabilities at some point in the past, this would not only be an extremely time-consuming process, but would also introduce a lot of subjectivity into the accounting treatment. It is questionable whether the restatement of the acquisitions would add any real value to the financial statements.

These issues resulted in the IASB concluding that exemptions should be available to avoid restatements in relation to accounting areas where it would be too onerous to obtain reliable information, so that full retrospective application of IFRS is not applied to those areas. A reporting entity does not need to justify or explain why it has chosen to use the optional exemptions or not in order to comply with IFRS 1. However, communication of these decisions may be useful when explaining the impact of transition to IFRS to users of the financial statements.

In the first IFRS financial statements, the mandatory exceptions must be applied, and any of the optional exemptions may be applied. The mandatory exceptions prohibit retrospective adoption of IFRS, so there is no choice in the matter and the reporting entity simply has to apply IFRS from the date of transition to the relevant balances and transactions.

The optional exemptions must be carefully considered, and arguably are the most important part of IFRS 1 in terms of planning the IFRS transition. It is crucial that the reporting entity carefully considers which of the optional exemptions to apply, as choosing NOT to take the exceptions can create significantly more work and cost.

IFRS 1 allows some, all or none of the optional exemptions to be taken. In practice, perhaps not surprisingly, evidence shows that the majority of reporting entities take maximum advantage of the exemptions available. A report by the accounting firm BDO found that very few first-time adopters ignored relevant exemptions (BDO, 2010); for example, all but one of the companies surveyed took advantage of the optional exemption in relation to business combinations. Anecdotal evidence backs up these findings – in discussions with those that have been through the transition it is rare to find instances of exemptions not being taken. As one interviewee commented "Why would you choose not to take the exemptions? They are there to make adopting IFRS easier. There is enough work to do without making things more difficult and expensive."

Academic research performed on IFRS 1 implementation suggests that management makes choices about the use of the optional exemptions in order to minimise differences between previous GAAP and IFRS. For example, a study of French listed companies found that choices in accounting policy and in the use of the optional exemptions were made to offset the impacts of mandatory adjustments (Cazavan-Jeny and Jeanjean, 2009).

Table 3.2 summarises the mandatory exemptions and optional exceptions from IFRS 1. The points highlighted in bold are discussed later in the chapter as they are considered the most common of the exceptions and exemptions to affect reporting entities on their transition.

Due to the large number of exemptions and exceptions, and the fact that many of them are very specific and unlikely to feature in the financial statements of many first-time adopters,

Table 3.2 Mandatory exceptions and optional exemptions

Mandatory exceptions (IFRS 1.14 and Appendix B)	*Optional exemptions (IFRS 1 Appendix C–E)*
Estimates	**Business combinations**
Derecognition of financial assets and liabilities	Share-based payment transactions
	Insurance contracts
Hedge accounting	
Non-controlling interests	**Deemed cost**
Government loans	Leases
Classification and measurement of	**Cumulative translation differences**
financial assets	**Investments in subsidiaries, joint ventures and associates**
Embedded derivatives	
	Assets and liabilities of subsidiaries, associates and joint ventures
	Compound financial instruments
	Designation of previously recognised financial instruments
	Fair value measurement of financial assets or financial liabilities at initial recognition
	Decommissioning liabilities included in the cost of property, plant and equipment
	Financial assets or intangible assets accounted for in accordance with IFRIC 12
	Borrowing costs
	Transfers of assets from customers
	Extinguishing financial liabilities with equity instruments
	Severe hyperinflation
	Joint arrangements
	Stripping costs in the production phase of a surface mine
	Optional short-term exemptions:
	Comparative information for IFRS 9
	Disclosures about financial instruments
	Employee benefits
	Investment entities

our discussion will focus on those that are most likely to be applied.[1] The items discussed in the following sections are shown in bold in Table 3.2.

3.2.3.1 Estimates IFRS 1 requires that estimates contained in the opening statement of financial position are consistent with estimates made for the same date under the previous GAAP applied, the only exception to this rule being where it is believed that the estimates were in error (IFRS 1.14). The general principle is that where an estimate was required by previous GAAP, and assuming the estimate does not contain an error, the previously made estimate should be used in the opening statement of financial position subject to any adjustment necessary to reflect the requirements of IFRS. The following example illustrates this principle.

[1] *For detailed explanations and discussions of the exemptions and exceptions, there are a number of guides published and made available online by the large accounting and advisory firms, including those by Deloitte "First time adoption of IFRS – A guide to IFRS 1" (Deloitte, 2009), Grant Thornton "The road to IFRS – a practical guide to IFRS 1 and first time adoption" (Grant Thornton, 2012) and PwC "Preparing your first IFRS financial statements" (PwC, 2009).*

Estimates in the opening statement of financial position should not be updated to reflect conditions arising after the date of transition to IFRS. Revisions to estimates due to new information being received in relation to them are reflected in profit or loss in the period in which the new information arises.

Case Study 3.2: An Example of Applying IFRS 1 to Accounting Estimates

Company C recognises a provision of £3 million in its statement of financial position at the date of transition to IFRS. The provision has been recognised and measured under previous GAAP.

If the accounting policy used under previous GAAP is consistent with IFRS, assuming there is no error in the estimates inherent in the provision, it should remain recognised at £3 million in the opening statement of financial position under IFRS.

On the other hand, if the accounting policy used under previous GAAP is not consistent with IFRS, for example, under previous GAAP it was not measured at discounted amount, which is required under IFRS, the same estimation techniques as before are used to determine the amount of the provision, but this time it is measured on a discounted basis in the opening statement of financial position.

If previous GAAP had not required Company C to recognise the provision, Company C should use information that existed at the date of transition to determine the amount of the provision under IFRS for recognition in the opening statements of financial position.

3.2.3.2 Mandatory Exception – Hedge Accounting[2] A detailed examination of hedge accounting is outside the scope of this discussion, however, as this is an important exception from retrospective application of IFRS for some companies, the topic will be briefly addressed.

The exception is relevant in cases where prior to the date of transition, the reporting entity had entered into hedge transactions and accounted for them under previous GAAP. The IFRS financial instrument standards (IAS 39 *Financial Instruments: Measurement and Recognition* and IFRS 9 *Financial Instruments*) contain explicit and complex requirements on hedge accounting including a requirement that in order to apply hedge accounting to a transaction there must be full documentation relating to the hedging relationship and the effectiveness of the hedge. It is unlikely that the previous GAAP rules on accounting for hedge transactions are so precise.

IFRS 1 *First-time Adoption of IFRS* states that an entity shall not reflect in its opening IFRS statement of financial position a hedging relationship of a type that does not qualify for hedge accounting in accordance with IAS 39 (IFRS 1 B5), and hedge accounting must be discontinued. In addition, transactions entered into before the date of transition to IFRS shall not be retrospectively designated as hedges (IFRS 1 B6).

[2] *The IASB is finalising the revised hedge accounting rules that will form part of the complete version of IFRS 9* Financial Instruments (*replacement of IAS 39). Any changes to IFRS 9 requirements in relation to hedge accounting are likely to impact on IFRS 1's hedge accounting exception.*

IAS 39 can only be applied to hedge transactions from the point in time when its hedging criteria have been met, including the onerous documentation and monitoring of effectiveness conditions, which may be after the date of transition to IFRS.

3.2.3.3 Optional Exemption – Business Combinations This is perhaps the most important of the exceptions and exemptions for many reporting entities. The requirements are fairly complex, and the detail of them is outside the scope of this discussion, however an overview of the main issues will be given. It is worth noting that the optional exemption in relation to business combinations also applies to past acquisitions of associates and joint ventures (IFRS 1 C5).

The starting point is to understand that there are three options available in relation to accounting for business combinations that occur prior to the date of transition:

1. Apply IFRS fully retrospectively to all past business combinations, i.e., do not take the optional exemption.
2. Apply IFRS to restate one past business combination and all subsequent business combinations.
3. Do not apply IFRS to any past business combinations, i.e., make maximum use of the optional exemption.

As discussed earlier in this chapter, evidence shows that the vast majority of reporting entities take the third approach as it saves time and cost. As this is the most popular option it will be dealt with first.

It is crucial to understand that taking the optional exemption does not mean that there is no restatement of the amounts recognised in relation to business combinations under previous GAAP. IFRS 1 C4 contains some detailed and fairly complex requirements of limited restatements that must be made even when the exemption from full retrospective application of IFRS is taken. For example, some assets and liabilities may need to be derecognised, additional assets and liabilities may need to be recognised, and there may be different measurement bases used for certain assets and liabilities relevant to past business combinations.

The carrying amount of goodwill as was previously recognised under previous GAAP is carried forward into the opening IFRS balance sheet subject to two adjustments. The first adjustment relates to the recognition or derecognition of intangible assets whose carrying value is either deducted or added to the carrying value of goodwill depending on the difference between previous GAAP and IFRS requirements in respect of intangible assets being identified separately at acquisition. The second adjustment relates to goodwill impairment. IFRS 1 C(gii) requires that goodwill is tested for impairment at the date of transition to IFRS and that any impairment loss is recognised in retained earnings.

Partial restatements of balances in respect of business combinations are necessary even when the optional exemption in relation to business combinations is taken. It is crucial that sufficient time is scheduled to deal with these issues and that it is not assumed that taking the exemption means that there will be little work to do to implement the transition of business combinations to IFRS.

The second option in relation to the business combination exemption is to apply IFRS fully to one past business combination, in which case IFRS must also be applied fully to all subsequent business combinations. It is therefore possible to specify a particular past business combination to which IFRS will be applied retrospectively, with any previous business combinations not restated, but with any subsequent business combinations being accounted for using IFRS. This may be desirable if, for example, a particular business combination gives rise to assets that management would like to recognise at group level as required by IFRS but which are unrecognised under previous GAAP.

This choice must be carefully considered, as it will be, in most cases, extremely difficult to apply IFRS fully to a past business combination, especially if it occurred many years ago and for which there may be lack of documentation of conditions that existed at the time of the acquisition. This would make it very difficult to determine fair values with any degree of reliability and introduce unwanted subjectivity to the financial statements. If this option is taken, the ramifications of having to apply retrospectively the complex requirements of IFRS 3 *Business Combinations* to past acquisitions must be understood. These include, but are not limited to, matters such as:

- Determining the fair value of consideration paid, including contingent and deferred consideration and non-cash consideration.
- Identifying assets acquired including intangible assets and contingent assets, and liabilities including contingent liabilities.
- Determining fair values for acquired assets and liabilities at the date of acquisition.
- Performing an impairment review of goodwill each year subsequent to the acquisition.

For many past business combinations it will simply not be possible to reconstruct the acquisition as it would have been accounted for under IFRS, hence the reason for the optional exemption and why so few reporting entities choose to apply IFRS 3 retrospectively to past acquisitions.

3.2.3.4 Optional Exemption – Deemed Cost The deemed cost exemption is available for items of property, plant and equipment, for intangible assets, as long as they meet the IAS 38 *Intangible Assets* criteria for recognition and for revaluation, and for investment properties where the cost model is used as the measurement basis. In the case of intangible assets it is important to note that because IAS 38 is fairly restrictive in allowing the revaluation of intangible assets (permitted only where there is an active market for the asset), the deemed cost exemption is rarely used in relation to intangibles.

The deemed cost exemption simply means that, at the date of transition, instead of using the depreciated cost of an asset for its starting point under IFRS accounting, an alternative value or “deemed cost” can be used.

The general reasoning behind this exemption is that the IASB appreciates that trying to recreate the cost of an asset as if it had been acquired when IFRS was applicable will be difficult in many cases, especially for old assets and those with many component parts where original documentation may be lacking. The cost of reconstructing an IFRS-based cost for an asset simply outweighs the benefit to users of the financial statements.

Therefore, the reporting entity can choose to use deemed cost as the measurement basis for an asset on the transition to IFRS, with the deemed cost becoming the basis for subsequent depreciation, amortisation and impairment in relation to that asset. IFRS 1 permits that one of the following can be elected to become the deemed cost of an asset:

- Its fair value at the date of transition; or
- A previous GAAP revaluation at or before the date of transition (as long as the revalued amount is broadly comparable with fair value, cost or depreciated cost under IFRS).

Choosing to measure assets at fair value at the date of transition to IFRS does not mean that fair value accounting has to be continued subsequent to the transition to IFRS. Effectively, the fair value becomes the deemed cost for subsequent accounting purposes. If the reporting entity does not normally use the fair value model, this accounting treatment can be seen as a one-off revaluation. Measurement at fair value at the date of transition is a way to "refresh" the balance sheet and bring asset values up to date, with the advantages of strengthening the asset base recognised in the financial statements. However, as with any revaluation of depreciable assets, the downside is lower profit due to additional depreciation charges based on the revalued amounts.

Where the reporting entity has used a policy of revaluation under previous GAAP, those revalued amounts can be "frozen" and treated as deemed cost going forward. In this case, the deemed cost should be based on the most recent valuation obtained under previous GAAP.

3.2.3.5 Optional Exemption – Cumulative Translation Differences This exemption is important for reporting entities with overseas subsidiaries. Under IFRS, IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires that some exchange gains and losses arising on the retranslation of foreign operations are recognised separately as a component of other comprehensive income and in equity. Additionally, on the disposal of a foreign operation, the cumulative exchange gains and losses are recycled from equity into profit or loss for the year.

Full retrospective application of this requirement would be extremely onerous, as it would entail determination of the annual exchange gain or loss that would have arisen since the acquisition or formation of the overseas operation. Information may not be available for this exercise to be performed successfully, so IFRS 1 permits the cumulative translation differences for all foreign operations to be deemed to be zero at the date of transition to IFRS (IFRS 1 D13). Additionally, if the exemption is taken, the gain or loss on a subsequent disposal of any foreign operation excludes translation differences that arose before the date of transition.

This exemption is usually taken by first-time adopters as previous GAAP may not have required separate accumulation of exchange gains and losses.

3.2.3.6 Optional Exemption – Investments in Subsidiaries, Joint Ventures and Associates This exemption is relevant to the parent company's separate financial statements where an investment in a subsidiary has been made, and is also relevant for investments in associates and jointly controlled entities. The usual accounting rule is that such investments are recognised in the parent/investor's financial statements either at cost or in accordance with IFRS 9 *Financial Instruments*, i.e., treated as a financial asset.

IFRS 1 allows the investment to be measured at either:

- Cost, determined in accordance with IAS 27; or
- Deemed cost, measured at the date of transition to IFRS using one of the following:
  - Its fair value, or
  - Its previous GAAP carrying amount (IFRS 1 D14–D15).

The choice of measurement basis is available on an investment-by-investment basis, and provides an "easy option" in that the previous GAAP carrying amount can simply be carried forward and used in the opening IFRS balance sheet. The option to measure at fair value is not used often in practice as it requires ongoing assessment of fair value, and it is perceived that there is little benefit to using fair value in the separate financial statements of the investing company.

3.2.3.7 Optional Exemption – Share-based Payment IFRS 2 *Share-based Payment* contains complex requirements in relation to share-based payment schemes, both equity-settled and cash-settled schemes. An example of the former is an employee share option scheme, and of the latter is a cash bonus based on increase in the reporting entity's share price, sometimes known as a share appreciation scheme. The IFRS 1 exemptions provide relief from the full accounting requirements of IFRS 2 for old, share-based payment plans in that IFRS 1 D2 states that an entity is encouraged, but not required, to apply IFRS 2 to:

- Equity instruments that were granted on or before 7 November 2002; and
- Equity instruments that were granted after 7 November 2002 and vested before the later of:
  - the date of transition to IFRS, and
  - 1 January 2005.

This essentially means that IFRS 2 does not have to be applied to an equity-settled share-based payment plan that vested prior to the date of transition to IFRS. If any equity-settled share-based payment plan still exists in which the equity instrument was granted prior to 2002, IFRS 2 need not be applied even if not yet vested, though this situation is very unlikely to actually exist.

In the event that a reporting entity elects to apply IFRS 2, it may do so only if the fair value of the equity instruments determined at the measurement date has been disclosed publicly. Very few companies choose not to take the IFRS 2 exemption.

A similar exemption exists in relation to cash-settled share-based payment plans.

3.3 PRESENTATION AND DISCLOSURE

IFRS 1 does not provide exemptions from the presentation and disclosure requirements of other IFRSs (IFRS 1.20). This means that the first IFRS financial statements must include the full set of disclosure notes and comply with presentation as required by other IFRSs, as well as providing the specific disclosures and conforming with presentation requirements of IFRS 1.

In some jurisdictions it is required that financial statements include other comparative information or historical summaries of selected financial information, such as five-year summaries. IFRS 1 does not require such summaries to comply with the recognition and measurement requirements of IFRSs (IFRS 1.22). The IASB's view is that although a restatement of such information in compliance with IFRS would enhance the comparability of the information provided, the cost of the restatement would outweigh the benefit provided. Any such information that is presented must be prominently labelled as not being prepared under IFRS, and there should be disclosure of the nature of the main adjustments that would make it comply with IFRS. It is important to note that IFRS 1 does not require any quantification of these adjustments, a description is sufficient.

3.3.1 Explanation of the Transition to IFRS

IFRS requires that the reporting entity explain how the transition from previous GAAP to IFRS affects its reported financial position, financial performance and cash flows (IFRS 1.23). The explanation is required to assist users of the first IFRS financial statements to understand the nature and impact of accounting adjustments made on transition, and whether the financial statements need to be analysed in a different way.

IFRS 1 requires reconciliations to be provided in the notes to the first IFRS financial statements, which explain the transition to IFRS. Two reconciliations are required:

- A reconciliation of equity reported in accordance with previous GAAP to equity in accordance with IFRS for both of the following dates:
  - the date of transition to IFRS; and
  - the end of the latest period presented in the entity's most recent annual financial statements in accordance with previous GAAP.
- A reconciliation to its total comprehensive income in accordance with IFRSs for the latest period in the entity's most recent annual financial statements. The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for the same period or, if an entity did not report such a total, profit or loss under previous GAAP (IFRS 1.24).

Case Study 3.3 illustrates the reconciliations that would be required for a company that presents one year of comparative information.

Case Study 3.3: An Illustration of the Reconciliations Required by IFRS 1 with One Comparative Period Presented

Company D is preparing its first IFRS financial statements to the year ending 31 December 2014, and presents one year of comparative information. Implementing the requirements of IFRS 1 means that:

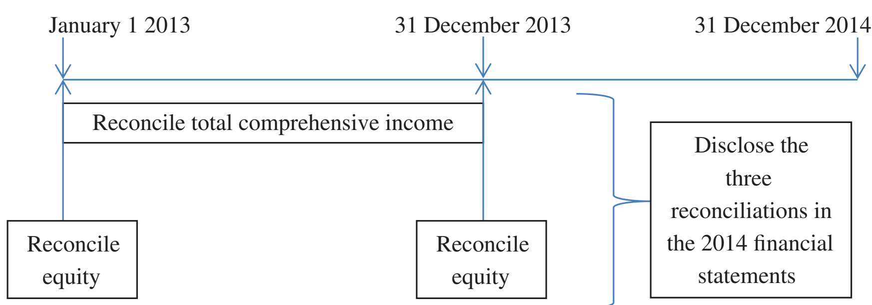
- The 2013 financial statements are prepared and presented under previous GAAP.
- IFRS accounting policies are applied to the opening statement of financial position at 1 January 2013.

- The 2013 financial statements become the comparatives for year ending 2014 first IFRS financial statements and are restated under IFRS for comparability to the 2014 financial statements.

And, following on from the IFRS 1 requirements to provide reconciliations, the following must be presented in the 2014 financial statements:

- Reconciliation of equity at 1 January 2013 – this is the date of transition to IFRS.
- Reconciliation of equity at 31 December 2013 – this is the end of the latest period in the most recent financial statements prepared in accordance with previous GAAP.
- Reconciliation of total comprehensive income for the year ending 31 December 2013.

The figure below illustrates the timing of the necessary reconciliations for Company D:



In some jurisdictions entities are required to provide two years of full comparative information. This gives rise to the potential for "missing" reconciliations of equity and total comprehensive income for one of the years of financial information presented, as illustrated in the example below.

Case Study 3.4: An Illustration of the Reconciliations Required by IFRS 1 with Two Comparative Periods Presented

Company E is preparing its first IFRS financial statements to the year ending 31 December 2014, and presents two years of comparative information. Implementing the requirements of IFRS 1 means that:

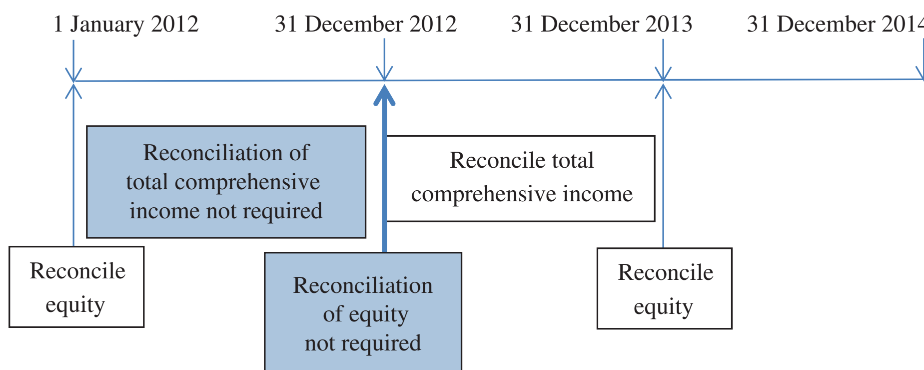
- The 2012 and 2013 financial statements are prepared and presented under previous GAAP.
- IFRS accounting policies are applied to the opening statement of financial position at 1 January 2012.
- The 2012 and 2013 financial statements become the comparatives for year ending 2014 first IFRS financial statements and are restated under IFRS for comparability to the 2014 financial statements.

And, following on from the IFRS 1 requirements to provide reconciliations, the following must be presented in the 2014 financial statements:

- Reconciliation of equity at 1 January 2012 – this is the date of transition to IFRS and is one year earlier than for Company D in the previous example.

- Reconciliation of equity at 31 December 2013 – this is the end of the latest period in the most recent financial statements prepared in accordance with previous GAAP.
- Reconciliation of total comprehensive income for the year ending 31 December 2013.
- This means that there is a "missing" reconciliation of equity at 31 December 2012, and of total comprehensive income for 2012.

The figure below illustrates the timing of the necessary reconciliations for Company E:



IFRS 1 does not expand on whether is it optional or recommended that reporting entities should make good this information gap and provide the reconciliations even if they are not explicitly required. It may be reasonable to assume that in the spirit of the standard, to assist users in understanding the transition to IFRS this information should be provided as long as the cost of providing it is not excessive.

3.3.2 The Equity Reconciliations

The importance of providing the equity reconciliations is due to the fact that the adjustments made to accounting policies on transition to IFRS are reflected in retained earnings, or another component of equity. Therefore, if users of the first IFRS financial statements are to understand the nature of adjustments made and their relative significance, the disclosure of impacts on equity is crucial.

IFRS 1 does not stipulate a particular format or method of presentation of the equity reconciliations, neither does it require any particular content. The standard simply requires that the reconciliations should give sufficient detail to enable users to understand the significant adjustments made to the financial statements.

The implementation guidance of IFRS 1 contains an example of the disclosure that would satisfy the requirements of IFRS 1. The guidance points out that this is only one way of satisfying the requirements, and entities should carefully consider how best to present the information in their particular circumstances. The example goes further than just showing a reconciliation of two equity figures, one using local GAAP and the second after the transition

to IFRS – the example shows all of the line items on the face of the statement of financial position, whether or not they have been affected by the transition. There are also accompanying footnotes to the reconciliation, which briefly explain the adjustments made. The narrative to the example also explains that it may be helpful to include cross-references to accounting policies and supporting analyses that give further explanation of the adjustments in the reconciliation.

Case Study 3.5: An Example of the Presentation of an Equity Reconciliation at the Date of Transition to IFRS

This example is a continuation of Case Study 3.1, in which the accounting policy changes required by Company B on its transition to IFRS were identified, and the impacts on equity discussed.

The example can now be developed to illustrate the reconciliation relating to equity at the date of transition to IFRS that would be required to satisfy the disclosure requirements of IFRS 1. If Company B follows the illustrative example of disclosure provided in IFRS 1's implementation guidance, the reconciliation would be presented as follows (note that for simplicity any tax effects of the adjustments have been ignored).

Reconciliation of equity at 1 January 2013 (date of transition to IFRS)

	Note	*Previous GAAP $'000*	*Effect of transition to IFRS $'000*	*IFRS $'000*
Assets				
Property, plant and equipment	1	10,000	4,000	14,300
	2		300	
Intangible assets	3	3,000	2,500	5,500
Inventories	4	5,300	(1,000)	4,300
Total impact on assets			**5,800**	
Equity				
Retained earnings	5	5,000	1,800	6,800
Revaluation surplus	6	0	4,000	4,000
Total impact on equity			**5,800**	

Notes to the reconciliation of equity at 1 January 2013

1. Property, plant and equipment was measured using the historical cost basis under previous GAAP, under which, measurement at revalued amount was not permitted. In accordance with IFRS, under which it is optional to measure a class of property, plant and equipment at revalued amount, the carrying value of land has been remeasured by $4 million to reflect its current fair value.
2. Borrowing costs relating to the construction of qualifying assets had been expensed under previous GAAP. Under IFRS, where borrowing costs meet certain criteria they must be capitalised.
3. Intangible assets under previous GAAP could not include development costs. In accordance with IFRS, development costs meeting certain criteria must be recognised as intangible non-current assets.
4. Inventories had been measured on a last-in, first-out principle under previous GAAP. Under IFRS the appropriate measurement basis is first-in, first-out.

5. The adjustments required to retained earnings are as follows:

	$'000
Borrowing costs (note 1)	300
Development costs (note 3)	2,500
Inventories (note 4)	(1,000)
Total adjustment to retained earnings	**1,800**

6. The adjustment required to the revaluation surplus is in relation to the remeasurement of properties, as explained in note 2.

3.3.3 The Reconciliation of Total Comprehensive Income

The reporting entity must also provide a reconciliation to its total comprehensive income in accordance with IFRS for the latest period in its most recent annual financial statements. This basically means that the most recently reported total comprehensive income under previous GAAP is reconciled to how it would have been reported under IFRS.

One of the potential problems with this reconciliation is that under previous GAAP there may not have been a requirement to report total comprehensive income, and therefore a reconciliation based on that figure may not be possible. IFRS 1 recognises this and allows the reconciliation to be based on profit or loss as reported under previous GAAP.

Again, the implementation guidance of IFRS 1 provides an illustrative example of a reconciliation of total comprehensive income, with accompanying footnotes.

Data extracted from the IFRS 1 reconciliations of two companies, Centrica plc and British Sky Broadcasting Group plc were used in Chapter 1 to illustrate the effect of transition to IFRS on company accounts.

Case Study 3.6: Deciding on the Presentation of the Reconciliations and Supporting Information – An Example from a Canadian Energy Company

A large Canadian-based energy company went through its transition to IFRS in 2011, and included in its first IFRS financial statements a detailed note explaining the transitional adjustments as required by IFRS 1. The company also included in its 2010 financial statements a note explaining the exemptions from retrospective adoption of IFRS that were to be taken, reconciliations of the main line items on the face of the financial statements from Canadian GAAP to IFRS and details of the accounting policy changes including comments on the materiality of the adjustments made.

A consultant who worked with the company on its transition provided some insight into how the decisions about presenting this information were made. A lot of thought was given to the best way of presenting the information to make it as understandable as possible. The audit committee members worked with the chief financial officer to develop a list of matters deemed significant enough for discussion in the notes to the financial statements. One matter relates to the activities of the company and the associated accounting treatments. The consultant commented that accounting for oil and gas properties under IFRS meant the recognition of exploration and evaluation assets for the first

time, and a detailed note was provided to help users of the financial statements to understand the appearance of this asset in the statement of financial position. A significant adjustment was also made to derecognise a government grant received and the reason for this derecognition was provided to minimise the risk of any misunderstanding about its disappearance from the financial statements.

A decision was taken to provide more information in the reconciliations than was considered strictly necessary to meet the IFRS 1 requirements. All line items were reconciled, with each reconciling item referenced to a supporting note, and the disclosure runs to 12 pages. The audit committee pushed for this level of disclosure, arguing that without it the users of the financial statements would struggle to understand the accounting implications and to differentiate between the more significant and the less significant adjustments. Drafting the disclosures took some time and the accounting department was initially reluctant to prioritise this work but agreed that the company should err on the side of caution and produce more information rather than not enough.

The company keeps a permanent page on its website dealing with its IFRS transition which has links to the 2010 and 2011 financial statements containing the transition information in note format. There is also a link to a corporate presentation that was made in 2011 in which the key transitional matters are explained. The company's view is that the historical information remains useful for analysts performing trend analysis in particular.

3.3.4 Errors, Presentation Differences and the Statement of Cash Flows

3.3.4.1 Errors When an entity is preparing its transitional financial statements, it may become apparent that an error occurred in the financial statements prepared using previous GAAP. In accordance with IAS 8, errors are adjusted by prior period adjustment, and therefore, like the IFRS transitional adjustments, impact on retained earnings. IFRS 1 requires that in this case, the reconciliations should distinguish between the correction of errors and changes in accounting policies on transition to IFRS. This is important because it enhances the reliability of the financial information and a failure to disclosure adjustments adequately due to correction of error would detract from the overall usefulness of the first IFRS financial statements.

3.3.4.2 Presentation Differences In the example of Company B, all of the changes in accounting policy related to recognition or measurement. However, some presentation changes may also be made. A simple change in how an item is presented will not impact equity or total comprehensive income and so will not feature as part of the required reconciliations.

However, because IFRS 1 requires an explanation of the effect of transition to IFRS, a description of presentation changes should be given even though they do not impact the reconciliation.

3.3.4.3 Statement of Cash Flows Adjustments to the cash flow statement that are required on the transition to IFRS should also be explained. IFRS 1 does not contain specific guidance on the disclosure requirements in relation to adjustments to the statement of cash flows. Depending on the number and significance of adjustments made, a full reconciliation of the statement of cash flows as presented under previous GAAP to that presented under IFRS could be disclosed, or a simpler narrative description could be given where adjustments were minimal.

The implementation guidance of IFRS 1 contains an illustrative example of the disclosure of a material adjustment to the statement of cash flows under IFRS. The narrative simply explains a presentation difference affecting one element of the statement of cash flows, quantifying the amount involved.

3.3.5 Other IFRS 1 Disclosure Requirements

IFRS 1 contains specific disclosure requirements in relation to some of the exemptions and exceptions from full retrospective disclosure. These relate to the use of fair value as deemed cost, use of deemed cost for investments in subsidiaries, jointly controlled entities and associates, and designation of financial assets and financial liabilities. The disclosures are mainly around the adjustments made from previous GAAP to IFRS, and in the case of the financial assets and liabilities, the classification adjustment made.

3.3.6 Jurisdiction-specific Disclosure

A particular jurisdiction may impose additional reporting requirements or provide additional guidance on disclosure in relation to the first-time adoption of IFRS. For example, in Canada, the Canadian Securities Administrators (CSA) published guidance on the nature and extent of disclosure in other information issued with financial statements to help users understand the impact of transition on the financial statements. While this type of disclosure is outside of the financial statements, it is helpful to consider whether any such guidance is pertinent to an entity's transition, as the disclosures would be driven by the amounts recognised in the financial statements and the accounting policy choices that have been made on transition. This issue is considered in more detail in Chapter 7.

3.3.7 Interim Financial Reports

IFRS 1 itself, and indeed IFRS generally, does not require an interim financial report to be presented. However, listed entities are usually required to produce interim financial reports to satisfy the regulatory requirements of the jurisdiction in which they are listed. The interim financial information may be required on a quarterly or half-yearly basis. Entities presenting interim financial reports follow the requirements of IAS 34 *Interim Financial Reporting*, and interim financial reports also fall under the scope of IFRS 1 when they are presented for part of the period covered by an entity's first IFRS financial statements (IAS 1.2).

IFRS 1 requires specific disclosure in relation to the transition to IFRS to be made in interim reports falling under its scope. This disclosure is in addition to the disclosures required by IAS 34. The disclosures required by IFRS 1 are:

- A reconciliation of equity in accordance with previous GAAP at the end of that comparable interim period to equity under IFRS at that date; and
- A reconciliation to total comprehensive income in accordance with IFRS for that comparable interim period (current and year to date). The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for that period or, if an entity did not report such a total, profit or loss in accordance with previous GAAP (IFRS 1.32a).

These reconciliations are similar to the reconciliations required in the annual financial statements discussed in Section 3.3 and should contain information that enables users to understand the impact of the transition to IFRS on previously reported interim financial information.

In addition to these reconciliations which must be included in each interim financial report presented in the first IFRS reporting period, IFRS 1 also requires additional disclosure in the first interim report presented in that period. The additional disclosure requirement is to present the reconciliations of equity from previous GAAP to IFRS at the date of transition to IFRS and at the end of the latest reporting period, and the reconciliation of total comprehensive income from previous GAAP to IFRS for the latest period in the most recent annual financial statements (IFRS 1.32b). These reconciliations do not need to be presented in any interim financial report other than the first, though an entity could choose to present them in subsequent reports.

IAS 34 contains a requirement that the entity shall disclose any events or transactions that are significant to an understanding of the current interim period (IAS 34.15). Therefore, it is important that the entity considers if any additional disclosures are required in the interim financial reports to assist users to understand the transition to IFRS.

The same requirements discussed in Section 3.3.4 above in relation to material adjustments to the statement of cash flows, and in relation to the correction of errors apply in the interim financial report.

CONCLUSION

This chapter has discussed the main requirements of IFRS 1 and highlighted some of the IFRS planning points that need to be considered in relation to the application of this complex standard. Readers are urged to consult with experienced IFRS specialists in relation to implementing IFRS 1, and to make use of the many freely available guides to implementation to gain further knowledge and to see more detailed examples and illustrations. One of the main issues to consider is the use of the optional exemptions, and guidance should be taken on the implication of taking, or not taking, each of the exemptions relevant to an entity. In terms of wider impacts of the standard, it is essential to ensure that systems are capable of capturing the necessary data and performing the reconciliations that are required. A reasonable amount of time should be planned in relation to the application of this standard, and this time should be spent as early in the transition process as possible.

The application of IFRS 1 needs to be understood by the users of the financial statements, and the reconciliations should be presented in a way to make them as user-friendly as possible. The extent of supplementary information that is to be provided needs careful consideration. Too little information will leave the users with insufficient facts to comprehend fully the adjustments that have been made on applying IFRS for the first time. Providing too much could result in information overload, and key transition facts could be obscured by too great a volume of material provided. A balance must be struck to ensure that information is complete and presented succinctly without being too brief to be useful.

II PLANNING AND IMPLEMENTING A TRANSITION PROJECT

4 ESTABLISHING THE IFRS TRANSITION PROJECT

This chapter will outline the benefits of establishing IFRS transition as a major project within the reporting entity, a project spanning many different functions and having potentially far-reaching, and maybe unanticipated, consequences. Entities yet to go through transition are well placed to draw on the experiences of those that have already moved to IFRS-based reporting. The experiences are not always positive, with many transitions being rushed and poorly planned, especially for early adopters working to tight deadlines. This, while unfortunate for the organisations involved, provides valuable learning points for those yet to plan their transitions.

The main stages of the project will be outlined and some examples of how to map the project will be discussed, drawing on case studies to provide evidence of how the project was managed in different organisations. In this chapter the first two stages of the project will be explored, namely establishing the project team and scoping the project. This chapter will also consider the involvement of external specialists and the costs of transition, with the need for proper budgeting and adequate financing. Subsequent chapters will discuss impact assessments, IT and systems issues, the wider implications of transition on the business, and finally matters relating to training and communications.

4.1 THE BENEFIT OF EXPERIENCE

It may seem an obvious point that the transition to IFRS must be carefully planned and executed, even in small organisations with few complexities in their accounting and financial reporting. The transition is likely to cause changes not only in accounting systems and to the financial information that is presented internally and externally, but will also have many wider impacts on the organisation and its stakeholders, all of which need to be identified and incorporated into the transition project. The scale of change caused by the transition to IFRS may be much greater than anticipated, so the transition requires strong leadership, competent project members and adequate resourcing.

4.1.1 Negative Experiences – What Did Not Go Well

The great advantage for organisations that are now facing the prospect of a transition to IFRS is that there are lessons to be learned from the experiences of companies and other reporting entities that have already gone through the transition. Individuals that have worked on transition projects either as part of management of the reporting entity or as an external consultant can provide many examples of what did not go well in the transitions that they have been involved with, and it is interesting that the same issues seem to feature in most transitions, almost regardless of the scale or complexity of the transition. Some of these problem areas are discussed in this section, which is largely based on interviews and surveys conducted with a number of individuals who have been involved with a large number of transitions in different

countries including Canada, the UK and Ireland, Australia, Germany, the Czech Republic, South Africa and India.

4.1.1.1 Resistance to Change It is human nature that individuals like to stay within their comfort zone and to some degree will resist changes. One interviewee commented that "Accountants tend to like procedures and doing the same thing each month-end and year-end. Resistance to change was definitely one of the biggest problems I saw in organisations moving to IFRS. There needs to be a dynamic individual in charge of the project who can 'sell' the transition and encourage the accountants to embrace the changes rather than fight against them." This is one of the reasons why involving a project management specialist in the transition planning team is a good idea, as they will be skilled in change management and overcoming resistance to change.

Another key issue in ensuring buy-in to the transition project is securing the involvement of a senior person, board level or equivalent, to act as the sponsor for the project. One interviewee commented that he thought this was one of the most important issues in planning a transition, because without the presence of a high-profile board member on the team, the project would tend to be seen as "just an accounting issue" and that the sponsor can be effective in making individuals more accepting of the changes taking place.

Another interviewee worked on a transition where senior management were not committed to the transition, seeing it as a cause of unnecessary disruption and cost, and doing little to ease the implementation of the necessary changes. In fact the senior management team actually caused problems by arguing against the use of IFRS (this was a case where legislation mandated the use of IFRS for certain organisations), which made it easy for those preparing the financial statements to get away with a low level of commitment to the transition project.

One interviewee summarised this problem as follows:

> *"The main problem I have encountered as a consultant involved with many IFRS transitions is the lack of management buy-in. Management does not see IFRS as a priority, sees little benefit in devoting resources to it and sees the transition as something imposed either by regulation or by a parent company. This makes it very hard to run the transition project effectively, as no one wants to take responsibility for it or to devote much time to it."*

4.1.1.2 Timescales and Keeping on Track It is very easy to underestimate the amount of time that is needed to plan and execute the transition effectively. A lack of time has obvious ramifications such as increased likelihood of error and overstretched resources. It also means that issues considered as lower priority may be ignored or dealt with superficially, as all efforts are concentrated on getting the IFRS financial statements ready.

The most common piece of advice that those having gone through the transition usually give, is to start to plan as early as possible, and to keep monitoring the transition project to ensure it stays on track. One problem with starting the project years before the first IFRS reporting period is that it can be hard to keep momentum going, which is where project management specialists can add value. If the first reporting period is years away, it can be hard to spark much interest in the transition, and to keep interest levels high.

A related issue is whether individuals are working on the project full time, or if they are involved with the transition project in addition to their usual workload. In the latter case it is very easy to lose project momentum, as team members will be focusing on their day-to-day tasks and seeing their responsibilities in respect of the transition just as additional work to fit around existing responsibilities. Of course, it is not always possible to justify individuals working full time on the project, especially in smaller scale transitions, but keeping on track and meeting milestones is still a significant issue to be considered even when planning a relatively simple transition.

4.1.1.3 Underestimating the Wider Impact of the Transition It is easy to fail to identify all of the implications of the transition for the organisation, and to think that the impacts will be mainly, or wholly, felt in the accounting function. A problem in some transitions is that wider impacts are not considered at all as part of the transition project, or are left until the end of the transition project to deal with. Some of the wider impacts that should be considered in planning the transition could include the following:

- Impacts on business processes at the business unit level;
- The need for systems changes and enhancement of internal controls;
- The changes that may be made to internal information systems and reporting;
- Implications for performance measurement and knock-on effects on bonuses and remuneration packages;
- Implications for how liquidity and solvency are measured and impact on covenants and other agreements;
- Planning for tax implications;
- The need to educate finance and some non-finance personnel to ensure they are IFRS-literate;
- Managing investor relations and communicating with external stakeholders.

Note that this is not an exhaustive list of wider implications and many more may be relevant, especially in a large, multinational organisation, and especially those with a complex group structure.

Therefore, the transition planning should not just focus on accounting and financial reporting issues, but should consider issues such as those listed above. An all-encompassing approach to the transition should ensure that there is buy-in to the change from across the organisation, and that the project is as cost-effective as possible.

One interviewee used the example of a public sector organisation's transition to illustrate the type of wider impact that can arise on transition to IFRS. He commented that,

> *"When the organisation was reviewing its contracts for accounting implications as part of the transition project, it found that one significant contract had been treated as an operating expense, when in fact the contract related to a service concession agreement. The accounting impact was easy to deal with, but in fact the organisation should never have entered into the contract as it represented a form of private finance initiative, which is forbidden by the relevant regulations. The contract had to be renegotiated and while the issue was nothing to do with IFRS per se, it was as a result of the transition that the problem was discovered. People planning a transition should be aware that scrutinising documents and contracts for potential accounting implications can reveal wider issues that need to be resolved."*

4.1.1.4 Underestimating the Differences between Previous GAAP and IFRS In some transitions problems arise because management underestimates the differences between previous GAAP and IFRS. This is especially the case where previous GAAP is based on similar principles to IFRS. Even in this case there will be many changes needed in financial reporting to comply with IFRS, and in jurisdictions where previous GAAP is not based on similar principles to IFRS, clearly there is scope for a much greater magnitude of change.

One interviewee faced an extreme example of differences between previous GAAP and IFRS when working on a public sector transition. She comments that,

> *"There was a major change in the underlying principles of accounting, not just a few different accounting standards. Previously the public sector body has used cash accounting, so there was a change from cash to accruals accounting, not just a move to a different set of accounting rules. Few people had any formal accountancy qualifications and it took a long time for the organisation to attract skilled staff and develop training materials for existing staff, and there was also a big resistance to the changes. People just had no concept of using judgement and making significant estimates and the ability to apply technical knowledge was very weak."*

This illustrates just how challenging a transition can be when the whole emphasis is changing from a more prescriptive previous GAAP to the relative flexibility offered by IFRS.

A point worth noting is that it is often the disclosures that cause an issue. Under many previous GAAPs, disclosure requirements are much briefer than those required by IFRS, and it is easy to underestimate the time and effort that will be required to produce the notes to the financial statements that are required under IFRS. For example, new data may need to be collected in certain transactions and balances, requiring changes to systems and reporting formats, and new internal controls.

4.1.1.5 Limited Expertise in IFRS Experience shows that even those organisations that carefully planned their IFRS transition found they did not have enough personnel involved in the project with sufficiently detailed knowledge of IFRS. In many jurisdictions there was, and to an extent still is, a general lack of people sufficiently knowledgeable about IFRS. This valuable resource becomes even scarcer when a large number of organisations are going through the transition at the same time, making the use of external consultants expensive and possibly difficult to procure.

One interviewee commented that on many transitions that he was involved with, the organisation identified that more IFRS knowledge was needed and began a recruitment drive. But it took much longer than anticipated to attract and retain individuals with IFRS experience, which severely affected the project and caused significant delays in performing the accounting impact analysis and implanting systems changes. Another interviewee commented that in some organisations she was aware that the most IFRS-literate staff tended to leave for better paid and more attractive positions at other companies, and with IFRS skills being in short supply, it was the firms that could pay the most that were able to compete most successfully for the most competent individuals.

Therefore, part of the IFRS transition project should focus on ensuring that there is sufficient IFRS knowledge, either by providing training for internal personnel or by planning to use external resources to bring that essential knowledge into the team.

4.1.1.6 Lack of Leadership and Input from Other Business Functions All projects need a strong owner or leader who can drive the project forward, negotiate for resources, liaise between different functions involved with the project and communicate information to the top level of an organisation, ensuring that the organisation as a whole buys into the project. Some of those organisations that have gone through the transition felt that the transition project would have benefitted from stronger leadership and steering through the various phases of the transition, and in particular that more could have been done to make the transition be seen as important and a cross-function issue. In many cases the transition was left entirely to the accounting function to deal with, which may be reasonable for smaller organisations. But a lack of input and liaison with functions outside of the accounting function means that the wider consequences of IFRS transition are poorly understood and in some cases not identified or planned for at all.

A strong project owner or leader should be continually monitoring progress, to ensure that milestones and deadlines are met and that risks and problems are identified and resolved as quickly as possible. One of the benefits of planning IFRS transition as a cross-function project is that it involves non-accountants from the start, and achieves liaison with other departments early on in the project lifecycle. This should mean a more cost-effective transition, and one that is easier to embed across the organisation.

4.1.1.7 Lack of Involvement of External Auditors and other Specialists/Over-Reliance on Consultants In some organisations the lack of involvement of external auditors caused problems. In particular, if the external auditors were not engaged with the transition from an early stage, the changes made to accounting and financial reporting on the transition to IFRS were not seen favourably by the external auditors, leading to further changes to systems, data collection having to be made and financial statements being amended. In turn, this had implications for time and resources in already stretched accounting functions.

The extent of involvement of external auditors will be discussed in more detail later in the chapter. For the purpose of this section it is sufficient to highlight that involving the external auditors when planning the transition should avoid unwanted surprises at later stages in the project, and the more engaged the external auditor is with the project, the smoother it is likely to run.

However, a number of interviewees thought that in many cases organisations relied too heavily on their external auditor or other consultants. One comment made by a consultant who worked on many European transitions summarises this issue well:

> *"Firms relied very heavily on my input, and at times I felt as if I was running the whole project and making all of the key decisions for the client. I was not involved as an auditor, so objectivity was not the issue, but I did worry that management just left me to it and did not really understand the accounting and other implications of the transition. I think that firms should at least make sure that the executives are well informed about the decisions being made, and that IFRS is not just seen as a one-off project that they don't need to be involved with and just treat as a problem to outsource."*

4.1.1.8 Unclear Objectives A problem, particularly for the early first-time adopters of IFRS, was that the transition was not always performed as a project with clear objectives, and while the accounting aspects of the transition may have been adequately planned for, the wider objectives were not considered. In some cases this resulted in wrong decisions being made, some necessary parts of transition not being performed or other parts duplicated, the

production of unnecessary data and management information, an over-reliance on external consultants; all of which led to pressure on deadlines and extra costs.

One of the benefits of seeing IFRS transition as a project to be managed using established project management principles is that clear objectives can be set at the start, allowing the whole project to be executed in a focused and expeditious manner. The setting of objectives will allow the benefits of the transition to be articulated clearly, ensuring that maximum advantage is taken of the situation. For example, the transition can lead to stronger internal controls over financial reporting, expansion of expertise and knowledge in the staff involved with the transition, and better communication between departments can develop. Whether this type of benefit is seen as an objective of the project, or a by-product of it, without clear objectives and a focused project they are less likely to be achieved.

4.1.1.9 IFRS not Embedded within the Organisation A key message coming from those who have gone through the transition is the importance of not viewing the transition as a one-off issue. In many transitions the speed at which the transition had to occur, and the scarcity of internal IFRS knowledge, meant that the organisation was, to an extent, forced to rely heavily on outside help and expertise. This is a big contributing factor to why, in many organisations, IFRS was not embedded in the first few years of transition, but seen as a year-end exercise, often involving few people within the organisation. The problem is that continually bringing in outside help to work on IFRS-related reporting is expensive and unnecessary if the project plans to embed IFRS reporting at an early stage. In addition, when IFRS is not embedded, many of the processes involved in creating IFRS financial statements will be manual, which is obviously labour intensive, costly and, some would argue, more prone to error.

4.1.1.10 Going for the "Cheap and Easy" Option Many interviewees commented that, especially in transitions where time pressure was an issue, or where management was not bothered about trying to embed IFRS within the organisation, there was a tendency to go for quick fixes and the easier option rather than "doing it properly". This means that the many potential benefits that can be a by-product of transition do not accrue. One interviewee commented that in the transitions he had been involved with, management tended to want to devote the bare minimum of resources to the project, and to get by with spending as little effort as possible while ensuring that the financial statements were IFRS-compliant.

4.1.2 The Positive Slant on IFRS Transition

From the section above it would be easy to surmise that the transition to IFRS is likely to be full of negative experiences. However, there are plenty of positives that can come out of the transition, especially if the transition is well planned and started early, using project management principles.

There can also be direct cost and efficiency benefits that arise as a wider implication of transition. A study by the Canadian Institute of Chartered Accountants (CICA), based on interviews with senior representatives of publicly listed entities, found that some interviewees mentioned significant benefits that occurred as a result of the transition. For example, a representative of one company involved in exploration activities commented that as a result of a different accounting treatment for exploration costs, and changes in the allocation of costs to different projects, there was more attention being paid to costs incurred (CICA, 2012). This could have significant implications for reducing operating cash outflows and for the cost control of significant development projects.

Other examples of positive aspects are illustrated by case studies based on discussions with people who have been through the transition, and anecdotal evidence from other sources.

Case Study 4.1: A Positive Impact of Transition – Improved Dialogue with Industry Peers

In some industries, the transition to IFRS fostered networking and an improved dialogue between companies operating in the same sector. Anxious to present a united message to stakeholders, it is common that working groups are established within an industry to discuss the impacts of transition, both accounting and wider impacts, and to establish appropriate responses. A main objective of such groups is to consider the accounting policies that should be developed for industry-specific transactions and balances. In the UK, the external audit firms often played a part in setting up these groups for their clients from the same sector. One interviewee commented on the usefulness of these working groups in developing accounting policies that would become industry norms, and that the legacy of the interaction with accountants going through the transition at the same time has proved to be a long-lasting benefit of the transition. The interviewee said that there is a much more open communication channel for discussion of accounting and other issues with industry peers.

Case Study 4.2: A Positive Impact of Transition – Improved Controls Over Financial Reporting

Many organisations take the opportunity to build an in-depth assessment of systems and controls into their transition project. An interviewee who worked on the transition project of a large German manufacturing company commented that rather than just amend existing systems and controls, the company made changes to systems to improve efficiency, and at the same time tasked the internal audit department with performing a detailed review of the effectiveness of controls over financial reporting. This was an expensive add-on to the transition project, but in the long run it has made systems more efficient and strengthened the control environment and range of control activities performed. The interviewee commented that the external audit firm now considers there to be a low control risk over financial reporting. The external auditors largely perform a controls-based audit, reducing the time that the audit takes, and the disruption factor is much reduced. At the same time management can rely more on the output of the accounting system, helping in their monitoring of key performance metrics.

Case Study 4.3: A Positive Impact of Transition – Improved Asset Management Control in the Public Sector

Public sector entities face specific challenges in the move to IFRS. A feature of many public sector entities prior to using IFRS is their poor documentation of assets that they own or control. Several interviewees with experience of public sector IFRS transition cited this as a major problem, but all agreed that the transition forced the entities to improve not only their documentation but also their whole asset management system including the identification, assessment and valuation of non-current assets. This leads to improved efficiency and control over operations, and assists in the decision-making processes, for example, on procurement and capital expenditure. One interviewee also commented that the transition highlighted problems whereby the knowledge of a particular issue was confined to a single person, and there was no physical documentation of the matter concerned. This made the organisation seek methods of ensuring that this situation did not arise going forward and that a central depository for documentation on property and leasing arrangements was created.

4.1.3 Top Tips for Planning a Transition to IFRS

Based on the interviews and surveys conducted with individuals that have worked on transition projects, a list of ten top tips is shown in Table 4.1. The tips are relevant to most transitions, whether taking place in a private or public sector organisation, and whether the transition is to IFRS as issued by the IASB, or to a national GAAP that is substantially converged with IFRS. It is interesting that while the individuals who provided their top tips worked in a very wide range of transitions varying in scope and size, geographical location and organisation type, the same tips were offered by most individuals.

Table 4.1 Top tips for planning an IFRS transition project

Planning tip	*Commentary*
1. Start planning the transition as early as possible	This will ensure that sufficient time can be spent on all stages of transition, reducing risk of error or late completion, and allowing plenty of time for unexpected issues to be resolved.
2. Secure a sponsor for the project at executive level and commitment to the project from the board or equivalent	The project needs to have appropriate status and credibility, which can be provided by the sponsorship of senior management and should help address change management problems that may be encountered.
3. Identify the skills that are needed and develop in-house IFRS expertise	Training is an essential part of the project and should happen at an early stage to avoid overreliance on external specialists, which can make it difficult to embed IFRS within the organisation.
4. Wherever possible have project team members working full time on the transition	This will ensure that project members focus on the objectives of the project and are not sidetracked by other responsibilities.
5. Involve the external auditors from the start of the project	The input of the external auditors is important and means that accounting policies developed will be appropriate, and the likelihood of unexpected audit problems arising is reduced.
6. Consider the wider impacts of the transition and plan appropriate responses	Many organisations are surprised at the extent of wider impacts on the business and with the benefit of hindsight would have conducted a thorough business impact assessment at the same time as identifying accounting impacts.
7. Prioritise the accounting implications carefully and spend time on assessing necessary disclosures	Often disclosure issues are left towards the end of the project but can be one of the more onerous issues to deal with.
8. Embed the changes and do not deal with IFRS adjustments outside of normal accounting processes	Using spreadsheets maintained outside of the accounting system to create the necessary adjustments and disclosures is risky and inefficient.
9. Communicate the major impacts of the transition earlier rather than later	Relevant staff, for example in procurement, treasury and human resources, need to know relevant changes, and non-executive board members should be aware of all major impacts.
10. Try not to overrely on using external consultants at the expense of building up knowledge and expertise within the organisation	While in many transitions external consultants are essential in bringing necessary skills to the project, there should also be an accumulation of knowledge in-house, otherwise IFRS never gets embedded.

4.2 THE PROJECT PLAN AND KEY PROJECT MEMBERS

Having seen the lessons learned from those that have already moved to IFRS, it is fairly obvious that the transition to IFRS demands careful planning and execution to avoid the problems outlined in the previous section. A project plan should be developed commensurate with the size and complexity of the organisation involved. The project plan should follow the general principles of project management, considering matters such as deadlines and milestones, resource availability, the cost of transition, and an assessment of risks and ultimate goals of the project. This section will consider the risks and opportunities to be assessed and then move on to explore how the project should be planned, including the structure of the team, the development of a high-level project plan, and the need for the plan to be tailored carefully to meet the specific needs of the organisation.

4.2.1 Risks and Opportunities

The transition to IFRS will impact on many areas of the organisation, necessitating changes in systems, information needs, liaison between departments and external communications with stakeholders. There may also be a need for a wider cultural change, as behaviours may need to be modified to embrace these changes and make the transition a success. It is important that the risks and potential problems associated with the changes are first identified and then carefully evaluated and planned for. Indeed, the transition to IFRS should be approached as a business risk like any other major change affecting the organisation, and risks should be prioritised according to their probability of occurring and the magnitude of their potential impact on the business. But the changes may also present opportunities, and these must also be identified in order for the organisation to get the most benefit possible from the transition.

The more commonly perceived risks and potential problems involved in the transition process are summarised in Table 4.2, along with the potential benefits. This table does not consider

Table 4.2 Risks and benefits of IFRS transition

Potential risks	*Potential benefits*
• Limited knowledge of IFRS rules and principles • Burden on accounting resources • Dealing with negative attitudes towards IFRS rules and principles • Lack of time to plan and execute the transition • Systems changes and potential for ineffective controls over financial reporting • Ultimate risk of non-compliance with IFRS and qualified auditor's opinion • Costs of transition especially if relying on external advisors • External stakeholders lack understanding of first IFRS results • Potential for more volatility in profit and negative investor reaction • Lack of senior management understanding of, and engagement with, the transition • Difficult to determine the knock-on effects of the transition across the business	• The transition is a chance to overhaul systems and improve efficiency and integration of financial reporting • Can lead to improvements in control and management information systems • For multinational groups it presents an opportunity to streamline financial reporting and make consolidation easier and less prone to error • Can be an aid in improving dialogue with investors and other external stakeholders • Training staff will bring an enhancement of their knowledge and competence

Strengths	Weaknesses
• Organisation has good relationship with external advisors • Effective internal audit and risk management functions exist • There is plenty of time before the first IFRS reporting period	• Lack of IFRS-literate personnel • Accounting resources are already stretched • Complex accounting issues exist • Changes difficult to implement due to widely dispersed operations in many countries
Opportunities	**Threats**
• Accounting systems can be overhauled • Accounting policies can be reviewed and made more appropriate • Better communication with users of financial statements can be developed • Industry-norm accounting practices can be developed	• IFRS requirements may change before the first reporting period • Users of financial statements will not understand the accounting impacts • Inconsistency of accounting policies with industry peers

Figure 4.1 SWOT analysis of an IFRS transition

specific accounting issues relating to the particular requirements of IFRS, which are discussed in detail in Chapter 5.

At the start of the project the risks and opportunities should be identified and mapped, to provide an overview of both the challenges facing the project team and the potential benefits that can be derived from the transition. The earlier the project is established, the more time there is for risks to be planned for and managed, and for the benefits to be maximised. A SWOT (Strengths, Weaknesses, Opportunities, Threats)[1] analysis could be performed to summarise the main issues facing the business and the project team itself. The SWOT analysis model is useful in helping the project team to formulate an overall strategy for the transition, which can then be used to develop the detailed project plan. An example is shown in Figure 4.1.

The matters identified during the SWOT analysis should be prioritised, with key risks mapped in terms of impact. This will enable the project team to focus on the key issues early in the initial planning phase, ensuring that all are dealt with appropriately.

4.2.2 Establishing the Project

The IFRS transition project must be tailored to the individual circumstances of the organisation, and a variety of matters need to be considered in setting up the project to ensure that it is

[1] *In the SWOT model, strengths and weaknesses derive from internal factors, while opportunities and threats are external factors. When looking at IFRS transition, however, most organisations look at each of the components from an internal perspective as well as considering external factors.*

focused on key objectives and achievable in the timescale. The typical types of matters to be considered include the length of the project lifecycle, the members of the project team, and how to bring the team together. Each of these matters is discussed below.

4.2.2.1 Short-term or Longer-term Project A short-term project may be suitable for smaller entities with no complex transitional accounting issues, but even in this situation careful planning of the transition within a short time frame is essential. The transition will typically involve the restatement of figures produced under previous GAAP, with manual processing of data, and with few changes to accounting systems and controls. A short-term project of this type may be outsourced to external specialists and the transition could potentially be carried out close to the reporting deadline.

The obvious advantage here is that the transition, due to its simplicity and short time frame, will not be costly, and will not be a drain on resources. However, there may be a reliance on external advisors to execute most of the accounting for the transition which will have cost implications and also means that it is much less likely that internal management and accounting personnel are engaged with the transition, making embedding IFRS difficult.

Another advantage is that leaving the determination of accounting adjustments until close to the reporting deadline means that there is more time for consequences to be planned for, and more time for knowledge of IFRS to be developed. Also, due to the changing landscape of IFRS requirements, it may be beneficial to leave the necessary calculations and data capture as late as possible, to negate the need for tracking changes in the standards and continual re-education on up-to-date IFRS rules.

On the downside there is major risk associated with this method of executing the transition, in that there will be very little time to deal with any unforeseen problems that arise before the deadline date. This could have catastrophic consequences if a major problem cannot be resolved without significant time and effort, resulting in late publication of financial statements and possibly issues for the auditor's report if the financial statements ultimately do not contain a statement of compliance with IFRS or contain a material misstatement. For this reason alone, very few IFRS transitions are performed using a short-term project close to the deadline. The risk is too great when dealing with so many complex and not well-understood reporting requirements.

4.2.2.2 The Project Team One of the first matters that must be decided is the structure and membership of the project team. Clearly, the size and composition of the team will be determined, to a large extent, by the size and complexity of the reporting entity, though there will be common features to all IFRS transition project teams. The potential members of a transition project team are discussed below.

Project Leader An important issue is determining the project leader or owner. As discussed in the first section of this chapter, lack of strong leadership is commonly cited as a problem by those that have already gone through the transition. The project needs a strong and credible leader not only to make sure that the project is planned thoroughly and well executed, but also to ensure that the whole transition is given the appropriate status within the organisation. The project leader is likely to be a member of key management personnel, facilitating communication about IFRS-related issues with senior management. However, in some transitions the project leader position is outsourced; for example, it is not uncommon to see an external specialist, often an IFRS consultant, heading up the transition project.

Depending on the scale and complexity of the transition, a decision will have to be taken as to whether the project leader should be working full-time or part-time on the project. Having a full-time project leader obviously means that they can focus fully on IFRS-related issues and focus on the project itself. Anecdotal evidence shows that the decision not to have a full-time project leader is something that is frequently regretted, because a part-time project leader with ongoing responsibilities will not view IFRS transition as their priority. In this situation the project is more likely to run into problems such as missing deadlines or poor communication, and when a crisis arises, there may be no one available to resolve the issue if the project leader has other commitments at that time.

IFRS Specialists Depending on the scale of the transition there will need to be one or more IFRS specialists involved. In large transitions, the IFRS specialists may form their own sub-project team. The role of the specialist is to oversee the parts of the project to do with identifying accounting implications and some of the wider impacts of the transition. If the organisation lacks IFRS specialists, then there will be a need to rely on the help of external specialists, to recruit new employees with the relevant knowledge, or to provide detailed training to existing members of staff. The specialists will be heavily involved all the way through the project, but will be particularly crucial project members towards the start of the project, when the accounting implications will be identified and prioritised.

Accounting/Corporate Reporting and Systems Representatives of the accounting/corporate reporting function will be key project members, as they will be largely responsible for executing key stages of the project such as establishing accounting policies, developing financial reporting packages and drafting the first IFRS financial statements. They will also be involved with drafting disclosures for use in the notes to the accounts and other data for use in internal and external communications. Depending on the organisational structure, where accounting and systems functions are merged, this may be the same group of people who will develop new systems and controls over financial reporting. Alternatively, separate individuals who are responsible for IT systems and controls but not involved in accounting specifically should be involved with the project.

Internal Audit/Audit Committee The internal audit function will ultimately be providing assurance on the systems and controls developed during the transition, so it makes sense to have their involvement from the start of the project. The audit committee will need to be briefed on new accounting policies and will want reassurance on the robustness of information provided by new methods of data capture. It is a common requirement of corporate governance codes that the audit committee contains a financial reporting expert, and the inclusion of this committee member in the project should bring knowledge and skills to the transition team.

External Advisors/External Auditor The need for external advisors will be considered in more detail later in this chapter. However, it is worth noting that even if the transition is not reliant on the use of external specialists, it is considered important that early dialogue regarding the transition project is established with the external auditor, and that the auditor is kept informed of developments as the project progresses. Many experienced project managers also consider that having at least one external person as a project member, whether they are an advisor or auditor, is advantageous in that they can bring an objective viewpoint to discussions and help to keep meetings focused on key issues.

Project Management Specialists In large-scale transitions the team will benefit from the input of one or more project management specialists who will be able to bring skills and valuable contributions such as the following to the project:

- Effective negotiation for resources, both financial and personnel;
- Cost control, and managing risk exposure;
- Use of project management software to aid the execution and monitoring of the project;
- Ability to be creative when faced with problems and challenges;
- Facilitate communication between team members and help to resolve any disputes that arise;
- Bring a fresh pair of eyes and be able to see the bigger picture, as the project management specialist may not be an accounting expert so is less likely to be caught up in technical details.

Case Study 4.4: The Use of External Project Management Specialists

An external auditor who has been involved in many large-scale transitions commented on the use of project management techniques in the transitions that he was involved with. The auditor thought that not enough use was made of "pure" project management people within transition teams, and that in their absence the project manager rarely understood the importance of changing behaviours, working to get the transition accepted within the organisation, planning an effective communications strategy and setting the right tone that the transition was not "just an accounting issue". The auditor also felt that when non-accountant project managers were used in the team there was more focus on embedding the transition and on taking the advice of the external auditors. He thought that companies were often sceptical when the external auditor offered additional support as it was seen as just trying to sell another service, but that a project management specialist was often more open to suggestions from the external auditor and to offers of assistance.

Representatives from Different Business Functions Typically, the project team will include representatives from a variety of different business functions, depending on the extent of implications that IFRS will have across the business. Normally, in a large-scale IFRS transition, the following representatives would be involved to some extent:

- Treasury – Members of the treasury department can provide input relating to financial instruments and matters such as covenants to which the organisation is exposed through its financing arrangements. Disclosure is needed on the risk associated with financial instruments, so information will need to be generated by the treasury team in relation to this.
- Human resources – HR personnel will need to be aware of the implications of IFRS on performance measures that may affect bonuses and profit-related pay, and can also provide input on matters such as share-based payment schemes and pension plans which will have specific accounting issues associated with them.
- Communications/knowledge transfer – A communication strategy will need to be devised to ensure that the expectations of external stakeholders are managed well. And internal communications are just as important, so the communications team will need to consider how best to disseminate information about IFRS transition within the organisation.

- Legal – There may be legal consequences that need careful consideration, such as contract negotiations and lease clauses that may contain, for example, embedded derivatives, and the information that needs to be disclosed in relation to provisions and contingent assets and liabilities arising from litigation.

Representatives from Business Units Again, depending on the organisational structure and scale of the transition project, it may be essential to include representatives from each business unit affected, whether this is at legal entity level or a lower level such as business units. These representatives will play an important part in the communication of key aspects of the transition across the organisation, and should help to encourage “buy in” to the changes necessitated by the transition.

4.2.2.3 Bringing the Team Together As in any major project, one of the keys to success lies in making sure that each project member has a clearly defined role and understands their specific responsibilities. Successful teamwork depends on matters such as the team members being allocated appropriate roles and tasks, the team having adequate resources, and on effective processes within the team being established.

A team kick-off meeting should be held, during which the team leader is appointed and the key parameters of the project are laid out, including deadlines and milestones. It is important that the team members understand not only their own roles and responsibilities but those of the other team members also, as this will help in the development of communication channels for the distribution of information and in the establishment of lines of reporting within the team. In a large transition project it is likely that not all the team members will have worked together before, in which case each team member should share their experience with the others to demonstrate the value and skills they are bringing to the project. The team members should share contact details, which are then collated so that they can be accessed easily. One of the commonly cited failings of working in a team is the difficulty of contacting other team members, so while this may sound trivial, it is very important that team members know who to contact and how to contact them.

Negotiating for resources is also important, especially if there is a lack of IFRS knowledge within the organisation meaning that recruitment or reliance on external consultants is necessary. Resourcing the project may require significant up-skilling of personnel and training should be arranged as soon as possible. IFRS training, especially if it is bespoke to the organisation, can be expensive and so a training budget should be established and approved. A detailed budget for the whole project should be drawn up, while recognising that the exact nature of the costs to be incurred and their timing and amount are likely to be very much based on estimates at the start of the project.

The project leader should also establish the ground rules to be applied to how the team will work together. This should include consideration of the frequency of team meetings, and whether meetings need to be face to face or can take place by conference call or virtual meeting. Communication procedures need to be put in place, with all team members aware of the outputs they are expected to produce and the required timings of these outputs.

Figure 4.2 summarises the steps involved in establishing the transition project team.

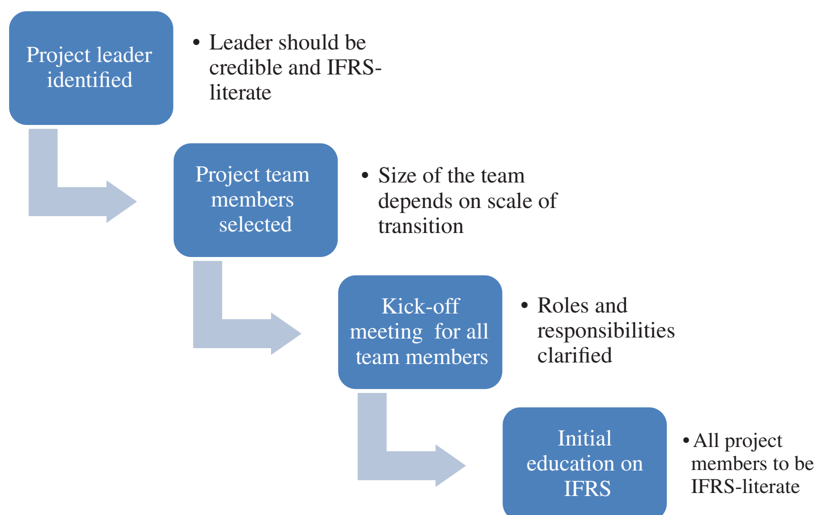


Figure 4.2 Establishing the transition project team

4.3 DEVELOPING THE PROJECT PLAN

Once the team is established its first task is to plan the key stages in the transition. The number of stages and the order in which tasks are performed will depend on the scale and complexity of the organisation's transition, but a roughly similar progression is relevant to most transition projects. This section will explore these basic stages of a transition project and consider the additional work that should be planned in specific circumstances. An initial starting point in a group of companies is the decision as to the scope of the IFRS transition within the group, as this will be a major determinant of the entire scale of the transition project.

4.3.1 IFRS Transition Choices for a Group of Companies

In a group, assuming that local regulations allow a choice, a key decision that must be made at the start of the transition planning relates to which companies in the group are going to make the transition to IFRS. This is a very significant issue, as workload will increase with additional reporting entities forming part of the transition project. Requirements for legal entities to report under IFRS will vary between jurisdictions, but the basic principle is that a choice of three options usually needs to be made:

Option 1 Only the consolidated accounts are prepared under IFRS, leaving the individual financial statements of the legal entities reporting under local GAAP. This is a very common situation and is seen in jurisdictions where legal entity financial statements have to be prepared under national GAAP, or where there is a choice to move the legal entities to IFRS but local accounts would still be needed for tax assessment.

Option 2 The consolidated accounts are prepared under IFRS, along with some group members (most likely the parent company), while others remain reporting under local GAAP.

Option 3 The consolidated accounts are prepared under IFRS and all legal entities in the group also move to IFRS.

Table 4.3 Typical IFRS reporting options in a group

	Option 1	*Option 2*	*Option 3*
Consolidated Accounts	IFRS	IFRS	IFRS
Parent Company Accounts	Local GAAP	IFRS	IFRS
Subsidiary Accounts	Local GAAP	Local GAAP	IFRS

This is summarised in Table 4.3.

There are many advantages and disadvantages of the various options. These are discussed in relation to Option 1 and Option 3 below, with Option 2 being a mix of the two. Clearly the driving factor in the decision is likely to be regulatory, but there are other matters to consider in making the choice. Care should be taken when making this decision, especially if tax implications are a significant factor in the decision. There should be dialogue with tax specialists to ensure that appropriate tax planning advice is obtained and that tax advantages within the group are maximised. There should also be communication with tax authorities as there is a danger that in some situations the decision to keep some components of the group reporting under local GAAP for tax reasons could be viewed as tax evasion, so discussion about the reasons for keeping some parts of the group outside of IFRS should take place with the authorities, and their view on the situation should be sought.

4.3.1.1 Option 1 This is often seen as the simplest method of transition, as the individual financial statements of group members do not change, and it is only the group accounts that go through a transition to IFRS. This can significantly reduce the workload of transition. For the individual financial statements and the accountants involved in their preparation it will be business as usual. In some jurisdictions there may be tax advantages to maintaining the individual company financial statements under local GAAP.

The main disadvantage with Option 1 is that there will be considerable work involved in adjusting the individual financial statements at consolidation to ensure IFRS compliance. As the adjustments will not form part of a year-round accounting process, there may be issues with the generation of information needed to make the necessary adjustments, and to provide information needed to be disclosed in the notes to the consolidated financial statements. Even though the accountants at legal entity level will still be preparing their accounts under local GAAP, they will need to be trained in IFRS to be able to understand the information to be provided in relation to IFRS adjustments.

4.3.1.2 Option 3 A key advantage of moving all reporting entities to IFRS at the same time is that it provides the opportunity to streamline group financial reporting and create a stable base for the future with a consistency of accounting policies across the group. This can be particularly beneficial in multinational groups where the financial reporting of overseas subsidiaries can be brought into line with the rest of the group. From a conceptual point of view, this situation embodies the principle of harmonisation. And from a practical point of view it will make consolidations simpler and quicker and should reduce the risk of error or misstatement at group level. There may also be the opportunity to redesign group-reporting systems, making them more efficient, and to strengthen controls. From a business management point of view there would be greater collaboration between the finance functions of the various reporting

entities, which should work to promote better communication and understanding between them.

The downsides of an all-embracing move to IFRS include cost and logistics. The transition project would have a very wide scope in some cases, and many would argue that it is better to focus on transition at group level rather than trying to implement IFRS across group members when it is not actually required.

4.3.2 A High-level Overview of the Project Plan

In any significant project the first plan to be developed should be a high-level plan, which provides a “big picture”. This makes it easy for team members to visualise how the plan will progress, as it identifies key stages or milestones and provides a visual summary of the project. The high-level overview can then be used to develop a much more detailed project plan that breaks down each stage into component tasks and allocates the tasks to project members.

Given the overriding need to complete the transition in time to meet deadlines for publishing financial statements, it is imperative that the high-level overview contains a clearly identified timeline. Without this, work is likely to fall behind deadline, causing the final stages of the project to be rushed, and increasing the chance of error.

The matters that are often cited as taking up much more time than anticipated include:

- Training staff on the detail of IFRS;
- Identifying accounting implications and necessary systems changes;
- Dealing with specific and significant accounting issues such as those relating to financial instruments;
- Drafting the first IFRS financial statements including the notes to the accounts;
- Liaising with external consultants.

Given that the ultimate deadline of publishing the first IFRS financial statements is, in most cases, fixed by regulation, it is sensible to plan the project using a backwards simulation method (Chorafas, 2006). This involves planning focused on the final milestone, i.e., the publication of the first IFRS financial statements at a certain date, and the project plan is developed working backwards from that ultimate goal. Using this method, the desired publication date is the starting point of planning, and the tasks needed to reach that goal are mapped out working backwards from that date.

Figure 4.3 shows a high-level overview for a transition project, and includes a post-implementation stage of the project that would take place after the publication of the first IFRS results.

The completion of the transition project should not mean that the project team is disbanded. There will be many ongoing issues that need continual evaluation, and a post-implementation review should be conducted. The project team will probably evolve into a different sort of team, tasked with dealing with matters as they arise over the first few years of IFRS accounting and reporting. There will be a need to ensure that IFRS is not seen as a one-off project, and that IFRS becomes embedded into the organisation’s systems and controls as quickly and smoothly as possible.

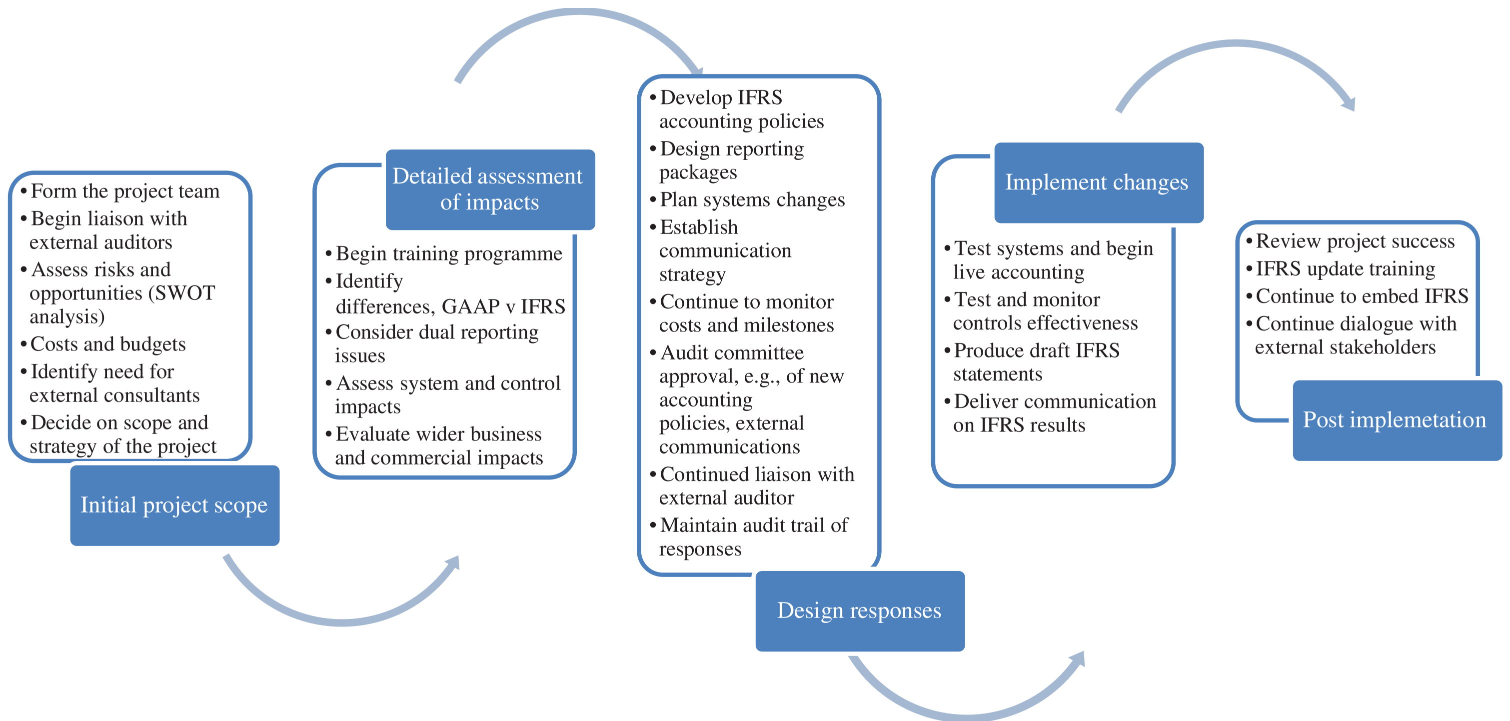


Figure 4.3 A high-level overview of a transition project

4.3.3 Initial Project Scope

Once initial decisions have been made about the project team members and a high-level overview scoped out, an overall strategy for the transition should be decided. For example, is the aim to produce only the essential IFRS information, the minimum necessary for regulatory compliance, or should the project have a broader strategy to include other business objectives and to maximise the return on investment of time and resources into the project? This is an important decision, as it will affect the whole focus and scope of the transition and has implications for the amount of internal and external resources that will be required for successful implementation.

Table 4.4 below outlines typical matters for initial assessment of the project team.

Table 4.4 Specific planning matters to be considered

High-level matters	*Specific planning issues*
Establishing deadlines and milestones and review stages	• How will the transition be structured and phased? • When should milestone dates be placed into the time frame? • How will performance of the project be monitored and reviewed?
Identifying key accounting and related impacts	• How to recognise the major balances and classes of transaction that will be affected by different IFRS requirements • Whether results are likely to be more volatile under IFRS • The extent to which new accounting policies will be needed • The contrast between previous GAAP and IFRS in terms of fundamental concepts and the use of judgement
Evaluation of tax consequences	• Impact of IFRS on tax planning • Differences between local GAAP and IFRS in accounting for current and deferred tax • The potential impact on effective tax rates
Evaluating data requirements	• Are new disclosures needed under IFRS and how will relevant data be captured? • The need for maintaining two sets of data, one under previous GAAP and one under IFRS, for the comparative period
Considering changes needed to accounting and information systems	• Whether a new financial reporting package will be required • Will IFRS be embedded into existing systems? • Whether there will be parallel running of previous GAAP and IFRS systems or a switch over at one point in time • The need for new accounting manuals and internal control procedures
Analysing human resource requirements	• The need for training existing staff on IFRS requirements • To what extent external specialists will be relied upon • Whether new employees with IFRS knowledge will need to be recruited
Identifying cross-functional implications	• Which business functions will be most affected? • Identifying specific impacts of IFRS on non-accounting functions, e.g., HR, risk management, procurement, legal • Establishing a dialogue across functions and business units to ensure engagement
Preparing a budget for the project	• Identifying incremental costs and negotiating a budget • Considering the extent of contingency to be built into the budget
Deciding how to communicate transition issues to external stakeholders	• Identifying stakeholders' expectations • How much information will be provided as the transition project progresses? • Methods of communication

There is a wide range of matters included in the list above. A consistent theme in feedback from those who have gone through IFRS transition is that they had no appreciation at the start of the transition project of the breadth of the scope that would be needed, and how many non-accounting impacts the transition would have.

External advisors will often make use of checklists to assist with project planning, and these should cover the most common matters that fall under the scope of the transition.

4.3.4 Detailed Assessment of Impacts

Perhaps the most significant stage of the project is the assessment of impacts. Chapter 5 will look at the assessment of accounting impacts and Chapter 6 focuses on the wider business and commercial impacts. External advisors will be experienced in identifying accounting impacts, which, for organisations with complex issues such as financial instruments, will be a key planning matter. Accounting impacts will differ between sectors, so ensuring that the specific impacts relevant to a particular industry are addressed is important.

When conducting any impact analysis, it is important to prioritise the impacts, in order to manage risk exposure and to ensure that sufficient resources are allocated to design and implement the required responses to the impacts. Therefore, a crucial part of this stage of transition is to assess the significance of each impact identified and to consider the relationship between the impacts, especially between accounting and non-accounting impacts. For example, developing a new IFRS-compliant accounting policy on revenue recognition could impact on the wording of customer contracts and sales negotiations.

In multinational situations, the impact assessment will be complex and time-consuming, as the impacts may differ among the jurisdictions in which the organisation is located. The impact assessment should take place using a bottom-up approach, to ensure that the individual circumstances of each business unit are addressed separately. Failing to do this could mean that specific local impacts are not identified, and appropriate responses not implemented.

4.3.5 Design Responses

For accounting impacts, the responses will largely be the development of new accounting policies that comply with IFRS. The output of this will be draft accounting policies and a procedures manual, not forgetting policies and procedures relating to the disclosures necessary under IFRS.

In groups of companies, financial reporting packages will need to be drafted, and training should be considered to ensure that the new procedures are understood fully.

One of the biggest issues in this stage of the project is data conversion and collection. It is likely that systems will need to be revised, possibly substantially, in order to capture the new data needed for IFRS reporting. A decision will need to be made as to whether systems should run in parallel to capture IFRS data and previous GAAP data. Data conversion will need to be managed carefully to ensure that no data are lost or corrupted on conversion, and strong control must be designed to ensure the completeness and accuracy of financial reporting. For organisations that are required to certify the effectiveness of internal controls, this will be a major consideration in the design of any system changes.

Responses will also have to be designed for the non-accounting impacts identified. These responses could range from entity-wide issues such as the introduction of new management information systems, to much more detailed and specific responses; for example, the changes to documentation needed in the treasury department in respect of hedging transactions. It is important to map the changes in accounting policies to the non-accounting impacts that arise as a consequence, and then to devise and map an appropriate response to the non-accounting impact.

It is worth noting at this point that proper communication in relation to responses is critical – especially for the non-accounting responses – as it will be harder to engage non-accounting functions in the process and their personnel may not understand the reason for the changes, making it harder for them to accept and implement the responses required. Therefore, IFRS training sessions and briefings should be held across the business functions and business units to ensure that those affected appreciate the need for the changes imposed on them, and can engage with the process of transition.

4.3.6 Implement Changes

When it comes to implementing changes, the success of this stage of the project depends on how well planned the previous stages have been. Implementation will involve the following:

- Approval of IFRS-compliant accounting procedures and policies;
- IFRS reporting systems being tested, going live and beginning to capture data;
- Management information systems report using IFRS terminology and policies;
- Completion of group financial reporting packages and consolidation of information;
- Production of the first IFRS financial statements including restated comparatives;
- Communication of results and IFRS impacts with external stakeholders.

The main concern at this stage is to ensure adherence to the new policies and procedures, so the strength of controls over financial reporting is an important consideration. Given that many transitions take place in a relatively short time frame with a fixed deadline, and that stages of the project previous to implementation may overrun, this stage is likely to be very time pressured. This heightens the risk of non-compliance with new policies and procedures, either through error or through trying to find an alternative shortcut to those prescribed. Chapter 6 will explore control-related issues in more detail.

At this stage of the transition results will be presented externally under IFRS for the first time. For large organisations there will be much media attention and public scrutiny of the financial statements. Appropriate methods of communicating IFRS issues to external stakeholders should have been planned for from an early stage in the project, and this is the time when those plans will be implemented. Managing expectations is crucial, and ideally there will have been some public communication of IFRS matters at earlier stages of the transition, with the aim of beginning the process of stakeholder education on the impact of IFRS on the organisation's results and position a long time before the issuance of the first IFRS financial statements. The organisation will want to demonstrate not just that it complies with IFRS, which will be taken for granted, but that the transition process went smoothly, with limited and well-managed risk exposure. The various methods of communication that have been employed successfully will be examined in Chapter 7, with an evaluation of the relative merits of each.

4.3.7 Post-implementation Review

All significant projects should have a post-implementation review. Having just gone through the implementation stage of the project, the project members will have a clear recollection of the project and so the review should be conducted shortly after the completion of the implementation stage.

In simple terms, the post-implementation review will consider what went well in the transition project, and what did not go well. Valuable lessons can be learned which help in the planning of any future major project that the organisation undertakes.

The following should be considered in a post-implementation review.

DETERMINE WHETHER THE PROJECT GOALS WERE ACHIEVED

This may include an evaluation of these matters, though of course the specific goals will vary between organisations:

- Were IFRS financial statements delivered on time?
- Are the financial statements fully compliant with IFRS?
- Is the audit report unmodified?
- Are the appropriate personnel educated and IFRS-literate?
- Are the necessary controls in place and operating effectively?
- Has IFRS become embedded in the organisation?
- Were the wider implications identified and understood?

EVALUATION OF THE PROJECT'S COSTS

- What were the final costs of the transition?
- What were the causes of any major overspends?
- What are the ongoing costs?

CONSIDERATION OF THE EXTERNAL STAKEHOLDERS

- Were stakeholders' expectations managed well?
- What feedback has been received in dialogue with external stakeholders?

IDENTIFY AREAS OF POTENTIAL FURTHER DEVELOPMENT

- Have all of the expected benefits been achieved?
- Do systems and controls need further development?
- Is there a need for further training?
- Can the move to IFRS have wider benefits for the organisation?

The post-implementation review should highlight any further actions that need to be taken to embed IFRS successfully within the organisation. This will be dealt with in Chapter 6, where the issue of making IFRS "business as usual" will be explored.

4.4 THE USE OF EXTERNAL ADVISORS

A common theme emerging in discussions with those that have gone through IFRS transition is the reliance that was placed on the expertise of external advisors. It is unlikely that organisations planning the transition will have sufficient resources and skills to develop and implement the transition without external help. There are several planning considerations that involve the use

of external advisors, including determining the extent of reliance on them, establishing the nature of their input to the transition project, and deciding which external advisors to use. It is also crucial to assess the likely level of input required from the external auditors, and to evaluate whether their participation in the project creates threats to objectivity that will need to be managed carefully.

4.4.1 Overview of the Role of the External Advisor in the Transition Project

In some transitions the external advisor plays a crucial role, almost running the whole project, while in other transitions the role is less significant to the project as a whole, maybe giving advice to management on specific issues as they arise. So one of the first planning considerations is the extent to which external advisors will be involved.

Some of the matters that should be considered when formulating a view on the extent to which external advisors should be involved include the following:

- What is the current level of knowledge of IFRS within the organisation?
- Are there any envisaged problem areas, e.g., complex accounting issues?
- Is there sufficient resource to staff the project without external help?
- Does management have experience in managing such a significant project?
- Are significant changes to IT systems thought likely?
- What level of scrutiny is expected on the first IFRS financial statements?
- Can the organisation afford to pay for significant external resourcing?
- How keen is management to have a hands-on approach to transition?

Depending on the evaluation of these matters, the level of reliance on external advisors can be gauged.

The type of involvement is the next consideration. External advisors can help in any stage and any element of the transition project. Some of the more common areas in which they are relied on are shown in Table 4.5.

IFRS transition specialists will have a conversion or transition methodology, conversion checklists, diagnostic tools, impact analysis frameworks, systems designs, industry- and country-specific literature and GAAP comparisons ready for use. In choosing which type of advisor to use it is important to consider their specialism, for example in particular industry sectors or in specific jurisdictions, as we have seen that the IFRS transition must be tailored and made bespoke to the organisation.

4.4.2 Using an External Provider to Provide Assurance on the Transition

One way in which external providers can be involved in IFRS transition is that they can be engaged to perform a service in which they provide assurance on the transition. This can be an excellent way to minimise risk and obtain assurance on the quality of the first IFRS financial statements. Assurance could be sought on the following:

- The appropriateness of the new IFRS-compliant accounting policies;
- The effectiveness of controls over elements of systems that have changed;
- The completeness, accuracy and presentation of the opening balance sheet at the date of transition, and of additional disclosures required under IFRS;
- The impact of IFRS on key performance indicators and performance measures;
- The quality of communication regarding IFRS transition.

Table 4.5 Areas of involvement of external advisors

Area of involvement	*Typical activities of the external advisor*
Project management – external advisors can be used to manage the whole project, or to manage specific parts of it	• Project planning • Use of project management software • Supplying a full-time project manager to the organisation or someone to shadow an in-house project manager • Performing monitoring and post-implementation reviews
IFRS technical issues – to supplement and develop in-house knowledge of IFRS	• Analysing differences between previous GAAP and IFRS • Preparing illustrative IFRS financial statements • Helping to prepare draft disclosure notes • Advising on the application of IFRS 1, particularly the use of exemptions • Helping to apply complex standards, e.g., financial instruments • Providing staff to perform the conversion to IFRS and prepare the first IFRS financial statements • Performing or advising on valuations, e.g., intangible assets, impairment testing • Advising on industry-specific matters • Developing accounting policies and procedures manuals • Providing training on IFRS
Systems issues	• Advising on necessary changes • Creating bespoke software • Developing internal controls over financial reporting • Testing systems, procedures and interfaces
Audit – providing assurance on the changeover to IFRS and ensuring an audit trail	• Auditing elements of the transition • Advising on the selection of accounting policies • Assessing the strength of internal controls • Recommending documents necessary for an audit paper trail
Tax – assisting with tax planning	• Assessing the impact of IFRS conversion on tax payable • Advising on tax planning strategies • Helping the organisation in communications with tax authorities
Technical specialists in certain areas	• Helping to draft disclosures and provide valuations, e.g., for pensions, share-based payments and financial instruments
Implications of IFRS – helping the organisation to assess the wider impacts	• Mapping the consequences of moving to IFRS and assessing the significance
Communication – helping to develop and deliver effective communication	• Identifying key stakeholder concerns • Developing a communication strategy
Benchmarking – comparing transition issues across industry sectors	• Using experience gained in other organisations' transitions to improve efficiency and cut costs • Bringing a wider perspective to the project

Case Study 4.5: An External Consultant Advising on Canadian Transitions

One interviewee worked extensively as a consultant for clients going through the IFRS transition in Canada. The kind of work that she performed for clients varied greatly. In smaller transitions she would run the whole project, taking it through from initial accounting impact assessment to preparing draft financial statements including the preparation of disclosure notes, and creating all of the necessary documentation. An important part of her transition implementation approach involved creating a pack of information for the client's external auditors, detailing the IFRS accounting policies that had been selected, the adjustments made to create the opening statements of financial position and all other key issues that had been discussed with the client. Other clients engaged her to provide a second opinion on the recommendations made by their external auditors. In some projects the consultant provided liaison between management and external auditors. Consultants can offer a wide range of services not impacted by the objectivity factor that affects services provided by external auditors to their clients.

4.4.3 Advantages and Disadvantages of Reliance on External Advisors

While in a lot of cases it will be essential to involve external advisors in at least part of the IFRS transition project, there can be dangers in outsourcing too much of the work. A recurring theme in interviews with those that have been through transition is that with the benefit of hindsight many of them regret that so much of the transition work was performed by external providers, as this limited the amount of IFRS knowledge that accumulated within the reporting entity. This meant that in subsequent reporting periods the external advisors had to be involved again, and while this has clear cost implications, the broader issue is that IFRS becomes viewed as something not embedded within the organisation, and a lack of in-house IFRS knowledge can become a significant problem.

Clearly, management often chooses to rely on the external advisor heavily, perhaps due to resource and time constraints, and there will be many advantages as well as disadvantages to this.

ADVANTAGES

- Frees up management's time to focus on the day-to-day running of the business.
- Arguably the risks associated with IFRS transition should be reduced, as external advisors bring expertise and experience.
- It is less likely that unanticipated surprises will emerge late on in the project.
- The project will be smoother, more efficient and sufficiently resourced.

DISADVANTAGES

- Cost – the advice will be expensive.
- Limited management involvement means it is harder to establish the status of the project within the organisation.
- It is more likely that the project will be seen as a "one-off" issue, and that IFRS will not become embedded.
- Internal staff may be less likely to develop knowledge of IFRS if much of the accounting is outsourced.

4.4.4 The External Auditor's Role

It is widely agreed that having the external auditor involved with the transition from the start is important, because having their views from an early stage in the project will help to prevent unwelcome complications further down the line. The question is to what extent the external auditor can or should be involved in the design and implementation of the transition. While the reporting entity may want the external auditor to be involved heavily, due to their financial reporting expertise and knowledge of the organisation's operations and business, for issues of professional ethics the external auditor has to remain objective. The reasons for this and the level of permissible involvement are discussed in this section.

4.4.4.1 Objectivity Issues Auditors operate within an ethical framework, and are bound by codes of ethics that provide principles and rules that must be adhered to when performing audit or assurance services. There are many such codes. The International Federation of Accountants (IFAC) issues the *Code of Ethics for Professional Accountants*, which stands as an ethical code in its own right and can guide the development of national codes too. The national codes may differ in their detailed requirements for auditors, but they share a common theme that objectivity is an overriding issue that must be considered when performing audit work and taking on other audit-related services. In other words, when the auditor gives their opinion on the financial statements, it must be perceived that the opinion is independent and free from bias, otherwise the credibility of that opinion is jeopardised.

There are many potential threats to objectivity if the external auditor becomes too involved with the IFRS transition, one of which is the self-review threat. The principle is that the auditor will not be perceived to be giving an objective opinion if they have played a part in preparing the financial statements on which the opinion is being given. Self-review can mean simply preparing, or helping to prepare, all or part of the financial statements, but can also extend to situations where the auditor has developed accounting systems, or recommended accounting policies. For these reasons, under most ethical codes auditors are not allowed to perform such roles if the involvement is significant to the financial statements. Clearly, in an IFRS transition, if the auditor were to be involved heavily, there could be a perceived threat to independence because of self-review. The auditor would be unlikely to be critical, and would be less sceptical of the procedures used to produce the figures being audited.

The management threat is also potentially significant. This threat arises from the perception that the auditor takes on the role of management, for example in designing accounting policies or developing effective controls over financial reporting. Other threats to objectivity arise due to self-interest, this being largely a financial issue, where the auditor charges a fee for providing services related to IFRS transition.

The issue that must be considered, therefore, is how these threats can be safeguarded against. To eliminate the self-review threat, separate teams from the audit firm could be used, one to work on IFRS transition, and one to work on the audit. The situation should be subject to engagement quality control reviews. In the UK, for example, it is quite common for the audit team to be local to the reporting entity, with assistance with IFRS transition being provided by a centrally located team comprising IFRS specialists. To minimise the management threat, the final decision on the new IFRS accounting policies to be adopted must be made by the client.

The key thing is that both the audit firm and the client understand the potential threats and respond appropriately. In organisations that have an audit committee, it is usually the case that

additional work to be performed by the external auditors is pre-approved by the committee, and failure to ensure that this has happened could be seen as a corporate governance failure. It is important that the type of work that will be performed by the external auditor in relation to IFRS transition is documented and understood by both parties, and the distinction made as to whether the work is performed as part of the audit service or as an additional audit-related service. In some jurisdictions it is prohibited for an audit firm to provide services other than those that fall under the scope of the audit, in which case a different external provider should be engaged.

Many companies that went through transition in the EU in 2005 involved both their external audit provider and a separate firm of advisors. The external auditor gave input where appropriate, subject to the consideration of independence issues, and the other advisors were able to become more immersed in the transition project, often taking a pivotal role in its planning and performance.

Case Study 4.6: An External Auditor's Involvement in Irish Companies' Transitions

One interviewee spoke of the broad range of level of involvement she had experienced while acting as external auditor for Irish companies moving to IFRS. She described one end of the spectrum as "whole immersion" – here she would be involved heavily with the transition, almost to the extent of acting as project manager, providing management with choices to avoid objectivity issues but essentially executing much of the transition. At the other end of the spectrum she would give advice on specific areas for clients where management was well informed on IFRS or was consulting an additional IFRS expert to plan and implement the transition. She also commented that the amount of auditor involvement could change as the transition progressed. For example, with one client she thought involvement would be minimal, but several unexpected complex accounting issues arose and she participated much more in the transition than was originally planned for. Where the engagement was of the "whole immersion" type, objectivity was safeguarded by documenting all of management's decisions on key issues and operating segregation of duties where possible by involving personnel in the transition team who would not be involved with the annual audit of the client.

4.4.4.2 The Type of Involvement of the External Auditor An ICAEW survey (ICAEW, 2007) found that the support offered to clients included advice on the development and selection of accounting policies, providing model IFRS financial statements, issuing guidance notes, and giving training sessions on IFRS. The author's own research indicates a wide range of transition-related services provided to their clients, as illustrated in Figure 4.4. Auditors were asked to estimate the proportion of time spent advising on different elements of the transition. Providing advice on new accounting policies and preparing model financial statements accounted for most of the auditor's involvement.

Case Study 4.7: Auditor Involvement in IFRS Transition for a Small Listed UK Company

In the wave of transitions for UK listed companies that took place in 2005, a small listed company relied heavily on the input of its external audit firm. The management of the company had no knowledge at all of IFRS accounting, and indeed the audit firm had little experience either. During the planning phase, the auditors performed an accounting impact analysis using checklists prepared by the firm's technical department. The auditor commented that even the technical department had

little prior experience of IFRS, and the accounting impact analysis was made very difficult by the fact that certain IFRSs were still being finalised at the time of the planning, so some accounting impacts could only be guessed at, with the wider impacts being even more unknown and difficult to plan for. The audit firm provided pro forma financial statements and helped the client to prepare for discussing some of the implications of transition with other parties, particularly its bank, because lending covenants were affected by the restatement of the statement of financial position.

Case Study 4.8: External Auditor Involvement in the IFRS Transition of a Large Canadian Company

The Canadian transition happened later than the EU's transition for listed companies, and the Canadian experience had the benefit of hindsight. The external audit firms were very well prepared and could offer clients a range of services to help them through the transition. The company that is the focus of this case study operates in oil exploration and production. The company's auditors used an interactive diagnostic tool to analyse the accounting implications in detail, and, using experience gained in working on transitions of other oil companies, could offer insight into the wider business implications. The auditors helped the company with the regulatory disclosures necessary in the years running up to the first IFRS financial statements and gave advice on how to communicate IFRS matters to shareholders and other external parties in the presentations and webcasts that were made. The interviewee commented that the audit firm provided a sounding board for management who often needed some informal assurance that the right decisions were being made, for example in the development of new accounting policies, and the sufficiency of disclosure in the notes to the financial statements about accounting policies and the use of judgement.

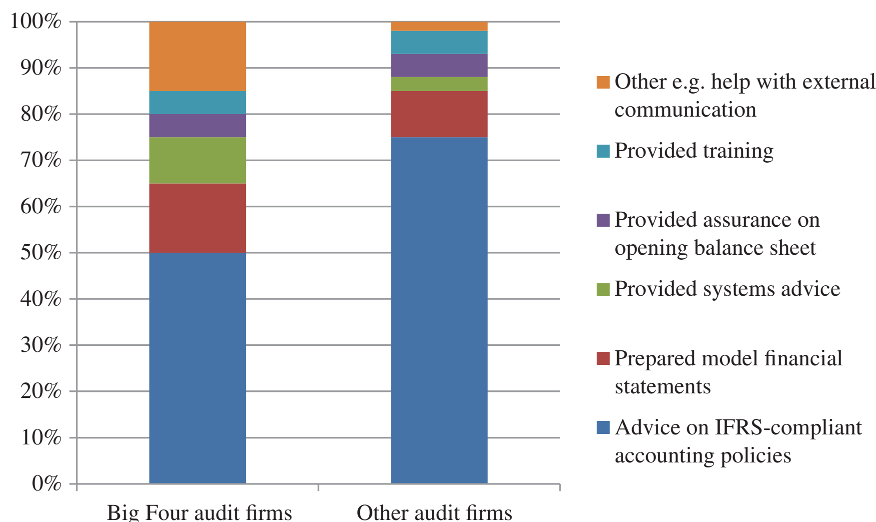


Figure 4.4 External auditor involvement in IFRS transition
Source: Author's own research based on interviews conducted with auditors and consultants.

Anecdotal evidence indicates that reporting entities are not always happy with the input given by the external auditor. Interviewees have commented that in relation to the transition of UK listed companies to IFRS in 2005, some audit firms were slow to give assistance with selection of accounting policies and disclosure requirements, which seemed to be linked to the audit firm itself building up knowledge of IFRS and training staff. One interviewee, having worked with IFRS before joining a UK listed company that subsequently went through IFRS transition, commented that he "probably had better knowledge on IFRS than the auditors". However, these issues can be seen very much as teething problems, as by now all major audit firms, have established methodologies and years of experience in working with IFRS. Smaller audit firms however, may lack this experience if their client bank still uses local GAAP, so familiarity with IFRS should not always be assumed.

There may also have been delays while the audit firm developed its own views on the application of IFRS requirements and prepared in-house guidelines and audit methodology to deal with new accounting issues. A similar picture is seen in other jurisdictions, for example in Canada, where a CICA study found that companies were sometimes surprised at how long it took the external auditor to form an opinion on an accounting matter (CICA, 2012). An interesting point noted in the same study is that some preparers of financial statements felt that their external auditor maintained a very rigid approach to the application of IFRS requirements, based on the approach used in their own firm's literature on the matter in question, despite alternative applications being equally valid.

4.5 THE COSTS OF THE TRANSITION

Budgeting for the transition should be a key element of planning the project. Costs can be substantial, and as with any significant project, costs should be budgeted and carefully monitored throughout the project life cycle. Many studies have looked into the typical types of costs that are incurred on transition to IFRS. One study suggests that the costs incurred by Greek companies in their transition to IFRS tended to relate to systems modifications, external consultant's fees, and the incremental costs of dual reporting (Naoum, Sykianakis, and Tzovas 2011).

Evidence from the author's own research gives an insight into the scale of costs incurred on transition to IFRS. Preparers of financial statements at a variety of organisations were asked to estimate the incremental cost of transition to IFRS, and selected results are shown in Table 4.6.

Table 4.6 An illustration of the costs of transition for a selection of companies

Company description	*Estimated cost of transition to IFRS*	*Cost of transition as a % of revenue*
A UK manufacuring company	£480,000	0.4%
A Canadian property development company	CN $935,000	0.2%
A German distribution and haulage company	€1.3million	0.1%
A UK retail company	£3million	0.06%

Table 4.7 Typical costs of transition by type of cost

Element of the transition	*Proportion of total costs*
Internal staff time	45%
External audit	16%
Use of consultants and specialists	14%
Update of systems and controls	8%
Training	5%
Tax advice	5%
Other e.g. liaison with providers of finance, communications	7%
Total	100%

The information in Table 4.6 illustrates that range of total costs that can be incurred on transition, and also shows that for smaller companies, the amount they spend on the transition is a higher proportion of their revenue.

A study of the costs of transition for Canadian companies revealed a similar trend, with costs varying proportionately with the size of the reporting entity and the complexity of the transition. The highest transition cost was incurred by a large financial services company (CFERF 2013).

It is also interesting to see how the total cost of transition is broken down into component parts. Table 4.7 is based on the authors own research and illustrates, based on the responses of those interviewed, the proportion of costs that is allocated to different elements of the transition.

When conducting interviews on the costs of transition, it was very clear that smaller companies devoted a lot more of their budget to external consultancy and additional services provided by the external auditor. For some small entities this took up the vast majority of their total costs of transition. Larger entities tended to spend a higher proportion of costs on the internal project team, software updates and systems-related issues.

Many cost surveys have been conducted in different countries, and a discussion of the type and extent of costs incurred in each country is beyond the scope of this book. It is interesting to note, however, that costs will vary dramatically between and within countries. In a study of the costs of IFRS transition in Romania, 36% of the finance directors sampled stated that training costs were the most important costs incurred, followed by consultants' fees, audit and then adjustment of accounting systems (Ionaşcu *et al.*, 2007). In the same study, the average cost of transition was only €30,384, much lower than in many other countries, possibly due to the smaller sizes of the companies involved and the low cost which characterises the local labour market.

Other studies estimate the costs to be incurred in jurisdictions yet to go through the transition. One suggests that one-off transition costs in the US would amount to $8 billion, with an element of the costs to be fixed, and therefore affecting smaller firms proportionally more than larger firms (Hail, Leuz, and Wysocki, 2010). The same study showed that small companies with material IFRS adjustments faced the largest increase in audit fees in the year of transition, of 36%, leading the researchers to conclude that smaller companies incur disproportionately more IFRS transition-related costs than larger ones.

There are several key factors that can help to reduce IFRS transition costs:

- Ensuring that the relevant staff receive detailed training in IFRS at an early stage of the project, and that education is ongoing due to the changing landscape of IFRS requirements.
- Treating the transition as a major project and employing specialist project managers who are not necessarily from an accounting background.
- Beginning to plan the project as early as possible and not underestimating the amount of time that it will take.
- Engaging with the external auditor at an early stage and maintaining a dialogue with them, even if much of the advice is provided by a different firm of specialist advisors.
- Keeping all business units involved at all stages of the project.

A specific cost to be considered is that of the external audit. With the extra work involved in the first year of presenting IFRS financial statements, it is not surprising that the external audit fee will increase, due to additional audit procedures needed on auditing the opening balance sheet and the restatement of comparative information. One study in this area looked into the cost of transition incurred by Australian publicly traded companies, and found that smaller companies faced an increase in audit fee on average of 30%, while large companies suffered an increase of 19.8% (De George, Ferguson, and Spear, 2013). Research on the transition costs of New Zealand public sector entities revealed an increase in audit fee of between 5% and 35% across the range of entities surveyed, with the highest increase being for energy companies (Redmayne and Laswad, 2013).

Another aspect of research conducted into the costs of transition considered the cost increase per accounting area. In the ICAEW study mentioned previously, it was evident that the accounting areas in which significant additional costs were incurred included financial instruments, employee benefits, revenue recognition, consolidation, leases and asset valuations, and tangible and intangible assets (ICAEW, 2007). Another study found that much of the increased audit costs suffered on transition relate to the following specific accounting areas: financial instruments, hedge accounting, share-based payment, goodwill, intangible assets and tax adjustments (De George, Ferguson, and Spear, 2013).

The costs associated with education and training also should not be underestimated. This can vary substantially between companies, depending on the existing knowledge level in respect of IFRS, the number of people who need to be trained, and the complexity of accounting issues to be dealt with. Studies have shown that the amount spent on training may also follow a national pattern, because in countries where local GAAP is significantly different to IFRS, more education on accounting fundamentals will be needed, as well as detailed technical training.

Those heading up the IFRS transition project may have to fight for resources – both in terms of money and human resources. Evidence shows that organisations tend to underestimate how much of both the transition will demand. It may be difficult to convince senior management to allocate resources to the project, especially if it is seen as "just an accounting issue" and there is little consideration of the wider business impacts of the transition. Lack of resource puts obvious strain on those involved with the transition, and increases the likelihood of errors, inefficiencies and missing deadlines.

Table 4.8 An overview IFRS transition action plan for XYZ Co

Activity	1st half 2011	2nd half 2011	1st half 2012	2nd half 2012	1st half 2013	2nd half 2013	2014 onwards
Establish project management team							
Implement project management team							
Engage with those charged with governance							
Engage external advisors							
Perform accounting impact analysis							
Identify and implement systems changes and control amendments							
Develop new accounting policies							
Prepare format IFRS financial statements							
Assess wider impacts and plan for changes at company level							
Go live with IFRS reporting							
Create and deliver external communication strategy							
Post-implementation review							

Table 4.9 IFRS transition detailed action plan for XYZ Co

Project stage	*Responsibility*	*Timing*	*Key actions*
Establish project management team	Finance director/ CEO	1st half 2011	Negotiate for resources Select project team members Agree responsibilities and key milestones Hold kick-off meeting
Implement project management team	Project team leader/Finance director	Ongoing	Training on IFRS Develop and implement transition project Ensure ongoing dialogue with advisors and external auditors Maintain project documentation Monitor resourcing and budgeting Hold regular meetings to discuss progress
Engage with those charged with governance	Project team leader/Finance director	Ongoing	Create high-level backing for the project Obtain approval, e.g, use of external advisors, funding, ultimately approval of new accounting policies Educate on the key issues and wider impacts
Engage external advisors	Project team leader/Finance director Audit committee	Ongoing	Discuss project plan and key milestones Input to accounting policy development, systems implications and wider issues, subject to independence constraints Regular involvement and updates on progress
Perform accounting impact analysis	Accounting and finance team members/External advisors	2nd half 2011	Identify and prioritise accounting impact including disclosure requirements Develop knowledge and understanding on specific IFRS issues Plan resources needed to deal with specific issues
Identify and implement systems changes and control amendments	Accounting and finance team members/External advisors/Internal audit	2nd half 2011 and 2012	Design necessary amendments to systems and processes Create controls over new financial reporting systems Obtain assurance on new systems and controls
Develop new accounting policies	Accounting and finance team members/External advisors	2nd half 2011 and 2012	Design IFRS-compliant accounting policies Decide on IFRS 1 exemptions to be taken Develop procedures for dealing with areas of subjectivity and for determining materiality
Prepare format IFRS financial statements	Accounting and finance team members/External advisors	2nd half 2012	Prepare pro formas for each financial statement Prepare draft accounting policies note Prepare pro forma notes to the financial statements Obtain input from external advisors on suitability of format and presentation of financial statements and on accounting policies Present to audit committee for review and approval

(*continued*)

Table 4.9 (***Continued***)

Project stage	*Responsibility*	*Timing*	*Key actions*
Assess wider impacts and plan for changes at company level	Project team/External advisors	Ongoing	Identify and prioritise wider impacts by liason with non-accounting business functions Engage with other departments to explain IFRS impacts Arrange organisation-wide training on key issues
Go live with IFRS reporting	Accounting and finance team	2013	Comparatives to be reporting using IFRS Embed IFRS within the reporting systems Continue to monitor systems and controls effectiveness
Develop and implement external communication strategy	Project team	Ongoing	Identify potential areas of stakeholder concern Present impact assessment at an early stage to stakeholders Plan and deliver effective presentation of first IFRS results
Post-implementation review	Project team	2013 onwards	Continue to review IFRS reporting system for effectiveness Perform review on costs and resources used in the project Obtain stakeholder feedback on presentation of IFRS results

4.6 PREPARING AN ACTION PLAN

The initial planning stage should culminate in the preparation of an action plan to summarise the main stages of the project, important timings and the allocation of responsibilities. This document is high level and will be updated as the project progresses. Typically, the action plan will contain a simple summary of the main stages along with a timeline, supplemented with more detail, the length of which will depend on the complexity and size of the project itself.

An example action plan is shown in Table 4.8 and Table 4.9. This is for a fictional IFRS transition, for XYZ Co, which is undergoing a transition from national GAAP to IFRS. Table 4.8 shows the high-level action plan prepared for the company, including an overview of the main stages of the project and a timeline. Table 4.9 provides more detail on each of the phases of the action plan including key action points and responsibilities.

CONCLUSION

The wide range of issues that must be considered in establishing the IFRS transition project have been illustrated, and the importance of effective planning cannot be over-emphasised. Selecting the right team members, early education to ensure they are IFRS-literate, and devising a realistic project timeline with achievable milestones are crucial parts of project management, as without these essential building blocks the transition will not be efficient or effective. Involving external advisors is likely to be an essential feature of most transitions, but heavy reliance has its advantages and disadvantages. The monetary costs of transition can be substantial, and should be budgeted for.

The following chapters will look at several project stages in more detail. Chapter 5 will consider assessing the accounting impacts of the transition to IFRS, and the development of new accounting policies. Chapter 6 will look at the wider impacts of IFRS adoption including systems issues, change management and involving the audit committee. Chapter 7 focuses on the presentation of the first IFRS results and the need for clear communication and education strategies.

5 ASSESSING THE ACCOUNTING IMPACTS OF IFRS TRANSITION

The most significant part of planning the transition to IFRS involves identifying the accounting impacts, developing new appropriate accounting policies, and implementing any necessary system changes. This is where the project team will need to use technical knowledge of IFRS and, depending on the complexity of the accounting issues involved, there may be a need to rely on experts and bring in help from outside the organisation. The use of the exemptions allowed under IFRS 1 *First-time Adoption of IFRS* will also need to be addressed, as will the need to capture additional information for disclosure in the notes to the financial statements.

This chapter discusses the matters to be considered in performing an accounting impact assessment of the move to IFRS, looking firstly at how the accounting impact assessment should be performed, and then going on to explore how the new IFRS-compliant accounting policies should be developed, including consideration of costs and benefits of new policies, the potential for volatility in financial reporting, tax implications, and presentation choices.

5.1 CONDUCTING AN INITIAL IMPACT ASSESSMENT

5.1.1 The Basics of Impact Assessment

Assessing the accounting and disclosure requirements of converting to IFRS is a crucial part of the transition project. Experts in IFRS transition strongly advocate that sufficient time and effort is used in the impact assessment. If the assessment is rushed or not performed in sufficient detail, it could be that some of the necessary changes in accounting policies or disclosure requirements are not identified at all, or only come to light later in the transition project, causing delays, inefficiencies and additional costs late in the project lifecycle. Accounting impacts not identified or appropriately prioritised can lead to problems such as:

- Last-minute changes to reporting processes and systems;
- Greater reliance on manual work and performing sections of the transition outside of the embedded systems;
- Pressure on resources, increasing the likelihood of error.

The ultimate risk is a material misstatement in the first IFRS financial statements, though evidence shows that this appears to be relatively uncommon.[1]

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[1] *The ICAEW reported a high level of compliance with IFRS in the 200 companies studied as part of its IFRS transition survey (ICAEW, 2007). Similarly, the Committee of European Securities Regulators (CESR) reported a good general level of compliance with IFRS amongst EU companies following implementation in 2005 (CESR, 2007). However, there is evidence that compliance is uneven and varies between countries (Pope and McLeay, 2011).*

Failing to detect and plan for the wider impacts can also cause problems. For example, in the case of renegotiating debt covenants it is clearly preferable to approach the lender only once, armed with all relevant information, than to have to arrange a succession of discussions each time a new impact on the covenant is discovered as IFRS implementation progresses.

The key issue is that the impact assessment must be very detailed and tailored to the specific reporting entity, with accounting impacts analysed on a line-by-line basis. The impacts also need to be prioritised in terms of their effect on the financial statements and the amount of work that will be needed to make the transition from previous GAAP to IFRS. The changes are likely to be significant, with implications for systems and controls and for gaining assurance over the quality of the financial information produced using new accounting policies and amended information systems. A summary of the process is shown in Figure 5.1 below.

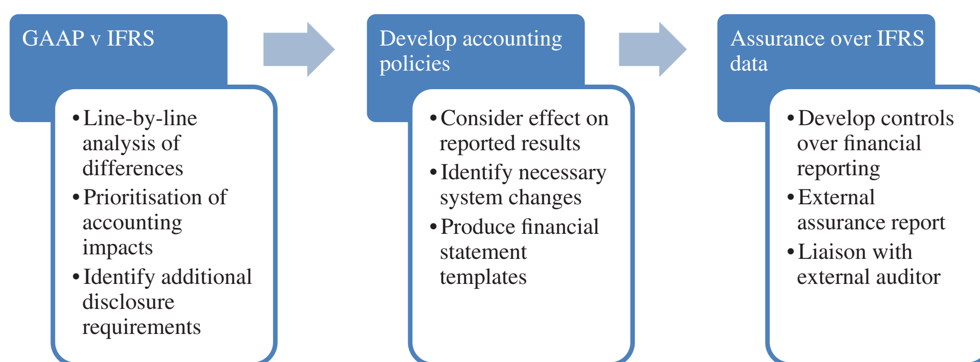

Figure 5.1 An overview of the stages in assessing and responding to accounting impacts on transition

It is also important to understand that the work that is needed to assess the impact of an item may not be proportionate with the amount of work that is entailed in implementing that item's transition to IFRS. As one external advisor said in reference to the IFRS transitions he has been involved with, "you sometimes have to do an awful lot of work to prove that you have no transition issue to deal with". He cited an example of an organisation with a large number of lease agreements, all of which had to be reviewed in detail to see if any of them contained embedded derivatives. This took an enormous amount of time, but ultimately only a few of the leases were found to contain a clause that gave rise to an embedded derivative.

In addition, items that are relatively insignificant in monetary amounts and not complex to account for may require a lot of work as part of the transition to IFRS, in terms of both identifying the accounting issues and planning their transition to IFRS. This is particularly relevant for items that require a significant amount of disclosure detail in the notes to the financial statements. It is important to use materiality appropriately and remember that materiality can be used as a way to prioritise the impacts that have been identified.

Case Study 5.1: An Example of an Onerous Accounting Implication of IFRS Adoption – Holiday Pay Accrual in a Public Sector Entity

In one UK public sector organisation, a local authority that implemented IFRS in 2010, it was quickly identified that a holiday pay accrual would have to be recognised under IAS 19 *Employee Benefits*, which was not required under UK GAAP. This issue was easy to identify, and the required accounting treatment was not complex. However, an enormous amount of work was needed to determine the amount of the holiday pay accrual to be recognised, as new systems had to be implemented and human resources documentation scrutinised for a large number of employees. For a labour-intensive organisation this was one of the biggest workloads in IFRS implementation, even though the numbers were relatively insignificant and the accounting requirement quite straightforward.

Therefore, it is important that the impact assessment properly considers the amount of effort that will be needed to implement transition for each issue identified, and that this consideration is not simply based on the monetary materiality or accounting complexity of the item. Factors such as the availability of existing documentation, the ease with which systems can be amended and the volume of transactions involved in the class of transaction should be reflected in the impact assessment too.

It is also important that corners are not cut with the aim of reducing costs or simply to try to meet a tight deadline. If poor practices develop from the start, it can be very difficult to go back and correct them later on, and there could be a tendency to let the bad practices carry on rather than try to change them.

5.1.2 Documentation Issues

In order to perform the accounting impact analysis, a great deal of documentation will need to be evaluated. This is not just documentation of the accounting processes and systems, but also the underlying documentation in respect of individual transactions and balances, including agreements, contracts and similar items. Just a few examples of the types of document that will need to be assessed and examples of their relevance to IFRS transition are given in Table 5.1.

This table only shows a few examples of the types of documentation that will need to be reviewed carefully. One issue that may create problems, therefore, is a lack of appropriate documentation, which may be caused by cultural issues within the organisation, by previous GAAP not requiring such precise documentation as that required under IFRS, or may be relevant to transactions that occur at no monetary value. Situations where transactions occur with a minimal amount of cash changing hands quite commonly have little documentation attached to them, and under previous GAAP this may not have been an issue if the transaction had no accounting impact. However, under IFRS the accounting treatment could require recognition and so a measurement, maybe at fair value, could be necessary. It clearly could be difficult to even know about the existence of the transaction if there is no record in the accounting system and no documentation. An example could be an asset that had been gifted to an organisation, or a building that is leased for an insignificant nominal sum.

Table 5.1 Examples of documentation to be evaluated when performing an accounting impact analysis

Documentation	*IFRS relevance*
Performance-related pay scheme details	Look for existence of cash- or equity-settled share-based payment plans Terms of plans will determine vesting period and existence of vesting conditions
Employment contracts	Determine policy on holiday pay and other compensated absences Evaluate impact of short- and long-term employment benefits, e.g., bonuses, medical and life insurance benefits
Contracts with customers or sales policies	Existence of revenue recognition trigger points Determine if any revenue is deferred Assess impact of any customer loyalty schemes in place Consider if revenue figures need adjusting to represent fair value
Purchase agreements	Contracts may contain embedded derivatives or give rise to arrangements with lease characteristics
Treasury management hedge accounting records	Assess effectiveness of hedge transactions Evaluate probability of hedged transactions occurring Determine the cost, if any, of entering the hedge Details of valuation models and inputs
Lease agreements	Determine whether finance or operating leases Separate any land element from building element Review for clauses giving rise to embedded derivatives
Borrowing agreements	Agreements may contain clauses such as cap and floor options, giving rise to embedded derivatives
Legal correspondence	Assess for existence of situations that may give rise to provisions or contingent liabilities
Organisational structure	Determine existence of key management personnel and other potential related parties

Case Study 5.2: The Problem of the Lack of Documentation in Identifying the Accounting Impacts of Transition

In some organisations a culture persists that is seemingly reluctant to hold up-to-date documentation on matters relevant to accounting issues. This may be linked to weak governance, a lack of internal audit function or may simply be down to the size of the organisation – in smaller organisations there is deemed to be less need for documentation as the owner-manager “knows” what is important and doesn’t see the need for details written down. Whatever the cause, situations where relevant documents simply do not exist, are very out of date or just difficult to find can create problems in assessment of accounting issues on IFRS transition. Several external advisors interviewed for this book stressed the importance of this issue and indicated that a lack of documentation was one of the biggest problems in the IFRS transitions that they worked on.[2] These problems are often seen in public sector entities, especially those where there have been many historical reorganisations and where there is a lack of paper trail even for significant contracts and agreements.

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[2] *One interviewee described hunting through rat-infested basements and another having to track down an ex-employee of an organisation who left 6 years previously, in order to find documentation relating to significant matters such as leases and asset acquisitions which were material to the financial statements. These were both in large organisations where culturally little importance is attached to documenting transactions properly, even if they have significant accounting impacts.*

Case Study 5.3: Problems Where Previous GAAP Did Not Require Detailed Documentation to be Maintained

Under UK GAAP, smaller companies reporting under FRS 4 *Capital Instruments* were not required to recognise derivatives on the balance sheet. The lack of a need for documentation for accounting purposes often meant that only the most basic details existed for this type of financial instrument, for example, the forward exchange contract itself, but not necessarily detailed records relating to the effectiveness of a hedge or documentation of the risk management objective and strategy, both of which are needed for an appropriate accounting treatment under IFRS. It was, therefore, often difficult to determine whether the IFRS definition of a derivative had been met and how the transaction should be accounted for. In addition, considerable effort was needed to establish appropriate records on transition to IFRS for the ongoing accounting for the transaction to be correct.

5.1.3 Becoming IFRS-literate

Assuming that documentation does exist, in order to assess the potential accounting impact properly, the reviewer must be IFRS-literate. In order to conduct the impact assessment, an understanding must be gained of the differences between the previously applied GAAP and IFRS, which should then be applied at the organisational level.

For major economies yet to convert fully to IFRS there are likely to be resources already available to provide a high-level comparison of the requirements of previous GAAP to IFRS. All of the larger accounting and audit firms have dedicated websites containing information that will be useful in gaining an understanding of the main differences. Just entering "IFRS v GAAP" into an Internet search engine will generate a lot of useful results. GAAP v IFRS comparisons are widely available for most major jurisdictions yet to convert fully to IFRS, including the US, UK, India, China, Brazil, Japan and Indonesia, to name just a few. A full list of some of the currently available IFRS resources can be found in Appendix 2, and a more detailed discussion on the wider training and education issues of the IFRS project is contained in Chapter 7.

5.1.4 Involvement with Industry Peers

Experience has shown that when conducting an impact assessment, many organisations consider the actions of their industry peers, and in fact may work alongside them to evaluate the impact of IFRS on the issues that are common to the industry in which they operate. This can be extremely useful as it potentially leads to industry norms developing in accounting treatments, therefore improving consistency and comparability. And the process of coming together to discuss potential accounting treatments can be very informative for all involved, especially when faced with new accounting requirements demanding the exercise of significant judgement, and where there is limited knowledge and experience of applying IFRS.

In the EU, at the time of the major wave of transition in the mid 2000s, several working groups formed in major industries to discuss accounting treatments for significant issues. For example, in the pharmaceutical industry, where research and development is a crucial issue, groups met to discuss the application of capitalisation rules to intangible assets. Similar groups developed

in telecommunications and software development industries, where revenue recognition is a significant issue (Peyret and Rueff, 2010). In some cases the group meetings involved firms of external auditors, who facilitated the events for their clients operating in certain industries.

5.1.5 The Output of the Impact Assessment

The ideal output of the impact assessment is a detailed document that provides a clear analysis of the differences between previous GAAP and IFRS, prioritises the impacts, and contains for each impact identified a transition action plan. Depending on the size and complexity of the organisation's transition, this document could range in size and detail from a few pages long for a small and simple business with few classes of transaction, to many hundreds of pages for a large and complex organisation.

Commonly, the impact assessment is conducted in two parts. First, a high-level, overall assessment is carried out, at the level of significant classes of transaction and account balances. This will help to direct attention to the priority areas of the financial statements where most significant issues lie. The high-level overview is useful for communicating the main impacts of IFRS transition to those who need an awareness, but not a detailed understanding of, the impact on the financial statements. Second, a detailed line-by-line comparison of previous GAAP and IFRS is made with reference to the existing accounting policies of the organisation, which will pinpoint the exact nature of changes that need to be made to accounting policies, and their knock-on effects. The more detailed document will drive the implementation process and is a key part of the project documentation.

Extracts from typical impact assessment documents are shown on the following pages. Table 5.2 shows the high-level accounting impacts analysis performed on the line items recognised in the statement of financial position. Table 5.3 shows the detailed accounting impact analysis performed on certain elements of non-current assets. The organisation and its IFRS impacts are fictional, and include some of the more typical impacts faced by organisations when considering the transition impacts to do with non-current assets.

This is where a detailed knowledge of both previous GAAP and IFRS is essential, and external help may be needed, either from the external auditor or another expert, as discussed in the previous chapter. The accounting impacts are prioritised according to their significance. It is worth remembering that the impact assessment must include all accounting policies and elements of the financial statements, so will involve considering not just the recognition and measurement of items, but also the overall presentation of the financial statements and the necessary disclosures in notes. For some organisations the disclosure issue can be extremely significant; for example, banks that need to implement the disclosure requirements in relation to financial instruments, so these presentation and disclosure issues should not be assumed to be insignificant.

To summarise, in considering the accounting impacts of moving to IFRS, it is useful to consider the impacts in terms of whether they affect:

- The recognition of items in the financial statements;
- The measurement of those items;
- The presentation and classification of those items;
- The extent of disclosure necessary in the notes to the financial statements.

Table 5.2 Example high-level accounting impact analysis

This impact assessment is based on XYZ Co's (a fictional company) transition from previously applied national GAAP to IFRS. The first table is an illustration of the format and content of a high-level overview of the significance of transition issues for the main line items in the company's statement of financial position.

Line item heading under previous GAAP	*Line item heading under IFRS*	*Relevant IFRS*	*Level of significance*
Intangible Fixed Assets	Intangible Assets	• IAS 38	High – research and development costs
Tangible Fixed Assets	Property, Plant and Equipment	• IAS 16 • IAS 36 • IAS 17	High – componentisation of assets Medium – depreciation and revaluation Low – borrowing costs
Investment Property	Investment Property	• IAS 40	High – measurement at fair value
Investments	Financial Assets – shares	• IAS 39 • IFRS 9	Medium – disclosure
N/A*	Financial Assets – derivatives*	• IAS 39 • IFRS 9	High – measurement and disclosure
Stocks	Inventories	• IAS 2	Low – measurement of work in progress
Debtors	Receivables	• IAS 39	Medium – disclosure of aged receivables
Cash	Cash	• IAS 39	Low – disclosure in cash flow statement
N/A*	Assets held for sale*	• IFRS 5	Medium – presentation and measurement
Trade and other creditors	Trade and other payables	• IAS 39 • IFRS 9	Low – little difference GAAP v IFRS
Taxation	Tax payable	• IAS 12	Low – disclosure
Bank loans	Borrowings	• IAS 39 • IFRS 9	Medium – disclosure and measurement
Obligations under finance leases	Finance lease payables	• IAS 17	High – separation of land and buildings
N/A*	Financial Liabilities – derivatives*	• IAS 39 • IFRS 9	High – measurement and disclosure
Deferred tax	Deferred tax	• IAS 12	High – determination of deferred tax
Provisions	Provisions	• IAS 37	Low – little difference GAAP v IFRS
Share capital and reserves	Equity	• Various	Low – little difference GAAP v IFRS

**Note that there are three line items under IFRS that have no equivalent under previous GAAP – these are items not dealt with under a specific GAAP standard but which do have an IFRS equivalent. In the case of derivatives, these would not have been recognised at all in the financial statements under previous GAAP, and in the case of assets held for sale, the assets would have remained recognised as non-current assets and not disclosed separately as an individual line item.*

Impact	*Description of impact*
High	Significant impact on financial statements and/or significant amount of work to implement transition. Likely to affect materially the reported level of profit or financial position.
Medium	Some impact on financial statements and/or some additional work to implement transition. Impact on reported level of profit or financial position less likely to be material.
Low	Insignificant impact on financial statements and/or insignificant amount of work to implement transition. No material impact on reported level of profit or financial position.
Not applicable	No transitional impacts identified.

Table 5.3 An example of a specific accounting impact assessment on non-current assets

The table builds on the previous high-level impact analysis on XYZ Co's statement of financial position. It shows examples of some of the main areas of difference in accounting for non-current assets categorised by financial reporting standard, and indicates whether the accounting impact is likely to be high, medium, low or not applicable to XYZ Co. The table also shows the main actions required in terms of implementation and includes systems changes and additional data requirements. Note that this is purely an illustrative example of the types of matters to be included in an impact assessment document and is in no way representative of the full amount of differences that would be identified when conducting an impact assessment for an actual company.

IFRS reference	*Description of difference in accounting under IFRS*	*Implementation issues identified and issues to consider for accounting policies*	*Significance of impact*
IAS 38 Intangible Assets	**Accounting treatment of development costs** Under both previous GAAP and IFRS research costs are expensed. IFRS requires that where certain criteria are met, development costs must be recognised as an intangible asset. The option to expense such costs is not available when the criteria are met. Under previous GAAP there is an option to expense development costs even when recognition criteria have been met. This is XYZ Co's accounting policy and consequently the company does not recognise development costs as an intangible asset under previous GAAP.	Processes to be developed to clearly differentiate research costs from development costs to enable capitalisation of the development costs that meet IAS 38 criteria. Systems to be put in place to benchmark R+D projects against IAS 38 criteria, e.g. ensure availability of market research reports, results of technical feasibility studies, forecast cash flows from the project. New general ledger codes to be set up to capture development costs that meet the criteria. Consider possible commercial implications of disclosing development assets in the financial statements. New accounting policy to be developed and disclosed. This issue is considered high impact due to its potential materiality to the accounts, and the work that may be involved in setting up the necessary systems and processes to ensure correct accounting treatment.	High
IAS 16 Property, Plant and Equipment	**Depreciation and component accounting** IFRS contains detailed requirements on the determination of depreciation and uses the concept of componentisation of assets. Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately (i.e. component accounting is required). Where there is more than one significant part of the same asset, which has the same useful life and depreciation method, they may be aggregated for the purpose of accounting for depreciation. Non-significant components can be aggregated and treated as one asset even where they have different useful lives but depreciation should reflect the consumption pattern of the various components. Under previous GAAP, component accounting does exist but is not a specific requirement, and XYZ Co does not practise component accounting.	Existing assets must be broken down into components and a useful life and depreciation method determined for significant components. A judgement will need to be made as to what constitutes a significant component of an asset. External valuations may need to be obtained to determine the carrying value and useful life of significant components. Review relevant accounting and management information systems including the asset management and capital expenditure elements of those systems to ensure additional information requirements can be handled by those systems. XYZ Co's accounting policy to be brought into line with IFRS and disclosed. Judgement will need to be used to decide if this is an area of accounting where significant estimates are used, if so this needs to be disclosed per IAS 1. This is considered to be a high impact area due to the materiality of properties to the accounts.	High

IAS 16 Property, Plant and Equipment	**Annual review in relation to depreciation** IFRS requires that the residual value and the useful life of an asset shall be reviewed at least at each financial year-end and if expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate. Under previous GAAP reassessment of residual values is only required for material residual values to take account of the effects of technological changes. A change in depreciation method is permitted only if it gives a fairer presentation, and there is no requirement for an annual review.	Procedures to be put in place to ensure the annual review of residual value and useful life. Judgement needed to determine the materiality level at which the annual review will take place. Reporting system to be developed so that any factors that impact residual value or useful life are flagged, e.g., obsolescence of an asset. XYZ Co's accounting policy to be brought into line with IFRS and disclosed. This is not considered to be an area of significant estimation in the financial statements.	Medium
IAS 16 Property, Plant and Equipment	**Accounting for revaluation losses** IFRS requires that if an asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. Under previous GAAP the treatment of revaluation losses is different in that revaluation losses caused by a clear consumption of economic benefit are always recognised in profit or loss and not recognised in equity.	The reasons for decreases in asset values must be understood in order to differentiate between a revaluation loss and an impairment loss. New general ledger codes and headings will be needed to account for revaluation losses. XYZ Co's accounting policy to be brought into line with IFRS and disclosed. This is not considered to have a significant impact on the financial statements.	Medium

(continued)

Table 5.3 (*Continued*)

IFRS reference	*Description of difference in accounting under IFRS*	*Implementation issues identified and issues to consider for accounting policies*	*Significance of impact*
IAS 16 Property, Plant and Equipment	**Regularity of revaluation** IFRS requires that revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. Previous GAAP is much more prescriptive, requiring revaluations at least every 5 years.	XYZ Co already measures properties using a revaluation model so there is no change in accounting policy. A deemed cost for assets at the date of transition to IFRS will need to be determined. The need for revaluation at a fixed point in time is eliminated under IFRS, to be discussed with property valuation specialists as this affects the services provided to the company and may have contractual implications. Procedures will need to be established to determine whether a revaluation should be performed close to the reporting period, i.e., whether fair value is materially different to carrying amount, e.g., monitoring of market values of XYZ Co's properties on an ongoing basis. This is considered to have a medium level of impact as XYZ Co's properties are not in a volatile market so revaluations unlikely to be needed more frequently than under previous GAAP.	Medium
IAS 23 Borrowing Costs	**Capitalisation of borrowing costs** IFRS requires that borrowing costs must be capitalised for qualifying assets during the period when the asset is being prepared for use in the manner intended by management, whether for use or sale. IAS 23 contains detailed rules on the measurement of borrowing costs to be capitalised including those from a general pool of borrowings. Under previous GAAP the capitalisation of directly attributable finance costs is not mandatory.	XYZ Co's accounting policy under previous GAAP is to expense all finance/borrowing costs and is therefore not compliant with IFRS. A new accounting policy to be developed that complies with IAS 23. Although this will mean a change in the recognition of finance/borrowing costs, the amounts involved are not likely to be significant and therefore this is considered a low impact area. Reporting system to be developed to ensure that borrowing costs that must be capitalised are identified. Impact on capital expenditure procedures to be considered, e.g., authorisation of capital expenditure linked to specific or general borrowings where relevant.	Low

The impact assessment should feed through into the other planning areas, as discussed in the previous chapter. For example, many of the accounting issues identified will have relatively obvious impacts on systems and controls, which will be easy to recognise. However, the wider impacts may need more consideration. For example, for XYZ Co, there may be the need to involve external specialists in performing asset valuations and for communicating the need to review the residual lives of assets annually to those responsible for asset management.

Note that items are classified as high, medium or low impact depending on the following factors:

- The significance of the potential accounting impact, i.e., materiality to the financial statements;
- The amount of extra disclosure that is necessary in the notes to the financial statements;
- The significance of amendments necessary to systems and controls over financial reporting;
- The cost and effort that will be needed to plan for wider impacts of the transition to IFRS.

5.1.6 The Importance of a Line-by-Line Analysis

When assessing the impacts of transition to IFRS, it is natural to want to focus on the "big issues" that have the potential to alter reported profit substantially or will be complex and time-consuming to deal with. But the accounting impacts that often cause the most problems in an IFRS transition are fiddly and small issues, sometimes linked to disclosure in the notes to the accounts.

Many of those that have gone through transition comment along the lines that "the devil is in the detail", implying that while on the face of it there may not be a large amount of significant differences between previous GAAP and IFRS, when a line-by-line comparison is conducted, many differences will emerge, which may have a much more significant impact on the financial statements than originally thought, and with potentially wide-ranging effects on the transition. This is illustrated in the example below.

Case Study 5.4: The Issue of Lease Accounting for UK Companies Moving to IFRS

UK GAAP deals with lease accounting in SSAP 21 *Accounting for Leases and Hire Purchase Contracts*, under IFRS it is covered by IAS 17 *Leases*. Both are based on similar principles in that finance leases are recognised as an asset with a corresponding liability, whereas operating leases are not recognised and lease rentals are simply expensed. The standards are both based on the concept of substance and risk and reward, use similar criteria or conditions to determine whether a lease is a finance lease or an operating lease, and require relatively extensive disclosures in the notes regarding obligations under lease contracts. This may lead to a perception that the issues to be faced when switching from reporting under SSAP 21 to IAS 17 will be minimal, as the standards are underpinned by the same conceptual approach.

To an extent this is true, generally speaking leases classified as finance or operating under SSAP 21 will continue to be treated in the same way under IAS 17. However, a short paragraph of IAS 17 contains a requirement that the land and buildings elements of leases are accounted for separately.

This is a very significant issue, because it means that, unlike under UK GAAP, when a lease of land and buildings is considered as a whole, under IFRS such leases need to be "unbundled" into a land element and a buildings element and dealt with separately.

The accounting treatment required by IAS 17 is not particularly more difficult than that of UK GAAP. It is the wider implications in terms of how to unbundle already existing leases, obtain valuations and allocate fair value to the land and the buildings elements and ensure that leases entered into going forward separate the two elements for ease of accounting that makes the issue onerous. For organisations with many hundreds of such leases in place at the time of transition, such as retailers and many public sector entities, this seemingly small difference in the financial reporting requirements created a huge amount of work and pressure on deadlines to convert to IFRS.

This demonstrates the importance of applying an in-depth knowledge of IFRS requirements while preparing the impact analysis. Even well-trained accounting personnel who are conversant with IFRS are unlikely to be familiar with the nuances of every single IFRS requirement, especially in specialist industries where the application of certain IFRS requirements is challenging. This is where the use of external IFRS experts is often a useful, if not essential, part of the transition planning.

5.2 DEVELOPING IFRS ACCOUNTING POLICIES

Performing the impact assessment will indicate the areas for which accounting policies need to be developed. All existing accounting policies need to be evaluated for compliance with IFRS, and it is likely that most of them will need to be amended in some way, though of course the magnitude of such amendments will depend on the extent of differences between national GAAP and IFRS.

Chapter 2 contained some guidance on developing accounting policies under IFRS. A brief reminder of the main issues discussed in Chapter 2 is given below:

- If an IFRS specifically applies to a transaction, other event or condition, the accounting policy should be developed by applying that relevant IFRS.
- In the absence of any specific IFRS, management will need to develop an accounting policy, which requires the use of judgement.
- In developing accounting policies, the Framework principles should be considered, and it is acceptable to take guidance from other standard setters in the absence of a specific IFRS.

Where a conflict exists between the Framework and the content of an IFRS, the IFRS should take priority. In performing a transition accounting impact analysis, any instances of potential conflict in accounting policies should be identified. Generally speaking, changes to accounting policies are not encouraged, and are only allowed if there is a mandatory change required, for example by the introduction of a new IFRS or revision of an existing IFRS. It is also permissible to change accounting policies voluntarily, i.e., in the absence of any change to IFRS requirements, but this is only possible if the new policy enhances the qualitative characteristics of the financial information presented. Where accounting policies are changed, it is done by retrospective adjustment.

A key point here is that the transition to IFRS gives the reporting entity the opportunity to evaluate its accounting policies and change them without having to justify a reason for the change, as long as the new policy is IFRS-compliant. This could be advantageous in that accounting policies could be made more industry-consistent, and old policies could be updated to better reflect current business practices. Accounting policies can also be chosen for their strategic benefit, for example opting to revalue non-current assets will enhance the asset valuations on the balance sheet and provide greater borrowing capacity. Or, as illustrated in the case study below, the move to IFRS may simply give the opportunity to adopt accounting policies that are deemed more appropriate.

Case Study 5.5: Streamlining Accounting Policies on the Transition to IFRS in a Group

Several UK subsidiaries were owned by a German company that also produced US GAAP financial information. The UK subsidiaries moved to IFRS and when the accounting impacts were assessed it was considered appropriate for the depreciation policy to be adjusted from the previous UK GAAP policy to a new policy that complied with both IFRS and US GAAP. This made preparing financial statements at group level much easier, although the change to depreciation policy did have some deferred tax consequences that were not picked up on until late on in the transition project.

5.2.1 The Extent of Accounting Policy Changes

As mentioned above, the amount of changes to accounting policies that must be made will depend on the magnitude of differences between national GAAP and IFRS. It is important to remember that in moving to IFRS, organisations in some jurisdictions or industry sectors are not just changing accounting policies in order to comply with a new set of rules, but are embracing a whole new framework and underpinning principles and concepts. In some cases there was a shift in focus of the primary intended user groups, which caused the rationale of accounting policies to be very different.

When EU member nations moved to IFRS in 2005, differences were noted at a national level in terms of the degree of change that had to be made to accounting policies. In the UK and Ireland, the legal system is based on common law, the main focus of financial statements under UK and Irish GAAP is the body of shareholders, and there is a well-established national accounting standard-setting body that uses many similar principles to the IASB when developing GAAP. By contrast, in many continental European countries, for example Germany and Italy, the purpose of the financial statements under GAAP was seen as focusing on corporate creditors and tax authorities, and different fundamental principles to those used in IFRS prevailed. For example, in Italian GAAP prudence took priority, whereas in IFRS prudence is very much downplayed in relation to other qualitative characteristics.

All of this meant that when the EU went through IFRS transition, there were considerable differences in the amount of revision that needed to be made to GAAP accounting policies, with those countries whose GAAP was fundamentally different to IFRS seeing very significant changes compared to those countries where national GAAP was more similar in principle to IFRS. This is not meant to be read as suggesting that UK and Irish companies did not have to

make many changes to accounting policies – this was certainly not the case – but the magnitude of change and the whole shift in the approach to financial reporting was greater in some of the other EU nations.

Within countries, organisations take different general approaches to determining the extent of changes made to accounting policies. Some will want to change as little as possible, maybe due to time and budget constraints. Others may see the transition to IFRS as the chance to review all existing accounting policies fully and take advantage of the new accounting principles, for example new options available under IFRS. There is a spectrum ranging from the organisations that embrace IFRS fully to those who make the slightest adjustments possible to current accounting practice to make it IFRS-compliant. There is no right or wrong answer here, as various constraints may force an organisation down the latter route. But conducting a full review and amendment of accounting policies to bring them into line with IFRS principles as fully as possible during the transition phase will save time and effort in later reporting periods when there may be pressure at that point to make further policy revisions; for example, due to the amendment of an IFRS requirement.

Evidence shows that in the EU transition to IFRS, in which many companies felt extreme time pressure and shortage of resources, there was some short-cutting in the development of new accounting policies. In the post-implementation years, some organisations with the benefit of hindsight thought that they had looked for an "easy fix" on accounting policies to make them IFRS-compliant, and regretted this afterwards (KPMG, 2009b).

It should also be emphasised that while many entities do have a large number of accounting policy changes when they move to IFRS, many have a much smaller number of changes to make. It is going to be an easier transition where fewer significant changes to policies occur, and many organisations simply do not want to be encumbered with more changes than are absolutely necessary for IFRS compliance. There may also be a feeling that changing the accounting treatment, if an item could send a signal that the previous treatment was at least inappropriate or at worst incorrect, is a message that preparers of financial statements will not want to send out.

5.2.2 Matters to Consider in Developing New Accounting Policies

It is important to get accounting policies right at the point of transition because of the difficulties involved in changing them post implementation. As discussed above, changes to accounting policies are not encouraged, and can create a perception of weak governance and control over financial reporting when they are made.

It is most likely that the development of accounting policies will involve the external auditors to some extent; they will be able to provide advice on the suitability of policies and wider implications of certain policy choices. It is important that the interpretation of IFRS offered by the external auditor is properly understood, bearing in mind that given the judgement involved with many IFRS-based decisions, different audit firms may have different ways of interpreting IFRS requirements. Some commentators recommend that preparers of financial statements read widely, and consider the interpretative guidance on IFRS issued by a range of large firms (Dultz, 2009) as part of the process of developing their own accounting policies.

Other matters that are likely to be considered when developing IFRS accounting policies include:

- Which accounting policy is most similar to previous GAAP and will reduce the accounting impacts of transition?
- Which accounting policy choice minimises the negative wider impacts of adopting IFRS, e.g., which has the least impact on debt covenants?
- What is the cost of implementing the new accounting policy compared to the benefit of applying it?
- What is the accounting policy of the parent company or other group companies?
- Are there any likely changes to relevant IFRSs, which mean that accounting policies will be subject to mandatory revision in the future?
- Will a particular accounting policy choice necessitate extensive and potentially costly disclosure requirements?
- Can presentation choices be made which maximise the usefulness of the financial statements and highlight relevant key performance indicators?
- Can the organisation benefit from the experience of others in the industry, and in other jurisdictions in developing new policies?
- Will choosing a particular accounting policy lead to the introduction of significant judgement and entail the use of estimation techniques?
- Does an accounting policy potentially introduce volatility to reported results?
- Which accounting policies work best for the organisation's results and key performance indicators?
- What are the tax implications of accounting policies?
- Is there any industry-specific accounting guidance that needs to be considered, e.g., Statements of Recommended Practice for some UK entities?
- Have regulators or monitoring bodies commented or provided additional guidance on specific areas?[3]

Some of these matters are discussed in more detail below, with illustrative examples and case studies used to demonstrate their application.

5.2.2.1 Cost and Benefit Analysis A cost and benefit analysis is particularly relevant when dealing with accounting policies where a choice is to be made between alternative permissible IFRS treatments. There are fewer of these alternatives now compared to when the first wave of IFRS adopters went through their transition, as one of the themes that has emerged from the IASB's programme of standard development over the last 10 years has been the reduction in the number of alternative accounting treatments.[4]

One of the remaining choices in IFRS is potentially the most significant for many organisations – the issue of whether to measure non-current assets, in particular land and buildings,

[3] *In the UK, for example, many organisations look to comments from the Financial Reporting Review Panel in interpreting standards and developing accounting policies.*

[4] *Many IFRSs used to contain "preferred" and "allowed alternative" accounting treatments. For example, it used to be permitted to either expense or capitalise borrowing costs relating to non-current assets and when consolidating a joint venture company, either the proportional consolidation or the equity method were allowed treatments in group financial statements. Most of these choices have now been eliminated, largely due to the FASB's critical stance on having a variety of permissible accounting treatments.*

using the cost model or the revaluation model. Given that IFRS generally favours the use of fair values when it is relevant and appropriate, from a theoretical point of view one might assume that organisations would choose to revalue assets when possible, especially organisations that choose to embrace the spirit of IFRS fully. However, numerous studies have shown that very few organisations take the fair value route when it is an option.

The limited use of fair value when it is available as an accounting policy choice is a good illustration of the factors that organisations consider when choosing accounting policies in terms of cost and benefit. The benefit is mainly theoretical – more relevant and up-to-date asset valuations, which enhance the qualitative characteristics of the reported financial position of the reporting entity. There may also be a more practical benefit, in that the higher asset values can allow easier negotiation of finance. So, given these benefits, why is the fair value option unpopular? Discussions with those that have been through IFRS transition indicate that the costs far outweigh the benefits, with the most commonly cited costs being the following:

- The monetary cost of having external specialists to provide valuations for assets;
- The ongoing costs of monitoring market values for assets in order to determine whether a further revaluation is necessary;
- The time and hassle factor of getting the revaluations done and accounting for them, including any necessary systems changes;
- Using the revaluation model introduces additional disclosure requirements, again with a time and hassle factor;
- The potential for volatility to be introduced to the financial statements.

While the discussion above has focused on the issue of revaluations, similar principles apply generally to decisions about accounting policies, in that developing policies will necessitate weighing up theoretical accounting pros and cons with commercial costs and benefits in order to devise a practical and IFRS-compliant accounting policy.

5.2.2.2 Volatility When faced with IFRS transition, one of the fears often cited by preparers and users of financial statements is the potential for volatility in both performance and financial position. For preparers in some jurisdictions, IFRS brings about an unwelcome change, in that many accounting treatments previously allowed under local GAAP, which could be used to smooth profits and enhance perceived stability in earnings, are not allowed under IFRS. Such practices included over-provisioning for reorganisation costs, litigation, and bad debts in a practice known as “big bath accounting”. This is much harder to carry out under IFRS due to the stricter recognition criteria for provisions.

There is also a perception that moving to IFRS will cause volatility in share prices, though whether this is a reasonable or a mostly unfounded concern is debatable. Some academic studies demonstrate that moving to IFRS does introduce volatility to profit and share price, while others conclude that the volatility is less than anticipated and does not appear to impact on company value to a significant extent. One of the main issues is how well the factors leading to volatility are explained, as it will be surprise impacts that are most likely to cause an unfavourable market reaction.

Regardless of the academic debate, it is certain that for some companies ongoing volatility will be a significant result of transition to IFRS, and that different industry sectors will be

affected by volatility in different ways. Two case studies below illustrate how volatility can affect the oil and gas and airline industries.[5]

Case Study 5.6: Volatility Caused by the Move to IFRS in the Oil and Gas and Airline Industries

Oil and gas companies have found the transition to IFRS difficult because of the lack of industry-specific guidance in IFRS, and applying general accounting principles to their complex activities and transaction streams is problematical. The companies are involved heavily in financial instruments as part of risk management strategy.

BP (British Petroleum) moved to IFRS in 2005 and was, at the time, the largest company listed on the UK's FTSE 100. Like other oil and gas extractors and energy suppliers, the company makes extensive use of hedges to minimise risks in relation to currency fluctuations and oil prices. The significance of its financial instruments creates potential volatility in profit, as was reported in 2006, when its Quarter 4 profits were 43% lower than its Quarter 3 profits, with the Chief Financial Officer stating that "accounting under IFRS has made our reported earnings more volatile" (Neveling, 2006).

The airline industry also relies heavily on hedge transactions to minimise risk exposure in relation to fuel prices, exchange rates and interest rates. Other accounting areas that cause volatility for airline companies include:

- Changes to the useful lives and residual values of property, plant and equipment, impacting on depreciation charges – in the airline industry the residual value of assets can be highly significant and the requirement for their annual assessment makes this an important accounting issue.
- Impairment of assets and potential reversals of impairment due to economic cycles affecting the recoverable amount of assets – the airline industry is particularly exposed to reductions in revenue due to economic downturns, which impacts on the value in use of its assets. South African Airways Group recorded an impairment loss in relation to aircraft and other property, plant and equipment of R128 million in its 2010 financial statements, and in the same year a reversal of previous impairments of R18 million. In 2011, an impairment of R56 million was recorded, and no impairment reversal (South African Airways, 2011).

The accounting treatments most likely to create volatility are linked to measurements of assets and liabilities and often involve fair value accounting. Some examples of potentially volatile areas include:

- Pensions – measurement of defined benefit pension plan assets at fair value and measurement of plan liabilities using significant estimates and judgements. The pension plan may not even have been recognised at all under local GAAP.
- Goodwill and other intangibles – impairments can create significant remeasurements of assets. Under local GAAP goodwill may have been amortised, so the introduction of

[5] *For more information on the IFRS transition issues facing these industries, summaries are available online. KPMG has two industry-specific IFRS documents available: "Accounting for leases of aircraft fleet in the global airline industry" (KPMG, 2007) and "The application of IFRS: oil and gas" (KPMG, 2008a). PwC has similar guidance in its publications "Financial reporting in the oil and gas industry" (PwC, 2011b) and "Examining IFRS for the US airline industry" (PwC, 2010b).*

annual impairment reviews will lead to goodwill being written off in lump sums rather than in a straight line over an estimated useful life.

- Financial instruments in general – those measured at fair value have the potential to create extreme volatility on an annual basis due to upwards remeasurements or impairment losses. The reasons for the volatility are hard to communicate due to the complexities of the transactions themselves and the associated accounting treatment.
- Hedge transactions – the ineffective element is recognised in profit so has the potential to bring volatility to the income statement. Again, this is very difficult for users of the financial statements to understand.
- Properties including investment properties – revaluation gains and losses are particularly relevant for investment properties where the gain or loss is recognised in profit. Under local GAAP the gains or losses may have been taken to equity rather than reported as part of profit.

To avoid volatility, the obvious choice is to try to avoid accounting policies that entail the use of fair value or other remeasurements, though this is difficult because, in most cases, the use of fair value is mandatory, or it is required that impairment losses are recognised immediately.

Some industry sectors will feel the effect of volatility much more than others, with the banking and insurance sectors likely to be most impacted, along with any industry where financial instruments are used extensively. As little can be done to avoid the accounting treatments giving rise to volatility, the best way to deal with the issue is to identify problem areas early on in the transition, and to communicate potential impacts as soon as possible. Communications should emphasise that volatility is not a one-off transition issue, but will affect financial statements on an ongoing basis. It is also recommended that the component parts of factors creating volatility are disaggregated, so that the components with cash flow implications are separated from those with no cash flow effect, as this is an important matter for analysts in particular when trying to estimate future cash flows.

5.2.2.3 Tax Implications It is important for tax specialists to be involved when accounting policies are being developed, to ensure that the tax implications of accounting policy changes are assessed and documented thoroughly. The impacts on income tax (the IFRS terminology for company or corporation tax) and deferred tax must be analysed carefully, so a detailed understanding of the differences between local GAAP rules on accounting for tax, and the requirements of IAS 12 *Income Taxes* must be developed. Deferred tax is particularly challenging, especially if the basis for the recognition of deferred tax assets and liabilities is different under IFRS compared to previous GAAP.

Differences in pre-tax profit caused by the application of new IFRS accounting policies can change the amount of current tax payable. New IFRS accounting policies may not be allowed under local tax legislation, so there must be careful analysis of new accounting policies to determine where the tax treatment of a balance or transaction may differ from the accounting treatment. This analysis relies on detailed knowledge of both IFRS and of local tax legislation, so should only be performed by tax specialists who have undergone training. External advisors are often engaged at this point to ensure the completeness and accuracy of the analysis performed.

The new IFRS accounting policies may affect taxes other than income tax, so the impact on sales taxes, capital taxes and any other local taxes should be considered. In larger and

more complex organisations such as multinational groups, there will be wider considerations, such as the impact of accounting policies on group tax planning strategy, transfer pricing, repatriation strategies relating to funds from overseas subsidiaries, the tax implications of foreign exchange gains and losses and asset transfers between group companies. Significant tax issues may need to be communicated to the relevant tax authority, and if changes are made to tax accounting methods, liaison with the authority may be advised to ensure compliance with local tax rules.

A further issue relates to deferred tax. Moving to IFRS will often lead to the recognition of new deferred tax liabilities, and sometimes assets, where the recognition principles are wider than those of local GAAP. For example, IFRS requires that a deferred tax liability be created when a property increases in value due to a revaluation, based on the principle that the revaluation creates a taxable temporary difference. Under some local GAAPs a deferred tax liability would not be recognised because the deferred tax recognition principle is stricter and only gives rise to a liability when it is anticipated that the property will be sold, creating a taxable timing difference.

The adjustments made to fair value on the restatement of the opening balance sheet into IFRS also give rise to deferred tax. For example, the Irish airline company, Ryanair, recognised additional defined benefit pension plan liability of €4,992,000, and an associated deferred tax asset of €615,000 at its date of transition to IFRS (Ryanair, 2005). In Siemens' 2006 Annual Report, the additional deferred tax debited to equity on transition from US GAAP to IFRS is stated at €1,664 million, the additional deferred tax liability mainly due to differences in asset valuations and accounting for pensions (Siemens, 2006).

5.2.3 Standards Including Choices

There are now fewer choices and options available when determining IFRS accounting policies, as many of the alternative treatments have been eliminated in the last 10 years. However, there are still many areas where explicit choices are available. Some of the more significant choices are highlighted in Table 5.4. Note that this is not intended to be an exhaustive list of accounting options, but more an indication of where a choice of accounting policy will be needed. Also remember that estimation techniques and other judgements will need to be developed in order to apply accounting policies.

5.2.4 Disclosure Notes

IFRS is known for containing extensive disclosure requirements. IAS 1 *Presentation of Financial Statements* requires the presentation of an accounting policies note including disclosures of significant judgements used by management in the preparation of the financial statements. It is also required to disclose additional information that is not presented elsewhere in the financial statements but is relevant to the users' understanding of the financial statements. In addition to the IAS 1 requirements, the individual IFRSs contain disclosure requirements, some of them being well known for being onerous to comply with – the standards dealing with financial instruments, pension accounting and share-based payment are good examples.

The impact analysis must consider the necessary disclosures. In one way this can be relatively straightforward, as the external auditor or other IFRS consultant will be able to provide a

Table 5.4 IFRSs including accounting choices

Standard	*Accounting choices*
IAS 1	Formats of the financial statements are not prescribed, so choice in overall presentation style
	Choice to show total profit and comprehensive income as a single statement or in two separate statements for profit and for comprehensive income
	Classification of operating expenses by function or by nature
IAS 2	Measurement of inventory at weighted average cost or using first-in, first-out method
IAS 7	Choice of presenting cash flows from operating activities using the direct or the indirect method
	Choice in allocation of cash flows relating to dividend and interest
IAS 16	Measurement of property, plant and equipment using the cost or the revaluation model
IAS 20	Choice of recognising a grant received in relation to an asset as deferred income or a deduction against the asset
IAS 27	Separate financial statements (parent company) account for investments in subsidiaries, associates and joint ventures either at cost or in accordance with IFRS 9 (i.e., treat as financial assets)
IAS 38	Measurement of intangible assets using the cost or the revaluation model
IAS 39/ IFRS 9	Choice in classification and measurement of certain financial instruments as available for sale (IAS 39) and fair value through profit and loss
IAS 40	Measurement of investment properties using the cost or the revaluation model
IFRS 3	Choice of measuring non-controlling interest using fair value or proportion of net assets method, on an acquisition-by-acquisition basis
IFRS 6	Measurement of exploration assets using the cost or the revaluation model

disclosure checklist to ensure the completeness of the disclosures made. However, the point is that often disclosure is left until the end, and the checklist completed in the final stages of accounts preparation. In the IFRS transition, disclosure issues must be thought through during the initial planning stage and when performing the accounting impact assessment because it is very likely that new disclosures will be needed, and planning is needed to ensure that all of the necessary information is captured by accounting systems or produced from other sources. For example, it may be necessary to engage a specialist to help to draft the disclosures necessary in respect of pension accounting, as detail needs to be provided on matters such as actuarial assumptions and actuarial methods used to determine the amounts recognised in the financial statements.

The accounting policy note itself can be troublesome to prepare, especially where management is not used to providing detailed descriptions of policies and estimation techniques and information on the use of judgements. Companies often provide boilerplate disclosures that, while compliant with IAS 1, are not perceived to be terribly useful to the users of the financial statements, so management is encouraged to tailor the disclosure in this note as much as possible. And while it may seem sensible in terms of efficiency to start with the accounting policy note from previous GAAP and to amend it for IFRS policies, this is often a very laborious process, and it is often quicker and easier to start from scratch in writing the IFRS accounting policy note rather than trying to amend the note as previously stated. Materiality should also be considered carefully as the provision of too much information clutters the financial statements

and obscures important information, detracting from the understandability of the statements as a whole.

Case Study 5.7: An External Auditor's View on Assisting with Disclosure Notes

An external auditor has worked on a number of EU transitions. She comments that even when dealing with management of a large listed entity with reasonable knowledge of IFRS, especially in terms of recognition and measurement principles, they still need assistance with disclosure issues. The auditor's approach was to compile a pack of information about disclosure – not just a disclosure checklist but also example real disclosures from industry peers and comments from the relevant regulatory authority, in this case the UK's Financial Reporting Review Panel. This information pack would then be used by management to select and develop the company's own disclosure rubrics. This was done as early as possible in the transition project to allow time for the accounting systems to be assessed for their capacity to provide the necessary data, with amendments made where necessary to ensure the completeness of disclosure.

5.3 POTENTIAL CHANGES TO IFRS

A significant matter to consider is the planned or potential changes to IFRS that may impact on chosen accounting policies. The IASB has a work plan, which involves many different areas of accounting, and it is often commented by preparers of financial statements trying to develop accounting policies that they are working with a "moving target". This was particularly a problem in the Canadian transition to IFRS that took place in 2010–2011, when there were many ongoing projects, which meant that developing new accounting policies was very difficult, as preparers did not have a stable platform of accounting standards to work with.[6]

At the time of writing, the IASB has a number of projects in its work plan for IFRS, the more significant of which are outlined briefly in Table 5.5. The projects and proposals are very complex and a detailed discussion is outside the scope of this chapter. The IASB regularly updates this work plan, and it can be accessed easily on the IASB website.

The impact of this on developing accounting policies is that any likely changes to a relevant IFRS should be considered in order to keep any necessary changes to the accounting policy minimal when the new or revised IFRS rules are published. For example, in developing an IFRS-compliant accounting policy on leasing, if transition to IFRS is occurring before the new leasing standard is released, it may be beneficial to make as few changes as possible to existing accounting treatments, as many more significant changes will be needed when the new IFRS becomes effective.

It is also important to understand the effective date of new or revised IFRSs and whether early adoption is allowed. If transition is happening prior to the effective date of a new standard,

[6] *In contrast, in the run up to EU transition to IFRS in 2005, the IASB had worked extremely hard to create a stable platform of standards intended to make the European transition as smooth as possible. Unfortunately for the Canadian transition, it occurred when the ramifications of the global financial crisis of 2007–2008 were still being felt, and in particular the IASB was working to improve IFRS especially in relation to financial instruments.*

Table 5.5 Current status of IFRS work plan focusing on major IFRS active projects

Project content	*Project summary*
IFRS 9 Financial Instruments (replacement of IAS 39): • Classification and measurement (phase I) • Impairment (phase II) • Hedge accounting (phase III) • Macro hedging	The project to replace the problematical standard IAS 39 with the new standard IFRS 9 was broken into several stages, with phase I dealing with classification and measurement, phase II with impairment and phase III with hedge accounting. The first section of IFRS 9 was issued in November 2009 and has been revised and amended several times since publication, but a final and complete version of the standard is still being developed. Limited amendments are currently proposed on classification and measurement of financial instruments and at the time of writing the IASB is considering feedback received on several Exposure Drafts issued in 2012, and the target date for releasing the final rules on classification, measurement and impairment is the second quarter of 2014. All reporting entities with financial instruments will need to evaluate the amendments made to IFRS 9 carefully and ensure that accounting policies are appropriate to its requirements and principles. Macro hedging was decoupled from the main IFRS 9 project and there is no target date for the release of the final requirements on this topic.
Leasing: A joint IASB and FASB project to develop a new standard on leasing, applicable to lessees and lessors, to be based on a new accounting concept for recognising leased assets termed the "right to use" model.	This major project has been ongoing since 2006, when leasing was added to the Memorandum of Understanding of the IASB and the FASB. Several Exposure Drafts have been published and deliberations are ongoing. The proposed accounting treatments will have potentially significant impacts for those organisations that currently account for operating leases, as the new "right of use" accounting model will result in the recognition of operating leases in the statement of financial position. There is currently no target date for the release of the new IFRS.
Revenue recognition: A joint IASB and FASB project to develop a new standard. The objective of the project is to clarify the principles for recognising revenue from contracts with customers and it will apply to all contracts with customers except leases, financial instruments and insurance contracts.	This project is nearing completion, and will have implications for all entities other than those with simple revenue streams. The aim of the project is to simplify accounting for revenue and to make revenue recognition more comparable across different industries. The proposed requirements are based on a robust principle-based framework and will require careful application to contracts existing with customers to ensure appropriate accounting policies are developed.
Insurance contracts: This project will ultimately result in a new standard applicable to all types of insurance contract, which will replace IFRS 4. This is a relatively industry-specific standard so may not have wide-reaching impact outside the insurance industry.	IFRS 4 was only ever intended as an interim IFRS, introduced as part of the stable platform of standards for EU conversion to IFRS in 2005. The IASB aims to improve the consistency in accounting for insurance contracts, by introducing principles surrounding their presentation and measurement. A comprehensive review of accounting for insurance contracts began in 2007 and several EDs have been issued. There have been concerns that the proposals may introduce unwelcome volatility. Field testing has been conducted in a number of countries to consider the accounting impact of the proposals. The IASB is currently re-deliberating comments received and there is no target date for the release of the new IFRS.
Rate regulation: A research project into potential accounting issues created by rate regulation activities.	The IASB plans to develop an interim IFRS to be used while the project on accounting in respect of rate regulation activities is carried out. Rate regulation is a restriction in the setting of prices that can be charged to customers for services or products. The project will consider whether rate regulation creates assets or liabilities that should be recognised in the financial statements.

but early adoption is allowed, then it makes sense to early adopt the new rules straight from previous GAAP rather than make two sets of changes, one from previous GAAP to "old" IFRS, and then from "old" to "new" IFRS requirements.

Table 5.5 shows some of the more significant projects that are work in progress and will result in changes to IFRSs within the next few years. The proposed changes on financial instruments and leasing will be the most significant for many companies, with many commentators warning that the amendments to the standard in terms of classification and measurement for financial instruments may cause increased volatility, and that the new accounting method proposed for leased assets could have far-reaching consequences for any entity involved in significant leasing activity.

The IASB has a continual review process for existing standards, and it is easy to overlook in error some of the less significant projects on major IFRSs. The IASB's Narrow Scope Amendment projects result in small changes to existing standards, and preparers of financial statements will need to ensure that the policies being developed are based on up-to-date IASB pronouncements. The external auditor will be able to advise on this, and the audit firm will have its own publications or documentation detailing the IFRSs that are relevant to a particular reporting period.

Changes to IFRS requirements may also happen in the future, following the IASB's post-implementation reviews, which will be conducted on several standards including IAS 19 *Employee Benefits*, IFRS 9 *Financial Instruments*, IFRS 13 *Fair Value Measurement*, and the consolidation standards IFRS 10, 11 and 12. These reviews are due to commence in 2015 and 2016, so changes are not imminent, but in the future may impact on accounting policies in significant areas. Also remember that, as discussed in Chapter 2, the IASB's conceptual framework project is ongoing, and the completion of that may also impact on recognition, measurement and disclosure issues.

The point of including this detail on proposed changes to IFRS and potential changes in years to come is to illustrate that IFRS is very much a moving target, and that impact analysis and the development of accounting policies need to be ongoing, as well as emphasising the importance of developing policies during the transition that, hopefully, can anticipate proposed changes to IFRS, reducing the need for revisions of policies in later years as the new IFRS requirements become effective.

CONCLUSION

This chapter has explored the most crucial aspect of planning IFRS transition, and has shown the numerous matters that need to be considered when developing IFRS-compliant accounting policies. For many organisations this will be a challenging aspect of transition, as it relies on detailed technical knowledge of local GAAP and IFRS, and a methodical approach to identifying the differences and selecting new accounting policies on the recognition, measurement and presentation of items.

In developing IFRS accounting policies, organisations may be tempted to make as few changes as possible to existing accounting policies. But the transition can be seen as an opportunity to enhance the reporting entity's accounting treatments and disclosures.

Preparers of financial statements will need to work closely with their external auditors to ensure that the policies being developed are appropriate and that any potential differences of opinion are highlighted and resolved as early as possible in the transition. Both preparers and external auditors need to pay close attention to the IASB's work programme and ensure that the development of accounting policies takes into account the latest effective pronouncements from the IASB.

6 WIDER TRANSITIONAL ISSUES – SYSTEMS, INTERNAL AUDIT AND THE AUDIT COMMITTEE, AND COMMERCIAL IMPLICATIONS

Assessing the accounting impacts and developing IFRS-compliant accounting policies involves technical knowledge and accounting skills, and that part of the transition project will be performed by those in the accounting function often with the help of external IFRS accounting specialists. It would be dangerous, however, to consider accounting issues in isolation, as the choices made can have significant wider impacts. The objective of this chapter is to examine those wider impacts, starting with impacts closely aligned to the accounting issues, namely impacts to do with systems, controls and internal audit. Some of these consequences may come as a surprise, and careful thought will need to be given to accounting policy choices to ensure that all significant impacts have been identified and evaluated. There may be real strategic and commercial effects of the transition, some advantageous and some not, and a wise selection of accounting policies should minimise the negative consequences at the same time as maximising any positive opportunities that the transition brings.

This chapter also considers the role of internal audit and of the audit committee. Both have important roles to play in helping to ensure that IFRS reporting becomes embedded in the organisation, and that assurance is obtained over the integrity of the IFRS reporting systems. The audit committee is well placed not only to be involved in the supervision of the IFRS transition project, but also to provide high-level "buy in" to the transition and help to set an appropriate tone at the top to promote the significance of the project to the reporting entity as a whole. The internal audit function is also likely to be involved with any post-implementation review that takes place, which is important not only in general project management terms, but also in maintaining the quality of IFRS reporting once the transition period ends.

6.1 SYSTEMS IMPLICATIONS

Moving to IFRS will inevitably impact on the reporting entity's systems and controls over financial reporting. The extent of this impact will vary tremendously. In a simple transition for a smaller entity with few classes of transaction and no complex accounting issues, the existing system may just need to be tweaked to ensure IFRS compliance. This is likely to be a rare situation, however. Most IFRS transitions will necessitate changes to how systems operate, including the introduction of new inputs and outputs to and from the system, more disaggregation of data, and improved links between financial reporting and other business systems. The capacity for the existing system to cope with the transition to IFRS must be analysed carefully. In an extreme scenario where extensive systems changes are needed, the best approach may be to start from scratch and implement a brand new reporting system, though this will bring cost and risk implications, which may be significant.

In many transitions the necessary changes to systems and controls are perceived as an opportunity to make improvements and improve efficiencies, though the costs of making changes can be significant. Some entities, for example, work on Enterprise Resource Planning (ERP) implementation at the same time as IFRS convergence, as part of their overall IT strategy. In particular, the move to IFRS can lead to a more robust control environment and hence greater assurance on the completeness and accuracy of the reported figures. A KPMG report suggests that the benefits of IFRS conversion include consistency of processes and applications that help to improve the global IT architecture of reporting entities (KPMG, 2008b). Many commentators, including AICPA, argue that an IFRS conversion project can lead to systems improvements and is an opportunity to bring in overdue enhancements to systems and business processes (AICPA, 2010).

6.1.1 Parallel Running and Dual Reporting

A significant consideration is the need for parallel or dual reporting systems during the transitional period. In the years leading up to the first IFRS reporting period, financial data will need to be maintained under previous GAAP – for filing financial statements in the transitional period leading up to the first IFRS reporting period, and under IFRS – as a basis for the comparatives in the first IFRS financial statements, and for producing the reconciliations between previous GAAP and IFRS figures as required by IFRS 1 *First-time Adoption of IFRS.* There may also be a need to maintain previous GAAP accounting processes for other purposes, such as tax assessment or contractual requirements.

The ideal scenario is to have a general ledger set up, and systems ready to begin capturing information for reporting under IFRS from the date of transition. Remember that this is the earliest point from which IFRS figures will be reported as comparatives in the first IFRS financial statements. At the same time, systems need to be able to continue to account for transactions under previous GAAP, for the reasons outlined above.

Figure 6.1 shows a typical timeline that could be used in implementing IFRS for an entity with a first IFRS reporting date of 31 December 2016.

2013	2014	2015		2016
Planning and design		**Implementation**		
Identify system requirements Decide on key responses Design amendments to IT systems Budget IT transition costs Consider wider implications of system changes		IFRS reporting goes live on 1 January		First IFRS accounts prepared to 31 December
Test systems using audit software		Parallel / dual reporting GAAP and IFRS		
Implement and test general and application level controls		Continue to monitor and test systems		

Figure 6.1 Typical stages in the IT conversion process

This is an illustration of best practice, and it is unlikely to be achieved unless there is very early planning for the transition beginning many years before the date of transition to IFRS. In many transitions there is not enough time to plan, install and test systems prior to going live with IFRS reporting at the date of transition. Anecdotal evidence suggests that even some very large organisations with complex transactions and accounting implications of transition relied on manual accounting processes and spreadsheets to determine the necessary figures for disclosure. In some cases there was a deliberate management decision to keep the IFRS adjustments outside of "normal" accounting processes, maybe due to a general resistance to change, and sometimes because the conversion was handled by external personnel, meaning that the whole transition was viewed as outside of regular business activities.

Keeping IFRS reporting as a separate process gives rise to the following problems and risks:

- Increased risk of error due to the manual nature of calculations and adjustments being made;
- Inputs to separately maintained spreadsheets and other recording methods are not likely to be well controlled;
- Difficulties in maintaining complete and accurate documentation and in maintaining an audit trail;
- Manual accounting can be time-consuming and labour-intensive, with cost consequences;
- Knowledge of IFRS accounting will become concentrated in a small group of people;
- IFRS does not become "business as usual" and is seen purely as a year-end issue;
- The wider impacts of IFRS on the business will be less transparent and harder to identify and respond to.

Entities that are yet to go through transition can learn from this experience. Keeping IFRS accounting outside of the general accounting system means that it will never become embedded in the entity's operations. The European companies that kept IFRS separate eventually did go through a process of integrating it with their accounting system, and for those planning a transition, the best approach is to plan the integration as early as possible.

Depending on jurisdictional requirements, parallel running may need to be continued after the first reporting period. For example, the reporting entity may produce IFRS financial statements to meet regulatory requirements, but keep previous GAAP accounts for tax purposes. And, as discussed in Chapter 5, in group scenarios the subsidiary companies may present their financial statements under local GAAP, but there will need to be IFRS-compliant subsidiary accounts for consolidation.

There may be other situations when parallel reporting is desirable. For example, a reporting entity may be listed on different stock exchanges, one of which requires IFRS reporting, but another does not allow IFRS reporting so local GAAP must be used. Or, a joint venture company could be owned by investors in different jurisdictions and need to have financial information under IFRS and a different GAAP for reporting purposes.

Smaller entities can get away with very few, if any, changes to existing systems, and then create the IFRS financial statements manually at the end of the first reporting period. There is no parallel running of previous GAAP and IFRS. This approach, however, leads to a higher risk of material misstatement due to the unfamiliarity with IFRS reporting, which increases the

likelihood of human error. Manual adjustments are also very time-consuming, and a wholly manual approach is unlikely to be feasible if there is a large volume of transactions and adjustments to deal with.

6.1.2 Typical IT System Changes

The move to IFRS is likely to necessitate some or all of the following system changes:

Design or selection of a new system This will be necessary where the existing system cannot provide the data needed for reporting under IFRS. It may be a whole system, or part of a system, that needs to be implemented. If the new system replaces an older system, that older system may be used for maintenance of accounting records under previous GAAP under a parallel reporting approach, which may be necessary for reporting or tax purposes.

Amendments to existing systems Where the existing system has the capability to produce the necessary information for reporting under IFRS then it can be modified accordingly. The scale of the change will be much less than if a new system has to be designed and implemented. Systems may need to be changed at an operational or sub-ledger level to ensure the integrity of data feeding through into the general ledger. For example, a sub-ledger system may need to be amended to allow separate tracking of research and development costs where they have a different accounting treatment under IFRS compared to previous GAAP.

Increased capacity for processing Where parallel reporting takes place, systems may need to be upgraded to allow a greater volume of processes to be performed without causing backlogs and delays.

Software considerations An assessment of software should be made to ensure that the software uses a platform that is compatible with IFRS. For those yet to go through transition this should not be a problem, as the leading ERP platforms support IFRS reporting and can offer parallel and dual reporting solutions, flexible ledger coding systems, adaptable consolidation processes and the ability to generate a variety of IFRS-compliant reports.[1] The global ERP providers have been providing solutions for accounting under IFRS for many years and have been involved with thousands of IFRS transitions, and so are well placed to assist in planning the transition.

Interface changes Whether completely new systems are implemented or existing ones amended, interfaces will need to be changed to allow the various system components to interact. This can extend to ERP systems and databases.

General ledger coding At the general ledger level, new general ledger accounts may need to be established; for example, in relation to newly recognised assets or expense types or for any reclassifications that take place during transition. Equally, accounts that are no longer needed can be deleted, though care should be taken to ensure that historical information is retained where this is necessary.

Data collection mechanisms IFRS will demand more disclosure in the notes to the financial statements, and systems need to be able to capture new data that were previously unreported; for example, data to allow roll-forward information to be

[1] *Software providers such as SAP, Oracle and Hyperion Financial Management, to name just a few, have extensive experience with IFRS reporting.*

presented, or alternative asset valuations to be reported. This may impact on any Enterprise Master Data System that is in place.

Changes to processes IFRS may demand different calculations or for new computations to be built into software processes. New inputs may be needed to enable this to happen, or inputs may be needed more frequently or from different sources. Data inputs may become more granular; for example, the system for recording capital expenditure may need to change to allow the componentisation of acquired assets, necessary for determining depreciation for individual components. Processes may have to deal with new classifications of data, for example in the allocation of operating expenses into new categories.

System outputs Changes to how outputs are presented or the frequency of the output being produced may be needed. For example, different outputs may be needed to create the notes to the accounts, especially in relation to the IFRSs with extensive disclosure requirements, such as financial instruments and operating segments.

Increased scope Where more reporting entities are consolidated than under previous GAAP, systems issues will need to be considered on a wider scale. Financial reporting packages may need to be used by more group members and the data contained in the packages will probably need to be modified.

Storage and memory capacity As discussed above, in many cases a parallel running approach will be used during the transition to allow financial reporting information to be gathered using both previous GAAP and IFRS simultaneously. Consideration must be given as to whether there is sufficient storage capacity for all of these data, especially given that IFRS requires more data than previous GAAP. The old financial information will need to be retained, so it is crucial that access to that information is maintained and that the information retains its integrity. Extra storage capacity may need to be acquired for the old data.

General and application level controls In making changes to the IT environment, and to software processes, care must be taken to maintain the strength of controls over the system. A detailed examination of IT controls is beyond the scope of this discussion but it is worth pointing out that controls over access to the system and those to ensure the accuracy and completeness of inputs are very important factors in the overall level of control over financial reporting. This is highly relevant in those organisations that monitor the effectiveness of internal controls and make a statement on their effectiveness, such as those entities complying with the Sarbanes–Oxley legislation or similar.

6.1.3 Integrating IT Changes with the Overall Transition Project

It is important that the nature and scale of these types of changes are thought about early in the transition-planning phase. Ideally, as soon as the accounting impact analysis has been carried out, the systems implications should be considered. The experience of those that have gone through IFRS transition is that, very often, the planning focuses on the technical accounting issues, with the systems consequences very much an after-thought later on in the project lifecycle. This leads to inefficiencies and adds to the already high cost of transition.

It is worth considering the inclusion of an IT specialist in the IFRS project team, so that IT-related issues can be flagged as soon as they arise. It will also help communication between the finance and IT departments, which is crucial given that the successful delivery of the first IFRS financial statements depends on close cooperation between these two departments.

There is evidence that when the finance and IT departments work well together, the transition will be well planned and run smoothly. For example, it is important that when accounting implications are identified, their IT consequence is pinpointed and a response formulated. A case study is used below to illustrate this idea.

Case Study 6.1: IT Implications of IFRS Transition for a Technical Facilities Management Company

This company provides a technical facilities management solution to customers including retail complexes and office buildings. The company provides a bespoke service to its clients with services including remote monitoring of the clients' assets and systems, tracking maintenance on systems such as air conditioning, ventilation and water supply and providing engineers when needed. The company interfaces its own IT systems with those of its clients to some extent, and IT is a critical business issue.

The transition to IFRS necessitated some IT changes being made. While these changes did not directly impact on the client service that was being provided, the IT staff felt resentful of spending time on what were perceived to be unnecessary IT changes when they could have been working on more important projects. Operations managers were put under pressure to free up staff to work on IFRS-related matters but wanted staff to be deployed on customer-focused IT issues that are business-critical. The issue was resolved by bringing in a small pool of external IT consultants to plan and implement many of the IT changes that were made. This was expensive but it was considered important to keep operational staff focused on customer service, leaving the transition issues to be dealt with separately.

Some specific issues that need to be considered in relation to IT aspects of the transition include:

- Education and training – IT personnel will need to understand the language of IFRS and some of the accounting concepts, but will not need to know the detailed accounting requirements. Some training will be useful to aid communication between the finance and IT departments. It may be useful for IT personnel to understand key elements of IFRS reporting including the extensive nature of disclosure requirements, the principle-based nature of accounting, the use of significant estimates and judgements, and some IFRS terminology, without going into the detail.
- Staff resources – depending on the scale of amendments needed to the IT architecture, more staff may need to be allocated to the project. Where parallel running is used, there will need to be enough staff to maintain and monitor the IFRS and the local GAAP reporting systems. The entity may consider outsourcing some of the IT work.
- Use of external specialists – in large transition projects with extensive IT changes it is common for specialists to provide input. The type of input could range from recommending different software packages, analysing the IT impacts of the various accounting adjustments, and designing software amendments to complete immersion in the project involving the implementation of brand new systems.
- Costs – again, depending on the amount of work needed on IT, the associated costs can be significant and need to be budgeted carefully. According to a KPMG report, the average company with US$1 billion of revenue has 650 different IT applications, and some larger entities have thousands of applications (KPMG, 2009c). The costs of assessing IT system impacts and implementing solutions in such entities is inevitably

going to be substantial. A different KPMG report suggests that IT costs are generally 50% of the cost of conversion (KPMG, 2008b). The costs vary according to the nature of the business and size of operations.

- The impact on other business processes – systems and processes outside financial reporting are also likely to be affected, for example those dealing with treasury management, human resources and procurement may have different inputs based on IFRS reporting, or different outputs may be needed to feed into IFRS reporting packages, so care must be taken to have an integrated approach to systems changes across the business. A common example is that costing processes may need to be updated, for example new cost structures for manufactured goods may need to be determined.
- Internal reporting system impacts – models used for forecasting and budgeting, internal management financial reports, Enterprise Performance Management information, business segment performance analysis and other elements of the Management Information System may be impacted by new IFRS-driven data. Users will need to be made aware of any significant changes.

6.1.4 Building IT Issues into the IFRS Project Plan

The driver for identifying IT changes is the accounting impact assessment. Ideally, at the same time as preparing the accounting impacts assessment documents, the IT consequences of each accounting impact should be determined. If not done at the same time, the IT issues should be considered as soon as possible, due to the long lead time that some system changes may entail.

The project plan documentation should include a summary of the main IT issues for each accounting impact identified. An illustration is shown in Table 6.1, using property, plant and equipment to provide some example accounting impacts and their relevant IT implications.

The key point from this illustration is the level of detail contained. Every accounting impact has at least one systems-related issue, and in reality there would be much more detail and many more impacts than shown in this simple example. Ideally, the document would also contain a classification of the significance of the systems issue to be resolved, and cross-referencing to the detailed IT response that is planned.

Documentation should clearly map the accounting impacts and IT responses. The external auditors will need to see an audit trail which they can use to update their own systems documentation, saving time and helping them to understand the rationale behind systems changes. This will be particularly important for the auditor's assessment of systems and controls.

6.1.5 XBRL and IFRS

The use of Extensible Business Reporting Language (XBRL) is becoming widespread, and is supported by the IASB. In short, XBRL is a tool used to communicate information in a consistent manner. It does not change the figures that are reported, only affecting the way that the figures can be used.

XBRL places tags on data, enabling the data to be extracted and used in different ways. For example, financial statements that have been XBRL tagged can be extracted and presented in

Table 6.1 An example of the IT consequences of changes to the accounting treatment of non-current assets

IFRS accounting impact (difference from previous GAAP)	*IT and systems-related issue/response*
IAS 16 requires componentisation – significant components are accounted for separately	Amendment at sub-ledger level to ensure asset balances below a certain level are maintained separately Implication for procurement and capital expenditure processes and identification of significant asset components
IAS 16 requires depreciation over economic useful life for each significant component	Amendment at sub-ledger level to allow multiple depreciation calculations per asset component – one IFRS-compliant, one GAAP-compliant, one under tax rules Modify interface with fixed asset register
IAS 16 requires useful life and residual values to be reviewed annually and depreciation amended accordingly. Residual values can be adjusted upwards.	Mechanisms for amending depreciation to be installed on the system System to flag when the review is needed Input fields related to residual value adjustments to allow increase or decrease in value
IAS 16 requires revaluation losses to be recorded in profit or in equity	New general ledger codes to be introduced where revaluation losses were not previously recognised
IAS 16 requires disclosure by class of asset on numerous matters including depreciation, impairment losses, exchange rate differences	Reconfigure systems to allow reporting at the level of a class of asset New data to be captured specific to exchange rate differences
IAS 23 requires borrowing costs to be capitalised according to specific recognition criteria and calculated to include specific items such as exchange rate differences	Processes to be amended to capture all relevant borrowing costs on qualifying assets System-generated calculations to be updated to fit IFRS requirements, e.g., to ensure exchange rate differences are included
IAS 36 requires impairment testing when there is an indicator of impairment	New reports to be generated to allow assessment of potential impairment indicators, e.g., asset obsolescence
IAS 36 requires impairment reviews to be conducted at the cash-generating unit (CGU) level	Systems must be capable of collecting assets together into appropriate CGUs A new model for determining recoverable amount based on value in use or fair value less cost to sell to be developed

a different way, maybe to make analysis easier. XBRL-tagged information is therefore more interactive than static information.

XBRL tags are defined and ordered using a taxonomic system. The IASB has an established IFRS Foundation XBRL team, which has created an IFRS Taxonomy for use by IFRS adopters. The IFRS Taxonomy is updated annually and is translated into many languages including Japanese, Arabic, Spanish, Korean and Chinese. In addition, the IASB has developed xIFRS, an online tool that supports viewing and understanding of the IFRS Taxonomy.

The relevance of XBRL to IFRS implementation is that when planning system amendments as part of the IFRS transition project, a matter to consider is whether the entity wants to, or is required to, report IFRS financial information using XBRL. For example, in the UK, company tax information is required to be submitted using XBRL, so IFRS data may be needed to be tagged for submission to the relevant authorities. Even where XBRL is not required, its use is growing, so entities may wish to be in a position to use XBRL at some time in the future.

6.2 INTERNAL CONTROLS, INTERNAL AUDIT AND THE AUDIT COMMITTEE

All of the changes to systems and accounting methods described in the previous section have significant issues for internal controls over financial reporting. Even small changes to systems can increase the risk of error or fraud, so the transition project must consider how to manage the internal control environment and processes so as to minimise these risks. This is especially important for those reporting entities where senior management certifies on control effectiveness; for example, entities that fall under the scope of Sarbanes–Oxley or similar legislation. Certifying officers will need to have confidence that systems are accurately generating IFRS-compliant data, many of which are being disclosed for the first time, and that controls have been designed properly and are being implemented correctly.

This section will consider the control issues that need to be planned for, as well as the role of internal audit and of the audit committee. In particular, the importance of the role of the audit committee will be highlighted, as the buy-in of the audit committee to transition planning and execution is a crucial element in its success.

6.2.1 Using the COSO Framework to Evaluate Internal Controls

Many organisations make use of the COSO framework[2] as a mechanism for establishing internal controls to promote good corporate governance. The framework is an effective tool for management to use in order to evaluate the effectiveness of internal controls, and as it focuses on internal control over financial reporting, it is useful in its potential to reduce the risk of fraud and error in accounting.

According to the framework, there are five internal control components:

- The control environment
- Risk assessment
- Control activities
- Information and communication
- Monitoring[3]

It is useful to consider how each of these is specifically relevant to an IFRS transition, as each of the components can be considered as part of the transition planning, potentially strengthening the controls over the process and reducing the risk of misstatement in the first IFRS financial statements, and subsequently reported financial statements.

6.2.1.1 Control Environment The control environment is the foundation on which other elements of internal control are built. It relates to management's commitment to good governance and controls, and emphasises the need for an appropriate "tone at the top", which means that senior management promotes the value of integrity and sound ethical behaviour.

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[2] *COSO is the abbreviation used for the Committee of the Sponsoring Organisation of the Treadway Commission, which is an initiative of five organisations, including AICPA and the Institute of Internal Auditors.*

[3] *An alternative version of the COSO framework linked to Enterprise Risk Management includes three additional elements relating to objective setting, event identification and risk response.*

Of key relevance to IFRS transition is that senior management must understand the importance of the transition to the financial statements and accounting function and, crucially, its wider impact on the business. There should be a perception that the transition is an important issue for the organisation, and not just something for the accountants to deal with. This should make the wider impacts easier to plan for and ease communication difficulties. The following case study illustrates the importance of setting an appropriate tone at the top in relation to the transition.

Case Study 6.2: An External Auditor's View of the Importance of Setting the Correct Tone at the Top

An audit partner who worked on many transitions in the UK described the problems one of his clients faced when senior management failed to engender the importance of the company's IFRS transition. He described how the transition was left in the hands of the financial controller, with very little support from anyone outside the accounting function. The transition was discussed at board meetings, but only in terms of the potential impact on reported profit and dividends. The board members did not pay much attention to the wider impacts of the transition and were not really interested in the project itself. The financial controller, who was project leading the transition, found it very difficult to get the information he needed from business units because they had not been informed why the information requests were being made. Information, when eventually received, was often incomplete and irrelevant. This caused the project to miss milestones, and the final implementation phase was rushed. The audit partner felt strongly that senior management should have supported the project, as did the financial controller; but ultimately management blamed the financial controller for running an inefficient project and for "disrupting" business operations.

The audit partner's view was that management wanted nothing to do with the transition, seeing it as a pure accounting issue, leaving the financial controller with no authority or means of effective liaison with the business units. While the partner thought the situation with this client was extreme, he thought that it was not uncommon, in the transitions that he was involved with, for senior management to fail to promote the significance of the project to the business as a whole. To put it simply, if senior management does not see the significance of the IFRS transition to the business, then no one else will either, making it hard for the project team to discharge their responsibilities.

The control environment is not just about the overall attitude of management. It is also concerned with organisational structure, levels of responsibility and power, and human resources issues. These relate to the IFRS transition, for example:

- **Integrity and ethics** Many IFRS accounting treatments require the use of management judgement. Care must be taken to ensure that subjective decisions in relation to accounting policies and accounting estimates are made objectively and without management bias.
- **Open discussions** A culture should be encouraged to develop in which accounting judgements are discussed and in which decisions based on judgement can be challenged.
- **Reporting lines** It should be clear to whom the IFRS project team is reporting and the method and frequency of reporting updates on the project.
- **Accountability** Who has overall responsibility for the success of the project and do they have sufficient authority to steer the project through to the end?

6.2.1.2 Risk Assessment Risk assessment means evaluating the risks that threaten the reporting entity's ability to meet its objectives. Traditionally, objectives are classified as those relating to operations, financial reporting or compliance, and risks tend to be classified into the same three categories. It may be tempting to think that the risks relating to IFRS transition will mostly fall into the financial reporting category, but moving to IFRS has wider implications for business than just financial reporting, so the risk assessment must take a holistic approach. A simple way to think about risk assessment, and to generate risks that arise from the transition, is just to ask, "What could go wrong?"

A risk assessment relating to IFRS transition, if performed in detail, could throw up hundreds of different risks, and the key issue is that once risks have been identified, a response should be developed to mitigate the risk. The risks should be evaluated for their likelihood and impact, with this determining the nature of the response, and the evaluation should be documented fully. A few examples of typical risks are given below. The division into the three categories is not really necessary and there is often overlap, with some risks being, for example, both a compliance risk and a financial reporting risk. But the categories can help to add structure to the risk assessment, and help to pinpoint an appropriate response.

Table 6.2 shows examples of risks that could be identified while planning a transition to IFRS.

Note that in a real life risk assessment the financial reporting risks would be broken down into much more detail, amounting to possibly hundreds of separate risks, and would be entity-specific. The accounting impact assessment described in Chapter 5 will be the main driver for identifying the risks of transition, and in general the greater the magnitude of difference between previous GAAP and IFRS, the greater the scale of risks that will need to be addressed.

Table 6.2 Examples of operational, financial reporting and compliance risks

Operational risks	*Financial reporting risks*	*Compliance risks*
Insufficient IFRS knowledge within the organisation	Accounting policies not IFRS-compliant	Directors' report or other supplementary information fails to discuss IFRS issues
Systems not adequate to capture the necessary information	Inaccurate or insufficient disclosure in notes to accounts	The company tax implications of IFRS transition not considered fully
Not enough staff to execute the transition	Material misstatement in reported figures	Systems changes mean that an incorrect certification on internal control effectiveness is given
IFRS changes not communicated to relevant external parties	Inappropriate management judgement exercised to determine reported figures	Failure to provide the necessary information to comply with regulatory requirements, e.g., in interim reports
Changes in responsibilities not documented or communicated	Over-reliance on a small number of IFRS-literate personnel	Financial statements not filed by deadline date
Restatement of balance sheet means debt covenants breached	Systems changes cause loss of financial information	
Changes to remuneration policy mean loss of personnel	Financial statements not presented consistently compared to industry peers	

A key part of the project planning will be to evaluate these risks and design appropriate responses. This is an area where business functions can work together to devise a strategy for mitigating risk exposure. Many large organisations have dedicated risk management or risk and compliance functions, which, in conjunction with the accounting and internal audit functions, can ensure that risks are identified and assessed appropriately.

It is common project management practice for a risk register (also known as a risk log) to be created, which details each risk, its probability and impact, and the mitigating response that has been identified. Risks can be scored and prioritised. The risk register should be put together early in the project lifecycle, and continually developed as the project progresses. It is important that risks are tracked throughout the transition, as new risks may emerge when parts of the project have been implemented.

As well as specific risks, the more general risks associated with the change that the IFRS transition will entail should be considered. Change management will be considered in more detail in Chapter 7, so for the moment it is sufficient to point out that changes in the business caused by the transition, such as the recruitment of new personnel, reliance on external specialists, revamped information systems and the use of new technology, should be built into the risk assessment.

6.2.1.3 Control Activities Control activities are the means by which risks are mitigated. Therefore, the specific control activities that should be in place in respect of the transition to IFRS will be driven by the risk assessment and documented in the risk register. The general principle is that control activities are the detailed responses designed specifically to mitigate the risks identified. Control activities include general control activities over technology. According to the COSO framework, controls may be preventative or detective in nature, and can be manual or automated, and segregation of duties is specifically mentioned as a control activity that should normally be deployed (COSO, 2013).

As discussed earlier in this chapter, organisations will find that they need to maintain previous GAAP records as well as IFRS-compliant records in the period running up to IFRS reporting, and consider the need to maintain previous GAAP accounting after the transition. The controls over previous GAAP reporting must therefore be maintained, at the same time as establishing the need for controls over IFRS reporting. The need for two systems and two sets of internal controls over financial reporting can place strain on already stretched resources. External specialists can be used to evaluate existing controls, develop improvements and additional controls, and/or to perform tests of controls in order to evaluate their effectiveness.

In addition, extra controls should be designed and implemented to ensure that the two accounting systems are kept totally separate, and that previous GAAP information does not get mixed up with IFRS information, and vice versa. Input controls will need to be strong so that data are not input to the wrong system.

It is useful to consider the different types of control activities and how they can be used during the transition to IFRS, as well as some of the problems with their use. Some controls are more important than others, and of course these controls should be in place anyway in relation to financial reporting – it is just a matter of ensuring they are extended to the transition. There are many parts of the transition that create risk, where better controls and stronger monitoring procedures will be needed.

High-level Reviews This is an activity whereby a senior person performs a review of financial information, to assess it for reasonableness and to look for unusual trends or other unexpected matters that could highlight an error. Examples could be:

- Performing analytical reviews on monthly and quarterly financial information;
- Comparing financial and non-financial data to look for unusual relationships;
- Measuring results against targets;
- Benchmarking financial information against that of industry peers.

High-level reviews will be important in relation to IFRS disclosure requirements, to ensure completeness and accuracy, and also that the disclosures are understandable. Disclosure checklists are useful here, and their use should be combined with other controls such as approval – the disclosure checklist should be reviewed and approved once complete – and segregation of duties, with the checklist being completed by someone other than the preparer of the disclosure notes.

The problem with this type of control is that its success depends, to an extent, on the level of familiarity that the person performing the review has with IFRS. It will be hard for someone with little experience of IFRS to develop expectations and anticipated outcomes in respect of the information they are reviewing and pick up potential misstatements if they are unfamiliar with the reporting framework.

Trend analysis also depends on comparing like with like, so it is important that comparative information has been adjusted properly to reflect IFRS for the comparison to be meaningful.

Controls Over the Selection of Accounting Policies The selection of accounting policies, and the use of optional exemptions in IFRS 1, should be controlled rigorously. Inappropriate choices, as well as leading to the creation of less than satisfactory financial statements, could lead to significant problems such as disagreement with the external auditor and time and cost implications of rectifying the problem at a later date. Controls in this area should address:

- Training – to ensure that those responsible for selecting or developing accounting policies have the right knowledge and skills for an educated decision to be made.
- Authorisation – all new accounting policies should have the approval of the audit committee.
- Use of specialists – where external specialists have been used to help management in the selection of accounting policies, management must take the ultimate decision, and there should not be over-reliance on external help.

Authorisation and Approval These controls simply act as a way to ensure that financial information is reviewed and authorised, for example, before being input to the accounting system. However, this is quite a narrow way of thinking about this type of control, and all aspects of the transition project should be reviewed and authorised before being executed. The controls can be hierarchical, so that the more significant the item or matter being authorised, the more senior the person or group of people giving the approval.

To give a few examples, controls should be put in place for the authorisation of the following:

- All material restatements and reclassifications in drawing up the opening balances at the date of transition.
- New models used in determining figures to be reported.
- The use of experts to provide figures for inclusion in the financial statements.
- Any system changes should be approved before being implemented and going live.
- Communications with external parties, such as institutional investors; for example, forecast results under IFRS should be approved by senior management.

A lot of these points may seem obvious, and a well-governed organisation would have this type of control in place anyway for all aspects of financial reporting. It is important to remember that there should be evidence of authorisation – in audits of IFRS transitions, the testing of controls sometimes finds this to be lacking even though authorisation has taken place.

Supervision and Review This is linked to authorisation and approval, in that in order to approve a transaction or other matter, the person giving the approval must first have reviewed it. Supervision and review is particularly important when the accounting team processing IFRS transactions are themselves going through something of a learning curve, and may not be fully conversant with all relevant IFRS requirements and principles. Therefore, having a review procedure in place is an important detective control, as it means that a more IFRS-literate reviewer should be able to pick up any errors that have occurred.

Many organisations conduct an extremely thorough review of financial information at various points in the IFRS transition. It is common for the opening balance sheet at the date of transition to be reviewed, sometimes by internal audit, sometimes by an external specialist, to ensure that the starting point for reporting under IFRS is accurate.

IT Controls IT controls fall into two categories. General controls are related to security of the IT system and also to its development and implementation. Application controls exist to ensure the validity of the information processed by the IT system.

General controls will be extremely important where there are significant changes to the IT system as a result of the transition. Controls will need to be in place over the development and implementation of the system to ensure that objectives have been met, and controls should also ensure that adequate testing of the system takes place before it goes live.

Application controls will also be very important, especially where there are changes to processes within the system. There are many types of application controls, just some of those relevant to the transition include: input controls – to ensure the completeness and accuracy of information entering the system; and identification controls – to enable users of the system to be identified. It is the application controls that must be tested rigorously before the system goes live. This can be quite time-consuming and testing should be carried out as early as possible so that there is enough time to resolve any problems that are revealed.

Spreadsheet Controls In some transitions, where financial information is contained in spreadsheets or where processing is performed outside of the general ledger, controls should be put in place to ensure the integrity of the data held on the spreadsheets. This is an extremely important issue, as the financial information is outside of the normal IT control environment,

leading to a high risk of error, either in the data that are input, or the processing of them within the spreadsheet. Relevant controls could include:

- Restricting access to spreadsheets using passwords;
- Encrypting data held within the spreadsheet;
- Locking cells that contain key formulae or other critical information;
- Regular backups of information held on the spreadsheet;
- Using test data to check the accuracy of computations and analysis.

Segregation of Duties The principle of this control is that responsibilities within a business process should be separated as much as possible, with duties allocated to different individuals, or groups of individuals. This is a powerful control for combatting fraud, but is also useful as a preventative and detection control against error. Ideally, the duties of maintaining accounting records, authorisation, and performing reconciliations should be segregated, and in situations where duties cannot be segregated, for example in a small accounting department with few staff, compensating controls should be used.

Physical Controls These work to restrict access to the accounting system. This can be important in ensuring the authenticity of financial information entering the system, and its accuracy. It also means that sensitive information can only be accessed by certain people. Physical controls include password protection and can also include tangible controls such as locks and swipe card access to restricted areas. In relation to the IFRS transition, password protection and other mechanisms to prevent unauthorised access to the systems are important.

6.2.1.4 Information and Communication The COSO framework places a lot of importance on information flows and methods of communication, focusing on the quality of information and the effectiveness of information. Management can only make sound decisions based on high quality information that is communicated in a timely manner to the appropriate personnel.

In relation to IFRS transition, management will need to consider the type of information they wish to receive during the project, and information needs may change as the transition progresses, for example, as the accounting impacts and effects on results become clearer. Information and communication issues are closely related to IT issues, so when systems impacts are being analysed, the transition team must remember to consider the knock-on effect of system changes on the type of information that will be produced.

6.2.1.5 Monitoring Monitoring should be ongoing, and is a key part of good project management as well as being a component of good internal control. In many organisations an internal audit function performs the monitoring role, and the audit committee oversees monitoring activities.

The internal auditors are well placed to monitor the transition, as long as they are IFRS-literate and operate independently of the IFRS project team, enabling them to be objective when carrying out their monitoring activities. Section 6.2.4 will deal specifically with the role of the internal audit function and the audit committee in the IFRS transition.

A potentially significant issue in relation to monitoring internal controls and their effectiveness is that in many jurisdictions, members of senior management are required to discuss control-related issues in the annual report, often in the Management Disclosure and Analysis (MD&A) section or its equivalent. In Canada, for example, Chief Executive Officers and Chief Financial Officers certify on the design and implementation of disclosure controls and procedures and on internal control over financial reporting. The certifying officers will need strong assurance over controls relating to transition to have the confidence to make their certifications, and should consider strengthening monitoring procedures during the changeover period. This is where the internal audit function can play an important part in the IFRS conversion, as they can be tasked with monitoring the effectiveness of controls, focusing on those areas of the transition with the highest risk.

6.2.2 Controls Over Fair Value Measurements

IFRS requires or permits the use of fair value in relation to many balances and transactions. The use of fair value measurements creates specific control issues that must be addressed. Controls are important for management to gain assurance over the fair value measures being disclosed, but a further consideration is that the external auditor will be scrutinising the methods used to determine fair value. In fact it is a requirement of International Standards on Auditing that when evaluating how management has arrived at an estimated value, the auditor tests the operating effectiveness of the controls over how management made the accounting estimate, and performs other procedures relating to how management made the accounting estimate and the data on which it is based. Management therefore needs to ensure that controls procedures over fair value estimates are sufficiently robust to hold up to the auditor's scrutiny.

However, the determination of fair value can be extremely complex and inherently subjective, which can make it hard to establish effective controls. The extent to which this is a problem depends on the type of balance or transaction for which the fair value is being determined – it can be easy to establish controls for simpler items such as a tangible asset, but much more difficult for a complex financial instrument. Even audit firms may lack detailed knowledge and understanding of fair value accounting methods and disclosure requirements, especially in jurisdictions where local GAAP generally does not allow fair value as a measurement model. In the US it is only relatively recently that fair value measures have been used extensively, giving rise to concerns when fair value measures were introduced that familiarity with the concept was lacking for both preparers and auditors of financial statements (Johnson, 2007).

In the case of complex areas like financial instruments, knowledge of the relevant transactions and their appropriate accounting treatment may be confined to a few people in the organisation. This makes segregation of duties challenging, and review procedures difficult to implement. It is important that in the case of financial instruments, there is segregation of duties between personnel who instigate and manage a transaction, and personnel responsible for the accounting.

Some of the areas in which controls should be used are discussed below, along with the difficulties in developing and implementing controls over fair values.

Judgement The use of judgement means there is a risk of management bias in determining fair value, which may be unintentional. It is difficult to create strong controls to detect management bias, other than review procedures. Where there is an option

to use fair value that has been taken by management, the choice of accounting policy itself may be the subject of management bias. Controls are needed to ensure that there is an appropriate business rationale for the policy decision, but controls over what can amount to the integrity of management are hard to enforce.

Identification of relevant balances and transactions Controls will be needed to ensure the completeness of balances measured at fair value. Where there is a large volume of such items this can be difficult.

Use of models Models may need to be used to determine fair value. Controls are especially important where a model has been developed specifically for use by the reporting entity, or where the model is different to one used by industry peers. International Standards on Auditing suggest that controls should be in place over the design and development, or selection, of a model; the uses of the model in determining fair values, and the maintenance and periodic validation of the integrity of the model (IAASB, 2013). In addition, before a model is used, its theoretical soundness and mathematical integrity should be tested and its output reviewed. For example, when valuing complex financial instruments, management may rely on a model to measure the value of a derivative at the year-end. There would need to be controls over the selection of the model, as several exist that can be used to value derivatives (the Black–Scholes, Cox–Ross, and Binomial models can all be used to value instruments such as derivatives).

Management assumptions There should be controls over the assumptions that have been used by management in determining fair values, for example where the assumptions form the basis of a model. Controls are needed over the relevance and consistency of assumptions used and are likely to be limited to authorisation and approval of key assumptions, for example, by the audit committee.

Data inputs Controls will be needed, as in any area of accounting, over the completeness and accuracy of the source data, and their input to the process used to determine fair value. Some inputs may come from outside the accounting system, and so their integrity will need to be considered. IFRS 13 *Fair Value Measurement* ranks inputs used in measuring fair value in a hierarchy, with observable inputs being the highest ranked and unobservable inputs the lowest ranked. Controls will need to be in place to assign inputs to a level in the hierarchy, as this information is needed for disclosure purposes. For example, when valuing derivatives, inputs to a valuation model could include interest rates, market prices, volatility factors and exercise prices, and controls would be needed to ensure the accuracy of such inputs to any model used as a basis of generating information for inclusion in the financial statements.

Use of experts It is common for reporting entities to obtain expert assistance in determining fair values. Controls should be in place over matters such as the selection of the expert to ensure their expertise is appropriate and that they are objective, the scope of work given to the expert, and how the expert's work is reviewed and evaluated before being used as a basis for financial reporting.

Documentation Controls over the maintenance of adequate documentation are critical, as there must be a clear audit trail showing how fair values have been determined. In some accounting treatments, such as in respect of derivatives and hedge accounting, documentation plays a crucial part in determining the accounting treatment, so the documentation must be in line with the requirements of the relevant standards.

Capturing information for disclosure Extensive disclosure requirements exist in relation to fair value accounting. Controls need to be implemented, focusing on ensuring that the correct information is captured for disclosure. Disclosure is made by class of

asset and liability under IFRS 13, so controls are needed over the proper classification of items into the relevant classes.

External conditions Inputs to processes and models used to determine fair value often come from outside the organisation and are often linked to market conditions; for example, interest rates, exchange rates and price indexes. Controls are needed to make sure that external conditions are monitored meticulously, and that any necessary changes to inputs are made in a timely manner.[4]

Post-reporting-date controls Events that occur after the reporting date can impact on year-end fair value measurements, so controls will need to be in place to monitor relevant matters continually.

6.2.3 The Role of the Audit Committee

Both the audit committee and the internal audit function have important roles to play in the transition. The audit committee has an oversight function, and should be ready to review aspects of the transition and assess the effectiveness of the project. The committee also has a part to play in setting an appropriate tone, in supporting the view that transition is a significant issue with a wide range of consequences. The audit committee should also oversee the internal audit function, and should provide appropriate direction to the internal auditors, who can be important in many parts of the transition, providing assurance on systems and monitoring control activities.

Requirements and best practice guidelines in relation to the establishment of audit committees vary between jurisdictions and this section will discuss in general terms the oversight role that an audit committee can play in IFRS transition.

Training is a critical consideration. Audit committee members are expected to be conversant with financial reporting issues, and an initial matter to consider is whether training is needed. Hopefully, one or more of the audit committee members will be IFRS-literate, in which case those members may play a leading part in the committee's involvement with the transition project. In any case it is doubtful that all audit committee members would be sufficiently knowledgeable on IFRS that no training would be needed.

The audit committee should also ensure that it is comfortable with the frequency and method by which it will be kept informed of developments in relation to the transition. The committee will not be able to oversee the transition properly and provide input where necessary without a good level of communication from the project team leader on pertinent issues.

The audit committee should have involvement in various aspects of the transition project:

Evaluate the overall transition plan The audit committee should evaluate the plan, first in principle and then in detail. Initially, the audit committee should make sure it is happy with the strategy and scope of the transition project. In terms of detailed analysis, the

[4] *The financial crisis of 2007/8 caused immense market instability, which, for preparers of accounts, meant that determining fair values of some financial instruments was an extremely difficult task. Various audit regulators, standard setters and other commentators reacted to this, providing guidance on the audit of fair values in such difficult circumstances and a discussion of measurement problems.*

plan should be assessed for reasonableness; for example, the audit committee should consider the following matters:

- Is the first IFRS reporting deadline likely to be met, and are the milestones realistic?
- Is the project adequately staffed and are any additional resources required?
- Is the composition of the project team appropriate, and who is leading the project?
- Will external specialists be brought in, and, if so, have they been identified?
- Does the plan cover all necessary issues, e.g., has training been considered and is there a communication strategy?
- Has the correct decision been made regarding which reporting entities will move to IFRS, i.e., is the transition at group level only, or at the legal entity level?
- How will accounting impacts be identified and prioritised?
- Will systems need to be amended or changed and what are the impacts on internal controls?
- Have the wider issues been considered and planned for?
- Is there sufficient funding for the project?
- What will be the involvement of the external auditors?
- Is senior management setting an appropriate tone for the transition, i.e., treating it as a major business change?
- Have project risks and opportunities been identified and appropriate responses planned?

Although the audit committee may not need to approve the transition plan officially, the plan should be reviewed and weaknesses identified by the committee should be discussed with the project leader and other appropriate senior management with a view to remedying the problem areas.

Financial reporting issues A principle of most governance codes is that the audit committee has a responsibility to review the financial statements of the reporting entity and any formal announcements relating to financial performance. This means that the audit committee should monitor the use of significant judgements in preparing the financial statements as well as their overall presentation and the adequacy of the disclosures made in the notes. One of the major oversight functions of the audit committee is in relation to the new IFRS-compliant accounting policies, which need to be assessed carefully and approved for use. In relation to its oversight of financial reporting, the audit committee may wish to consider these issues:

- Which accounting impacts are the most significant?
- How will management make accounting policy decisions? What key factors affect the choice of policy and the determination of estimates?
- Are any accounting treatments very subjective, and how will management exercise judgement in those areas?
- Will the presentation of the financial statements be significantly different?
- Which exemptions and exceptions from full retrospective application of IFRS will be taken?
- What will the likely impact be on key performance indicators and accounting ratios?
- Are reported earnings likely to be more volatile in the future?
- What is the extent of new disclosure requirements?
- Are there any newly recognised assets and liabilities and what is their impact on the appearance of the balance sheet?

- Is fair value accounting going to be used, and what methods will be used to determine fair value?
- What will be the impact on interim reporting?
- Have impacts on management accounting, budgeting and forecasting been considered?

Oversight in relation to management judgement The use of management judgement was included in the list of issues above, but this is such an important issue that it is worth separating out and treating in its own right. It has been mentioned several times previously that IFRS is a principle-based reporting framework, and judgements need to be made in many areas of accounting, including the selection and development of accounting policies, choosing the basis for accounting estimates, developing models and assumptions to assist in the determination of fair value, deciding on matters significant enough to warrant disclosure or separate presentation, and deciding on the scope of consolidation.

In some transitions, management may be exercising a much greater degree of judgement than under previous GAAP, especially where that previous GAAP was fairly prescriptive. Where management is less familiar with exercising judgement, there is more chance of judgement not being sound, leading to risk of management bias and potential misstatement in the financial information. In all transitions, but particularly in this scenario, the audit committee has a role in overseeing management's judgement, and in providing a review mechanism for significant judgements.

Internal controls and internal audit The audit committee is generally required to review the organisation's internal controls over financial reporting, and in some jurisdictions management makes a certification on internal controls. In addition, generally, the audit committee oversees the internal audit function. Therefore, the audit committee has a part to play in gaining assurance over the adequacy of internal controls and should consider how the internal audit function should help to provide this assurance.

The involvement of the external auditor The audit committee generally has two roles in connection with the external auditor. First, the audit committee reviews the objectivity of the external auditor and should consider any threats to objectivity, and second, the audit committee assesses whether the external audit firm should be providing the organisation with any non-audit services.

As discussed in Chapter 4, there are strong arguments for involving the external auditor with the transition as much as possible, however, this has to be balanced with the objectivity threats created when the external auditor could be perceived to be taking on a management role, and due to the significant self-review threat created if the external auditor becomes too involved with the preparation of financial statements. The audit committee will need to ensure that they are comfortable with the level of involvement of the external auditor, and that any threats are reduced to an acceptable level through the use of appropriate safeguards. In some cases the provision of a non-audit service by the external auditors may be in breach of regulatory requirements and/or the organisation's own code of conduct, in which case the audit committee will have to be very clear on the difference in nature between an audit service and a non-audit service, and where the involvement of the external auditor actually lies.

During the audit of the first IFRS financial statements, the external auditors' procedures may reveal errors and misstatements. Auditors are required to discuss misstatements with those charged with governance, and the audit committee would be involved with this.

Appointing external specialists The audit committee may be involved with approving the use of external specialists, for example IT and tax specialists. The committee should consider the qualifications and experience of any specialists appointed, and objectivity threats, though these are less important than the threats discussed above in relation to the external auditor.

Impact on other board committees The audit committee is well placed to consider whether other board committees need to be involved with aspects of the transition, and the nature of any such involvement. For example, any changes to employee pay, such as the terms of bonuses, will need to involve a remuneration or compensation committee, and where a risk committee is established, the risks associated with the transition should be considered fully by the members of that committee. The audit committee can also consider how much involvement other non-executive board members can, or should, have with transition, and the need for training, as the non-executives outside of the audit committee may not be very knowledgeable on accounting issues, let alone the specifics of IFRS.

Wider issues The audit committee is likely to be comprised of individuals with a breadth of different business experiences, and is therefore in a good position to review the wider issues that have been identified by the transition project team. The audit committee members may be able to provide some input here too, spotting issues that they have seen in other organisations that are relevant to the transition planning and execution.

Communications The audit committee is responsible for reviewing any IFRS-related communications in the run up to the publication of the first IFRS financial statements. They may provide input to the decisions on the timing of communications and the methods used. Ultimately, the audit committee needs to be satisfied that communication on the transition, and particularly on its potential impact on performance and financial position, is provided to the correct user groups in a timely manner.

6.2.4 The Role of the Internal Audit Function

Internal auditors have a unique position in an organisation, having cross-functional involvement across business units. This means that the internal audit function can have an important input to the transition project. The amount of involvement with transition will depend on the size and scale of both the transition and of the internal audit function, but with careful planning the maximum involvement can be achieved. Some examples of how internal audit can be deployed within the transition project are given below:

Project management Internal audit can be given significant roles within the project team, and a technically competent internal auditor with a good knowledge of IFRS could make a good project team leader. The nature of internal audit work is that it is often project-based in nature, so internal auditors often have excellent project management skills and are proficient at keeping projects on track.

Identifying accounting impacts Internal auditors are used to preparing financial analyses and will be familiar with the organisation's accounting policies, so they could be tasked with identifying and quantifying accounting impacts. This will necessitate a good knowledge of IFRS as well as previous GAAP, so training may be needed for this work to be given to internal audit.

Identifying systems and controls impacts The internal audit function is likely to have extremely good knowledge of the organisation's systems and controls, and internal

auditors are likely to be the best people to assess the extent and nature of changes to systems that will be necessary on transition. Depending on the skill-set of the internal auditors, they could also be involved with designing and recommending systems changes and control improvements.

Documenting and testing systems and controls The internal auditors can provide assurance on the accounting systems that have been developed for IFRS reporting, as well as maintaining documentation of the system and surrounding controls.

Identifying wider issues The internal auditors can be tasked with dealing with particular wider impacts of the transition. For example, contracts and agreements such as leases and purchase agreements may need to be assessed to consider whether they are affected by the transition.

Risk management Internal audit often plays a supporting role in risk management within an organisation, so is well placed to evaluate the risks associated with IFRS transition, and to recommend appropriate responses.

Consistency As the internal audit function will work across geographical boundaries, it can promote consistency across an organisation; for example, in testing that new accounting policies are being applied consistently.

For internal audit to be involved successfully with the transition, care should be taken that conflicts do not arise in the work that is being performed. For example, if the internal audit team identifies the necessary systems changes and helps to develop appropriate responses, the same team may not be objective if also tasked with testing and evaluating that same system. As mentioned above, there is also a need for the internal auditors to have a good working knowledge of IFRS, and in some cases a very detailed knowledge on certain areas; for example, if considering systems requirements for a specific accounting area. The audit committee will need to work in conjunction with the IFRS transition team here, to provide some oversight and to help ensure that the internal audit team is used as effectively as possible within the constraints of their technical knowledge and ability, and whilst maintaining some objectivity.

Successful involvement of internal audit also relies on there being good communication and cooperation between the internal audit function, IFRS project team, audit committee and business units.

6.3 EVALUATING THE WIDER IMPACTS

The transition to IFRS is more than a technical issue to be dealt with by a reporting entity's accounting function. The wider impacts can be commercially and strategically significant, the extent of which some early adopters of IFRS did not always realise until late in the transition project. Organisations yet to move to IFRS can benefit from the experience of early adopters by understanding the type of wider impacts that have occurred, whether they represent an opportunity or a problem, and how to build these issues into the transition project. At the initial planning phase of the transition, a SWOT analysis can be performed, as described in Chapter 4, and this will highlight any immediate wider impacts perceived at the start of the transition.

Once accounting impacts have been identified, the wider impacts can be considered. Ideally, the strategic and commercial implications should be evaluated, and appropriate responses planned. The extent of wider impacts will depend on the size and complexity of the organisation involved, its capital structure, the nature of its operations and the environment in which it

operates, as well as other factors. This is often where the transition throws up unexpected consequences having impacts on employees, investors, customers and suppliers, as well as affecting a variety of business functions within the organisation. The finance function will need to ensure it has a good level of communication and cooperation with other business functions, and one objective of the transition project should be to make external parties aware of how the move to IFRS affects them, with mitigation strategies developed where the impacts are detrimental.

Some of the more common significant impacts are discussed below, and a table is provided to link IFRS requirements with a range of wider business and other consequences that can surface when the transition is underway.

6.3.1 Human Resources Impacts

In large transition projects, there can be considerable and wide-ranging impacts associated with human resources. Some are quite obvious; for example, the need to assess resources and bring in additional skills if necessary. Other impacts are less easy to plan for, and might only become evident as the transition progresses.

The transition project can be extremely labour-intensive, and those that have gone through transition often comment that they underestimated the amount of time and effort that would be needed at each stage in the process. The human resources function should be involved right from the start of the project, to identify resourcing requirements and to plan for acquiring more skilled staff if necessary. Many transition consultants recommend that educating existing accounting staff may not be the only solution to building up IFRS knowledge within an organisation, and the human resources department may need to be instructed to recruit suitably qualified and knowledgeable personnel. At a time when other reporting entities are also going through transition, skills can quickly become very scarce, and therefore expensive.

One report suggests that over 50% of IFRS adopters in the EU, Japan and Korea required additional staff to complete the transition project (Ralph, 2009). This demand for IFRS-literate accountants, coupled with a shortage of supply can push up labour costs significantly. There is evidence that in some countries, such as Brazil, there is simply not enough skilled staff to resource the transition, and competition between companies to attract appropriately qualified and experienced individuals is very high (ACCA, 2013). A US-based accounting speciality staffing expert predicts that in the US there will be a race for talent as more companies move to IFRS reporting and that the scarcity of accountants skilled in IFRS demands a well thought-out recruitment strategy to avoid excessive costs being incurred (Beekman, 2011). Human resources departments therefore need a strategy to ensure that the organisation can secure enough resource of the right calibre to staff the transition team.

Early identification of the need to recruit is important in order to secure good personnel. Using temporary staff can offer a flexible solution, but the same problem applies to temporary as well as permanent staff – any scarcity of IFRS knowledge in the marketplace will significantly increase the costs of hiring.

Of course, the flip side of this issue is that when there is a high demand for IFRS-literate staff, those organisations lucky enough to employ such personnel may find that they face an exodus of talent, if their employees are tempted to leave to pursue opportunities elsewhere.

Experiences from the UK, Australian and Canadian transitions show that knowledgeable IFRS personnel are likely to be headhunted, with large salaries enticing them away from existing employers. The human resources function should work with management to identify if this could be an issue and, if so, take pre-emptive action to prevent a loss of valuable knowledge.

A further human resources issue is that roles may change within the accounting function due to the transition, and new roles may be created. Depending on the level of difference between previous GAAP and IFRS, the new accounting regime may involve more judgements being made, with less focus on just processing transactions and number-crunching. So human resources may need to develop new job specifications and performance measures to include higher level analytical and judgement skills.

A potential benefit of transition for multinational organisations is that where IFRS is followed in different jurisdictions in which the firm operates, there should be an enhancement of the geographical mobility of staff within the organisation. This is enhanced where a common training method is used across different locations, ensuring that employees are IFRS-literate across the organisation and use the same terminology and apply the same thought process to accounting issues. Training is, of course, a crucial element of the transition project in its own right, and is discussed in some detail in Chapter 7.

Human resources functions should also be aware of some of the specific accounting impacts that affect employees' contracts, pension arrangements and remuneration packages.The effect on employees can be significant, and even when it is not so significant, it can be a cause of concern, which needs to be managed carefully. This is especially the case for any amendments to remuneration packages, long-term incentive plans, or bonus schemes and other means of performance assessment that are put in place or occur as a consequence of new accounting processes. Employees will view any such changes with suspicion and may want to negotiate higher pay to compensate for any actual or perceived reduction in benefits.

6.3.2 Debt Covenants, Financing and Treasury Management

The collection of adjustments made on transition to IFRS will cause reclassifications and remeasurements of many assets and liabilities. The aggregate effect can be highly significant to an entity's liquidity and solvency profile.

Some debt covenants do not cater for mandatory changes to accounting policies. The restatement of the balance sheet on transition to IFRS will change the entity's liquidity and solvency structure and may cause covenants to be breached. Financing strategies should be reviewed to understand their accounting implications under IFRS. Covenants may need to be renegotiated to ensure continuity of borrowing facilities. Communication with providers of finance should be early in the transition project, with anticipated impacts on debt covenants clearly laid out. The provider of finance may wish to continue to use previous GAAP measures in relation to existing covenants in place, meaning that dual reporting needs to be maintained in respect of the matters covered by the covenant.

Accounting for financial instruments is complex and even the basic requirements are difficult to summarise in a meaningful way. Essentially, under IFRS financial instruments are categorised, and their categorisation drives the measurement basis, with some instruments measured at fair value, others at amortised cost. For financial instruments measured at fair value, some changes in fair value are recognised in profit and some changes recognised in equity and disclosed as

a component of other comprehensive income. Some instruments, such as derivatives, must be measured at fair value, and the use of hedge accounting complicates matters.

In addition to the complex recognition, derecognition and measurement rules, there are extremely extensive quantitative and qualitative disclosure requirements. And, as discussed in Chapter 5, IFRS 9 *Financial Instruments* is replacing IAS 39 and this is an accounting area with a changing landscape of guidance.

Treasury management and accounting functions will need to cooperate closely to ensure that the relevant accounting requirements are complied with and that appropriate documentation is maintained for all financial instruments and especially those that will be measured at fair value and those relating to hedge transactions.

Systems may need to be changed, for example, to monitor hedge effectiveness, to determine fair values and to produce information for disclosure such as sensitivities, maturity schedule and age profiles of debt and receivables. The treasury management function may need to be involved with developing new models to determine the fair value of financial instruments. For some financial instruments the fair value may be provided by an external party; for example, a provider of finance, in which case communication with the external party is essential to ensure that the fair value is provided at the correct time and using an appropriate measurement basis. In many cases it is very difficult or even impossible to measure fair value retrospectively, especially in the case of complex financial instruments, so the external party must be aware that this information will be required of them.

Hedge transactions already in place may not meet the criteria for hedge accounting under IFRS and the transactions may need to be re-engineered. There is evidence that on transition to IFRS, some organisations reduce the use of hedging transactions due to the complexities of recording, measuring and monitoring the transactions, so this is a case where the accounting requirements can have a direct impact on business decisions.

New models may need to be developed to perform impairment testing on a range of financial instruments and there must be robust controls to ensure that all indicators of potential impairment are identified. Some impairment indicators will be external to the business and harder to recognise, especially where management is unused to performing detailed impairment reviews on financial instruments.

Disclosures of risk factors including credit risk, liquidity risk and market risk allow financial management strategies and processes to be scrutinised. Management may be reluctant to disclose some of this information, considering it to be commercially sensitive.

Instruments held at fair value through profit increase the potential volatility of reported profits, and other instruments create equity volatility. This increased volatility makes the forecasting of results more difficult for management.

6.3.3 Mergers and Acquisitions

Potential commercial implications of the transition arise from new rules on business combinations being followed after the transition to IFRS. An organisation's mergers and acquisition strategy may be affected, and the teams responsible for assessing target companies and for negotiations with the vendor must be made aware of both the implications of

IFRS on their evaluations and of the financial reporting consequences of strategic acquisitive decisions. Some potential matters to consider include:

The structure of the consideration paid and payable on an acquisition IFRS requires that consideration be recognised at fair value, including any contingent consideration and deferred consideration. Therefore, the financial reporting impact of any earn-out clauses, or similar elements of consideration payable in the future, need careful consideration as they can affect the amount of goodwill recognised, and will need annual re-evaluation until the date the relevant elements of consideration are settled or extinguished.

Due diligence Under IFRS 3 *Business Combinations* there is a requirement to identify all assets and liabilities of an acquired entity at the date of acquisition, and generally to determine a fair value at that date. This requirement demands a thorough investigation of the target organisation's assets, liabilities and operations, and significant judgements may need to be made regarding the fair value of assets and liabilities acquired. It is particularly important that acquired intangible assets are identified separately and recognised as assets in their own right, separate from goodwill, in the consolidated financial statements. All of this means that due diligence for most major acquisitions must be planned carefully, extremely rigorous, and performed with the measurement rules of IFRS in mind.

Post-acquisition results Under IFRS the post-acquisition results may be different to those that would have arisen under previous GAAP. There are several reasons for this, including the non-amortisation of goodwill under IFRS, the separate recognition and amortisation of acquired intangibles, adjustments made in relation to contingent consideration, and the requirements for goodwill to be tested for impairment on an annual basis. Of course, the exact impact of all of these issues will vary from acquisition to acquisition, but organisations may expect to see more volatility (often due to goodwill impairment) than was seen under previous GAAP in the post-acquisition periods.

Impairment testing Under IFRS, goodwill arising on a business combination is required to be tested annually for impairment, which can be an extremely time-consuming and laborious process, especially where goodwill is allocated across a number of business units. Impairment write-offs can lead to volatility in reported results, and even relatively small impairments can signal problems in the business or at least raise concerns over business performance.

Measurement of non-controlling interest Under IFRS, the non-controlling interest (also known as minority interest) can be measured at book value or at fair value, with the decision made on an investment-by-investment basis. Management will therefore need to decide on a measurement basis, bearing in mind that this will also impact on the amount of goodwill recognised.

6.3.4 The Potential Business and Commercial Impacts of the Transition

The development of new IFRS-compliant accounting policies will have knock-on effects on many areas of the business. This means that, for many organisations, a great deal of time is spent during the transition planning on a detailed review of the wording of contracts, agreements, invoice terms, covenants and other documentation to look for implications for financial reporting under IFRS. Many documents will contain explicit or implied references to previous GAAP, and wording will need to be changed to include the appropriate IFRS

reference. The meaning of some documents will change, and in many cases their contents will need to be changed to maintain or create a desired accounting income. For example, customer contracts may need to be changed to achieve a certain pattern of revenue recognition following the implementation of IAS 18 *Revenue.*

Table 6.3 indicates some of the more common wider impacts. It briefly describes the impact,

Table 6.3 The potential business and commercial implications of the transition

Accounting policy/ area affected	*Why the wider impact is identified, i.e., related IFRS requirement*	*Business and commercial implication*
Revenue recognition	IAS 18 *Revenue* requires revenue to be recognised when certain criteria, known as the sale of goods criteria, have been met. Generally, elements of contracts need to be separated and accounted for on an individual basis. Revenue is usually recognised when risk and reward have transferred to the purchaser and where obligations have been fulfilled. Elements of revenue should be accounted for separately where appropriate, e.g., provisions of goods separated from provisions of services when supplied under the same contract. IAS 18 may also differ from previous GAAP on the measurement of revenue, particularly where revenue is deferred. Generally, revenue is recognised at fair value, and deferred elements discounted to present value.	Contract milestones and revenue recognition trigger points may need to be revised, especially on long-term contracts to supply goods or services. Contracts with customers and schemes such as customer loyalty plans may need to be reworded or have terms revised. The necessity for complex arrangements with customers such as bill and hold, consignment stock arrangements, goods sold on sale and return and arrangements for sale with potential repurchase should be reviewed in detail to determine the substance of the arrangement and at what point it is appropriate to recognise revenue. Contracts involving multiple elements will need to be disaggregated to enable revenue to be allocated across the different elements (e.g., sale of goods and sale of services recognised separately). Relationships with customers may suffer if contracts are changed without good reason. Effort needs to be made by account managers to explain any changes made to contractual terms.[5] Managers working on projects will be impacted if contract milestones change, leading to projects having to be resourced differently and possibly affecting project appraisal methodologies such as Earned Value Management systems and calculations. Changing contract terms may result in a different revenue recognition pattern and timing than under existing GAAP, impacting on trend analysis.
Receivables: impairment and aged analysis	IFRS 7 *Financial Instruments: Disclosures* requires disclosure of information about the significance of financial instruments to an entity in terms of risk exposure and how risks are managed. Trade receivables fall under the definition of a financial asset and therefore disclosures may be necessary, including disclosures on exposure to credit risk,	Credit control policies and procedures may need to be made more robust and more transparent. Disclosure of credit control policies allows users to better gauge working capital management and can highlight problems in this area. Because more information on liquidity and working capital management is disclosed, credit rating agencies are likely to do more analysis, which may impact on credit ratings.

[5] *As discussed in Chapter 5, the IASB and the FASB have a joint project on revenue recognition, which will lead to the introduction of a new standard on revenue. The implications of the potential new requirements on the recognition and measurement of revenue should be evaluated when considering revenue-related wider impacts.*

Table 6.3 (*Continued*)

Accounting policy/ area affected	*Why the wider impact is identified, i.e., related IFRS requirement*	*Business and commercial implication*
	impairments and allowances against trade receivables, the ageing of trade receivables, and a discussion of how risks are managed, for example the credit control policy.	Existing and potential customers and suppliers may change their terms, credit limits and prices in light of the additional information available.
Research and development	IAS 38 *Intangible Assets* requires research costs to be expensed, and where development costs meet certain criteria then they must be capitalised as an intangible asset. Development costs are capitalised only after technical and commercial feasibility of the asset for sale or use is demonstrated, i.e., the entity must intend and be able to complete the development for use or sale and demonstrate how the asset will generate future economic benefits. The capitalisation criteria should be reviewed annually to ensure that they are still appropriate to recognise capitalised development costs. Capitalised development costs are amortised over the estimated useful life of the asset.	Research and development costs need to be considered separately. Procedures need to be developed to consider whether development costs have to be recognised as an asset. In many businesses there is a very fine line between what is classified as research and what constitutes development, and controls need to be robust to ensure that revenue and capital expenditure are differentiated and accounted for appropriately. This will be significant where previous GAAP requires all R+D costs to be expensed and therefore there is no history of separate recording and accounting for research costs and development expenditure. Internally, changes will need to be made to the process of recording R+D projects, e.g., new ways to record the time spent on projects, the need for more specific cost recording and cost allocations between R+D projects. The disclosure of information on in-progress R+D may highlight products considered to be commercially successful, while any write-offs of development costs signal a poor development strategy or failure to bring a product successfully to market.
Leasing	IAS 17 *Leases* requires classification of leases based on indicators, which may mean that more leases are classified as finance rather than operating (or vice versa) than under previous GAAP. Finance leases are those where substantially all of the risk and reward are transferred to the lessee under the terms of the lease. Leases of land need to be separated from leases of buildings and accounted for separately. IAS 39 / IFRS 9 *Financial Instruments* require embedded derivatives to be assessed and accounted for as financial instruments. Lease agreements can contain embedded derivatives. IFRIC 4 *Determining Whether an Arrangement Contains a Lease* requires arrangements that are similar in nature to a lease to be identified and the nature of the lease element evaluated and recognised accordingly.	Lease negotiations and the wording of lease contracts will need to be revised to ensure that various IFRS-related matters are taken into account, such as clear identification of whether the lease is operating or finance in nature, separation of land and building elements of leases and the existence of embedded derivatives. Arrangements need to be assessed for the potential to include a lease arrangement even when this is not the legal situation, e.g., power purchase agreements for utility companies. Lease negotiations may become more complex and the wording of clauses may be changed, particularly around the issue of the risk and reward of using the leased asset. Recognition of more leases on the balance sheet affects reported liquidity and could affect ability to raise further finance. The proposed new accounting treatment on leases will significantly alter the financial statements of reporting entities involved in significant finance or operating leases. New accounting policies will need to be developed when the proposed new standard becomes effective, and the changes to the financial statements will need to be communicated carefully to all users of financial information. The changes may be sufficiently significant to alter a company's commercial and financial strategy on lease agreements.

Table 6.3 (*Continued*)

Accounting policy/ area affected	*Why the wider impact is identified, i.e., related IFRS requirement*	*Business and commercial implication*
Procurement	IAS 39 / IFRS 9 *Financial Instruments* require embedded derivatives to be assessed and accounted for as financial instruments.	Supplier contracts need to be reviewed for the existence of embedded derivative elements and other matters such as arrangements containing leasing aspects. Procurement procedures may become more complex. Suppliers will need to understand the reasons for any changes in contractual terms. On a more general note, procurement processes that require suppliers' financial statements to be analysed, e.g. for the justification of establishing a preferred supplier, may need to be reviewed and training provided to procurement personnel where the supplier is moving to IFRS to enable effective analysis to be performed.
Contracts to supply	As above – contracts may contain embedded derivatives.	Contracts to supply goods and services will also need to be examined for the existence of any clauses giving rise to embedded derivatives. Supply contracts may need to be re-worded and with any changes in terms explained to customers. Contract registers should be set up for both supply-side and procurement contracts to ensure adequate documentation exists.
Share-based payment	IFRS 2 *Share-based Payment* requires that in most situations expenses be recognised for equity-settled and cash-settled share-based payment plans during the vesting period based on the fair value. Extensive disclosures are required in relation to share-based payment plans. The existence of certain performance conditions in the plan impacts the calculation of the expense to be recognised.	The terms of share-based payment plans (including stock option plans and share appreciation rights) need to be scrutinised to determine the amount of any expense that should be recognised. The wording of plans issued post IFRS implementation needs to be considered carefully, as including certain types of performance target as a vesting condition affects the measurement of the amounts recognised. Changes to employee remuneration packages including share option schemes and share appreciation rates will not be seen favourably by employees. Some organisations may decide to stop offering share-based payment schemes due to the complexity of the accounting treatment and adverse impact on profit.
Pensions	IAS 19 *Employee Benefits* requires a pension liability or asset to be recognised in respect of a defined benefit pension plan's net deficit or net surplus position. Measurement of plan assets and liabilities is generally at fair value for assets and present value for liabilities, and actuarial gains or losses are recognised in equity (the options for accounting for retired benefit pension plans have been revised recently). Gains or losses resulting from curtailments or settlements of a plan are recognised when the curtailment or settlement occurs.	The inclusion of pension deficit for the first time in the financial statements will affect the liquidity / solvency profile and possibly affect the ability to raise finance. Close communication with those responsible for the entity's pension plan is essential. Actuarial valuations will be needed and may be more frequent than under previous GAAP. Specialists may need to be used to prepare the necessary disclosures; this can be costly. Employees may be concerned about the security of their pension arrangements, causing problems in terms of labour relations and negotiations on pension rights.

Table 6.3 (*Continued*)

Accounting policy/ area affected	*Why the wider impact is identified, i.e., related IFRS requirement*	*Business and commercial implication*
	Extensive disclosure is required in the notes to the financial statements not only on the reported figures but also matters such as key actuarial assumptions.	
Employment contracts	IAS 19 *Employee Benefits* covers short-term employment benefits such as salaries, bonuses, compensated absences including holiday pay and sick pay and termination / redundancy payments in its scope, and in general applies an accruals principle to them. Some of the requirements are surprisingly complex / time-consuming to apply in some situations.[6] Long-term incentive plans such as policies on sabbatical leave may also fall under the scope of the standard.	Contracts need to be assessed for items that need to be recognised / accrued under IFRS, including short- and long-term benefits such as employees' rights to sabbatical leave, whether unutilised holiday pay is carried forward and the details of any performance-related pay. Any contracts that include performance targets will need to be reviewed, as the targets may be measured differently under IFRS. Changes to employees' remuneration form a sensitive issue and will require careful handling involving the HR department. Legal advice may need to be taken on whether it is possible / advisable for employment contracts to be amended. Careful communication with employees is needed to ensure they understand the reasons for any changes, and HR involvement is necessary. This may cause employee resentment / suspicion if the changes are not understood.
Preference shares	IAS 32 *Financial Instruments: Presentation* requires that in most cases preference shares are recognised as a liability, with preference dividends classified as a finance cost. Only irredeemable preference shares without an obligation to make cash payments are classified within equity.	The terms preference shares need to be reviewed to determine if they contain any contractual obligation to transfer cash to the holder. On reclassification of preference shares from equity to debt, a greater amount of debt is recognised on the balance sheet, affecting liquidity and solvency analysis, and higher finance costs reduce interest cover. This may affect the ability to raise capital and the terms of debt covenants. There may be an incentive to issue fewer preference shares to avoid these impacts.[7]
Assets and liabilities held at fair value	Various IFRSs require or permit the use of fair value, mainly in connection to non-current assets. Management can decide to measure a number of assets at fair value, including properties (investment and non-investment) and certain intangible assets. Fair value changes are recognised either in profit or in equity, as dictated by the relevant IFRS. IFRS 13 *Fair Value Measurement* requires a hierarchy of inputs to be used to determine fair value and disclosures of the methods used are required.	If fair values are used, there are cost implications, as often external specialists will be used to determine the amounts recognised. Models will need to be developed for determining fair value, with inputs as reliable as possible. Valuation experts may be unused to valuing assets according to the IFRS framework, so the scope of their work needs to address specifically the measurement basis that is to be used. Fair values can introduce volatility to both the reported financial performance and financial position, and the causes of volatility may need careful explanation to the users of the financial statements.

[6] *Accounting for holiday pay can be very onerous to deal with under IFRS and some organisations have changed their policy in relation to this in order to ease the accounting difficulties.*
[7] *There is evidence that some companies have bought back preference shares to avoid reclassifying from equity to debt under IFRS. This was noted in the transition, for example, of some Dutch companies to IFRS (ICAEW, 2007).*

Table 6.3 (*Continued*)

Accounting policy/ area affected	*Why the wider impact is identified, i.e., related IFRS requirement*	*Business and commercial implication*
		Fair values can make profit less predictable, so elements of remuneration packages based on results may need to be restructured so as not to penalise directors and employees for profit fluctuations outside of their control.
Assets held for sale and discontinued operations	IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations* requires disclosure in relation to assets (and associated liabilities) that are held for sale; generally, this means that the sale is highly probable within 12 months. Disclosure of the results of discontinued operations is also required. This means that significant asset disposals and discontinued operations may be recognised earlier than under previous GAAP. Descriptions of facts and circumstances of the sale and the expected timing must be given.	Management needs to consider carefully the timing of approval of plans to discontinue / sell off business segments, as this may trigger disclosure in the reporting period prior to the sale taking place. Disclosure of discontinued operations and significant asset disposals can highlight operational problems. Management may consider disclosure of the facts surrounding the sale as commercially sensitive. The disclosure of the existence of significant discontinued operations and / or assets held for sale could affect the ability to raise finance and generally deter investors depending on the reasons for the strategic reasoning behind the sale. There could be implications for the share price if the financial statements reveal significant business components held for sale.
Segmental reporting	IFRS 8 *Operating Segments* requires that listed entities disclose performance and other information about the entity's operating segments as it is reported to the chief operating decision maker, usually interpreted as the board or similar.	How the board receives financial information should be reviewed, e.g., whether results are reported on a geographical basis or by business segment, and the level of disaggregation considered. Changes may be considered to the management information systems to ensure that information reviewed by the board is sufficiently robust to stand up to public scrutiny. Disclosure of segmental results could reveal commercially sensitive information and information not previously revealed about an entity's performance. For example, the disclosure may allow analysts to calculate margins and efficiency ratios per business segment. The disclosure also allows users of the accounts to see how senior management reviews the performance of the entity. Less than comprehensive disclosure could signal weak governance.
Related parties	IAS 24 *Related Party Disclosures* requires disclosure of information on material related party transactions. The definition of related party could be much wider than previous GAAP, and includes key management personnel and their close relations and other entities under their control. Related party transactions can include lease agreements, rental arrangements, the provision of	A list of all related parties meeting the IFRS definition will need to be compiled. As this extends beyond the reporting entity, for example including other companies controlled by board members, care must be taken to ensure completeness, especially as there may be a reluctance to disclose some relationships and transactions with the reporting entity. Enhanced related party disclosures could come under scrutiny and be cause for comment depending on the nature of the transactions.[8]

[8] *In jurisdictions with limited or no previous requirements to disclose, for example, the remuneration of directors, this disclosure will be read eagerly by shareholders and others keen to see that the level of pay and other benefits is fair.*

Table 6.3 (*Continued*)

Accounting policy/ area affected	*Why the wider impact is identified, i.e., related IFRS requirement*	*Business and commercial implication*
	guarantees or collateral, as well as purchases or sales of goods and services. Specific disclosure is required on management compensation including remuneration and other short-term benefits, longer-term benefits and termination payments.	Any transactions deemed to be on non-commercial terms detrimental to the reporting entity are likely to be criticised and in extreme situations affect investment decisions.
Cash flow information	There is no exemption under IAS 7 *Statement of Cash Flows* from the requirement to present a statement of cash flows. A statement of cash flows will need to be presented in every set of IFRS-compliant financial statements.	Providing a statement of cash flows allows better analysis of liquidity, which may enhance the ability to raise finance. Conversely, a cash flow statement that reveals poor or deteriorating operating cash flows can seriously hinder the ability to raise finance.
Total of IFRS transition adjustments	IFRS 1 *First-time Adoption of IFRS* requires the adjustment to retained earnings on transition to IFRS is made through retained earnings, which impacts the distributable profits and hence potentially dividend payments.	Legal and/or regulatory requirements on distributable profits need to be assessed carefully in the context of the impact of transition in total on the level of the entity's distributable reserves. Large reductions in retained earnings may hamper the ability to pay a dividend. Any restriction on the ability to pay dividends and impact on distribution policy may affect investors' perception of the entity. The current dividend policy may not be sustainable under IFRS. This will need careful communication to investors. Changes in dividend policy could have implications for the share price and hence measures such as P/E ratio.

why the impact arises, and any relevant commercial consideration. This is meant to be indicative only of some wider impacts, as clearly each entity going through transition will have its own specific impacts to deal with, but it gives an indication of the wide scope of business and commercial issues that can arise on the adoption of IFRS.

Ideally, the assessment for wider impacts should be performed concurrently with the accounting impact assessment. This should ensure that a full consideration is given to each accounting issue, for example the requirement of an IFRS and the development of a new accounting policy, and how that new financial reporting issue translates to a commercial or business implication. The accounting impacts should be mapped to the wider impacts, which are then prioritised and where relevant the wider impact is communicated to the appropriate business unit for their response to be formulated.

Table 6.3 highlights some of the commercial and other wider implications of applying new accounting policies and extending the amount of disclosure in the financial statements. In addition, a case study is included below to illustrate two issues – research and development and revenue recognition.

Case Study 6.3: Wider Business Implications of IFRS Transition for a Systems Manufacturer Operating in the Aerospace Industry

A large company works in the aerospace industry, supplying systems and components to a number of customers, each of which is a significant source of revenue for the company. Typically, a customer approaches the company to design, develop and install major aircraft systems such as electrical, safety and mechanical systems. Each contract to supply is designed to include milestones, and for each project a Gant Chart is developed, which influences the timing of invoices being raised. Project managers are assessed on how and when milestones are reached, and a system may take several years from the initial customer concept and enquiry to successful installation and project completion.

This scenario gives rise to many accounting implications, but the company considers the two most important in terms of the non-accounting impacts relate to research and development and revenue recognition. Looking first at revenue recognition, the existence of milestones in the contract to supply can trigger the recognition of revenue. On adopting IAS 18 *Revenue*, the company decides to amend the milestones to minimise changing the pattern of revenue recognition in the financial statements. The customer is informed and is not really affected by the changes, though there is a small change in the timing of invoices being raised. This, however, has significant business implications for the project managers and engineers working on the systems being developed. The project managers are frustrated at the changes to the contract they are working on, as changing the milestones makes it difficult to assess the project, and while the changes in revenue recognition are minimal, there are changes to the cash flows of the project, which, in turn, alter Net Present Value calculations performed on the project. There is confusion as to why the changes have been made, and the company has to spend time in explaining the issues to the engineers and project managers. There is an impact on staff morale.

The second issue relates to research and development. Under previous GAAP there is no requirement to capitalise development costs, so the company does not have systems and processes in place to separate research costs from development costs. On transition to IFRS, IAS 38 *Intangible Assets* requires development costs to be assessed in order to determine if they need to be capitalised as an intangible asset. The obvious implication is that the company has to spend time to develop a system of categorising research and development spending, including a very clear policy on how to differentiate between the two, and also needs to develop methods of assessing whether development costs meet the IAS 38 criteria for capitalisation. In many instances there is a grey area between what is research and what is development, and management not being used to exercising judgement in this area, finds this problematical.

A complicating factor exists in that the project managers want the engineers working on their projects to capitalise as much cost as possible, as this can then be charged to the customer. There is, therefore, pressure and incentive for research costs to be treated as development costs, especially at the point in time when the contract activity is on the cusp of turning from feasibility studies and research to more applied development activity. Engineers do not want to be perceived as "wasting" time doing non-development work, which was not really an issue when all the costs were treated in the same way.

For this company, none of these issues were really considered in detail until late in the transition project. The company, with the benefit of hindsight, would have planned for the non-accounting issues earlier and in a more robust manner, taking time to discuss the implications of changing systems with project managers and engineers, and potentially avoiding some of the conflicts and morale problems that occurred.

CONCLUSION

This chapter has addressed the wider implications of IFRS transition. Away from the requirements of IFRS and the impact on financial information, considerable impacts are likely on systems and controls, contracts, agreements, remuneration policies, treasury management, and procurement, each with potentially significant knock-on effects for the reporting entity's strategies and business processes. These wider impacts are easy to underestimate, and in some cases difficult to identify without a very good knowledge of IFRS. The nature and scale of wider impacts varies considerably, and the IFRS transition plan must ensure that accounting impact assessments are used to consider the potential wider impacts on a line-by-line basis, to avoid any unwelcome surprises later in the conversion to IFRS.

7 TRAINING, COMMUNICATION AND CHANGE MANAGEMENT

The move to IFRS-based financial reporting needs careful consideration in terms of knowledge management and internal and external communication. For those closely involved with the transition, they will need to acquire an in-depth understanding of the new accounting and disclosure requirements. For others within the organisation, education will be needed on the broader principles of IFRS, its business impacts and commercial implications. Members of non-accounting functions may require in-depth knowledge of a particular aspect of an IFRS requirement in order to assess its implications on a specific area of the business. Education and training should be a priority consideration in the overall transition project.

As well as communicating the IFRS message internally, there needs to be a well-thought-out communication strategy for external parties. Shareholders, investors, lenders and other users need to receive clear and timely information on the progress of the transition to IFRS, and its accounting and wider impacts. If this information is not well communicated, there might be a loss of confidence in the reporting entity's financial information, which, when mixed with the potential for a lack of understanding of the reported results, could lead to adverse reactions from individuals, the market, and organisations such as credit rating agencies.

This chapter explores the issues that need to be addressed in respect of educating and communicating IFRS-related matters, and suggests effective ways that these issues can be built into the transition project. Methods of communicating matters relevant to the transition will be explored, and some examples are included to illustrate these issues.

7.1 EDUCATION AND INTERNAL COMMUNICATION

7.1.1 Education and Training on IFRS

Finance personnel must develop a deep understanding of business transactions and the rationale behind them, in order to make decisions as to the appropriate accounting treatment.

For a successful implementation of IFRS, members of the project team and other selected personnel must be IFRS-literate. The extent of education needed will depend heavily on the existing knowledge of IFRS within the organisation. But it is not just the accountants that need to be knowledgeable on IFRS – a broader education plan should be devised to meet the needs of anyone touched by the transition project. As part of the IFRS transition project, a training needs analysis should be performed. This will establish not only the people that need to be educated, but will also prioritise the education plan.

IFRS training can be expensive. In many countries there is a scarcity of educators with detailed knowledge of IFRS, which pushes up the cost of training. The IFRS project as a whole can incur significant costs, as discussed in Chapter 4, and within the total costs, the costs of training

can be a substantial component. In a study of Greek companies that moved to IFRS, over one third of finance directors stated that personnel training costs were the most onerous of the costs incurred in their transition projects (Ionaşcu *et al.*, 2007). Therefore, early identification of training needs is essential, to secure training providers and at a reasonable cost.

The accountants closely involved with the transition will clearly need an in-depth knowledge of IFRS. Many professional accountancy bodies have included IFRS within their examination syllabi for many years and it is therefore likely that, for organisations yet to go through transition, there will be some knowledge of IFRS amongst the more recently professionally qualified members of the accounting department, or they may have studied IFRS at university. The amount of detailed technical training that is needed also depends on the extent of difference between previous GAAP and IFRS. Where previous GAAP is very different from IFRS, either in principle or in terms of specific requirements, detailed training will be needed. Even in jurisdictions where previous GAAP and IFRS are relatively similar, training will still be needed to highlight the differences that do exist.

The level of IFRS literacy varies tremendously between organisations. In organisations that recruit a lot of qualified finance professionals and support continuing professional development with a well-developed training programme, personnel are likely to be at least aware of key IFRS requirements even if they have little actual experience with IFRS reporting. At the other end of the spectrum there are smaller organisations with few recently qualified personnel, and public sector entities which may have used a completely different system of accounting prior to IFRS. Although their accounts personnel may be experienced, they often have no experience of following the type of accounting processes, drafting disclosures or exercising the type of judgement required by IFRS.

There is also the potential problem that a little knowledge is a dangerous thing. In some transitions, especially where it has been difficult to up-skill existing staff or to obtain external assistance, there have been situations where individuals with just a little IFRS knowledge become seen as experts, leading to inappropriate decisions being made in respect of accounting policies, systems and processes.

The author's own experience in providing IFRS training indicates that in many cases education is needed not just on IFRS, but on wider accounting topics. Given that most relatively senior accounting personnel will have qualified some time ago, they often need refreshing on some aspects of local GAAP as well as learning about the new IFRS requirements that will be applied. It is difficult to conduct an accounting impact analysis unless there is a detailed knowledge of both previous GAAP and IFRS. A key issue is that, wherever possible, IFRS training is made specific to the organisation. Generic training on IFRS requirements is, of course, useful, and an essential starting point, but the benefits of technical training are immeasurably magnified when the training is put into the context of the actual transition that is taking place, and applied to the specific situation of the organisation.

For the accountants it is very important that IFRS education is ongoing. As discussed in previous chapters, IFRS exists in an evolving landscape, with the annual improvement cycle as well as a series of projects working on the revision of existing IFRS requirements meaning that new rules and guidance are being developed continually. Accountants involved in the transition need to keep abreast of future developments, as they can be important factors in determining the selection of accounting policies.

Away from the accounting function, training is also required. Some considerations in assessing the extent and type of training away from detailed technical accounting education are given below.

IFRS project team – All members of the project team should acquire a working knowledge of the principles of IFRS, though the exact detail of their training needs will depend on the extent and nature of their involvement with the project. There may also be a need for training on project management and effective membership of a project.

Internal audit and the audit committee – Those working in overseeing the transition need detailed knowledge. For members of the audit committee, who will, for example, be involved in approving the selection of IFRS accounting policies, in-depth understanding of how IFRS requirements should be applied is essential. And internal auditors who are monitoring the effectiveness of controls over financial reporting must understand the basis of financial reporting in order to determine and evaluate appropriate control mechanisms.

Senior management – Board members or the equivalent level of senior management will need to know basic principles of IFRS and will probably be interested in industry-specific issues. Training should focus on the significant differences between previous GAAP and IFRS and the implications of adjustments on the headline figures that are used to monitor performance, both internally and externally.

Specific business functions – Personnel working in business functions affected by IFRS will need some training on basic principles but also specific and in some cases very detailed training on the aspects of IFRS most relevant to their work. For example, the treasury management team should understand the issues involved in accounting for financial instruments; the legal team should be aware of the accounting requirements in relation to provisions and contingencies; and human resources should be aware of the impacts of standards dealing with pensions and employee compensation.

The human resources function should be involved with the training element of the transition, ensuring that IFRS training is part of the organisation's learning and development strategy, and that training is factored into individuals' performance and development reviews.

7.1.2 Methods of Education and Training

Since the first wave of IFRS adoption in the EU, when there were limited IFRS education resources available, a plethora of different types of IFRS education and training resources have become widely accessible. Organisations need to review the different ways in which they can provide training and education to their staff, and devise an appropriate education strategy. These days a mixed strategy can be used, with different types of training used at different stages in the transition project and for different user groups. A recent survey of Indian accountants faced with learning about IFRS suggested that the majority favoured interactive workshops and e-learning, with a smaller proportion of those surveyed preferring a traditional classroom-based learning environment (Srivastava and Bhutani, 2012).

Table 7.1 provides a summary of different training methods that can be used for IFRS learning programmes and an outline of the advantages and disadvantages of each.

In large organisations a mix of these training methods could be used. For example, the accountants may attend a bespoke training course, while others involved with the transition

Table 7.1 Training methods and their advantages and disadvantages

Training method	*Advantages*	*Disadvantages*
In-house bespoke training **A training provider is engaged to create a learning solution, which is delivered at the organisation's premises or made available online to its employees.** **The training could be provided by specialist IFRS educators, the organisation's auditors, or external consultants.** **The training is usually live, though sessions can be recorded and made available to employees. Increasingly, webinar formats are used to increase accessibility.**	Training can be extremely entity-specific and therefore beneficial to the entity, focusing on the key issues it faces. Often delivered by trainers with a lot of experience and who can bring insights obtained from working with other organisations. If the same trainer or team of trainers works with the entity throughout its transition, it becomes an efficient method of training, bordering on consultation. Training can be as long or as short as deemed necessary.	Probably the most expensive training solution, although if many staff train at the same time, the cost per head can be reasonable, and possibly lower than generic training.
Generic classroom-style course **An organisation arranges for its employees to attend training offered by an external provider. The training is generic and will be attended by delegates from different organisations.**	This is usually cheaper than arranging for bespoke training. Having a few staff at a time attend an external course can be less disruptive than everyone attending a bespoke course at the same time.	The training will not be entity-specific, though it may focus on a particular industry or on one accounting issue.
E-learning course **A generic training solution available online. This could be a generic course on IFRS, or could be created specifically for an organisation.**	Its great benefit is accessibility. An e-learning course can be delivered globally to a large number of people. This method of training reduces travel costs. Training can be fitted around work commitments and is extremely flexible. Tests of understanding can be built into the learning programme.	The lack of interaction is a problem. There is limited opportunity for dialogue or asking questions.
Specific IFRS qualification **Some professional bodies offer qualifications in IFRS. Typically, learning material is available online, which students work through prior to an examination, which can be in a traditional written format, or can be e-assessment.**	The qualifications offer an incentive to students as they demonstrate knowledge of IFRS. Some qualifications can be taken without prior accountancy training. For the employer, offering a qualification may fit with a commitment to develop staff and promote a culture in which learning is valued.	The broad syllabus will mean students are learning issues not always relevant to the entity. There can be a cost in terms of study leave as well as registering for the exams. For the employer, there may not be much tangible benefit in the employee gaining a qualification.

but with less need to know the detailed IFRS requirements could attend a generic introductory course on IFRS.

In different countries there may be demand for different types of learning, often dependent on the level of IT accessibility and familiarity. Blended learning solutions involving, for example, webinars and virtual classroom scenarios are difficult in areas where access to the Internet is limited.

Case Study 7.1: IFRS Training Programme Implemented in a Large Utility Company

In 2005, a large UK-based utility company moved to IFRS reporting. None of its senior accounting personnel had experience with IFRS and a training needs analysis revealed that a significant education programme needed to be established, not just for the accountants, but for all of those impacted by the transition. The company engaged a professional education firm specialising in providing accountancy training to develop a bespoke training solution. Initially, a series of one-day training sessions was delivered to the accounts department, beginning with introductory topics, then with each training day focusing on a particular accounting area. The training included exercises where the application of IFRS was discussed in detail as well as being applied in numerical calculations; this was considered important given the level of judgement that needs to be used in IFRS financial reporting. One training day each month was delivered over an 18-month period.

As well as the accountants, other groups attended training sessions that focused on the areas most relevant to them, for example the treasury team received two days' training on IAS 39 so that they understood the accounting implications of financial instruments.

The company encouraged employees to further their development by obtaining the ACCA Diploma in International Financial Reporting. It was agreed that employees would be given three days of study leave to prepare for the examination and that the company would pay the costs of obtaining the qualification. This was seen as a motivational policy, and the company benefitted from an accounting team that developed a deeper understanding of IFRS.

As mentioned in Table 7.1, some professional bodies have created qualifications in IFRS, enabling individuals on successful completion of the training programme and assessment to acquire up-to-date knowledge of IFRS. For example, in India, the Institute of Chartered Accountants of India (ICAI) has developed a Certification Course, which covers not only the fundamental IFRS requirements, but also specific issues in the transition from Indian GAAP to IFRS. In the US, AICPA has developed a similar qualification, and the ICAEW, ACCA and ICAS all have online education programmes.

7.1.3 Internal Communication and Change Management

An organisation moving to IFRS must consider how to communicate key messages about the impact of the transition internally. As discussed in Chapter 6, the transition has a wider scope than just the accounting department, and as with any major project causing changes to working practices, the reason for the changes should be communicated. In brief, a change management strategy should be in place to ensure that changes are understood and accepted. This, in turn, should improve the effectiveness of the transition project.

Change management strategy should be an important element in the transition project. It is a fact of life that most people inherently resist change, and this can be seen as a common theme in organisations going through transition. Interviews with those that have worked on a transition project revealed that "resistance to change" was often seen as a big problem in the transition, and was certainly the most often quoted non-technical problem, but that often little effort was put into managing this attitude. This may be due to the fact that transition projects are often run by accountants who, while being technically competent, have little experience in change management and communication strategies. In fact, an IFRS transition is a good example of a project that needs a strong emphasis on these issues, as the move to IFRS is often enforced and therefore has not been developed as a commercial strategy to benefit the organisation specifically. This means that the transition and the changes that it causes are unwanted, leading to feelings of hostility, and the transition project needs to be "sold" carefully to create acceptance of the situation.

Therefore, for the transition project team, an important planning consideration is how to overcome any resistance and barriers to change. Change management theories emphasise that changes need to be accepted by the people impacted and that the best way to do this is to build strategies into the project that address people's concerns and resistance. Effective communication is instrumental in this.

Case Study 7.2: Difficulties in Getting the IFRS Message Across – A Public Sector Example

For many public sector reporting entities, the move to IFRS is much more of a shift in the financial reporting framework than for private sector firms. An interviewee who was involved heavily with the transition of public sector entities to IFRS spoke of a lack of acceptance of the transition at senior executive level, an attitude which permeated down through the whole organisation, meaning that the transition project was viewed negatively by almost everyone involved. There were no IFRS "champions" who would sell the benefits, or even explain the reasons for the changes to the staff involved. The accounting personnel simply saw the transition as a huge and unnecessary change that could only bring about extra work, tighter deadlines, the need for re-education and would possibly threaten people's jobs if they could not demonstrate that they understood the new IFRS requirements. It was very difficult to embed IFRS reporting in an organisation where there was an almost exclusive reluctance to accept the changes, and even after several years of reporting under IFRS this attitude remains.

There are many theories on how best to communicate important changes within an organisation, with most of them suggesting that two essential elements are part of effective communication, leading to more acceptance of the changes occurring.

First, communication should explain the rationale behind the changes. Therefore, in an IFRS transition, it is important to explain the reasons for the organisation moving to IFRS. If the move is the result of a mandatory ruling, a brief outline of the relevant regulation should be provided as part of the communication. If the move is voluntary, it is even more important to explain the reasoning behind the change, as people will want to understand the strategic thinking behind the decision.

Second, whatever the reason for the transition, communications should emphasise the benefits of the move to IFRS, making this discussion as entity-specific as possible. People will be happier to accept the changes caused by the transition if they feel there is going to be a positive outcome for the organisation, and ultimately for themselves as employees. Staff need to know how the transition affects them, and will be much more engaged with the process if they understand what the accounting and wider impacts mean for them personally; for example, any changes in job specifications, responsibilities, reporting lines and performance measures.

Key messages should include the following:

- An overview of the reason for the change.
- Explanation of key benefits of the transition, specific to the organisation.
- Discussion of how the transition fits with the organisation's mission or strategy.
- Outline of timeline and key milestones.
- Impacts of the transition, made as specific as possible for the intended audience.
- Emphasis that this is not "just an accounting issue".
- Explanation of the resources available to implement key changes.
- Details of training plans that are being organised.
- Clarification that the transition has the support of senior management.
- A facility for making comments/asking questions about the transition.
- Weblinks or other mechanisms of obtaining more information.
- If few significant impacts are expected, then a statement that this is the case should be made, as this is reassuring for those people who are concerned needlessly about the implications of the transition.

It is important to communicate these messages widely within the organisation, which should help in avoiding the situation where transition is seen purely as an issue for the accounting function. Having the messages "championed" by a board member or other senior member of management can also be effective in ensuring that individuals take notice of the communication, even if they are not impacted greatly by the transition themselves.

The key messages can be summarised along with an outline of how they affect the identified audience or what actions should be taken. More, or less, detail can be given depending on the size and complexity of the transition and the range and magnitude of wider impacts that the transition will create. An example of the main content typical in explaining the main issues involved in IFRS transition to a general audience of an organisation's employees is shown in Table 7.2, for a company moving to IFRS in 2015 following a mandatory requirement.

An important communication consideration is identifying who should receive the key messages about the transition. Change management theory stresses that identifying the audiences affected by the change is critical. Everyone affected should be communicated with, and there is the potential problem of people being left out of the loop, leading to a lack of engagement with the project. A list of those within the organisation who need to understand the impact of the transition project may include:

- All board members (or equivalent) including non-executives, and senior managers.
- All accounting personnel.
- All members of the internal audit function.

Table 7.2 Key communication messages

Headline content	*Detailed content*
What is the IFRS transition project?	Explanation of project objectives. Summary of who is involved with the project.
Why is the organisation performing this project?	Outline of regulatory requirements, i.e., mandatory move to IFRS reporting beginning in 2015.
How is the project progressing?	Diagram showing key milestones and deadlines.
How will it impact on the business?	Summary of wider impacts – a very high-level overview is all that is needed for a general audience and this may just be a statement that no significant impacts are expected.
How will it impact on employees?	Any significant impacts should be mentioned and if they are likely to cause concern, detail should be provided of when more information will be available and how the individuals can raise their concerns. Positive impacts should be highlighted to provide a balanced view.
What do employees need to do now?	Attend a briefing meeting. Read posts about the transition made on the company's intranet. Respond to information requests/specific actions as requested by the transition team.

- Senior members of departments affected by the transition, e.g., human resources, legal, treasury, customer and supplier relations.
- Selected heads of business functions, the number depending on the organisational structure and geographical spread of the business.

The best method of internal communication will vary depending on size and organisational structure. Smaller entities can hold meetings for attendance by all who need to hear the key messages. Larger organisations can benefit from using newsletters, internal webinars or conference calls, and have packs of information available on intranet sites.

Case Study 7.3: Internal Communication Methods in a Global Logistics and Postal Services Company

This company set up a specific site on the staff intranet dealing with IFRS implementation. The intranet contained some IFRS learning resources, a plan including major milestones for the transition, and a blog was maintained to highlight key transition issues. This was considered an important part of engaging employees with the transition, even if they had little to do with the project itself. The intranet site kept staff informed of the progress made in the transition, and was also a relatively inexpensive way for the company to communicate with the business functions all over the world.

7.2 EXTERNAL COMMUNICATION AND PRESENTATION OF IFRS TRANSITION INFORMATION

The communication of IFRS matters to interested external parties is one of the most crucial matters that must be planned for. Yet, it is something that is often overlooked and left until late in the transition project to deal with. Although the exact content of the facts and issues to be

communicated won't be known until later in the transition project, a strategy for communication should be developed as early as possible.

This section will explore various communication-related matters. First, the reason why communication is such an important issue will be discussed. Then the discussion will move onto the type of information that should be provided. Finally, the methods of other types of communication will be considered, including a discussion of the relative benefits of presentations to external parties, the provision of packs of information, and holding interactive sessions such as webinars. A typical communication strategy will be explored, outlining potential timings as well as means of communicating key messages to users of financial statements. The presentation of the first IFRS financial statements and other information required by regulation is covered in the next section.

7.2.1 Why Communication Matters

The financial statements, and information published alongside, are the key mechanism by which organisations communicate performance. A wide range of users are interested in financial information, including, but not limited to, shareholders, lenders, employees, customers, suppliers and agencies and regulatory authorities. These users need to be able to understand the information presented to them in order to appraise the financial performance and position of the reporting entity, and in some cases perform their own analysis and reach specific conclusions.

For the various users of financial statements there are many positives and negatives arising from the transition to IFRS in terms of their examination of the first IFRS financial statements, which are summarised below:

Likely Negative Impacts:

- The financial statements will look different and may contain new elements; for example, where a statement of changes in equity was not required under previous GAAP.
- New terminology will be used, making information harder to digest.
- New assets and liabilities may be recognised, distorting inputs to ratio analysis.
- Reclassifications of items will make trends analysis difficult.
- One-off adjustments on transition can have highly material impacts, which may need to be eliminated when comparing results over time.
- Volatility caused by new accounting treatments, for example, fair value accounting, creates difficulties for analysis of performance.
- It may be harder to understand the underlying performance of the business.
- The volume of disclosure will probably increase, and can be off-putting for reviewers of accounts.
- Some new disclosures are less likely to be relevant to some user groups.
- More use of judgement and subjective accounting treatments could mean figures are not perceived to be as accurate as previously.
- Comparisons between organisations may be hampered by different ways IFRS requirements are applied.
- Varying use of the first-time adoption exemptions makes calculations and comparisons difficult.

Potential Positive Impacts:

- Disclosure of new figures means more detailed analysis can be performed; for example, on segmental information, ageing of receivables, asset impairments.
- The nature of disclosure for some items is narrative, which can be easier for some users to understand.
- Enhanced disclosure in accounting policies provides insight into how figures have been determined.
- Disclosure on risk is useful in understanding business strategies.
- Where sectors have common accounting policies, comparisons between companies may be enhanced.

The extent to which these negatives and positives balance against each other will be determined, to a large extent, by the level of IFRS literacy of those parties analysing the financial statements. If the users of the financial statements know little about IFRS, the negatives will be exacerbated, and the users' lack of knowledge means they are unlikely to benefit from the positive impacts. However, effective communication can play a significant role in helping the users of the financial statements to understand the key elements in an IFRS transition, even if the users have little IFRS knowledge. A good communication strategy is needed to explain matters clearly, including both the financial and wider implications of the transition, highlight the positives of the move to IFRS reporting, and respond to the potential concerns of the users of the financial statements in a proactive way.

A particular issue is that many user groups will perform financial analysis in the form of reviewing financial ratios and key performance indicators (KPIs). A summary of some of the impacts that the move to IFRS may have on these ratios and headline figures is given in Table 7.3.

Users of financial statements will often make adjustments to the reported figures before using them to calculate ratios. For example, unusual or exceptional items or fair value adjustments may be eliminated from the ratio analysis to make the figures more comparable. But in order to make such adjustments the users need to have a good level of familiarity with the IFRS financial statements, firstly to appreciate the adjustments are necessary, and secondly to find the information needed to make the adjustments. There is a risk that poorly communicated information will be difficult to use and interpret, and given the volume of IFRS financial statements, information away from the main financial statements may be hard to find.

7.2.2 Understanding the Audience

In developing any communication strategy, it is important to identify the target audience in order to supply the correct information to suit their needs. Just as the transition to IFRS has a range of wider impacts within the reporting entity, creating a great deal of change that needs to be managed carefully, the external parties affected by the transition will need to consider their own responses to the changes that will occur and put their own change management plans in place where necessary. This will be particularly important where changes relate to business processes such as supply chain management, procurement, treasury, and customer account management.

Table 7.3 Impact of IFRS adoption on ratios and key performance indicators

Ratio/KPI	*Impact of transition to IFRS*
Return on capital employed (ROCE)	Upwards asset revaluations make ROCE appear worse due to higher revaluation surplus recognised (hence capital employed) and higher depreciation charge, which reduces profit.
Asset turnover	Upwards asset revaluations worsen the ratio of revenue to assets.
Gearing ratio	Recognition of additional liabilities, e.g., lease obligations, and reclassification of preference share from equity to debt worsens gearing.
Interest cover	Additional items recognised as finance charges, e.g., preference dividends will worsen interest cover.
Margins and headline figures such as EBITDA[1]	Expense reclassification, the recognition of new expenses or the absence of expenses no longer recognised, e.g., goodwill amortisation, and changes in the pattern of revenue recognition can improve or reduce margins and affect EBITDA. Margins and headline figures likely to be more volatile.
Current and quick ratios	Measures of liquidity are affected by inclusion of new items within current assets and current liabilities, e.g., derivative financial assets recognised as either current assets or current liabilities, and assets and liabilities classified as held for sale.
Earnings per Share and Price/Earnings ratio	Will be affected by volatility in reported profit.
Cash flow ratios	Changes in the structure of the cash flow statement and the allocation of cash flow to headings within it may alter ratios based on the cash flow statement information.

As discussed in the section above, many users will analyse the financial statements and use ratio analysis and similar techniques to understand financial performance and position. A KPMG report suggests that in planning communications relating to IFRS transition, user groups including shareholders, institutional investors, lenders, debt investors, analysts, credit rating agencies, unions, regulators and the financial media should all be considered (KPMG, 2009a).

Other users may utilise the financial statements for other types of analysis. For example, users wishing to perform business valuations will look for predictive value in the reporting figures, as they try to forecast future earnings or dividend payments, which can be used as inputs to valuation models. Net asset value is also a common basis for business valuation techniques. Clearly, the move to IFRS will impact on reported earnings and net asset values, and analysts need to be provided with sufficient well-explained information to separate accounting adjustments from changes in the underlying business in considering changes in the figures they use in their valuation models. In addition, any volatility introduced to the accounts, for example, through the introduction of fair value accounting, will make earnings harder to predict. Analysts are not always experts in financial reporting, so there is the potential for some confusion and lack of understanding. The communication of matters relating to the transition must be as clear and transparent as possible.

[1] *EBITDA is earnings before interest, tax, depreciation and amortisation. It is commonly used as a rough measure of operating cash flows especially when adjusted for working capital movements.*

The issue of whether IFRS adjustments will impact future cash flows is important. Many would argue that a lot of the adjustments in the previous GAAP to IFRS reconciliations are purely paper adjustments and have little "real" impact on an organisation's predicted cash flows, meaning that there should not be a strong market reaction on the transition to IFRS. However, some academic research suggests that the market does react to IFRS reconciliations that are disclosed and that the impact of the adjustments is incorporated and reflected in changes in share prices (Horton and Serafeim, 2010).

To the reporting entity itself there are risks created by poorly communicated information. If the IFRS results are poorly understood, creating an adverse reaction, the share price could suffer. There may be implications for credit ratings and the ability to raise finance or matters such as obtaining insurance. This will particularly be the case where users of the accounts find it difficult to distinguish the impacts on performance caused as a direct result of the transition from underlying trends in performance. Therefore, it is in the best interest of the organisation to ensure there is transparency in how transition issues are presented and communicated, and the timing of these communications.

A further potential risk lies in the fact that under IFRS there will be a greater amount of information disclosed on issues such as risk exposure. While these disclosures will be of interest to many user groups of the financial statements, they also present the management of the reporting entity with the issue of deeper scrutiny of how such risks are monitored and controlled. Users may challenge management on some of these issues, particularly in relation to how risks are managed, and as part of its communication strategy, management should consider its ability to respond to challenges and questions on the new information that is provided in the financial statements.

Academic studies have explored the issue of voluntary IFRS transition-related disclosures. One study, of UK listed reporting entities moving to IFRS in 2005, found that the voluntary provision of financial information prior to the year of transition would tend to have a favourable impact for the reporting entity in terms of investor relations (Iatridis, 2012). The same study concluded that the companies most likely to disclose voluntary IFRS transition information would be those with the most to gain from such disclosure – typically companies with strong financing needs where management felt it important to demonstrate through disclosure that they had identified and understood the impacts of IFRS adoption.

7.2.3 Explaining the Impacts of the Transition – Timing of Communications

Organisations need to decide when they are going to begin communicating transition issues, and the means of communication. Early communication is definitely recommended, as it gives users of the accounts time to get used to IFRS-style information and to develop their own knowledge of IFRS before the publication of the first IFRS financial statements that they will be analysing. In some jurisdictions advice has been given to preparers of financial statements on the timing as well as content of IFRS communications. For example, in the EU, the Committee of European Securities Regulators (CESR)[2] encouraged companies to provide detailed numerical information in the last financial statements prepared under previous GAAP. The UK-based Hundred Group of Finance Directors recommended a different approach, suggesting that the

[2] *In 2011, the CESR was replaced by the European Securities and Markets Authority.*

first detailed financial information should be provided after the last of UK GAAP accounts were published, but before the first IFRS-compliant interim reports were issued.

There is no right or wrong timing or frequency of communications. Many would argue that early communication is better. However, it would not be advisable to publish IFRS information until there is assurance as to its validity. It would be disastrous to release IFRS figures that were subsequently found to be in error, as this would raise questions about the competence of the preparers of the financial statements and the integrity of the transition project as a whole. A restatement of previously published information sends a very poor signal to markets and the users of the financial statements. However, most commentators recommend early communication, and believe delays in information can cause a negative market reaction (Dilks, 2005). Academic research also backs up the idea that early communication is desirable, especially if significant changes will be seen in earnings as a result of the transition. An Australian study of 150 firms that moved to IFRS in 2005 proposed that early disclosure of IFRS effects for firms experiencing greater adverse financial impact from IFRS is beneficial for the users of financial statements, and that early release of information will give the users and market participants more time to absorb the information and avoid misunderstandings (Wee, Tarca, and Chang, 2012). It is advisable to release information on the main areas of change as early as possible, especially where significant change is anticipated either in reported performance or in actual business processes and commercial decision making, to help the audience to prepare their own response.

Figure 7.1 below shows a typical timescale for reporting IFRS information, assuming a first IFRS reporting date of 31 December 2015. Depending on the readiness of certain information, it can be provided earlier, in the year ending 31 December 2014, to provide users with as much time as possible to acquaint themselves with the transition impacts affecting the reporting entity's results, and the wider impacts.

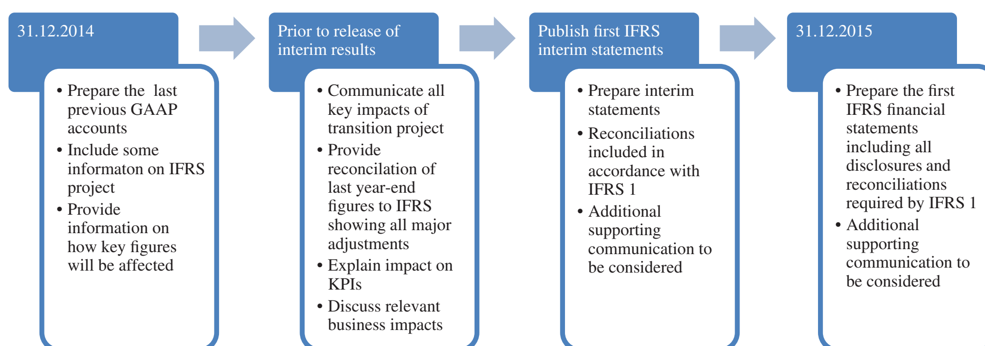

Figure 7.1 A proposed timescale for communicating externally

In developing a timescale for making disclosures on the transition, a reporting entity may wish to consider the actions of industry peers. The Hundred Group of Finance Directors in the UK suggested that organisations in the same industry and sector should coordinate the timing of communications to enable users to better understand the information presented, and to avoid unhelpful competition between companies. A cohesive approach to the transition taken by companies operating in the same sector can give shareholders and other users of the financial

statements some confidence that the sector is facing the transition in an organised way, for the mutual benefit of everyone involved.

Conversely, the disclosures about transition could be used to the reporting entity's advantage; for example, by releasing information ahead of competitors.

7.2.4 Developing a Communication Strategy – Content of Information

The main issue is to decide on the contents of communication at the various stages of the transition. Learning from the experience of organisations that have been through transition is useful. Many produced an IFRS presentation or briefing pack, which was supplementary to the financial statements, and contained a variety of types of information to help a wide range of interested parties to understand the scope and key elements of the transition project, as well as specific information on accounting impacts.

In providing this information it is important to determine the audience and to tailor information specific to its needs. Organisations may wish to produce separate information for different user groups; for example, a pack of information for institutional shareholders, another for lenders, and so on. The decision as to whether this is necessary will be driven by demand from the users, and the size of the different user groups. It may not be worthwhile producing specific information for a small group of users. In many cases, the different user groups may require very similar information anyway, so a more general set of information should suffice.

An IFRS transition information pack would be likely to contain some or all of the following:

Confirmation of timescale and deadlines – There should be clarification on the timing of the transition, including the date of the first IFRS reporting period end. This information can be shown on a simple timeline to make it easy to understand. The reporting entity could also specify the anticipated publication date of the first IFRS interim financial statements and the first full financial statements, and can include events such as Annual General Meetings on the timeline.

Explanation of the reason for transition – It is helpful for users to understand whether the move to IFRS is a regulatory requirement or a non-mandatory change. If it is non-mandatory, the reasons for choosing to move to IFRS should be given, with the benefits highlighted.

Background to IFRS – Depending on the target audience, they may benefit from a brief overview of the regulatory framework of IFRS, the global take-up of IFRS and underpinning principles.

Glossary of terms – Some communications, especially those in the early phase of transition, include a glossary, to help the audience to understand new IFRS terminology.

Key elements of the transition project – Information on the progress of the transition project at the time of the communication, including key milestones that have been reached and how the risks associated with transition have been identified and managed. Risk assessment and the implementation of appropriate responses are of interest to investors and lenders in particular. They want assurance that problems such as systems inadequacies and control failures are not likely to arise, as this will affect the quality of the financial information they will be analysing.

Accounting policy changes – This will be a key part of the communication and all policy changes that impact in a material way on the financial statements should be included. The discussion should include a summary of the difference between

previous GAAP and IFRS, and quantification of the impact on the reported figures. Communications usually structure this by accounting area, focusing first on the most significant impacts. Quantification is recommended. Often the most recently reported figures under previous GAAP are adjusted to show how they would appear under IFRS for the various accounting areas being discussed.

Quantification of the overall impact – Reconciliations of key figures from previous GAAP to IFRS should be given, focusing on the key performance indicators of interest to the audience. It is useful to restate some previously published figures under IFRS so that users can gauge the main impacts. There is often a statement to emphasise that the change in accounting treatments does not necessarily change the underlying performance of the organisation. Also, there should be a clear description of those adjustments that are one-offs, and those that will be ongoing features of the IFRS financial statements. It is also important to highlight which of the accounting adjustments have a real cash impact, and which do not.

Impact on non-GAAP measures – Where non-GAAP measures have been part of the financial statements under previous GAAP, users will expect the same measures to be present under IFRS. The impact on non-GAAP measures should therefore be included.

Wider impacts – The business and commercial impacts should be outlined. Depending on the audience, matters such as the impacts on dividend policy, taxation, financial strategy, acquisition strategy, covenants and other significant contracts and agreements should be included. These changes may affect the relationship between the reporting entity and the external party, who may have to respond to the wider impact that the transition is causing.

Assurance – The audience is likely to want to know what assurance mechanisms have been or will be applied to the transition, for example whether the external auditors or another provider has been used to obtain an assurance report on the restated figures that have been presented.

Cash flow impacts – Many users are more interested in cash flows than profit, and the communication should address this. It is likely that the move to IFRS will not significantly change cash flows unless there is a change in underlying business decisions as a result of the new accounting requirements, for example, changes to treasury management policy or to the granting of share options to employees.

The information presented should highlight key messages and avoid information overload. Possibly six to ten key messages should be included and succinctly explained.

It is also important that even where there are minimal impacts arising from the transition, this should be explained carefully. If an issue is not mentioned, the audience will not necessarily assume that this is because there is no impact. For example, if the transition is thought to have no potential impact on dividend policy, this should be highlighted as a key message. In other words, messages need to be considered for inclusion in the external communication with reference to their importance to the audience, thinking of their main concerns and interests. Key messages are not just about significant impacts but can also be about the impacts that are not thought likely to arise.

The consistency of information is also an issue. It is important that all accounting impacts have been identified and explained, to avoid any unwelcome surprises in information provided after initial communications regarding the transition.

A further matter that should be considered in preparing IFRS information is that boilerplate disclosures are of little use. The audience will want to see the specific application of IFRS to the reporting entity and will gain little understanding from communications that are too general and fail to take into account the specific impacts of transition on its reported results.

It is likely that organisations will liaise, to a great extent, with their external auditors in deciding on the content, presentation method and timing of IFRS transition communications. This is understandable given that management will have to exercise considerable judgement in deciding on key messages and supporting information to be disclosed prior to the year of transition. There is some evidence to suggest that external audit firms have a significant impact on the content and the quality of IFRS transition communications. An Australian academic study, looking at the IFRS transition information provided by more than 400 companies, found that the quality of disclosure was very much influenced by which audit firm was providing guidance, and that management seemed to have deferred to their external auditors for guidance (Gallery, Cooper, and Sweeting, 2008).

Management will need to balance its appetite for disclosure with the information needs of the audience. In some organisations, management may be reluctant to make disclosures that are deemed "unnecessary", taking a prudent approach, and providing only the minimum required disclosures to satisfy regulatory requirements. In other organisations, management could be more willing to provide information above that which fulfils regulatory needs, in which case more detailed and possibly earlier disclosures may be given. A principle to consider for management taking a more conservative view of disclosure is that comparisons will be made of organisations operating in the same industry. An organisation giving less information than its industry peers, or making disclosures comparatively late, may be viewed less favourably, especially given that users of the financial statements are likely to demand high quality information in a timely manner to make judgements about the impacts of the transition.

An organisation could use the IFRS transition as an opportunity to revamp the look and feel of its external communications, and to ensure that presentation and disclosure of financial information is comparable with those of its peers. The disclosures can infer a lot about the image of the reporting entity; for example, whether it is open and transparent in its communications with key stakeholders, and communications should be reviewed carefully to ensure that an appropriate message about the reporting entity is being portrayed in this time of transition.

7.2.5 The Use of Non-GAAP Measures

Many investors welcome the inclusion of non-GAAP[3] measures in the financial information provided by organisations. In particular, surveys have shown that non-GAAP measures on earnings and components of profit provide a greater insight into an organisation's financial performance and are often factored into investment decisions (PwC, 2007).

The period of transition to IFRS provides a good opportunity for reporting entities to review the non-GAAP measures that they communicate, if any, and to consider providing new measures,

[3] *Non-GAAP measures are also known as alternative performance measures or adjusted earnings measures. The term refers to a measure of performance disclosed in the financial statements but not required by IFRS. A common example is EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation).*

or improving on existing measures. This is especially true where non-GAAP measures were not utilised to a great extent. IFRS contains a relatively relaxed approach to the reporting of non-GAAP measures. While their use is not explicitly encouraged, neither is it discouraged by the IASB. In different jurisdictions there are different attitudes to the use of non-GAAP measures. They are common in many EU countries. A survey of UK companies in 2007 found that 45% of the companies surveyed included non-GAAP measures on the face of the income statement (Deloitte, 2007). However, in the US, the practice is less prevalent.

In other jurisdictions that have adopted IFRS, the use of non-GAAP measures has increased. Some commentators argue that this is a response to the increased size and complexity of IFRS financial statements compared to those produced under previous GAAP. For example, it is common to see financial summaries including selected KPIs and explanations of financial trends presented in documents issued with the financial statements. This may be partly in response to the needs of the users of the financial statements, who no longer feel they have the knowledge or the time to spend on finding relevant information in a set of IFRS financial statements, which may be very long and difficult to understand.

Non-GAAP measures can be useful during the period of transition to IFRS for reporting entities that under previous GAAP provided financial information using such measures as they provide, for users of the financial statements, and an element of consistency within the financial statements. The use of familiar non-GAAP measures means that the first IFRS financial statements have some similar content and presentation compared to those under previous GAAP, easing the burden of change for the users of the accounts.

In deciding whether to present non-GAAP measures, considerations should include the following:

- Are there any prohibitions on reporting additional items within the jurisdiction; for example, if accounts formats are prescribed by legislation or listing requirements?
- Do analysts use non-GAAP measures, and, if so, which are the most useful?
- Is the additional information best presented on the face of the financial statements or in the notes?
- Will the non-GAAP measures be consistent with other key performance indicators already disclosed, for example those in the Operating and Financial Review or equivalent?
- Do the non-GAAP measures genuinely enhance the qualitative characteristics of the financial statements?
- Do other reporting entities in the industry report these measures?
- Can consistency of calculation and presentation be assured?

7.2.6 The Method of Communication

Organisations have employed a variety of means to communicate information on the transition. Typically, one or a mixture of the following methods is used:

Presentations – This involves PowerPoint presentations, handouts and packs of information. Typically, the finance director or chief financial officer runs the presentation; other presenters could include the project manager, a member of the audit committee and one or more senior executives. The external audit firm may also be represented.

There will be a dialogue with the attendees and an opportunity for questions and answers, which is a major benefit of this method of presentation. The slides and hand-out information will usually be made available, for example, on the organisation's website.

Webinars/webcast – This is essentially the same as the presentation described above, but with the presentation happening online, rather than in front of a live audience. The webinar will be recorded and made available on the organisation's website. The advantage is that a wider audience can be reached, at the same time as maintaining the interactivity that occurs in a face-to-face presentation.

Vodcasts/podcast – These may be simpler to prepare than a webinar or webcast and can be more accessible. Again, they can be made available for viewing, listening and download from the organisation's website.

Written reports – These may be sent out in hard copy, or made available on the organisation's website. The disadvantage is the lack of interactivity, though a wider audience can be reached. Many organisations produce a separate report outside of the financial statements summarising the impacts of IFRS transition – this can be a good strategy as it means that the transition issues are not "lost" in a long annual report, and key issues can be highlighted.

Social media – Organisations can utilise social media spaces such as their Facebook page, use Twitter or other social media to keep users informed on transition issues. For large organisations that already have the necessary infrastructure in place, this can be a cost-effective way of keeping people up to date with progress on the transition. The downside is that social media are used more for marketing than other business functions, so the IFRS messages may not reach the target audience.

Industry journals – Reporting entities may wish to contribute to trade or industry journals; for example, by having a member of the IFRS project team prepare an article on transition planning. This can be useful from a public relations perspective, and highlights that the company is trying to keep its stakeholders informed of the impacts of the transition.

A point on which there appears to be little consensus is whether the users of the financial statements actually enter into much of a dialogue with the reporting entity about IFRS transition. However, evidence from interviews conducted in the UK and Ireland suggests that more interaction than before occurred between the users and preparers of financial statements, in particular during meetings held with institutional investors.

7.2.7 Transition Communication Required or Encouraged by Regulation

In some jurisdictions, regulatory requirements impose a more prescriptive regime on the communication of IFRS transition matters. In planning the transition communication strategy, care must be taken to ensure that any mandatory reporting requirements outside of IFRS itself are identified and responded to appropriately.

Depending on the location in which they are listed, publicly owned organisations are often required, or strongly encouraged, to publish information alongside their financial statements, which provides a narrative view of the entity's recent performance, future developments and its governance and strategies. It makes sense that this information should include a discussion of the transition to IFRS, given its potential to impact significantly not only the financial information given in the accounts. And, as discussed in earlier chapters, the impact of the

transition can be much wider reaching, affecting business processes, commercial decisions and financing arrangements.

An example was seen in the EU transition of listed entities to IFRS in 2005. The Committee of European Securities Regulators (CESR) issued guidance recommending that EU listed entities should disclose information that described their plans and degree of achievement in their move towards IFRS when they published their financial statements for the financial year ending in 2003. The description should cover the general policies to address the operational and control issues as well as the risks and uncertainties associated with the transition as they affect the business. Further information was encouraged in the 2004 financial statements, providing more detail on the progress of the transition project including numerical reconciliations of equity and profit under previous GAAP to IFRS and explanations of the impact on cash flows (CESR, 2003).

The format and required content of this type of supplementary information does not fall under the scope of IFRS. It will be governed by regulation specific to the jurisdiction of the reporting entity, and the regulation may be legal in nature, or laid down by the relevant stock exchange or other regulatory body. The requirements may be prescriptive and rule-based, or they may be more principle-based and amount to best practice guidelines. The key issue is that regardless of whether the regulation contains any specific requirements in relation to reporting on the planning and implementation of IFRS transition, it is likely that the impact of the transition should be discussed in the narrative documents issued with the financial statements. As soon as the organisation begins to plan its transition, it should start to communicate some details of the plan itself, and the anticipated impacts of the transition.

A good example of regulations surrounding the communication of IFRS transition matters can be seen in the Canadian transition to IFRS. The Canadian Securities Administrators (CSA) issued a staff notice,[4] which outlined disclosures that should be made in the Management Disclosure and Analysis (MD&A) section of the annual report in the three financial years leading up to the year of transition. The matters expected to be discussed in the MD&A included a detailed discussion of the transition plan including information on internal controls, training, IT issues and business activities that would be affected. In addition, the discussion should cover significant differences in accounting expected to arise on the adoption of IFRS, and a description of the potential impact on the financial statements and results (CSA, 2008).

The CSA's reasoning for reporting entities to provide this information was that it should "reduce the level of investor uncertainty about IFRS readiness and inform readers about the potential for volatility in future reported results . . . [and] lead to a more stable and less disruptive transition to IFRS, which will be beneficial to both issuers and their investors" (CSA, 2010). The CSA was fairly rigorous in its review and monitoring of reporting entities' disclosures, assessing the level of compliance with the regulation and stating that entities deemed not to have complied may be requested to re-file their MD&A, having amended it to include sufficient detail on the IFRS transition.

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[4] *The relevant regulation is Staff Notice 52–320 Disclosures of Expected Changes in Accounting Policies Relating to Changeover to IFRS.*

Table 7.4 An example of the timing and detail of IFRS communications

Timing	*Disclosure requirement*
Three years before changeover date	Discuss the impact of IFRS adoption, with level of detail depending on the stage of planning of the transition.
Two years before changeover date – interim financial statements' MD&A	An update of progress on the IFRS changeover plan and any changes to the plan.
Two years before changeover date – annual financial statements' MD&A	Describe differences between previous GAAP and IFRS including changes in accounting policy, disclosing any assumptions made about future changes to IFRS. This can be a narrative disclosure.
One year before the changeover date – interim and annual financial statements' MD&A	Provide an updated discussion of the issuer's preparations for changeover to IFRS – by this time, the organisation will generally be able to discuss in more detail the key decisions and changes that will occur on changeover. The discussion should include decisions about accounting policy choices and application of IFRS 1 *First-time Adoption of IFRS*. Quantified information should be included about the impact of IFRS on each line item presented in the financial statements, if available.

In terms of the detail of the disclosure on transition, the requirements become more detailed as the transition date approaches. An example of the type of detail provided in each of the annual reports leading up to the issuance of the first IFRS financial statements is shown in Table 7.4.

The reason for including this detail on the Canadian disclosure requirements is two-fold. First, it reiterates the concept that disclosure of matters relating to the transition is important not just in the year of transition, but is beneficial to users of the financial statements at a much earlier stage. Second, it highlights that in some jurisdictions, disclosure beyond that required by IFRS, in particular IFRS 1, may be required, and reporting entities must ensure that any additionally imposed disclosure requirements are followed, to avoid negative reactions from regulatory authorities and from the users of the financial statements.

A similar situation arose in Australia's transition to IFRS in 2005. The Australian Accounting Standards Board (AASB) issued a pronouncement, AASB 1047 *Disclosing the Impacts of Adopting Australian Equivalents to International Financial Reporting Standards*, in 2004. The standard required reporting entities to disclose an explanation of how the transition to Australian equivalents to IFRSs was being managed; and a narrative explanation of the key differences in accounting policies that were expected to arise from adopting Australian equivalents to IFRSs (AASB, 2004). Similar to the Canadian disclosure requirements, as the date of adoption of IFRS grew closer, the standard required more numerical information to be disclosed. The manner of presentation of this information was not specified, so management would need to exercise judgement on the content of the information provided, as well as how to present it in a user-friendly way.

In summary, companies clearly need a communications plan, very likely linked to a change management plan relevant to internal parties, and a public relations plan relevant to external parties, to ensure that key messages are delivered in a timely manner to the appropriate

audience. Key outputs need to be planned carefully to ensure that any regulatory requirements are complied with, and that the information made available about the transition is as transparent and understandable as possible.

7.3 THE PRESENTATION OF IFRS 1 DISCLOSURES

This section looks at how reporting entities disclose and present the information relating to transition as required by IFRS 1. The previous section dealt with the communication of information outside the financial statements and in the periods leading up to the year of adoption. Although, as seen in the illustration regarding the Canadian transition, jurisdictions can impose specific requirements on this type of communication, generally reporting entities have a degree of flexibility in exactly how they communicate outside of the financial statements, and the content of such communications.

In the first IFRS financial statements, IFRS 1 *First-time Adoption of IFRS* requires extensive disclosures to be made regarding the transition. Certain matters must be communicated, and there is less flexibility in determining the content of disclosure here compared with the matters discussed outside of the financial statements. However, despite IFRS 1 requiring certain financial information to be provided, the reporting entity still has choices to make regarding the presentation of this information, and how much detail it provides in terms of explaining the financial and accounting impacts of the transition. This section will revise and summarise the IFRS 1 disclosure requirements and explore the different ways that the required information can be presented.

7.3.1 IFRS 1 Disclosure Requirements

IFRS 1 requires disclosures that explain how the transition from previous GAAP to IFRS affected the entity's reported financial position, financial performance and cash flows (IFRS 1.23). Chapter 3 contains a detailed description of IFRS 1's disclosure requirements. A summary of this is shown below:

- Reconciliations of equity reported under previous GAAP to equity under IFRS both:
  - (a) at the date of transition to IFRS; and
  - (b) the end of the last annual period reported under the previous GAAP. (IFRS 1.24a).
- Reconciliations of total comprehensive income for the last annual period reported under the previous GAAP to total comprehensive income under IFRSs for the same period. (IFRS 1.24b)
- If the reporting entity recognised or reversed any impairment losses in preparing its opening IFRS balance sheet, these must be disclosed. (IFRS 1.24c)
- Explanation of material adjustments that were made, in adopting IFRSs for the first time, to the statement of financial position, statement of total comprehensive income and statement of cash flows. (IFRS 1.25)
- If errors in previous GAAP financial statements were discovered in the course of transition to IFRSs, those must be disclosed separately. (IFRS 1.26)

7.3.2 Matters to Consider in Preparing and Presenting Disclosures in the First IFRS Financial Statements

Choices need to be made in respect of the amount of detail to be shown in the notes to the financial statements, and in other parts of the accounts in the first IFRS financial statements. Obviously, transitions involving a large number of complex adjustments will necessitate more detailed disclosures than simpler transitions. In all transitions, the external auditors will be in a good position to recommend the extent of disclosures necessary for compliance with IFRS 1. However, in all transitions, the preparers of the financial statements will have three main issues to consider – the method of presentation of the reconciliations required by IFRS 1, the extent of explanation that is required, and the disclosure that is needed in respect of comparative information. Each of these matters to consider is discussed below.

7.3.2.1 Method of Presenting IFRS 1 Reconciliations IFRS 1 does not specify the presentation method for the IFRS 1 reconciliations. The IFRS 1 implementation guidance includes an example of a reconciliation that presents the adjustments to each line item in the financial statements from previous GAAP to IFRSs with a narrative description and explanation provided in a footnote to the reconciliation. This is just an illustrative example, and while most reporting entities generally follow this type of presentation for their reconciliations, there is some freedom to tailor the presentation of information to make it as relevant to the reporting entity's transition as possible.

The key issue for the preparer of the information is to ensure it is as understandable as possible, and given the complexity of some of the adjustments this may be difficult. Most financial statements include the reconciliations simply presented as tables of information, with each significant adjustment disclosed separately. The tables often distinguish between different types of adjustments, for example separating classification adjustments from recognition or measurement adjustments.

Materiality will be an issue. Management should decide a level at which individual adjustments are sufficiently significant to warrant separate disclosure. Below that limit, adjustments can be aggregated. Even where several smaller adjustments have been aggregated for the purpose of the numerical disclosure, the narrative explanation may benefit from including a description of the aggregated items.

7.3.2.2 Amount of Detail to Explain the Accounting Impacts IFRS 1 contains a requirement that the disclosure should be sufficient to enable users to understand the material adjustments in the reconciliation statements. Management will have to exercise judgement in respect of the amount and content of narrative explanation provided. Too little information will leave the reconciliations in danger of being incomprehensible, but too much information is off-putting and can make it difficult to differentiate between headline adjustments and those that are less significant.

The wording should be as simple as possible, especially given the complex nature of many of the adjustments being made. An important issue, which may sound a little obvious, is to tailor the explanations as much as possible to the specific transition adjustments being presented. There is a problem that some first IFRS financial statements contain a lot of boilerplate disclosure that, while intended to provide useful information, can, in fact, distract from the specific issues in the transition that are being explained.

7.3.2.3 Comparative Information The reporting entity may wish, or may be required by local regulations, to present additional years of comparative information, above the minimum disclosure requirements of IFRS 1. For example, in some jurisdictions entities are required to present five-year summaries of key financial information. The users of the financial statements may expect to see the additional comparatives to assist their understanding even if the additional information is not required.

IFRS 1 does not require that additional comparative information is to be prepared under IFRS recognition and measurement requirements. IFRS 1, however, does require that in any financial statements containing historical summaries or comparative information in accordance with previous GAAP, an entity shall label the previous GAAP information prominently as not being prepared in accordance with IFRSs; and disclose the nature of the main adjustments that would make it comply with IFRSs. An entity need not quantify those adjustments (IFRS 1.22). This final point is important, as it makes it significantly easier to present additional years of comparative information without having to determine the exact amount of adjustments that would be necessary to make the comparatives IFRS-compliant.

Additionally, where regulatory authorities require the provision of several years of comparative information, the authority may release special rules for providing comparative information during the IFRS transition. For example, to ease the reporting burden, relief may be granted from the normally required amount of disclosure.

CONCLUSION

The need for strategies on education and training, and the communication and presentation of the effects of transition both internally and externally, is clear. For a smooth transition, an organisation must have a pool of skills available to plan and implement the transition, and knowledge should be built up internally to avoid expensive over-reliance on temporary staff. Training can be expensive, but is best viewed as an investment in talent, and organisations that place a priority on developing employees' IFRS knowledge early on in the transition project will be rewarded with a project team with a deep understanding not only of IFRS technical issues, but also with the ability to spot potential knock-on effects of accounting changes. Internal communications are also important, to ensure that the right messages are sent to the correct audience, securing buy-in to the project and hopefully encouraging acceptance of the changes in business activities. External communication should be planned carefully, to enhance the understandability of the first IFRS financial statements, but also to provide, at early stages of the transition process, a warning to users of the financial statements of the changes that transition will bring for reported results and other headline figures.

III THE WAY FORWARD – DEVELOPMENTS IN SELECTED COUNTRIES

8 THE TRANSITION TO NEW UK GAAP

In 2013, the UK's Financial Reporting Council (FRC) completed its project to revise financial reporting standards in the UK and Republic of Ireland. The revisions fundamentally changed the financial reporting regime, replacing almost all existing UK GAAP standards with three new Financial Reporting Standards, FRS 100, FRS 101 and FRS 102. At the same time, UK company law allows companies to follow IFRS if they wish to do so, and it is mandatory for the consolidated financial statements of listed entities to be prepared under EU-adopted IFRS.

The introduction of the new UK GAAP standards will prompt UK and Irish companies to make choices about which accounting standards they will follow going forwards. Those that do not yet follow IFRS may choose to do so; others will go through a period of transition to new UK GAAP. For the companies that move to IFRS, the preceding chapters in this book outline the main steps involved in planning and executing their transition. For companies moving to follow new UK GAAP these chapters are also useful, as most of the discussions about the transition project are equally applicable, especially because the new UK GAAP standards are largely converged with IFRS.

This chapter contains a summary of the new UK GAAP regime, relevant for readers in the UK and Ireland who are facing a transition to a new reporting framework, whether that is a transition to EU-adopted IFRS or new UK GAAP; and also covers some of the main differences between current UK GAAP and new UK GAAP which will affect transition planning.

8.1 A BACKGROUND TO THE CHANGES AND OUTLINE OF THE NEW REGIME

8.1.1 A Brief History of UK GAAP

It is useful to start with a brief recent history of UK financial reporting, to set the context for the new regime. The UK's Accounting Standards Board under the oversight of the FRC was responsible for issuing UK[1] financial reporting standards. Initially, Statements of Standard Accounting Practice (SSAPs) were issued, followed by Financial Reporting Standards (FRSs), and separate documents issued by the Urgent Issues Task Force provide specific guidance on selected issues. Over the last decade the standards issued have increasingly reflected the principles of IFRS, with some being almost identical to the equivalent IFRS. In this way the more recent pronouncements of UK GAAP represent convergence with IFRS. But the older SSAPs were not revised, leaving UK GAAP standards containing a mixture of old and new accounting terminology, methods and principles.

The FRC has, for some time, recognised that UK GAAP needed an overhaul, due to the concerns over consistency of accounting treatments mentioned above, but also because of

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[1] *The standards are commonly referred to as UK GAAP but are also applicable in the Republic of Ireland.*

an increasing perception that standards had become out of date with business practices, and that off balance sheet finance was a problem. Also, UK GAAP was felt to be inadequate in its requirements relating to financial instruments, in particular derivatives, and important information about transactions and balances involving financial assets and liabilities was felt to be missing from financial statements.

The other problem was that financial statements prepared under UK GAAP were difficult to compare to those prepared under IFRS, creating difficulties in evaluating the performance of companies against each other.

As well as the SSAPs, FRSs and UITF documents, UK GAAP also contains the Financial Reporting Standard for Smaller Entities (FRSSE), which is followed by the smallest companies as an alternative to full UK GAAP. The UK's financial reporting regime was overly complicated, especially given the EU's mandate for listed entities to produce consolidated financial statements using EU-endorsed IFRS.

Discussions on convergence of UK GAAP with IFRS began to gather pace when the IASB issued the IFRS for SMEs in 2009. In the same year, the ASB issued a Consultation Paper containing a policy proposal on the future of UK GAAP. The proposal was for a three-tier financial reporting regime. In summary, this meant that in the highest tier, listed entities and publicly accountable entities would follow EU-adopted IFRS in their consolidated accounts, and in the bottom tier, the smallest entities would continue to follow the FRSSE. For entities in the middle tier, it was initially proposed that they would follow the IFRS for SMEs. However, it was found that elements of the IFRS for SMEs are not compatible with EU law, and therefore could not be implemented as part of a new UK GAAP regime. In 2010, the ASB published a further proposal suggesting that instead of the IFRS for SMEs, entities in the middle tier of the financial reporting regime would follow a UK-specific standard of the Financial Reporting Standard for Medium Sized Entities (FRSME), which was very much based on the IFRS for SMEs but amended to make it UK-friendly.[2]

The developments outlined above, not surprisingly, generated a lot of comment and a significant amount of negative feedback was made to the FRC. In particular, the concept of public accountability caused controversy, with commentators arguing that its application would extend the mandatory use of IFRS to entities where the cost of adopting IFRS would outweigh the benefit (FRC, 2012b).

The consultation and development process eventually led to the issuance in 2013 of the final version of new UK GAAP, which is outlined in the next section. The concept of public accountability was removed; and changes were made to retain more features of existing UK GAAP and allow more choices in financial reporting, which, it is hoped, will ease the burden of transition. There were also changes in the names used, with the FRSME being re-named as FRS 102.

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[2] *More detail on the development of new UK GAAP and the various Discussion Papers, Consultation Papers and Exposure Drafts can be found on the FRC website at http://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/The-future-of-UK-GAAP.aspx*

8.1.2 The New UK GAAP Regime

There are currently three Financial Reporting Standards in new UK GAAP:

- FRS 100 Application of Financial Reporting Requirements;
- FRS 101 Reduced Disclosure Framework;
- FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland.[3]

The standards all have an effective date of accounting periods beginning on or after 1 January 2015, so the first annual financial statements that must be prepared under the new regime will be for the year ending 31 December 2015. Early adoption is permitted, with some exceptions.

UK GAAP will also retain the FRSSE, which will continue to be available for use by small entities. The FRSSE has been updated to reflect necessary changes caused by the introduction of FRSs 100 and 102, and a revised version which is effective from 1 January 2015 was issued in July 2013.[4] The purpose of each of the new FRSs is explored below.

8.1.2.1 FRS 100 Application of Financial Reporting Requirements This standard explains the UK financial reporting framework, setting out the requirements and choices for reporting entities. It outlines which reporting entities will be required or permitted to use EU-adopted IFRS, FRS 101, FRS 102 or the FRSSE.

EU-adopted IFRS is available to all companies (charities are not permitted to use IFRS). The new UK GAAP regime does not extend the requirement to use IFRS and retains the option for any company wishing to do so to move to IFRS.

FRS 101 is only available to a qualifying entity. A qualifying entity is a member of a group that prepares publicly available consolidated financial statements, so FRS 101 can be applied in the individual financial statements of subsidiary companies and the parent company in a group. FRS 101 contains a reduced disclosure framework to be used when preparing financial statements under EU-adopted IFRS, and the advantages of opting to use FRS 101 will be discussed later in the chapter. This is an option, qualifying entities can opt to use EU-adopted IFRS without taking the disclosure exemptions offered by FRS 101, or to use FRS 102 which also offers disclosure exemptions to qualifying entities, or even the FRSSE if they meet the definition of a small company.

FRS 102 is the replacement of UK SSAPs, FRSs and UITF documents, and is the single financial reporting standard that will be used by companies that are too large to apply the FRSSE, and those that opt not to apply EU-adopted IFRS, or FRS 101 if they are qualifying entities.

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[3] *At the time of writing, a Financial Reporting Exposure Draft of a fourth FRS, which will be FRS 103, is in issue. This standard deals with insurance contracts, and its content is deemed too specialist for further discussion within this book.*

[4] *It is likely that the FRSSE will undergo further revisions over the next few years, and will be impacted by the issuance of a new EU Accounting Directive, anticipated in 2014.*

The FRSSE is only available to entities defined as small, and the new regime does not alter the size limits, which are defined in the Companies Act 2006. The FRC suggests that small businesses are unaffected by the new UK GAAP standards, as there are no changes to the FRSSE other than minor amendments being made as a result of the introduction of the new UK GAAP standards (FRC, 2013b).

The situation appears complicated. But basically it means that:

- Entities that currently are required to use EU-adopted IFRS must continue to do so.
- Entities that currently use UK SSAPs and FRSs face a choice and can move to follow EU-adopted IFRS (with or without adopting FRS 101 if they are qualifying entities) or FRS 102.
- Entities that currently use the FRSSE can continue to do so, or can move to follow EU-adopted IFRS (with or without adopting FRS 101 if they are qualifying entities) or FRS 102.

Because it is likely that companies will avoid moving to another reporting framework unless there are clear benefits of doing so, it is anticipated that current FRSSE users will continue to use the FRSSE, and that the main cohort of companies going through transition to a new financial reporting regime will be those moving from existing UK GAAP to FRS 102, and that there will be a smaller cohort of qualifying entities that move to follow EU-adopted IFRS and take the disclosure requirements offered by FRS 101.

In any situation, when an entity moves to a new reporting framework, it will face transitional issues similar to those covered in Chapters 4 to 7, and this chapter will consider some of these issues again in the context of UK companies making a transition to one of the elements of the new UK GAAP regime.

There is also an option for companies that have previously gone through transition to IFRS to move back to UK GAAP. This is allowed following a Statutory Instrument, which amended existing legislation, and now permits companies to revert to UK GAAP, with some restrictions. It is estimated that approximately 20% of large private entities have opted to use EU-adopted IFRS (FRC, 2013b), and these entities may choose to move to FRS 102, or FRS 101 if they are qualifying entities.

8.1.2.2 FRS 101 Reduced Disclosure Framework This standard, as explained above, is available only to qualifying entities, i.e., it can be used for the individual financial statements of parent and subsidiaries in a group. Charities cannot adopt FRS 101.

The basic principle is that entities adopting this standard will use IFRS-based rules for the recognition and measurement of items in their financial statements, but exemptions are given from many of the disclosure requirements of IFRS, hence the title of the reduced disclosure framework.[5] The financial statements will have the look of UK GAAP, as they are presented under Companies Act rules, but follow the principles of IFRS. According to FRS 101 it is envisaged that the provision of these disclosure exemptions could result in cost savings in the

[5] *A reduced disclosure framework has been introduced in other countries, for example in Australia.*

preparation of financial statements of subsidiaries and ultimate parents, without reducing the quality of financial reporting (FRC, 2012a).

There are some restrictions on the disclosure exemptions; for example, in the case of qualifying entities that are financial institutions, disclosures are still required in respect of financial instruments and fair value measurement.

In order to apply the reduced disclosure framework, certain conditions must be met, including that an entity must notify its shareholders, and there must be a note to the financial statements that summarises the disclosure exemptions taken, and certain other relevant information.

FRS 101 outlines that certain disclosure exemptions are available in respect of the following balances and transactions:

- Share-based payment
- Business combinations
- Assets held for sale and discontinued operations
- Financial instruments
- Fair value measurement
- Statement of cash flows
- Accounting policies and errors
- Related party disclosures
- Impairment of assets

As well as disclosure exemptions, FRS 101 also contains a few amendments to EU-adopted IFRS in the areas of negative goodwill, reversal of impairment losses for goodwill and government grants.

A statement of compliance has to be made in the financial statements. It is important to remember that when applying FRS 101, the financial statements do not comply with IFRS, but are prepared under a UK GAAP standard. Therefore, in the year of transition to the new reporting framework, IFRS 1 *First-time Adoption of IFRS* is not applied, and no statement of compliance with IFRS should be made. Instead, a statement of compliance with FRS 101 is given in the financial statements each year.

8.1.2.3 FRS 102 The Financial Reporting Standard Applicable in the UK and Ireland

This standard represents the UK GAAP requirements that it is anticipated that the majority of companies will follow under the new regime. It is important to remember that FRS 102 is not the same as previous UK GAAP standards nor is it the same as the IFRS for SMEs. In a way, FRS 102 is a compromise between the two, in that it retains many features of previous UK GAAP but also aligns in other ways to IFRS rules and principles.

The summary section of FRS 102 states that the requirements in FRS 102 are based on the IFRS for SMEs (FRC, 2013a). However, the FRC could not simply take the IFRS for SMEs and introduce it to UK GAAP because it needed to be amended to bring it into line with company law.

One feature of FRS 102 is that it contains paragraphs specific to public benefit entities, so preparers of financial statements in the public sector should be aware of transitional issues, as well as private sector preparers.

FRS 102 is considerably smaller in volume than previous UK GAAP, at just over 300 pages compared to roughly 2,400 pages of UK GAAP (FRC, 2013b). Indeed, the standard itself states that it aims to provide entities with succinct financial reporting requirements. The FRC stresses that FRS 102 contains proportionate disclosure requirements.

The standard is user-friendly and many of the accounting issues are simplified, making it an attractive option for companies as it should reduce the burden of financial reporting. But transitioning to a new financial reporting framework should always involve careful planning, even if the new requirements represent a simplification of existing accounting practices. Section 8.2 will look at the main differences between existing UK GAAP and new UK GAAP, as this will form a significant part of the accounting impact assessment that needs to be performed on the transition to FRS 102.

8.1.3 Deciding which Component of the New Regime to Follow

Some of the issues discussed in this section are relevant to all companies, others only relevant to individual members of a listed group. Looking at group issues first, under the new UK GAAP regime, listed groups are still required to follow EU-adopted IFRS in the consolidated financial statements.

In the individual financial statements of group component companies that are qualifying entities there is a choice:

Option 1 – Move individual financial statements to full EU-adopted IFRS, i.e., including all disclosure requirements.

Option 2 – Move individual financial statements to FRS 101, i.e., use EU-adopted IFRS for recognition and measurement, and take some or all of the disclosure exemptions as permitted by FRS 101.

Option 3 – Move individual financial statements to FRS 102, i.e., use the principles of FRS 102 for recognition, measurement and disclosure, bearing in mind that FRS 102 contains some disclosure exemptions for qualifying entities.[6]

Given that only a minority of individual reporting entities within a group have moved to EU-adopted IFRS since this became an option in 2005, it is likely that few will choose to do so now, especially given the advantages offered by moving to either FRS 101 or FRS 102. Therefore, Option 1 as listed above will not be discussed further.

8.1.3.1 The issue of Consistency One issue to be aware of is that the Companies Act 2006 requires consistency in the financial reporting framework used within a group, unless there is good reason for this not to happen. Therefore, when evaluating the options and deciding which transition to make, it is important to consider the consistency across the group. This,

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[6] *As previously mentioned, there is also a situation where a qualifying entity is also classified as a small entity and uses the FRSSE, and it could continue to use the FRSSE under new UK GAAP.*

however, does not mean that all of the individual financial statements in a group need to use either FRS 101 or FRS 102, there can be a mixture as they are both part of the same financial reporting framework.

However, a group may need to justify the use of different FRS by different components of the group. For example, some commentators suggest that the tax authorities do not look favourably on group structures in which different accounting policies are being used by different components of the group, as this could lead to perceived or actual tax evasion.

8.1.3.2 Moving to FRS 101 – Pros and Cons When individual group companies prepare accounts using FRS 101, they will broadly be following EU-adopted IFRS for recognition and measurement. The big advantage of this arises because the consolidated financial statements have to be prepared using EU-adopted IFRS, and so it follows that there will be a consistency in accounting treatments, and accounting policies across the group can be streamlined. Ultimately, this will make consolidation easier and cost savings should be made. The FRC notes that the reduced disclosure framework should promote efficiency within groups (FRC, 2013b).

The benefits go beyond purely accounting, though. Where all the companies in a group use IFRS-based reporting, there is less risk of error during the reconciliation and consolidation process, and it is argued that, generally, corporate governance can be improved by reducing risk.

Of course, the main benefit of taking the disclosure exemptions of FRS 101 is that the individual financial statements will be much less difficult to prepare, and cost savings should be seen here too. However, it should be remembered that information may still need to be gathered at the level of the individual company for consolidation and disclosure at group level, even if not disclosed at the individual level. So changes may be needed to information systems and accounting processes to ensure that data are captured for disclosure at group level even if disclosure is exempted in the individual financial statements.

Another advantage of using FRS 101 is that at least some accountants in the group will be familiar with IFRS reporting from having to produce the consolidated financial statements on that basis. That knowledge and experience should be used to best advantage and can ease the transition from old UK GAAP to FRS 101. Compared to a transition to FRS 102, which is rather an unknown quantity containing elements of both IFRS and old UK GAAP, in which no accountants have received formal training via qualification, the transition to FRS 101 may be a good choice. There will be an inevitable learning curve in adopting FRS 102, which could be avoided to some degree by using FRS 101, assuming there is a reasonable amount of experience in IFRS reporting available.

8.1.3.3 Moving to FRS 102 – Pros and Cons Under FRS 102, many of the accounting treatments of old UK GAAP are retained, so it is arguable that it will be easier to make the transition to FRS 102 compared to the transition to FRS 101. The accounting impacts are likely to be less in number and significance. And for both preparers and users of financial statements the transition may be simpler to understand. However, this does not mean to imply that the accounting impacts will be minimal – as will be discussed in Section 8.2, there will be many significant differences in accounting treatments on moving from old UK GAAP to FRS 102.

FRS 102 contains similar disclosure exemptions to FRS 101 for qualifying entities, so the benefits are largely the same in terms of saving time and costs, and also the same issue arises

in terms of needing to capture information for disclosure at group level even if it is not required to be disclosed in the individual financial statements.

In terms of experience, as mentioned above, there will be a learning curve in adopting FRS 102. But, given that people are generally resistant to change unless they see a clear benefit, for cultural reasons it could be advantageous to move to FRS 102, as it retains elements of old UK GAAP and is not a complete change to IFRS-based reporting.

One of the disadvantages of moving to FRS 102, especially for larger private companies, is that if the company were to become listed, the financial statements would then have to be prepared under IFRS according to legislation. So, for reporting entities thinking of obtaining a listing, moving to FRS 102 would not be a good choice, as it would entail a subsequent transition to IFRS.

8.1.3.4 Tax and Legal Issues When moving to any new financial reporting framework there will almost certainly be some impact on taxable profits and hence the amount of tax payable under the new regime. For qualifying entities, a factor in deciding whether to move to FRS 101 or FRS 102 will be the potential impact on tax. At the time of writing, the tax impacts of moving to either standard are not yet clarified. The FRC is working with HMRC to ensure that impacts are identified and that the transition to new UK GAAP will be as smooth as possible from a tax point of view. The tax consequences of transition may be a deciding factor in whether qualifying entities move to FRS 101, for the advantages discussed above, or whether they move to FRS 102. Early discussion with tax specialists is to be encouraged.

In addition, whichever standard is followed, there are likely to be impacts on the amount of distributable reserves of the reporting entity. One of the reasons that many UK companies have decided to stay with UK GAAP rather than move to IFRS in the last few years is that they fear that transitional adjustments will have a significantly detrimental impact on the company's level of distributable reserves and hence the ability to pay a dividend. It is probably unavoidable that, whether an entity moves to follow FRS 101 or FRS 102, there will be some impact on the level of retained profits available for distribution, so this should be investigated as part of an impact assessment and may help to determine which of the standards should be followed.

However, for both tax and legal factors, it is wise to consider the bigger picture and the longer term. A short-sighted decision on which standard to follow based on assessments of impacts on tax and the ability to pay a dividend may not be the best choice in the long run. If transition matters are planned for properly, and crucially communicated to the appropriate audience, then shorter-term tax and legal consequences are likely to be less important than matters such as achieving consistency in accounting practices across a group, or moving to FRS 101 for commercial or strategic reasons such as a potential flotation of a company several years down the line.

8.2 ACCOUNTING AND WIDER IMPACTS OF THE TRANSITION

8.2.1 FRS 102 – Key Differences Between Existing UK GAAP and New UK GAAP

As most UK non-group companies will be moving to FRS 102, it is relevant to include at this point a summary of the main differences between previous UK GAAP and the new FRS 102 requirements. This section is not an exhaustive list of all differences, but intends just

to highlight some of the key accounting impacts that might arise.[7] Chapter 5 discussed the importance of a line-by-line accounting impact assessment to be performed early on in the transition project, and this is just as relevant in the transition to FRS 102 (or indeed FRS 101) as it is in the transition to IFRS.

FRS 102 is not the same as EU-adopted IFRS. It is based on the IFRS for SMEs, which is a simplified and condensed version of IFRS. In developing FRS 102, the FRC made the following types of amendments to the IFRS for SMEs:

- Retained a number of the options available in UK GAAP (e.g., the capitalisation of development costs and borrowing costs);
- Included elements of UK GAAP not covered in the IFRS for SMEs (e.g., the use of the merger accounting method of consolidation in some group situations);
- Simplified many of the requirements;
- Ensured compliance with company law;
- Anticipated some of the future changes to IFRS;
- Included content for public benefit entities.

Table 8.1 shows a summary of some of the main differences between existing UK GAAP and FRS 102, along with an indication of how the difference gives rise to a transition planning consideration.

8.2.2 First-time Adoption Accounting Treatment

Section 35 of FRS 102 deals with first-time adoption, outlining similar principles to those discussed in Chapter 3 in respect of IFRS 1 *First-time Adoption of IFRS*. This section of the standard applies when an entity adopts FRS 102 for the first time, irrespective of which financial reporting standards were followed previously. In the same way that a reporting entity moving to follow IFRS has to make a statement of full compliance with IFRS, the first FRS 102 financial statements must contain an explicit and unreserved statement of compliance with FRS 102.

The date of transition to FRS 102 is the beginning of the earliest period for which the entity presents full comparative information in accordance with FRS 102. Therefore, for entities preparing their first FRS 102 financial statements to the year ending 31 December 2015, the date of transition is 1 January 2014.

Comparative information must be restated to comply with FRS 102, and comparative periods can be presented for more than one preceding period, though this is unlikely to be seen.

On transitioning to FRS 102, an entity needs to go through a very similar process to an entity that is transitioning to IFRS. This is because FRS 102 contains very similar requirements to IFRS 1 in terms of the procedures that need to be performed in preparing the financial statements at

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[7] *For an in-depth analysis of the difference between previous UK GAAP and FRS 102, there are several publications available, and an entity's auditors will be able to provide guidance and help with performing an accounting impact analysis.*

Table 8.1 Accounting and wider impacts of moving to FRS 102

Accounting impact	*Transition planning consideration*	*Wider impact*
Presentation differences – new terminology is used (e.g., statement of financial position instead of balance sheet, inventory instead of stocks) along with requirements to produce new elements of the financial statements; e.g., statement of comprehensive income. There is some flexibility allowed on the use of terminology but Company Act formats continue to apply.	Changes to accounting systems will be needed such as new nominal ledger names, and new ledger accounts for new items to be recognised; e.g., elements of comprehensive income. New pro forma accounts to be drawn up including new elements and deleted defunct elements; e.g., statement of total recognised gains and losses. Management needs to decide on appropriate terminology and headings to be used in the financial statements and on certain presentational issues, e.g., whether to present other comprehensive income separately.	Education of users of financial statements on the new elements of, and formats of, the financial statements.
Statement of cash flows – only three headings on the statement instead of nine under previous UK GAAP. Also the cash flow statement has no exemptions from preparation unless the reduced disclosure framework is applicable.	Decisions to be made on classification of cash flows and new pro forma statement to be drawn up, including relevant notes to the statement of cash flows.	
There is also a different definition of cash and cash equivalents, which is a wider definition under FRS 102.		
A note to analyse the movement in net debt is not required.		
Disclosures – while FRS 102 does contain disclosure exemptions, there will still be different disclosures required than under previous UK GAAP. Disclosure is required on the use of judgement and sources of estimation uncertainty in the financial statements.	Systems to be analysed to identify what changes need to be made to ensure complete and accurate capture of data for disclosure. New notes to be drafted and auditor input may be advisable on matters such as key areas of uncertainty and judgement to ensure the adequacy of disclosures.	Controls to be developed to maintain the integrity of data. The notes may be different under FRS 102, and users may need education to help navigate around the information provided.

<table>
<tr>
<td>Property, plant and equipment – differences in how subsequent expenditure and major spare parts are recognised, and more emphasis on the componentisation of assets; e.g., land and buildings to be accounted for separately under FRS 102.

There are also differences in the costs that should be capitalised and the accounting treatment and disclosure of revaluation gains and losses.</td>
<td>The criteria for capitalisation of acquired assets and components of assets will need to be reassessed to ensure proper capitalisation of assets, e.g. major spare parts are treated as part of non-current assets, not included with inventories.

Systems need to be put in place for dealing with revaluations, especially revaluation losses, which have a different accounting treatment under FRS 102.</td>
<td>Impacts on procurement policy and capital expenditure budgets to be analysed.

Revaluation gains and losses are disclosed as Other Comprehensive Income, about which users of the financial statements may need to be educated.</td>
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<tr>
<td>Financial instruments – FRS 102 requires financial instruments to be classified as basic or non-basic. Generally, basic instruments are measured at amortised cost and non-basic instruments at fair value through profit and loss.

FRS 102 contains specific rules on measuring and recognising impairments on financial assets while existing UK GAAP does not specifically cover this area. Similarly, FRS 102 contains more explicit rules on the derecognition of financial instruments.</td>
<td>For entities that did not previously follow FRS 26, the first reporting period under FRS 102 will be the first time that non-basic financial instruments will be recognised, including relatively complex requirements in relation to hedge accounting.

There will need to be systems put in place to:
• Identify financial instruments
• Determine their classification as basic or non-basic
• Measure them at amortised cost or fair value at the year-end
• Capture the data necessary for disclosure
• Ensure the adequacy of documentation
• Consider the election to measure basic instruments at fair value
• Identify potential impairment and measure financial assets accordingly
• Recognise when instruments should be derecognised</td>
<td>Training will need to be given in this area as it will be significantly different for most reporting entities with non-basic instruments.

The FRC is likely to issue amendments to FRS 102 once the IASB has completed its projects on IFRS 9 Financial Instruments – entities will need to keep up to date with changes to rules on financial instruments.

Contracts will need to be reviewed to ensure all financial instruments that exist on transition are captured in the accounting system.</td>
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<tr>
<td>Investment property – FRS 102 requires measurement at fair value with changes recognised in profit. The only exception is where obtaining fair value would create undue cost or effort, in which case the property is treated as a non-investment property.</td>
<td>The measurement basis is different as open market value was used under previous UK GAAP, so those performing valuations, whether external or internal, will need to be informed of the different context for determining the value of investment property.

It may be difficult to justify treatment of an investment property as a non-investment property, so the exception should not be seen as an easy way to avoid fair value accounting.

Accounting systems to be amended so that depreciation is not charged on investment properties.</td>
<td>The move to fair value through profit and loss will introduce volatility to reporting earnings.

Shareholders may need to be educated on this point, and also to ensure they understand that fair value gains are not distributable profits – this element may be misunderstood by users of the financial statements.</td>
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(continued)

Table 8.1 ***(Continued)***

Accounting impact	*Transition planning consideration*	*Wider impact*
Leases – FRS 102 retains the distinction between finance and operating leases, but does not include the 90% test to differentiate between them. Instead, conditions are applied to the lease to determine if risk and rewards have passed to the lessor.[8]	Lease contracts need to be evaluated to determine whether they give rise to a finance or an operating lease. More judgement needs to be exercised in determining the nature of a lease.	It is not likely that moving from existing UK GAAP to FRS 102 will lead to reclassifications of many leases, but it may be time-consuming to perform the necessary evaluations to justify that this is the case.
Revenue recognition – there are some differences in wording that could mean that the timing and pattern of revenue recognition is different under FRS 102. The accounting treatment of long-term contracts is broadly similar, though there is a difference in the accounting treatment where the outcome of a contract cannot be measured reliably at the year-end.	Customer contracts for the sale of goods and services need to be assessed to determine when revenue should be recognised under FRS 102. Long-term contracts, e.g., construction contracts should also be evaluated and the degree of completion and whether the outcome can be measured reliably at the year-end needs to be considered.	Customer contracts could be reworded to justify a certain accounting treatment for revenue. Changing the timing of revenue recognition can have tax implications.
Borrowing costs – there is a wider scope for the capitalisation of borrowing costs under FRS 102, as the accounting treatment extends to qualifying assets (those that take a substantial period to get ready for intended use or sale). Note that capitalisation of borrowing costs is an accounting policy choice (unlike IFRS in which it is mandatory and not a matter of choice).	An accounting policy needs to be decided upon. The entity's activities need to be reviewed to determine if it has qualifying assets, e.g., inventories, investment properties and intangible assets could all qualify. Documentation to be assessed to ensure that all qualifying borrowing costs are captured, e.g., it can include finance charges on finance leases.	Capitalising borrowing costs will increase profit during the period of getting the asset ready for use or sale, but will mean future profit impacts, e.g., higher depreciation charges where the asset is property, plant and equipment. This changes the profit profile of the entity.
Employee benefits – FRS 102 has a wider scope in that it includes short-term compensated absences, e.g., holiday pay or sick leave, which are not covered explicitly in previous UK GAAP. In terms of accounting for pensions, FRS 102 is similar to previous UK GAAP, though there are small differences in recognising the elements of the movement in the pension account during the year. FRS 102 does not require the use of an independent specialist for providing an actuarial valuation.	Work will have to be performed to capture the necessary information to determine any accruals necessary for short-term compensated absences. This can be time-consuming and systems may need to be updated to ensure the data are available on an ongoing basis and not just the subject of a year-end data collection process. Accounting systems and processes may need to be amended to cater for the different recognition of items such as actuarial gains and losses. While the use of a specialist is not required, in most cases they will continue to be used, unless management is expert in this area.	This can be a time-consuming and costly exercise and needs input from non-accounting functions, i.e., human resources who need to understand the rationale behind collecting the information. Where external specialists are involved in determining the amounts recognised in relation to pensions, they will need to be informed of any accounting changes.

Deferred tax – FRS 102 contains a UK-specific "timing difference plus" approach to deferred tax. There are many differences in how deferred tax is treated compared to previous UK GAAP. The main implication is that deferred tax figures are likely to be higher, as deferred tax is recognised on revaluations of assets such as land and buildings, and fair value adjustments arising on business combination, amongst others. Deferred tax may not be discounted to present value, which will increase the liability for entities that have discounted under previous UK GAAP.	A detailed deferred tax impact assessment must be conducted to ensure that all relevant transactions and balances that give rise to deferred tax are identified, given the wider scope of recognition under FRS 102. Entities will need to change their accounting policy if they have previously discounted deferred tax.	Increased deferred tax balances impact on liabilities primarily, and can change the liquidity profile of the entity. Users may need to be educated so they understand the nature of the liability in terms of impact on future cash flows.
Foreign currency – FRS 102 introduces the concept of functional and presentation currencies, giving the option of presenting in a different currency where appropriate. There are differences in the accounting treatment of foreign currency items including investments in foreign operations.	Entities with foreign currency transactions and investments will need to assess the impact of FRS 102 on the retranslation of items at the year-end, and the recognition of exchange gains and losses arising.	Commercial decisions, e.g., the use of overseas suppliers, will impact on the financial statements, so the accounting function must liaise with other business functions to ensure the extent of overseas transactions is understood.
Business combinations and goodwill – there are many differences in detail here. One important issue is that under FRS 102, goodwill arising on a business combination is amortised its useful life, which is limited to 5 years in cases where the useful life cannot be reliably estimated.[9] There are also changes to the treatment of adjustments made to goodwill post-acquisition, the separate recognition of acquired intangible assets. Accounting for associates and joint ventures also contains differences.	Groups following FRS 102 need to perform a specific accounting impact assessment on their group structure, consolidation processes and disclosures. There are likely to be many changes of detail in how group companies are consolidated, and also in their recognition in the parent company's individual financial statements. There are also differences in the accounting treatment of changes in group structure and in step acquisitions and disposals of interests.	The accounting function needs to liaise carefully with other business functions dealing with mergers and acquisitions. Where due diligence is obtained in respect of an acquisition, the provider of the due diligence should be aware of the accounting impacts, e.g., the need to identify acquired intangible assets separately.

[8] *In FRS 102 there is no requirement to separate finance-leased assets into land and buildings elements, as required in IFRS.*

[9] *This is different to both previous UK GAAP, which required amortisation over a period of not greater than 20 years (though this was subject to a rebuttable presumption), and IFRS, which requires no amortisation but instead an annual impairment test of goodwill.*

the date of transition. The standard requires the following to be done in preparing the opening statement of financial position:

(a) recognise all assets and liabilities whose recognition is required by this FRS;
(b) not recognise items as assets or liabilities if this FRS does not permit such recognition;
(c) reclassify items that it recognised under its previous financial reporting framework as one type of asset, liability or component of equity, but that are a different type of asset, liability or component of equity under this FRS; and
(d) apply this FRS in measuring all recognised assets and liabilities. (FRS 102. 35.7).[10]

Generally, the FRS 102 accounting treatments are applied retrospectively. However, the standard contains several mandatory exemptions to this general rule, and on transition entities do not account for the following items retrospectively:

- Derecognition of financial instruments
- Hedge accounting
- Accounting estimates
- Measuring non-controlling interests

In addition, there are many optional exemptions that may be taken in terms of retrospective application of the new rule. The exemptions relate to the following:

- Business combinations including group reconstructions
- Share-based payment
- Fair value as deemed cost
- Revaluation as deemed cost
- Individual and separate financial statements
- Compound financial instruments
- Service concession arrangements – accounting by operators
- Extractive industries
- Arrangements containing a lease
- Decommissioning liabilities included in the cost of property, plant and equipment
- Dormant companies
- Deferred development costs as a deemed cost
- Borrowing costs
- Lease incentives
- Public benefit entity combinations
- Assets and liabilities of subsidiaries, associates and joint ventures
- Designation of previously recognised financial instruments

Management will need to decide, probably with the input of the external auditor, which of the optional exemptions to take. Based on transition to IFRS experience, it is likely that most reporting entities will make maximum use of the exemptions that are available.

8.2.3 FRS 102 First-time Adoption Disclosure Requirements

The first FRS 102 financial statements must contain additional disclosures that explain the impact of transition on the reported performance, financial position and cash flows. The

[10] *Reproduced with permission from the FRC.*

disclosure requirements are very similar to those discussed in Chapter 3 in respect of the disclosure requirements of IFRS 1. The financial statements should contain equity reconciliations at the date of transition to FRS 102 and at the end of the comparative period, a reconciliation of profit or loss for the comparative period, and narrative descriptions of the changes in accounting policy that have occurred on transition to FRS 102.

Figure 8.1 summarises the reconciliations that need to be prepared and disclosed in the first FRS 102 financial statements:

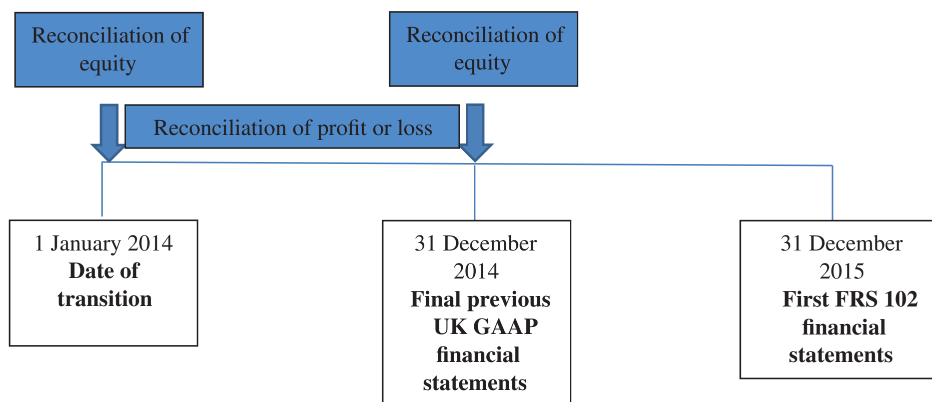

Figure 8.1 Reconciliations required on transition to FRS 102

The reconciliations should provide sufficient information for users to understand the main impacts of the transition. Chapter 7 contains a discussion of the matters to consider in presenting this type of information. At the time of writing, no further guidance has been provided by the regulatory authorities on disclosure of information relating to the transition, for example, in the directors' report or other information provided alongside the financial statements. Management of reporting entities moving to FRS 102 is advised to consider whether it is appropriate to include discussion of transition matters in such documents, and further guidance on this may be forthcoming in due course.

8.2.4 Transitioning to FRS 101

For qualifying entities that adopt FRS 101, they are in the position of moving to adopt EU-adopted IFRS (albeit with a few UK-specific amendments), but without the full disclosure requirements of IFRS. Therefore, the transition planning issues discussed in Part II of this book are relevant, though the planning considerations in relation to disclosure requirements will be less onerous.

The accounting impact analysis will be very important, as previous UK GAAP and EU-adopted IFRS are different in detail, and there will be a range of new accounting policies to be adopted; valuation methods to be devised, particularly in relation to financial instruments; estimation techniques to be developed and presentation and classification decisions to be made. All of these will have impacts on accounting systems and controls, but, as discussed earlier in this

chapter, the benefit here is that accounting processes within the group can be streamlined, leading to efficiencies and hopefully cost savings in the long run. It is worth remembering that while the recognition and measurement rules follow EU-adopted IFRS, the financial statements are actually being prepared using UK GAAP and the Companies Act 2006, so it is important that all relevant legal disclosures are made. The interaction between the disclosure requirements of FRS 101 and the Companies Act 2006 can be complex, and procedures should be put in place, such as the use of disclosure checklists, both to avoid unnecessary disclosure and to ensure that all necessary disclosures have been made.

FRS 101 contains disclosure requirements similar to those on FRS 102 for the provision of reconciliations of equity and total comprehensive income in the first FRS 101 financial statements.

At the time of writing, some entities have early-adopted FRS 101 for their December 2012 year-ends (PwC, 2013). These groups presumably thought it beneficial to go through the transition of the individual companies (that are qualifying entities) to FRS 101 as soon as possible, for the advantages of streamlining group accounting policies and processes discussed earlier in this chapter.

8.3 TRANSITION PLANNING ISSUES

Many of the themes from Part II of this book are relevant here, so to avoid repetition, just the main planning issues are outlined below, along with a reference to where further discussion of that matter can be found within Part II.

8.3.1 Initial Planning and the Timing of Impact Assessments

For many entities going through transition to new UK GAAP the transition will be less complex than for entities transitioning to full IFRS. This is because, in general, their activities may be less complex, less geographically diverse and involve a smaller range of classes of transaction. However, even in small and less complex transitions, planning is crucial and should commence as soon as possible to ensure that accounting and wider impacts are identified as quickly as possible. There is a risk of material misstatement whatever the size and complexity of the organisation and its balances and transactions. Planning the move to either FRS 101 or FRS 102 should involve the same stages as a transition to full IFRS, though, depending on the specific circumstances of the reporting entity, the project may be small scale and less demanding in terms of the resources needed to implement the transition project. The transition project should include the following:

Establishing a project team – In a small transition project this may involve a few people and there is likely to be more reliance on the input of the external auditor, especially where management has little financial knowledge and involvement in the accounting function. The formation of the project team and involving external specialists including the auditors is dealt with in Chapter 4.

Accounting impact assessment – Moving to either FRS 101 or FRS 102 from existing UK GAAP will necessitate a detailed line-by-line accounting analysis to identify and prioritise the accounting impacts, including disclosure issues. External auditors and other specialists will be able to provide a checklist to help management complete this assessment. The assessment should cover the existing accounting policies and

also consider whether new accounting policies need to be developed for items that may not have been recognised under previous UK GAAP; for example, in respect of certain financial instruments. The accounting impact assessment is discussed in Chapter 5.

Systems, controls and wider impacts – Accounting software will need to be updated and controls put in place to ensure that necessary disclosures are made in the financial statements. An assessment of potential wider impacts is essential, and many of those discussed in Chapter 6 will be relevant, including the impact on debt covenants, performance-related pay, taxation implications, contracts with customers and suppliers and the negotiation of leasing and other arrangements. Action may need to be taken to minimise the risk of depleting distributable reserves by choosing certain accounting policies. The involvement of the reporting entity's audit committee and internal audit function can be important in planning and implementing the transition, as discussed in Chapter 6.

Training and communication – There is likely to be a shortage of accountants with knowledge of the new UK GAAP requirements, so services may come with a premium cost. This is especially the case given that almost all accountants trained in the UK in the last 10 years have studied IFRS, not UK GAAP, as part of their professional examinations. All accountants should be aware of the implications of the new financial reporting regime, and it should feature as part of an individual's continuing professional development training, a point emphasised by the FRC in its Impact Analysis document (FRC, 2013b). Stakeholders will need to be informed of changes in the financial statements, such as new layout and terminology, though for smaller entities this need not be a major part of the transition implementation, as stakeholder groups will be fewer and their needs less complicated. These transition planning issues relevant to training and communication are covered in Chapter 7.

8.3.2 Costs

As with any transition, there will be costs incurred, and in some cases those costs may turn out to be significant. Entities that have not previously accounted for financial instruments under IAS 39 *Financial Instruments* or its UK GAAP equivalent FRS 26, and which have significant transactions and balances involving financial instruments are likely to incur the most costs of transition. However, for small entities and for those that do not have complex accounting issues, the costs should not be great.

The FRC believes that adopting FRS 101 within a group offers significant savings.

As discussed in Chapter 4, much of the cost of transition is one-off, occurring in the run up to the publication of the first financial statements under the new financial reporting regime, and in the long run, costs are likely to be reduced due to the less onerous disclosure requirements of both FRS 101 and FRS 102.

CONCLUSION

The new UK financial reporting regime represents one of the biggest changes for most UK accountants in practice and in business for many years. Groups have to make some important decisions about which UK GAAP standard they wish subsidiaries to follow, and in some cases the option to revert to UK GAAP from EU-adopted IFRS may be used.

Preparers of financial statements should view the transition as a significant project being undertaken in their organisation and use project management techniques to ensure that the transition is as effective and efficient as possible. It is likely that financial statements will look very different after the transition, and with profit and equity affected by the transitional adjustments, it is important to consider the wider implications, for example, on raising finance and on the amount of tax payable. Smaller UK entities transitioning to FRS 102 are likely to rely on external advice to plan and execute the transition, but this does not mean that management and others within the organisation should not build up a good knowledge of the relevant requirements. Too much dependence on the input of specialists and external auditors makes it difficult to embed the new reporting requirements, which ultimately must become business as usual for UK reporting entities.

9 THE WAY FORWARD – THE MOVE TOWARDS IFRS IN THE US AND SELECTED OTHER COUNTRIES

This final chapter will explore the specific issues facing the US and a selection of other countries in terms of the progress they have made in converging with, or adopting, IFRS. The next few years will see the US decide on its strategy for convergence, endorsement or adoption of IFRS – or the hybrid approach called condorsement. Other economies will decide whether to extend the use of either full IFRS or the IFRS for SMEs fully or partially within their jurisdictions. Some countries may decide to revise their own local GAAP and make it more aligned to IFRS, as is happening in the UK and Ireland. Whatever specific decisions are made, over the next decade there will be more and more reporting entities moving to follow IFRS-based financial reporting. The aim of this chapter is to consider potential future developments and highlight some of the transition issues relevant to the jurisdictions considered.

9.1 THE US AND IFRS

The US has not yet decided on its position regarding adopting, converging with, or endorsing IFRS for use by US companies. However, a move by the US towards IFRS-based financial reporting is seen by many as a crucial factor in the international harmonisaton of financial reporting. As David Tweedie said in 2010, when he was Chair of the IASB, "We can have international standards, but we will never have global standards without the United States" (Kranacher, 2010).

Chapter 1 contained an outline of the developments that have taken place in the last 10 years or so in respect of dialogue between the FASB, the SEC and the IASB and the major projects that have been established, and a reminder is provided here to highlight the key points of the progress that has so far been made. This section will also explore the main differences between US GAAP and IFRS, with indications of major transitional issues that may arise. For US firms, dual reporting is likely to be a key issue, with some commentators suggesting that a likely route to the US becoming more harmonised with IFRS could involve a dual reporting scenario lasting for at least three years and very possibly longer (Bellandi, 2012). IFRS is important for many US companies regardless of the SEC position on the use of IFRS within the US, because they have foreign subsidiaries that have to report under IFRS, or they are owned by foreign parent companies that are located in jurisdictions that require or permit the use of IFRS. For benchmarking purposes, many investors looking at the financial statements of US companies would prefer a situation of comparability, and an easy method of analysing the results of US companies in line with their foreign industry peers.

A PwC survey conducted in 2011 showed that 63% of over 2,700 responders expected that ultimately the SEC would require mandatory IFRS reporting in the US, and 66% believed that voluntary adoption of IFRS should be permitted for US domestic companies (PwC, 2011a). As well as preparers of financial statements, some academics also encourage the adoption of IFRS

in the US, for example, suggesting that its use would help to kick start the US economy, as it would encourage growth, create job opportunities and create access to finance (Fosbre, Kraft, and Fosbre, 2011). Other persuasive influence comes from the G20, with the G20 leaders in 2009 calling for the standard setters to redouble their efforts to complete convergence of global accounting standards by 2011.

Despite this apparent appetite for IFRS-based reporting in the US, it is important to note that no final decision has yet been made on the timing or nature of any harmonisation process for US companies, and while within the US there is considerable support for the use of IFRS-based financial reporting, there is also a sizeable body of opinion that argues against its adoption, citing costs, lack of IFRS literacy, and “change fatigue” as some of the reasons in favour of retaining the status quo. Some commentators suggest that due to the fundamental differences in how IFRS and US GAAP have been developed, it is unlikely that there will ever be a situation where complete convergence will happen. However, given that hundreds of foreign companies currently file IFRS-based financial statements in the US, it is not an insignificant feature of US financial reporting, and can only increase in prominence in the future.

9.1.1 Progress Towards Harmonisation

Much of the work of the IASB since its formation has been focused on convergence with US GAAP. In 2002, the IASB and the FASB agreed to work on a programme of convergence, detailed in the Norwalk Agreement, in which each board acknowledged their commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting (FASB, 2008). The boards agreed to work together to make their existing financial reporting standards fully compatible as soon as is practicable and to coordinate their future work programmes to ensure that compatibility is maintained.

Over the next few years, considerable progress was made. Both boards issued new standards or revised existing standards, which aligned the requirements of IFRS and US GAAP for certain accounting issues. These projects were outlined in a Memorandum of Understanding in 2006, further updated in 2008. For example, the IASB issued IFRS 5 dealing with non-current assets held for sale and discontinued operations, which aligned with US standard SFAS 144 on the same topic. The IASB published new standards on borrowing costs and segment reporting, which aligned substantially with US GAAP. The FASB issued guidance on research and development costs acquired in a business combination that aligned with IFRS. The two boards worked on joint projects in many areas to eliminate as many differences as possible between IFRS and US GAAP. These projects included the conceptual framework, business combinations, financial instruments, presentation of financial statements, intangible assets, leases, revenue recognition and fair value measurement. Some of these projects are still ongoing.

In 2006 the SEC reviewed the financial statements of more than 100 foreign issuers that filed IFRS financial statements including the required reconciliation to US GAAP. There were some concerns over the treatment of certain items in the financial statements, and over the manner of presentation of the financial statements and required notes (SEC, 2007). However, a momentous decision was made by the SEC in 2007. For the first time, IFRS financial statements would be accepted by the SEC without reconciliation to US GAAP. There were certain conditions; for example, the financial statements had to be prepared using IFRS as

issued by the IASB (and not amended by national authorities for use in particular jurisdictions), and they had to be prepared in the English language. This prompted many commentators to suggest that the move to IFRS in the US was inevitable, and a question of when rather than if (Johnson, 2008).

A proposed roadmap for moving to IFRS was published by the SEC in 2008. The proposal was that all US public companies would file financial statements prepared under IFRS by 2016 and that there would be staggered adoption of IFRS starting in 2014 for the largest reporting entities, known as accelerated filers. Certain entities would be given the option of early adoption. Unfortunately, progress in the convergence of US GAAP and IFRS has been slower than expected, and while the 2008 roadmap had been generally well received, many commentators in the US were concerned at the proposed timescale for transition to IFRS. Many of the respondents to the roadmap proposed in 2008 commented on the deficiency of IFRS in respect of some significant accounting issues, and also expressed concerns over the enforcement mechanisms of the IFRS regulatory framework, amongst other issues. The proposal and its comment period also coincided with the financial crisis that swept the globe in 2007–2008, and clearly the timing affected the appetite for a major change in the financial reporting framework in the US.

In 2010, the SEC maintained its position in support of convergence and in favour of the use of global accounting standards. There was no move to mandate the use of IFRS within the US but the SEC continued to evaluate IFRS and deliberate how a convergence could take place between US GAAP and IFRS (SEC, 2010). The proposed roadmap was revisited, with the SEC suggesting that more research was needed and that an earliest possible date for the use of IFRS in the US would be 2015. The areas of concern highlighted at this time included the independence of the IFRS standard-setting mechanism, the need for education on IFRS in the US, and the impact on analysts and auditors as well as the preparers of financial statements.

In 2011, a Work Plan was issued by the SEC, the purpose of which was to identify a range of matters to be considered in determining whether the US system should incorporate IFRS. The matters included the development and application of IFRS for US companies, developing investor understanding and education regarding IFRS, understanding the impact that changes in accounting standards would have on the US regulatory environment and a consideration of the wider impacts of moving to new financial reporting rules including corporate governance and legal issues (SEC, 2011b).

The Work Plan was further debated and in 2012 a final version was published by the staff of the SEC. The executive summary of the final version of the Work Plan makes it clear that the SEC has not made a decision on the adoption, convergence, endorsement or the hybrid approach of condorsement (SEC, 2012). It is clear that any decision to make IFRS reporting a more significant feature of financial reporting in the US is still far from being reached. Currently, the condorsement approach seems to be favoured, which would see US GAAP being retained but more aligned with IFRS through a phased implementation of convergence followed by endorsement.

This position was highlighted in a speech made by the FASB Chair, Russell Golden, in September 2013, in which he suggested that in the future, a global standard-setting environment would exist, with the key players being the IASB and the FASB as well as other national

standard setters. He also stated that the FASB should continue to develop US GAAP, actively participate in the development of IFRS and enhance relationships and communications with other national standard setters (Golden, 2013).

The new SEC Chair, Mary Jo White, has not made any decisions on IFRS nor suggested a timeline for further debate. In a recent speech she commented that a regime of global accounting standards is only possible if the standards are applied consistently and if there are strong enforcement mechanisms. She reiterated the sentiments of the FASB Chair by commenting that the US collaborates with national standard setters and international bodies such as IOSCO, and confirmed the close cooperation of the FASB and the IASB, with both boards actively involved in convergence projects (White, 2013).

9.1.2 A Comparison of US GAAP and IFRS

The objective of this section is to highlight some of the differences between US GAAP and IFRS. A detailed discussion of this topic is beyond the scope of this book, and this section does not, therefore, contain an exhaustive list of inconsistencies between the two financial reporting frameworks.[1] Before looking at specific accounting issues, it is useful to consider the general features of US GAAP that make it different to IFRS.

Volume and ease of use – US GAAP contains a mixture of detailed rules, implementation guidance, and industry interpretations, which amounts to approximately 25,000 pages of requirements and guidance for US reporting entities (Gornik-Tomaszewski and Showerman, 2010). Compared to IFRS, US GAAP is much longer and until relatively recently was fragmented, making it not a user-friendly set of standards. There is no equivalent of the IFRS for SMEs. The sheer volume of rules and interpretative guidance is a significant barrier to the US adopting or converging with IFRS. The accounting regime was simplified somewhat when the FASB amalgamated the existing US GAAP into the "Codification" that became the single authoritative source of US accounting standards for non-governmental organisations from 2009. The benefits of Codification include making the set of standards easier to use and navigate around, and making it easier for amendments to be made to US GAAP by the use of "Codification Updates".

Prescription versus judgement – There is a consensus of opinion that US GAAP is very rule-based, and a much more prescriptive financial reporting framework than IFRS. In fact, the SEC itself states that US GAAP contains more detailed, specific requirements than IFRS, and that in many instances, IFRS does not contain specific guidance that corresponds to a detailed US GAAP requirement (SEC, 2011c). Some commentators argue that the rules-based nature of the standards is linked to the litigious nature of the US (Walton, 2009), and it is also related to the fact that US GAAP, not being applied in jurisdictions outside of the US, is allowed to be specific rather than generic in nature, in that local variations in law, for example, do not have to be catered for. There is some movement against a set of prescriptive rules, however. The Sarbanes–Oxley Act of 2002 required the SEC to conduct a study into the impact of the US adopting more principle-based standards, such as IFRS, and the

[1] *There are many publications that contain detailed comparisons of US GAAP and IFRS, some of which are listed in Appendix 2.*

report concluded that principle-based standards should be favoured over more rules-based standards. A recent survey of US CPAs, however, found no overwhelming evidence that accountants practising in the US favoured one type of standard over another (McEnroe and Sullivan, 2012).

Industry-specific guidance – One of the benefits of US GAAP that it cited frequently is that it contains a lot of specific guidance for the application of GAAP in particular industries. In IFRS there is some, but not much (e.g., agriculture, insurance, extractive industries). This is one of the arguments used by those not in favour of moving from US GAAP to IFRS, as the lack of industry-specific guidance in IFRS is seen as highly problematical in certain industries.

Status of a conceptual framework – While US GAAP contains a conceptual framework, it exists outside of the Codification and is not authoritative guidance. By contrast, the IASB Framework is authoritative guidance and therefore it is perceived that the status of the US conceptual framework is lower than its IFRS equivalent.

Aside from the more generic differences there are, of course, many points of detail on which US GAAP and IFRS differ. Several studies have considered the main areas of difference between IFRS and US GAAP. One was undertaken by the accounting firm Ernst and Young, which analysed the IFRS to US GAAP differences reported by 130 companies preparing financial statements under IFRS with reconciliations to US GAAP (Ernst and Young, 2007). The survey results are a little out of date, as the joint FASB and IASB projects have eliminated some areas of difference, but the overall impression given shows the range of accounting differences that existed between the two reporting frameworks, and many of these differences persist. The most differences existed in the areas of business combinations and financial instruments, with taxation, provisions and pensions also accounting for a large number of differences in accounting treatment.

Moving on to look at specific areas of difference, Table 9.1 summarises just a very small number of the US GAAP and IFRS differences and links these to wider implications. Note that because companies are not going through a process of transition from US GAAP to IFRS, but are more likely to be concerned with dual reporting, the matters that would specifically impact on the planning of a transition from US GAAP to IFRS have not been considered in detail, but would be similar to those discussed generically in the second section of this book. Also note that the list is not intended to be comprehensive, but more to illustrate some potential areas of difference. There are many documents available which provide a comprehensive comparison of US GAAP and IFRS. In addition, most large audit and accounting firms have interactive tools that can be used diagnostically to provide a detailed review of an entity's accounting differences under US GAAP compared to IFRS.

One topic that is not addressed in Table 9.1 is that of financial instruments. In relation to this matter, which is material to many companies' financial statements, there are many areas of difference in the detailed requirements, though the projects leading up to the issuance of IFRS 9 *Financial Instruments* have achieved some harmonisation and the principles of accounting are broadly similar. Both the IASB and the FASB consider fair value accounting as the more appropriate measure for many financial instruments. The scope of the topic is much too broad to even briefly summarise, and this is made more difficult due to the fact that accounting for financial instruments is very much a moving target, with the phased project on IFRS 9 not due for completion until 2014.

Table 9.1 Main differences between IFRS and US GAAP

Accounting area	*US GAAP requirement*	*IFRS requirement*	*Examples of wider implication/commentary*
Presentation of financial statements – the same elements of financial statements are presented and there has been convergence in this area. But areas of detailed difference remain.	Extraordinary items are allowed for unusual and infrequent items. More prescription on headings, subheadings and subtotals used for SEC companies.	Extraordinary items not allowed. More flexibility in presentation. More encouragement of use of non-GAAP measures.	Users of financial statements need education on presentational differences. Management to make potentially more decisions on how to present information. Many US commentators are uncomfortable with the level of flexibility allowed in IFRS presentation, preferring a more consistent approach, which they believe allows greater comparability.
Property, plant and equipment – general rules on recognition are similar but there are differences on measurement.	Less emphasis on the componentisation of assets and annual review of residual value. The revaluation model is not allowed.	Requirement to treat individually significant components separately and review residual value. The revaluation option is allowed.	IFRS requires generally a more detailed accounting treatment – implications for accounting systems and controls Implications for analysis of the balance sheet, e.g., ROCE calculations affected, implications for comparisons of financial statements.
Borrowing costs – both require capitalisation of relevant borrowing costs but differences in measurement exist.	Borrowing costs do not include exchange rate differences and interest earned on borrowed funds cannot offset interest costs.	Exchange rate differences are included in the measurement of borrowing costs and offsetting is allowed.	Relatively minor difference in accounting measurement, few wider implications other than different calculations to be used. Documentation in relation to borrowing costs may need to be changed, e.g., to reflect exchange rate differences.
Impairment – both require impairment of non-current assets where indicators of impairment exist but measurement is different.	A two-step impairment and recoverability test is performed. More emphasis on testing individual assets for impairment, when groups of assets are tested collectively at the level of a business segment. Reversal of impairment losses is not permitted.	Impairment based on the difference between carrying value and recoverable amount. Impairments are performed on individual assets but normally at the level of a cash-generating unit, which is often a smaller collection of assets than a business segment. Impairment losses can be reversed for assets other than goodwill.	The difference in accounting measurement can create significant additional work in determining the impairment to be recognised under IFRS compared to US GAAP. For significant impairments there would be a profit implication due to the difference in the impairment loss recognised. It is likely that more impairments are recognised under IFRS, with profit implications.

Table 9.1 (***Continued***)

Accounting area	*US GAAP requirement*	*IFRS requirement*	*Examples of wider implication/commentary*
Intangible assets – both require capitalisation of acquired intangibles and generally do not allow recognition of most internally generated intangibles.	The revaluation model is not permitted. Generally, all research and development costs are expensed (though some industry-specific guidance does allow capitalisation in some industries).	The revaluation model is permitted in certain circumstances. Research expenditure is expensed and development costs must be capitalised where certain conditions are met.	The cut-off point between research and development costs needs to be established under IFRS so that capitalisation criteria are applied appropriately to development costs only. Capitalisation of development costs affects the timing of expenses being taken to profit and may have tax implications.
Investment property – treatment is substantially different.	US GAAP does not specifically differentiate investment property from other types of property, so they are measured on the cost basis.	Investment property is the subject of specific accounting rules, and a policy choice is made to measure either at cost or using the revaluation model with revaluation gains and losses recognised in profit.	Under IFRS the fair value model when applied to investment property can cause volatility in profit.
Leasing – currently both recognise finance/capital and operating leases as distinct but use different criteria to differentiate the two types of lease.	A numerical test is applied – a lease is a finance/capital lease where the lease period covers 75% of the asset's useful life or the present value of lease payments is 90% of the cost of the asset.	A more judgement-based approach is taken and no % rules are applied to determine the nature of a lease.	This is a good example of the different traditional approaches of US GAAP and IFRS – the former takes a quantitative, rules-based approach, the latter is based on applying principles to determine the substance of a situation. The joint IASB and FASB project on leasing is ongoing.
Inventory – both allow the use of FIFO and weighted average different measurement bases.	LIFO allowed – though there is much discussion at the time of writing on whether this will continue.	LIFO prohibited and FIFO or weighted average are the most common valuation methods.	Moving from LIFO to FIFO would impact profit and could have significant tax implications for entities holding large inventory balances. This is a controversial issue and has been much debated in the US financial press.
Provisions and contingencies – there are differences in the recognition criteria as well as some definitions.	Provisions are recognised when they are "likely to occur" – this is commonly applied at a probability of 75–80%.	Provisions are recognised when they are probable to give rise to an outflow – applied as a 50% probability threshold.	Application of IFRS means generally more provisions would be recognised as the probability judgement is based on a lower threshold, affecting the liquidity profile and profit.
Revenue recognition – US GAAP is much more detailed and industry-specific.	General recognition criteria exist but these are supplemented by extensive application rules and guidance for particular industries.	Revenue recognition principles exist for goods and services. A new IFRS is expected in this area very soon.	This is a controversial area and it is unlikely that the publication of revised IFRS requirements for revenue recognition will resolve the main area of difference, as it will not add industry-specific guidance to IFRS.

A similar issue is that of business combinations. Again, the principles of IFRS and US GAAP are similar, but there are differences in the detail. In 2008 the IASB issued a revised version of IFRS 3 *Business Combinations,* and the FASB issued two standards, SFAS 141(R*) Business Combinations* and SFAS 160 *Non-controlling Interests in Consolidated Financial Statements*, which should ensure that the accounting for M&A activity is the same whether an entity is applying IFRSs or US GAAP. While the standards do achieve convergence in the broad principle of accounting for business combinations, the points of detailed difference are too numerous to summarise properly.

9.1.3 Conclusion on Key Transition Issues for US Companies

The problem facing US companies is uncertainty. A few years ago many US commentators were confident that IFRS would be adopted in some form within the US, but now the situation is less clear. As discussed earlier, the debate over whether the US will follow an approach of convergence, endorsement or condorsement has died down, and there has been very little discussion of timelines, whichever approach may eventually be decided upon.

Despite this, many US organisations have studied the effects of convergence on their financial statements, and begun to analyse the wider impacts. A survey of financial executives conducted in 2010 found that 46% had already or were in the process of assessing the potential impact of IFRS on their accounting policies (KPMG, 2010). Certainly over the last few years knowledge and understanding of IFRS has increased in the US, and whichever method of harmonisation of the two financial reporting frameworks is decided upon, most companies have at least started to consider the changes in accounting and the wider implications that would arise.

It is likely that for many US entities, dual reporting will be an issue. Even if at some point in the future, US entities are preparing financial statements under an IFRS-based framework, they may need to keep accounting records under legacy US GAAP for tax reasons or for monitoring of contractual issues such as debt covenants. And, as explained earlier, for many US entities dual reporting is essential anyway, if they have foreign group members that are already reporting under IFRS. Entities therefore need to ensure that their accounting systems can cope with dual reporting and that controls are in place to safeguard the integrity of data processing.

For many US entities, the Sarbanes–Oxley (SOX) legislation is a crucial compliance issue. There needs to be sufficiently robust controls over financial reporting so that a statement of effectiveness of controls can be made in accordance with the legislation. Therefore, any systems changes caused by a move to dual reporting or to a whole new financial reporting framework must be planned and implemented carefully, involving internal audit to test the strength of controls over financial reporting and to ensure there are no control deficiencies. This is relevant to both ongoing systems issues and to accounting processes specific to the transition to the first year of reporting under a new financial reporting regime. For SOX compliance, documentation is also a key issue, so entities will have to make sure that any necessary changes to systems and controls are documented fully.

Training is a crucial issue in any financial reporting transition, as discussed in Chapter 7. In the US, many accountants are aware at least of the main features of IFRS, which is a vast improvement on the situation 10 years ago, when there was very little knowledge of IFRS in

the US.[2] One particular area in which US accountants may need to develop skills is in the exercise of significant judgements, as this will be much more a feature of accounting under IFRS-converged standards than under US GAAP.

Management will need to liaise carefully with external auditors at all stages of conversion, and in the preparation of financial statements using IFRS-converged standards. Again, this will be particularly important where significant management estimates and judgements need to be made. Some commentators have pointed out that accounting may become overly cautious due to the uncertainty about the potential for litigation using a more principle-based financial reporting framework (Hail, Leuz, and Wysocki, 2010) and therefore it may take time for the preparers of the financial statements to feel comfortable in applying their professional judgement in the more subjective areas of accounting.

Costs will need to be considered. As discussed in Chapter 4, the costs of transition to IFRS can be significant, and even if US entities move to dual reporting rather than an outright transition to IFRS, the costs of developing such dual-reporting systems will be considerable and maybe even greater than a transition. The SEC estimates that an average cost of transition would be approximately 0.13% of revenue (SEC, 2008) and that the average cost for those companies eligible for early adoption (under the proposed roadmap that was issued in 2008) of IFRS would be approximately $32 million at that time. An academic study suggests that the total cost of transition for the US economy as a whole could be in the region of $8 trillion (Hail, Leuz, and Wysocki, 2010). Undoubtedly the timing of the proposed roadmap coinciding with the financial crisis of 2008 did little to encourage the progress of transition to IFRS, with many companies baulking at the cost. Although IFRS transition has been a less visible topic of debate in the last year or so compared to in the late 2000s, it is likely that the debate will be reopened in the not-too-distant future, especially if companies emerge from the recession with both the cash to spend on transition projects and a renewed enthusiasm for financial reporting change based on seeing the long-term benefits of a converged financial reporting regime.

9.2 IFRS IN BRAZIL, RUSSIA, INDIA AND CHINA

Brazil, Russia, India and China are four rapidly growing economies that, while they differ from each other culturally and politically, are all experiencing tremendous economic success.[3] According to one report, China is expected to overtake the US as the world's largest economy sometime before 2020 and India is projected to have the biggest growth rate of all of the world's economies over the next four decades (PwC, 2011d). Both Russia and Brazil are also expected to increase in economic power, and the same report suggests that all four of the BRIC countries will be ranked in the top ten of the world's largest economies by 2050.

It is interesting to consider the level of IFRS adoption or convergence that has taken place in these countries. Brazil has made the most progress with adoption of IFRS, with the other countries showing a desire to converge with IFRS to varying degrees and with different

[2] *From the author's own experience of delivering training courses in IFRS; for example, in 2005 several delegates travelled from the US to attend an IFRS training programme in the UK because no appropriate courses could be found in the US.*

[3] *They are commonly grouped and referred to as the BRIC countries and it is estimated that within a few decades they will be amongst the wealthiest economies of the world, contributing a significant amount to global economic output.*

time frames. For all of these countries, the use of globally accepted accounting standards is advantageous to their expanding economies and the many thousands of companies within each of the countries that are trying to expand into overseas markets and/or attract foreign investment. While they exhibit very different cultural characteristics, they have a common desire to become important contributors to the global economy.

Looking at the IFRS experience of organisations in these countries can help reporting entities yet to go through transition to plan their transition projects. The discussions on each of these countries are shorter than the discussion in the previous section on the US situation regarding IFRS, mainly because, unfortunately, the literature on transition planning is much less developed in respect of countries outside of Europe, the US and selected other countries.

9.2.1 Brazil

Brazil's adoption of IFRS is well underway, with the two regulatory authorities – the Comitê de Pronunciamentos Contábeis (CPC) [The Brazilian Accounting Pronouncements Committee] and the Comissão de Valores Mobiliários (CVM) [Securities and Exchange Commission of Brazil] both being supporters of the country's move to IFRS. Listed entities have been required to use IFRS in consolidated financial statements from the financial year ended 31 December 2010, and early adoption was allowed from 2007. The separate financial statements follow Brazilian GAAP accounting standards that have been converged with IFRS. Financial institutions generally follow IFRS, and unlisted entities, depending on their size, use either Brazilian GAAP or IFRS (IFRS Foundation, 2013a).

In converging Brazilian accounting standards with IFRS, some modifications were made. These relate to the removal of the option to revalue intangible assets and property, plant and equipment; to accounting for interests in subsidiaries, associates and joint ventures in separate financial statements; and to construction contracts dealing with real estate.

Brazil was one of the first adopters of the IFRS for SMEs, with all small and medium-sized entities required to use the standard from financial years beginning 2010, unless they are a small (micro) entity with gross revenue less than R$ 3.6 million, in which case they file simplified accounts with the authorities. Brazil has made similar modifications to the IFRS for SMEs as made to full IFRS, as outlined above. All small and medium-sized entities in Brazil have the option of using full IFRS if they wish to do so.

One of the challenges that faced Brazilian accountants was that prior to the introduction of the IFRS-based reporting regime there was little separation between tax accounting and financial accounting. Preparers of financial statements were therefore not used to considering the accounts from the point of view of shareholders, and the level of detail demanded by IFRS disclosure requirements created a very steep learning curve. The volume of financial information required for disclosure increased significantly, and there was heavy reliance on external audit firms to help with disclosure.

The transition to IFRS was not without problems. In a CVM review of the first Brazilian financial statements prepared under IFRS, problems were found in 80%, and some commentators were surprised that the number was not higher (PwC, 2011c). This illustrates the importance

of adequate training, and allowing sufficient time for the new financial reporting rules to be understood properly.

9.2.2 Russia

In Russia, the Ministry of Finance is responsible for issuing Russian GAAP in the form of Russian Accounting Standards (RAS) and also for the endorsement of IFRS for use in the country. Russia supports the move to IFRS, and in 2011 IFRSs were endorsed for use, with listed entities required to adopt IFRS in 2012 for their consolidated financial statements. For companies currently using US GAAP and for those that only have debt securities listed, the move to IFRS is deferred until 2015. Russia has endorsed IFRS without making modifications to the standards. Russian GAAP continues to exist and the individual financial statements of group companies continue to be prepared using RAS. Russia has not adopted the IFRS for SMEs (IFRS Foundation, 2013c).

Russia's adoption of IFRS will help to attract foreign investment, and a key factor is the credibility of the financial statements prepared under IFRS. Little research has been performed on the impact of IFRS adoption, however, so it is too early to conclude that there is a correlation between the use of IFRS and a direct impact on capital flows into the country. According to some commentators this is important given the legacy of corruption in Russia, particularly, in relation to accounting, the practice of under-reporting profit to minimise tax liabilities (Borker, 2012).

The transition to IFRS in many Russian companies created many significant accounting impacts, as there was a large discrepancy between the accounting rules of RAS and those of IFRS. In RAS there is no conceptual framework, and areas of difference in accounting requirements include business combinations, valuation of non-current assets, impairment, leasing, financial instruments and deferred tax, to name just a few.

Similar to a theme raised in the discussion of the Brazilian transition, the level of disclosure required by IFRS would seem to be a problem. In Russia, as in Brazil, the national financial reporting standards required much less disclosure than IFRS. This issue is compounded in Russia by a cultural attitude of secrecy, which makes disclosure, especially of commercial issues, very unpopular. An academic study found that Russian managers feared disclosing information to their competitors (Combs, Samy, and Myachina, 2013), which very much goes against the principle of transparency inherent in IFRS reporting. Also similar to the Brazilian situation is the fact that under the national accounting regime, accounting was very much done for tax purposes, and the users of the financial statements were primarily the tax authorities.

A problem that arose in Russia, which is presumably not an isolated incident, lies in the translation of IFRS literature. There have been errors in translations of some material used by reporting entities (note that this does not imply that the IASB's official translations of IFRS are incorrect), which could obviously mean that an incorrect accounting treatment is applied. One study reports that some Russian translations used prior to 2011 contained major inaccuracies, for example text that omitted the word "not", therefore implying that something must be done when in fact it must not be done (Vysotskaya and Prokofieva, 2013). This situation should have been resolved now that official IFRS translations are available, but clearly this kind of problem did little to encourage Russian firms to adopt IFRS.

As in other countries, Russia lacked, and still is short of, skilled accountants who are IFRS-literate. There have been several initiatives to improve the state of knowledge of IFRS within the country, but a lot remains to be done. Naturally, training is concentrated in locations with a concentration of company headquarters and finance centres, and is not really embedded within accounting education.

9.2.3 India

In 2007 a programme of harmonisation with IFRS was announced by India's Ministry of Corporate Affairs, in which existing Indian GAAP Accounting Standards would be converged with IFRS. This roadmap did not lay out a complete adoption of IFRS. The new Indian GAAP standards that were developed, and named Ind AS, are based on IFRS but are modified to reflect specific Indian conditions. Therefore, India has not adopted IFRS but is converging its standards to follow IFRS principles. In 2011, 35 Ind ASs were issued, broadly aligned with IFRS. Initially it was expected that the transition to the new Ind AS would begin in 2011, but adoption has been delayed by a number of factors including the lack of readiness of companies to move to the new standards, which led the authorities to believe that it would be unfair to enforce the transition on Indian listed entities. The initial proposal was for the largest listed entities to adopt the IFRS-converged Ind AS in 2011, and a phased transition to follow for smaller entities, ending in 2014, but this timeline has been abandoned and an updated roadmap is yet to be released.

It is expected that, eventually, a two-tier financial reporting framework will be adopted in India, with listed entities required to use the converged Ind AS, and small and medium-sized entities continuing to use existing Indian GAAP, though there may be an option for these entities to adopt Ind AS if they choose to do so. India is not considering the adoption of the IFRS for SMEs (IFRS Foundation, 2013d).

Ind AS has not yet been implemented, pending issues such as tax-related matters being finalised. At the time of writing, both domestic and foreign listed entities are permitted by the Securities and Exchange Board of India (SEBI) to file financial statements prepared under IFRS as issued by the IASB and a small number of companies have taken this option.

In developing Ind AS, some options have been removed and some modifications made, so the eventual Indian accounting treatments will differ from IFRS as issued by the IASB in many ways. Some of the accounting areas that will not be treated consistently in Ind AS and IFRS are noted below:

- Associates
- Borrowing costs
- Financial instruments
- Business combinations
- First-time adoption of IFRS

The modifications made are mainly some small points of detail – generally, the principle of accounting is the same in Ind AS and IFRS.

Additionally, some options have been removed in relation to some areas of presentation of financial statements, including the statement of cash flows, government grants, investment property and intangible assets.

Indian companies considering the impact of moving to Ind AS will need to perform an accounting impact assessment of the type discussed in Chapter 5, and to identify and plan for wider impacts as explained in Chapter 6. There will, of course, be many areas of detailed difference, but the key areas where accounting policies are likely to be different under the new financial reporting rules include revenue recognition, non-current assets and depreciation, inventories, and financial statement presentation.

In a survey of Indian accountants, auditors, finance professionals and academics, a majority of respondents thought that staff being unfamiliar with the new accounting requirements was the biggest hindrance to implementation of the new standards. Other factors detrimentally affecting their adoption were cited as being the lack of reference material available and the new system being overly complicated (Srivastava and Bhutani, 2012). The same survey indicated a strong demand for face-to-face training, indicating that education is an important issue, and the lack of IFRS-literate accountants is a strong barrier to the harmonisation of accounting standards.

There are also calls for a wider scope of education on IFRS, as it is felt that many investors, analysts and other users of financial statements in India are not aware of the implications of moving to the converged Ind ASs. A recent study of investors' awareness of IFRS in India showed that while the majority were very or quite familiar with IFRS, only 16% of those surveyed felt "extremely confident" in making investment decisions which involve IFRS-based financial statements (Rohini, 2011). The study concludes with a recommendation that Indian companies and SEBI should invest in the education of shareholders in order to avoid misunderstandings of IFRS financial statements.

Other barriers to moving to the converged standards mirror those discussed with reference to the US adoption of IFRS-based reporting. One is to do with a nationalistic approach to financial reporting. Like the US, India has a well-established financial reporting regime comprising well-understood accounting standards, and this creates a sense of reluctance to move away from the accepted rules to a new set of requirements. As an Indian managing director stated, "In India, there is a great deal of pride in Indian GAAP. It is actually very comprehensive, very rigorous. Indian GAAP being what it is, people think that since we mastered Indian GAAP we are not so concerned about IFRS." (Meyer, 2009). This sums up very well the attitude amongst many Indian professionals, who, while they can see the conceptual benefits of using international financial reporting requirements, would prefer to stick with the rules that they are familiar with, especially given that the cost of transition is often perceived as outweighing the benefit derived.

Indian companies, like their US counterparts, are also likely to have to use dual reporting for at least several years, once the transition is underway. This is for various reasons including the fact that tax will probably be based on the old financial reporting rules for a period of time. Also, due to the new Ind ASs being a local version of IFRS, the financial statements produced using the new rules will mean that companies cannot make a dual statement of compliance with Indian GAAP and IFRS, which may be important for entities listed on several stock exchanges.

There have also been criticisms that the regulatory authorities have failed to provide sufficient implementation guidance to entities. This makes them very reluctant to start planning their conversions, as they feel that they are aiming at a moving target. National regulators can

learn from this, and ensure that enough practical support is given to companies and that clear guidelines are laid out.

9.2.4 China

China's position in terms of its accounting standards and harmonisation with IFRS is unique, shaped by its turbulent political, cultural and economic events of the last century. A detailed discussion of how history has shaped Chinese accounting, although interesting, is outside the scope of this chapter, but a brief summary of relevant issues is useful. Until 1978 there was little development of accounting standards, and indeed accounting education ceased almost entirely during the Cultural Revolution (Ping, Collins, and Shanping, 2013). The accounting guidance that did exist, known as Uniform Accounting Standards, was focused on governmental accounting issues due to state ownership of most enterprise. In the late 1980s China began a programme of economic reform, with the aim of modernising business and allowing freer international trade. The first Chinese stock exchanges were established in 1991, and at this point it was recognised that accounting regulations with a broader scope and more appropriate to private enterprise should be developed. As early as 1992 China's finance minister stated that harmonisation of Chinese GAAP with international standards was an objective, though at that time the IASB's standards were not specifically referred to as the point of convergence. By 2006, China's stock market had grown into the eighth largest in the world with a market capitalisation of RMB¥4,000 billion, approximately US$500 billion (Chen and Zhang, 2010).

China's approach to IFRS has been to publish national accounting standards that are substantially converged with IFRS, but the use of IFRS as issued by the IASB is not permitted within the country. The Ministry of Finance acts as the national standard setter and issues Chinese Accounting Standards. There is a specific Chinese Accounting Standard for Small Entities, and China has not adopted the IFRS for SMEs, though it has been translated into simplified Chinese, along with selected IFRSs. In 2005 the Ministry of Finance stated its aim of convergence with IFRS and currently, while there are some areas of difference, Chinese GAAP and IFRS are broadly similar (IFRS Foundation, 2013b). An academic study concludes that by 2006, Chinese GAAP had a 77% level of convergence with IFRS (Peng and van der Laan Smith, 2010). In 2007 a new set of Chinese Accounting Standards was issued including 38 specific areas of guidance, and which substantially furthered convergence of Chinese GAAP with IFRS.

Turning to look at implementation issues, just as in other countries, China has faced a significant shortage of experienced and IFRS-literate accountants, and training has been a huge priority, especially given the lack of accounting education in the country as a whole prior to the 1990s. China has also faced specific obstacles to convergence of its accounting standards. For example, fair value accounting was not introduced until 2006, largely due to a lack of infrastructure and free markets to support its use. Some commentators have suggested that even though Chinese Accounting Standards are substantially converged with IFRS, this does not necessarily mean that the financial statements produced under Chinese GAAP actually reflect convergence due to factors such as lack of monitoring and weak corporate governance practices in China, as well as a lack of understanding of IFRS principles and the use of judgement by local accountants.

One study found that on the adoption of the new Chinese Accounting Standards in 2007, there was a difference in how the standards impacted on financial statements depending on

the location of the business within China. For companies in slow-growing regions, the move to the new standards caused a significant increase in earnings, but in fast-growing regions the impact on earnings was much smaller (Zhang and Wang, 2012). This indicates that in a country covering such a wide geographical area as China, and with great disparity in the level of economic growth rates and development between regions, the implementation of IFRS-based financial reporting will not be uniform, an issue that governments should consider when developing a convergence strategy and which impacts on the accounting and wider issues of transition faced by individual companies.

CONCLUSION

This chapter has explored the transitional issues faced by a selection of countries, focusing on the US as a major capital market of the world, and the countries with rapidly developing economies that are predicted to vie for that position in decades to come. If anything, this chapter has shown that the move to IFRS-based financial reporting is anything but uniform in these countries. All have objectives to harmonise in varying degrees with IFRS, but have very different approaches and stages of conversion, and are affected heavily by politics and cultural issues which may hamper, or indeed speed up, the appetite for adoption of, or conversion with, IFRS.

For individual companies within these jurisdictions, there are unique transitional issues to deal with. And in other countries yet to go through transition to IFRS there may be a lack of infrastructural support for companies, as well as a lack of skill and experience in IFRS reporting, which makes transition planning problematical and necessitates reliance on external support, which can be expensive and fails to embed IFRS reporting properly in the business, meaning that all the benefits of going through a transition are unlikely to be accrued.

As mentioned at the beginning of this chapter, discussion of the transition plans of more countries, though interesting, is beyond the scope of this book. Interested readers are directed to the website of the IFRS Foundation, where a dedicated section deals with the use of IFRS around the world and jurisdictional profiles can be found which explain whether individual countries have adopted IFRS or have a stated objective of future convergence, whether that is via adoption, convergence or a hybrid method. Appendix 2 also contains a selection of resources including academic studies of IFRS adoption in some other countries, and readers are reminded that the global accounting firms all have country-specific resources that provide insights into the planning of an IFRS transition in the countries in which they operate.

APPENDIX 1: IASB STANDARDS

IFRS and IAS

IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments
IFRS 9	Financial Instruments
IFRS 10	Consolidated Financial Statements
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of Interests in Other Entities
IFRS 13	Fair Value Measurement
IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Statement of Cash Flows
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events After the Reporting Period
IAS 11	Construction Contracts
IAS 12	Income Taxes
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Separate Financial Statements
IAS 28	Investments in Associates and Joint Ventures
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 32	Financial Instruments: Presentation
IAS 33	Earnings per Share
IAS 34	Interim Financial Reporting
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IAS 41	Agriculture

IFRIC and SIC

IFRIC 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities
IFRIC 2	Members' Shares in Co-operative Entities and Similar Instruments
IFRIC 4	Determining whether an Arrangement Contains a Lease
IFRIC 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
IFRIC 6	Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment
IFRIC 7	Applying the Restatement Approach under IAS 29
IFRIC 10	Interim Financial Reporting and Impairment
IFRIC 12	Service Concession Arrangements
IFRIC 13	Customer Loyalty Programmes
IFRIC 14	IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction
IFRIC 15	Agreements for the Construction of Real Estate
IFRIC 16	Hedges of a Net Investment in a Foreign Operation
IFRIC 17	Distributions of Non-cash Assets to Owners
IFRIC 18	Transfers of Assets from Customers
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments
IFRIC 20	Stripping Costs in the Production Phase of a Surface Mine
SIC 7	Introduction of the Euro
SIC 10	Government Assistance – No Specific Relation to Operating Activities
SIC 15	Operating Leases – Incentives
SIC 25	Income Taxes – Changes in the Tax Status of An Entity or its Shareholders
SIC 27	Evaluating the Substance of Transactions Involving the Legal Form of A Lease
SIC 29	Disclosure – Service Concession Arrangements
SIC 31	Revenue – Barter Transactions Involving Advertising Services
SIC 32	Intangible Assets – Website Costs

Source: IFRS Foundation

APPENDIX 2: USEFUL REFERENCE MATERIAL AND FURTHER READING

IFRS STANDARDS AS ISSUED BY THE IASB

Registering at the IFRS Foundation website (www.ifrs.org) gives access to the current year's unaccompanied IFRSs and there is also free access to the technical summaries of the standards in a number of languages. Access to the full range of official IFRS documentation is by subscription, and this gives access to the current version of the Green Book – a guide through IFRS which contains useful educational material as well as the full text of the Red Book and Blue Book which contain the IFRSs and accompanying material such as bases for conclusions.

The IFRS Foundation also maintains a comprehensive list of educational material on IFRS, which can be accessed at http://www.ifrs.org/Use-around-the-world/Education/Pages/Learning-Resources.aspx.

IFRS Interpretations and Guidance

There are many IFRS interpretations available. All of the major accounting firms have IFRS interpretation material available, as well as numerous publishers all over the world. These texts are largely very long and detailed and aimed at accountants who need to know the detail of the IFRS requirements and their application. A brief selection is shown below.

Deloitte iGAAP: *A Guide to IFRS Reporting* Volume Set 2013
Ernst and Young: *International GAAP 2013: Generally Accepted Accounting Principles under International Financial Reporting Standards*
KPMG: *Insights into IFRS 2013*
PwC: *Manual of Accounting IFRS 2013*
Wiley: *IFRS Practical Implementation Guide and Workbook* (Abbas A. Mirza, Graham Holt, Liesel Knorr, 2011)
Wiley: *IFRS 2013 Interpretation and Application of International Financial Reporting Standards* (Bruce Mackenzie, Danie Coetsee, Tapiwa Njikizana, Raymond Chamboko, Blaise Colyvas, Brandon Hanekom, Edwin Selbst)
Wiley: *IFRS Financial Statement Disclosures: A Casebook and Guide* (Michael Turner, Gavin Huber, 2013)

Shorter Introductory Texts on IFRS

These offer a more concise introduction to IFRS, ideal for those looking at IFRS for the first time.
BPP Learning Media: *IFRS Explained* (2012)
IFRS For Dummies (Steven Collings, 2012)
Wiley: *IFRS Made Easy* (Steven Bragg, 2010)
Wiley: *An Executive Guide to IFRS: Content, Costs and Benefits to Business* (Peter Walton, 2011)
Wiley: *IFRS Essentials* (Dieter Christian, Norbert Lüdenbach, 2013)

Web Resources

There are some excellent web resources on IFRS. Some are entirely free, some require registration and some are subscription, i.e., paid services. Most websites contain IFRS summaries and application guides, newsletters, industry-specific guidance, disclosure checklists, illustrative financial statements and GAAP versus IFRS comparisons. Again, just a selection is given below.

AICPA IFRS Resources: http://www.ifrs.com
BDO International: Global IFRS Resources: http://www.bdointernational.com/Services/Audit/IFRS/Pages/default.aspx
CICA IFRS Resources: http://www.cica.ca/applying-the-standards/financial-reporting/international-financial-reporting-standards/item71221.aspx
Deloitte iasplus: www.iasplus.com
EY: IFRS Resources: http://www.ey.com/GL/en/Issues/IFRS
KPMG IFRS Institute: http://www.kpmgifrsinstitute.com
PwC IFRS Reporting: http://www.pwc.com/gx/en/ifrs-reporting/index.jhtml

Areas of Special Interest:

New UK GAAP

Bloomsbury: *Financial Reporting for Unlisted Companies in the United Kingdom and the Republic of Ireland* (Steven Collings, Paul Gee, 2014)
PwC: *Manual of Accounting – new UK GAAP* (2013)
PwC: *Similarities and Differences: A Comparison of Current UK GAAP, New UK GAAP (FRS 102) and IFRS*

US GAAP and IFRS

Harriman House: *Transparency in Financial Reporting – A Concise Comparison of IFRS and US GAAP* (Ruth Ann McEwan, 2009)
Pearson: *Comparative International Accounting* (Christopher Nobes and Robert Parker, 2012)
Wiley: *The Handbook to IFRS Transition and to IFRS US GAAP dual reporting* (Francesco Bellandi, 2012)
Wiley: *IFRS and US GAAP: A Comprehensive Comparison* (Steven Shamrock, 2012)

Other Countries

Deloitte iasplus jurisdictional resources homepage: http://www.iasplus.com/en/tag-types/country-publication-guide
The IFRS Foundation: Jurisdictional profiles http://www.ifrs.org/Use-around-the-world/Pages/Jurisdiction-profiles.aspx
Wiley: *International Trends in Financial Reporting under IFRS: Including Comparisons with US GAAP, Chinese GAAP, and Indian GAAP* (Abbas Mizra, Nandakumar Ankarath, 2012)

e-Learning and Other Educational Material

This is a selection of educational material. The e-learning available on various websites is for general use for those wishing to learn more about IFRS and for those applying the standards. The textbooks referred to are aimed specifically at students taking university or professional exams. Much of the e-learning is available free of charge, including the IFRS Foundation's own educational material.

Cengage Learning EMEA: *International Financial Reporting and Analysis* (David Alexander, Anne Britton, Ann Jorissen, 2011)
Deloitte IFRS e-learning material: http://www.deloitteifrslearning.com/
Deloitte IFRS University Consortium: http://www.deloitte.com/us/ifrs/consortium
Financial Times/Prentice Hall: *Advanced Financial Reporting: A Complete Guide to IFRS* (Derry Cotter, 2011)
Financial Times/ Prentice Hall: *International Financial Reporting: A Practical Guide* (Alan Melville, 2011)
IFRS Foundation IFRS Education Initiative: http://www.ifrs.org/Use-around-the-world/Education/Pages/Education.aspx
IFRS Foundation IFRS for SMEs training material: http://go.ifrs.org/smetraining
Kaplan Publishing: *A student's guide to IFRS* (Clare Finch, 2012)
KPMG University Connection: http://www.kpmguniversityconnection.com
Pearson: *Financial Accounting and Reporting* (Barry Elliot, Jamie Elliott, 2013)
PwC 'IFRS Ready' presentations: http://www.pwc.com/us/en/faculty-resource/ifrs-ready.jhtml

APPENDIX 3: SUMMARY OF IFRS TRANSITION PLANNING CONSIDERATIONS

Initial Planning Considerations:

Has a project team been established and does it include representatives from relevant business functions?
Is the project leader sufficiently experienced and credible?
Has a project overview, including key milestones, been created?
Does the project have the support of senior executives?
Is there likely to be a resistance to change to deal with?
Has a SWOT analysis been performed on the transition?
What is the timeline; when is the first IFRS reporting period?
What is the overall scope and strategy of the transition?
Has liaison with the external audit firm commenced?
If external consultants are needed, have they been engaged?
Has a training programme for project team members commenced?
Has the cost of the transition been estimated, and finance secured?
Is there a need to recruit more IFRS-literate personnel?
Is dual reporting required during the period of transition or after transition?
Does the project cater for a post-implementation review to be carried out?

Accounting and Financial Reporting Matters:

Has a line-by-line accounting impact analysis been conducted?
Are the IFRS 1 optional exemptions being applied?
Have accounting implications been prioritised?
What additional disclosures will be needed in the notes to the financial statements?
What are the accounting areas where significant judgement will need to be applied?
What level of materiality should be applied?
Is there an adequate audit trail for the adjustments made?
How will the presentation of the financial statements change?
Does management wish to minimise the changes made to accounting policies?
Do the accounting policies reflect the qualitative characteristics of useful information?
Will any new accounting policies introduce potential volatility to reported results?
Are the accounting policies based on the IFRSs effective at the reporting date?
What accounting policies have industry peers developed?
Do the external auditors concur with the choice of accounting policies?
Has the audit committee approved the choice of accounting policies?
Has a new accounting/financial reporting manual been developed?
Can the first IFRS financial statements contain a statement of full compliance with IFRS?
What will be the impact on any non-GAAP measures reported?
Will external specialists need to provide some figures for disclosure?

Wider Considerations – Systems, Business and Commercial:

Have systems implications been identified and appropriate responses planned?
Are any changes needed to management information systems?

Can IFRS processes be embedded, and not performed outside of the normal accounting systems?
Will internal audit or external consultants provide assurance on controls over financial reporting?
Has an appropriately detailed risk assessment been carried out?
Has an impact analysis been conducted to identify commercial and business implications?
Have tax implications been assessed and tax-planning advice sought?
Are there any significant contractual implications, and if so have appropriate responses been planned?
Is there a potential impact on debt covenants and other financial arrangements?
Will the adoption of IFRS impact on the mergers and acquisitions strategy?
Is there any impact on remuneration packages, pensions or bonus schemes?
Will there be an impact on the ability to pay dividends?
Are any impacts on the share price anticipated?

Communications and Change Management:

Has a communication strategy been developed?
Have key stakeholders been identified and their information needs assessed?
Is there any regulatory requirement for supplementary information on the transition to be provided?
Will changes be communicated within the organisation effectively?
Can training programmes be maintained to ensure IFRS knowledge is up to date?
Can an open dialogue with those affected by the transition be encouraged?

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INDEX

Note: Page numbers in **bold** indicate tables: those in *italics* indicate figures.

accountants, 218, 220
accounting
  fair value, 20–21, 120–122
  financial instruments, 152–153
  first time adoption, 197, 202
  guidance development, 4–5
  hedge accounting, 53–54
  impacts of transition, 105–128, 184, 204–205
  moving to FRS 102, 198–201
  project team expertise, 80
  UK GAAP, 196–205
  see also International Accounting . . . ; Statements of Standard Accounting Practice
accounting impacts, 105–128
  assessment, 105–128, 184, 204–205
  changes to IFRS, 125–127
  developing policies, 116–125
  IFRS 1 financial statements, 184
  initial assessment, 105–116
accounting policy, 25, 28–30, 116–125
  alternative treatments, 30
  application, 29–30
  choices available, 123, **124**
  control activities, 141
  cost-benefit analysis, 119–120
  definition, 28–29
  development, 28–30
  disclosure, 28–29, 123–125
  extent of changes, 117–118
  group companies, 47, **48**, 49, 117, 123
  IAS 8, 29–30
  IFRS 1, 47–50
  impacts of transition, 116–125
  information packs, 176–177
  matters to consider, 118–119
  selection, 29–30
  taxation implications, 122–123
  use of other GAAPs, 30
  volatility, 120–122
acquisitions, 153–154
action plans, **100**, **101–102**, 102–103
adjusted earnings measures, 178
adjustments
  cash flow impacts, 174
  IFRS 1, 49–50
  transition, 160
advisors *see* external advisors
aerospace case study, 161
airline case study, 121
alternative performance measures, 178
assets
  held at fair value, 158
  held for sale, 159
  non-current, 112–114, 119–120
associates, 56–57
audit committee, 129, 137, 146–149
  aspects of involvement, 146–149
  board committees, 149
  communications, 149
  evaluating overall plan, 146–147
  external auditors, 148
  external specialists, 149
  financial reporting issues, 147–148
  internal controls, 148
  oversight of management, 148
  wider issues, 149
audit function, project teams, 80
auditors *see* external auditors
Australia, 182
authorisation, 141–142

backwards simulation method, 85
benefits
  cost-benefit analysis, 50–51, 119–120
  employee, 200
  of experience, 69–76
  of IFRS, 15–23, **77**, 169
board committees, 149
borrowing costs, 114, 200, 212
BP (British Petroleum), 121
Brazil, 215–216, 216–217
British Petroleum (BP), 121
BSkyB Plc case studies, 18, 19
business combinations, 54–55, 201, 214
business functions, 81–82
business impacts, 154–161, **155–160**
business units, 82

Canada
  case studies, 62–63, 93, 96
  transition, 181–182
cash flows
  IFRS adjustments, 174
  impacts of transition, 160
  information packs, 177
  see also statement of cash flows
Centrica Plc case studies, 18, 19–20
change management, 163, 167–170
  identifying those affected, 169–170
  internal communications, 167–170
  public sector case study, 168
  resistance to change, 168
China, 215–216, 220–221
Chinese Accounting Standards, 220–221
Comissão de Valores Mobiliários (CVM), Brazil, 216
commercial impacts, 129, 154–161, **155–160**

Committee of the Sponsoring Organisation (COSO) framework, 137–144
communications, 163–183
  audit committee, 149
  internal communications, 163–170
  internal controls, 143
  UK GAAP, 205
  see also external communications
comparative information, 185
compliance, 41, **139**, 214
comprehensive income
  other, 33–36, **37**, **38**, 40–41
  total, 33, 62–63
Conceptual Framework (the Framework), 10, 25–28
  accounting policies, 116
  chapters of, **27**
  content, 26, **27**
  general purpose financial statements, 26–27
  purpose/status, 25–26
  qualitative characteristics, 27–28
consistency, 194–195
contingencies, 213
contracts to supply, 157
controls
  accounting policies, 141
  activities, 140–143
  authorisation/approval, 141–142
  environment, 137–138
  financial reporting, 75
  high-level reviews, 141
  IT, 142
  physical controls, 143
  review, 142
  segregation of duties, 143
  spreadsheet controls, 142–143
  supervision, 142
  UK GAAP, 205
  see also internal controls
convergence of standards, 12–14
corporate reporting, 80
COSO *see* Committee of the Sponsoring Organisation framework
cost-benefit analysis, 50–51, 119–120
costs, 97–102
  borrowing, 114, 200, 212
  key reduction factors, 99
  types of costs, **98**
  UK GAAP, 205
  US GAAP, 215
cross-functional issues, 73
cultural aspects, 5, 14–15
cumulative translation differences, 56
CVM *see* Commissão de Valores Mobiliários

data conversion/collection, 88
date of transition, IFRS 1, 45–46, 61–62
debt covenants, 152–153
deemed cost, 55–56
deferred tax, 50, 201
disclosure
  accounting policies, 28–29, 123–125
  Brazil, 217
  capturing information, 145–146
  case study, 125
  external communications, 178
  financial instruments, 163
  FRS 101, 192–193
  FRS 102, 202–203
  IFRS 1, 57, 64, 183–185
  impact of IFRS, 21–22
  Russia, 217
  UK GAAP, 192–193, 198, 202–203
  see also external communications
discontinued operations, 159
documentation
  case studies, 108–109
  changes under IFRS, 154–155
  examples, **108**
  fair value measurements, 145
  impacts of transition, 107–109
  IT, 135
  lack of, 107–109
dual reporting, 130–132, *130*, 214, 219
due process, 8–9

education, 163–170
  methods of, 165–167
  and training, 163–167
employee benefits, 200
employee remuneration, 152
employment contracts, 158
energy case studies, 62–63, 121
equipment *see* property, plant and equipment
equity
  case study, 61–62
  IFRS 1, 60–62
  reconciliations, 60–62
  statement of changes in, 36–38
errors, IFRS 1, 63
establishing projects, 69–103
estimates, 52–53
ethics, 94, 138
European Union (EU)
  accounting policies, 117–118
  EU-adopted IFRS, 189–192, 194–195, 197, 203–205
  IAS endorsement, 6–7
  industry peer working groups, 109–110
  regulations and communications, 181
  scope of IFRS 1, 44–45
  timing of communications, 174–175
  transition effects, 17, 19
exceptions under IFRS 1, 50–57
  disclosure requirements, 64
  hedge accounting, 53–54
  mandatory exceptions, **52**, 53–54
exemptions under IFRS 1, 50–57
  associates, 56–57
  business combinations, 54–55

cumulative translation differences, 56
deemed cost, 55–56
disclosure requirements, 64
joint ventures, 56–57
optional exemptions, **52**, 54–57
share-based payments, 57
subsidiaries, 56–57
experience of transition, 69–76
benefits of, 69–76
negative, 69–74
positive, 74–75
top planning tips, **76**
experts/expertise, 72, 145
see also specialists
Extensible Business Reporting Language (XBRL), 135–136
external advisors, 90–97
advantages/disadvantages, 93
areas of involvement, **92**
auditor lack of involvement, 73
auditor's role, 94–97
Canadian case study, 93
overview of role, 91
providing assurance, 91
transition project teams, 80–81
external audit fees, 99
external auditors, 94–97
audit committee, 148
case studies, 95–96, 125
involvement graph, *96*
lack of involvement, 73
objectivity issues, 94–95
senior management attitudes, 138
transition project teams, 80–81
type of involvement, 95–97
see also external advisors
external communications, 170–183
content of information, 176–178
developing a strategy, 176–178
early communication, 175
example of timing/details, **182**
importance of, 171
information packs, 176–177
methods, 179–180
negative impacts, 171
non-GAAP measures, 178–179
positive impacts, 172
presentation, 170–183
proposed timescale, *175*
regulations, 180–183
timing, 174–176
understanding the audience, 172–174
see also disclosure
external specialists, 149
see also external advisors

fair presentation, 41
fair value
accounting, 20–21, 120–122
assets/liabilities held at, 158
impact of IFRS, 20–21
internal controls, 144–146
measurements, 144–146
volatility, 121–122
faithful representation, 27–28
FASB *see* Financial Accounting Standards Board
fees, external audit, 99
Financial Accounting Standards Board (FASB)
IFRS works in progress, 126
US and IFRS, 207–211, 213–214
financial instruments
accounting for, 152–153
disclosure, 163
UK GAAP, 199
US GAAP, 211
volatility, 122
financial position, 18–20, 26
see also statement of financial position
financial ratios, 172, **173**
financial reporting
audit committee, 147–148
controls improvement, 75
risks, **139**
UK GAAP, 191–194
see also international financial reporting . . .
Financial Reporting Standard for Medium Sized Entities (FRSME), 190
Financial Reporting Standards (FRSs)
100, 191–192
101, 191–196, 203–205
102, 190–206
UK GAAP, 189–206
Financial Reporting Standard for Smaller Entities (FRSSE), 190–192
financial reports, interim, 64–65
financial statements
Brazil, 216
Chinese Accounting Standards, 220–221
disclosure, 21–22
general purpose, 26–27
IFRS 1 disclosures, 184–185
presentation, 25, 30–42
US GAAP, 208–209, 214
see also Conceptual Framework; presentation . . .
First-time Adoption of IFRS (IFRS 1), 43–65
comparative information, 185
comparative time periods, 45–46, 58–60
current developments, 45
date of transition, 45–46, 61–62
disclosure requirements, 57, 64, 183
equity reconciliations, 60–62
errors, 63
explanations about transition, 58–60
first financial statements, 184–185
interim financial reports, 64–65
objective of, 43–44
opening statement of financial position, 45–50
presentation

First-time Adoption of IFRS (IFRS 1) (*Continued*)
differences, 63
disclosures, 183–185
requirements, 57–65
reconciliations, 58–62, 184
retrospective exceptions/exemptions, 50–57
scope, 44–45
statement of cash flows, 63–64
statement of financial position, 45–50
total comprehensive income, 62–63
UK GAAP, 193, 197, 202–203
foreign currency, UK GAAP, 201
the Framework *see* Conceptual Framework
Framework for the Preparation and Presentation of Financial Statements *see* Conceptual Framework
FRSME *see* Financial Reporting Standard for Medium Sized Entities
FRSs *see* Financial Reporting Standards
FRSSE *see* Financial Reporting Standard for Smaller Entities

G20 *see* Group of 20 Leaders (G20)
GAAP
Ind AS, 218
local, 131
national, 12, 22–23, 49
non-GAAP measures, 178–179
use of other, 30
see also previous GAAP; UK GAAP; US GAAP
gas and oil case study, 121
general purpose financial statements, 26–27
going concerns, 41–42
Golden, Russell, 209–210
goodwill, 121–122
governance structures, 7–9
Group of 20 Leaders (G20), 13
group companies
accounting policies, 47, **48**, 49, 117, 123
consistency issues, 194–195
FRS 101, 195
parallel accounting, 131
taxation, 123
transition choices, 83–85
typical reporting options, **84**
UK GAAP framework, 194–195

harmonisation of standards, 12–15
challenges, 14–15
convergence, 12–14
cultural perspectives, 14–15
US GAAP, 13–14, 208–209
headhunting, 152
hedge accounting, 53–54
hedge transactions, 122, 153
holiday pay accrual case study, 107
Hoogervorst, Hans, 8, 21
human resources, 151–152

IAS *see* International Accounting Standards
IASB *see* International Accounting Standards Board
IASC *see* International Accounting Standards Committee
IFRIC *see* IFRS Interpretations Committee
IFRS 1 *see* First-time Adoption of IFRS
IFRS *see* International Financial Accounting Standards
IFRS Advisory Council, 9
IFRS Foundation, 7–8
IFRS Interpretations Committee (IFRIC), 9, 224
IFRS literacy, 109, 163–165, 172
IFRS for SMEs, 8, 11–12
Brazil, 216
China, 220
India, 218
UK GAAP, 190, 193–194, 197
impacts of transition, 105–116
basics of, 105–107
becoming IFRS-literate, 109
business/commercial, 154–161
documentation issues, 107–109
high level overview, 110, **111**
holiday pay accrual case study, 107
industry peer involvement, 109–110
initial assessment, 105–116
lease accounting case study, 115–116
line by line analysis, 115–116
non-current assets, 112–114
output, 110–115
process summary, *106*
project plans, 88
transition project plan, 88
UK GAAP, 196–205
what impact affects, 110–111
wider issues, 150–161
impairment, 212
income *see* comprehensive income
Ind AS *see* Indian GAAP Accounting Standards
India, 215–216, 218–220
accounting inconsistencies, 218
hindrances to progress, 219
two-tier system, 218
Indian GAAP Accounting Standards (Ind AS), 218
industry peers, 75, 109–110
industry specifics, US GAAP, 211
information
cash flow, 160
and communication, 143, 145–146
content of, 176–178
external communications, 170–183
IFRS 1 disclosures, 185
interim financial information, 41
internal controls, 143, 145–146
presentation of, 170–183
information packs, 176–177
information technology (IT), 132–136
control activities, 142
integrating with transition, 133–135
non-current assets example, **136**
project plans, 135
specific transition issues, 134–135
stages in conversion process, *130*

technical facilities case study, 134
typical system changes, 132–133
XBRL, 135–136
intangible assets, 112, 121–122, 213
interim financial information, 41
Interim Financial Reporting (IAS 34), 41
interim financial reports, 64–65
internal audit, 129, 137, 148, 149–150
internal communications, 163–170
benefits of IFRS, 169
key messages, 169, **170**
logistics/postal services case study, 170
rationale of changes, 168
internal controls, 137–146
audit committee, 148
control activities, 140–143
control environment, 137–138
COSO framework, 137–144
fair value measurements, 144–146
information/communication, 143, 145–146
internal audit, 148
monitoring, 143–144
risk assessment, 139–140
senior management case study, 138
International Accounting Standards Board (IASB)
changes to IFRS, 125–127
due process, 8–9
formation, 6–7
IFRS regulatory framework, 8–10
IFRS for SMES, 8
standards issued, 9–10, 223–224
US, 207–211, 213
works in progress, **126**, 127
International Accounting Standards Committee (IASC), 5–6
International Accounting Standards (IAS), 6–7, 9–10, 223–224
1, 28–29, 30–38, 41, **42**, 44, 123–124
7, 39, 160
8, 29–30
16, 112–114, 136
17, 156
18, 155
19, 157, 158
23, 114, 136
24, 159
32, 158
34, 41
38, 112, 136, 156
39, 126, 156, 157
international financial reporting, 3–23
accounting guidance, 4–5
benefits/impacts of IFRS, 15–23
BSkyB Plc case studies, 18, 19
Centrica Plc case studies, 18, 19–20
in context, 3–23
current harmonisation, 12–15
development, 3–7
IASB, 6–7
IASC, 5–6
IFRS regulatory framework, 7–12
national differences, 4–5
International Financial Reporting Standards (IFRS)
1, 21, 43–65, 160, 183–185, 223
2, 157
4, 126, 156
5, 159
7, 22, 155
8, 159
9, 126, 127, 157
13, 158
benefits/impacts, 15–23
fair presentation, 41
the Framework, 10
governance structure, 7–9
potential changes, 125–127
regulatory framework, 7–12
standard-setting bodies, 7–9
transition adjustments, 160
transition project, 69–103
see also EU-adopted IFRS; First-time Adoption of IFRS; IFRS . . .
International Organization of Securities Commissions (IOSCO), 6–7
inventory, 213
investment property, 122, 199, 213
IOSCO *see* International Organization of Securities Commissions
Ireland, 36, 95, 193–194
Irish company case study, 36, 95
Islamic finance, 14–15
IT *see* information technology

joint ventures, 56–57
judgement, 144–145, 148
jurisdiction-specific disclosure, 64

keeping on track, 70–71
key performance indicators (KPIs), 172, **173**

leader of project, 79–80
leadership, 73, 79–80
leasing
case study, 115–116
impacts of transition, 156
UK GAAP, 200
US GAAP, 213
legal issues, UK GAAP, 196
liabilities held at fair value, 158
line by line analysis, 115–116
listed company case study, 95–96
local GAAP, 131
logistics/postal services company case study, 170
loss *see* profit or loss

management buy-in, 70
management judgement, 144–145, 148
materiality, 106
medium-sized entities, 190
see also small and medium-sized entities

Memorandum of Understanding (MoU), 6
mergers, 153–154
monitoring, 143–144
MoU *see* Memorandum of Understanding

Narrow Scope Amendment projects, IASB, 127
national differences, 4–5
national GAAP
  harmonisation aspects, 12
  influence on IFRS, 22–23
  transitional adjustments, 49
negative transition experiences, 69–74
  cross-functional issues, 73
  external specialists, 73
  IFRS not embedded, 74
  keeping on track, 70–71
  lack of leadership, 73
  limited expertise in IFRS, 72
  previous GAAP and IFRS, 72
  quick and easy options, 74
  resistance to change, 70
  timescales, 70–71
  unclear objectives, 73–74
  wide impact of transition, 71
non-current assets
  accounting policies, 119–120
  impacts of transition, 112–114
  IT example, **136**
non-GAAP measures, 178–179
Norwalk Agreement, 6, 208
notes, disclosure, 123–125

objectivity of auditors, 94–95
oil and gas case study, 121
opening statement of financial position, 45–50
  accounting policy changes, 47–50
  adjustments accounting, 49–50
  case study, 49–50
  IFRS 1, 45–50
  retrospective IFRS 1, 46–47
operational risks, **139**
opportunities, 77–78
other comprehensive income
  IAS 1, 33–36, **37**, **38**
  Irish company case study, 36
  statement of profit or loss and, 40–41
Oxley *see* Sarbanes–Oxley legislation

parallel accounting, 130–132
peer dialogues, 75
pensions, 121, 157, 200
performance, 16–18, 27, 178
physical controls, 143
planning transition
  project plans, 77–90
  summary of considerations, 229–230
  top tips, **76**
  UK GAAP, 198–201, 204–205
plant *see* property, plant and equipment
positive transition experiences, 74–75
  asset management, 75
  case studies, 75
  financial reporting controls, 75
  industry peer dialogues, 75
postal services case study, 170
preference shares, 158
presentation
  complete set of statements, 31
  differences under IFRS 1, 63
  external communications, 170–183
  fair presentation, 41
  financial statements, 25, 30–42
  going concerns, 41–42
  IAS 1, 28–29, 30–38, 41, **42**, 44, 123–124
  IFRS 1, 57–65, 183–185
  interim financial information, 41
  statement of cash flows, 38–39
  statement of changes in equity, 36–38
  statement of financial position, 31–33, 40
  statement of profit or loss and other comprehensive income, 33–36, **37**, **38**, 40–41
  UK company case study, 40
  UK GAAP, 198
  US GAAP, 212
Presentation of Financial Statements (IAS 1), 28–29, 30–38, 41, **42**, 44, 123–124
previous GAAP
  control activities, 140
  documentation, 109, 154–155
  dual reporting, 130–132
  IFRS literacy, 164
  statement of cash flows, 39
  statement of changes in equity, 37–38
  transition project, 72
procurement, 157
profitability, 16–18
profit or loss, 33–36, **37**, **38**, 40–41
project *see* transition project
project management specialists, 81
project members, 77, 79–83
project plans, 77–90
  audit committee, 146–147
  design responses, 88–89
  development, 83–90
  establishing project, 78–83
  establishing team, *83*
  group companies, 83–85
  high level overview, 85, *86*
  impacts of transition, 88
  implementing changes, 89
  initial project scope, 87–88
  IT, 135
  key members, 77, 79–83
  opportunities, 77–78
  post implementation, 90
  project teams, 77, 79–83, *83*
  risks, 77–78
  short/long term, 79

project teams, 77, 79–83, *83*
  accounting function, 80
  audit function, 80
  bringing together, 82–83
  business functions, 81–82
  business units, 82
  case study, 81
  corporate reporting, 80
  external advisors/auditors, 73, 80–81
  IT specialists, 133–134
  leader of team, 79–80
  planning matters, **87**
  project management specialists, 81
  UK GAAP, 204
properties, 122
property, plant and equipment, 112–114, 199, 212
provisions, 213
prudence, 28
public sector, 75, 168

RAS *see* Russian Accounting Standards
ratios, financial, 172, **173**
receivables, 155
reconciliations
  FRS 102, *203*
  IFRS 1, 58–62, 184
“Red Book”, IASB, 9
reduced disclosure framework, UK GAAP, 192–193
reference materials, 225–227, 231–235
regulatory aspects, 7–12, 180–183
related parties, 159
research and development, 156, 161
resistance to change, 70, 168
retrospective adoption of IFRS 1, 46–47, 50–57
  estimates, 52–53
  exceptions, 50–57
  exemptions, 50–57
  full adoption, 46–47, 50–57
revenue recognition
  aerospace case study, 161
  impacts of transition, 155, 161
  UK GAAP, 200
  US GAAP, 213
reviews, 94, 142
risk assessment, 139–140, **139**
risk management, 174
risk registers/logs, 140
risks
  operational, **139**
  project plans, 77–78
  SWOT analysis, 78
Russia, 215–216, 217–218
Russian Accounting Standards (RAS), 217

Sarbanes–Oxley (SOX) legislation, US, 214
SEBI *see* Securities and Exchange Board of India
SEC *see* Securities and Exchange Commission
Securities and Exchange Board of India (SEBI), 218–219
Securities and Exchange Commission of Brazil (CVM), 216
Securities and Exchange Commission (SEC), US, 207–210
segmental reporting, 159
segregation of duties, 143
self-review, 94
senior management case study, 138
share-based payments, 57, 157
Sharia-compliant finance, 14–15
SIC *see* Standing Interpretations Committee standards
simulation, backwards method, 85
small entities, 190–192, 220
small and medium-sized entities (SMEs), 8–9, 11–12, 218
  see also IFRS for SMEs
South African Airways Group, 121
SOX *see* Sarbanes–Oxley legislation
specialists
  audit committee, 149
  IFRS specialists, 80
  IT in IFRS project team, 133–134
  project management, 81
  transition project, 73, 80
spreadsheet controls, 142–143
SSAPs *see* Statements of Standard Accounting Practice
standards *see individual standards*
standard-setting bodies, 7–9
  see also International Accounting Standards Board
Standing Interpretations Committee (SIC) standards, 224
statement of cash flows, 38–41
  IAS 7, 39
  IFRS 1, 63–64
  UK GAAP, 198
Statement of Cash Flows (IAS 7), 39
statement of changes in equity, 36–38
statement of compliance with IFRS, 41
statement of financial position
  IAS 1, 31–33
  IFRS 1, 45–50
  opening statement of, 45–50
  presentation, 31–33, 40
statement of profit or loss and other comprehensive income, 33–36, **37**, **38**, 40–41
Statements of Standard Accounting Practice (SSAPs), UK GAAP, 189–192
strengths, SWOT analysis, 78
subsidiaries, 56–57
supervision, 142
SWOT analysis, 78
systems, 129–136
  dual reporting, 130–132, *130*
  implications, 129–136
  IT, 132–136
  parallel running, 130–132
  UK GAAP, 205

taxation
  accounting policies, 122–123
  Brazil, 216
  Russia, 217
  UK GAAP, 196, 201
teams *see* project teams
technical facilities case study, 134
threats, 78, 94–95
timescales
  example of transition timing, **182**
  external communications, 174–176, **182**
  keeping on track, 70–71
total comprehensive income, 33, 62–63
training, 163–167
  audit committee, 146
  costs, 98, 99
  extent/types of, 165
  methods of, 165–167
  summary of methods, **166**
  UK GAAP, 205
  US GAAP, 214–215
  utility case study, 167
transition project, 69–103
  action plans, **100**, **101–102**, 102–103
  benefits of experience, 69–76
  costs of transition, 97–102
  establishing, 69–103
  external advisors/auditors, 73, 80–81, 90–97
  key project members, 77, 79–83
  project plans, 77–90
translation
  cumulative differences, 56
  IFRS literature, 217
Treadway Commission, 137
Treasury management, 152–153

UK case studies, 40, 115–116
UK GAAP, 189–206
  accounting issues, 196–204
  background, 189–196
  brief history, 189–190
  choice of components, 194–196
  consistency issues, 194–195
  costs, 205
  existing vs new, 196–197, 198–201
  FRS 100/101/102, 189–206
  IFRS 1, 193, 197, 202–203
  impacts of FRS 102, **198–201**
  impacts of transition, 196–205
  initial planning, 204–205
  legal issues, 196
  new regime, 189, 191–196
  planning issues, 204–205
  reconciliations and FRS 102, *203*
  taxation issues, 196, 201
UK listed companies, 95–97
uncertainty, 214–215
United States (US), 207–215
  harmonisation, 13–14, 208–210
  IFRS vs US GAAP, 210–214, **212–213**
  key transition issues, 214–215
  move towards IFRS, 207–215
US GAAP
  conceptual framework, 211
  convergence with IFRS, 13–14
  harmonisation, 13–14, 208–209
  IFRS vs US GAAP, 210–214, **212–213**
  industry specifics, 211
  key transition issues, 214–215
  prescriptive aspects, 210–211
  volume/ease of use, 210
  see also United States
utility case study, 167

valuation techniques, 173
volatility
  accounting policies, 120–122
  impact of IFRS, 20–21
  oil/gas/airline case studies, 121
  potentially volatile areas, 121–122

weaknesses, SWOT analysis, 78
White, Mary Jo, 210
Work Plan, US GAAP, 209

XBRL (Extensible Business Reporting Language), 135–136