YES, NO, MAYBE. What US Companies Need to Know

By Christiane Ohlgart and Steve Ernst

"The world won't wait." That was the message sent by a global investors panel at the U.S. Securities and Exchange Commission's roundtable on International Financial Reporting Standards in July.

The slow pace of decisions from United States regulators and standard setters toward a single set of high-quality global accounting and reporting standards contrasts to the rapid pace in the rest of the world.

In his first speech as incoming chair of the International Accounting Standards Board, Hans Hoogervorst pulled no punches when he directed his comments to U.S. regulators, saying the IASB's accounting standards are the only way to "unleash the full potential of a truly global" capital market.

Today, more than 100 countries use IFRS in some form as the primary reporting standard for listed companies. The IFRS adoption momentum is building with several major and growing industrial countries recently transitioning to IFRS — Brazil for 2010 year end and Canada and Korea for 2011.

In addition, China and India have ongoing projects to converge their local generally accepted accounting standards with IFRS.

The global transition is becoming too strong to ignore. Clearly, the capital markets are the strongest advocates for a consistent set of global accounting, reporting and disclosure standards by which deci-

Adoption, endorsement or condorsement — one of these approaches is in the wings as the world waits and while the SEC considers morphing long-standing U.S. GAAP into some form of IFRS for U.S.-registered companies.

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sions about capital allocation and investments will be made.

As companies of all sizes expand and connect through global operations, the lack of a single global accounting standard imposes the need for dual reporting processes, for instance — supporting both U.S. GAAP and IFRS — and is becoming more common and more expensive.

At least one SEC commissioner, Kathleen Casey, has stated that it would be a mistake for the U.S. to *not* adopt internationally accepted accounting and reporting standards. She said, "The commission is slated to make a decision on [IFRS] this year and we can no longer kick the can down the road. I believe the choice is clear — the commission must decide to incorporate IFRS for U.S. issuers."

The following discusses several IFRS transition scenarios, the steps that lead to an IFRS transition and adoption and strategies used to complete an IFRS transition while minimizing disruption to operations. This is based on the experience gained by Waldorf, Germany-based SAP A.G. with its own migration to IFRS, which was successfully completed in 2010.

Historical Perspective

For more than a decade, the capital markets have shown significant interest in a single set of robust, globally accepted accounting standards. Many multinational companies, national regulators and readers of financial statements support IFRS because the use of a common set of standards makes it easier to compare the financial results of reporting entities from different countries. For multinational companies with subsidiaries in multiple jurisdictions, it also lowers the cost of preparing those statements.

In December 2010, SEC Chairman Mary L. Schapiro confirmed that the SEC will be in position to make a decision on IFRS for U.S.-registered companies by the end of this year. If the decision is made to incorporate IFRS into U.S. reporting standards, the SEC will allow at least a five-year transition period.

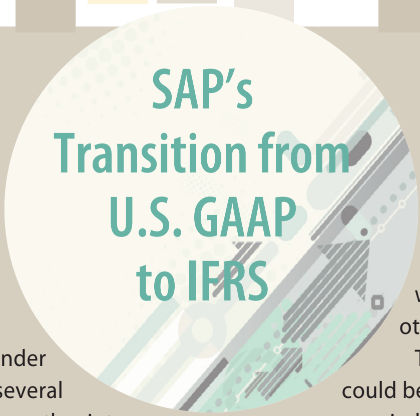
With the appointment of Hoogervorst as its chair, IASB has announced that it will prioritize the completion of the remaining ongoing convergence projects with the Financial Accounting Standards Board, begin developing a post-convergence agenda, work to bring significant countries like the U.S. on board, strengthen the institutional relationships and further its independence.

The notion of a single set of global accounting and reporting standards has been gaining momentum over the last few years. In a survey conducted in late 2007 by the International Federation of Accountants (IFAC), 90 percent of the senior executives responding from 91 countries agreed that a single set of international financial reporting standards was "very important" or "important" for economic growth in their countries.

In the May 2011 semi-annual IFRS preparedness survey conducted by the American Institute of Certified Public Accountants (AICPA), when asked if the SEC should require adoption of IFRS by U.S. public companies, 53 percent responded with "yes" or "yes, after more convergence."

Adoption, Endorsement And Condorsement

ADOPTION. Adoption of IFRS is the standard path that IASB has codified by IFRS 1, First Time Adoption of International Financial Reporting Standards. The key objectives of the IFRS 1 adoption process, as summa-



SAP's Transition from U.S. GAAP to IFRS

Waldorf, Germany-based SAP A.G. decided to transition to IFRS with a period of parallel accounting under U.S. GAAP and IFRS (and local GAAP where required). While SAP implemented IFRS as a result of European Union requirements, the reporting under IFRS worldwide resulted in yielding several benefits to the company, including smoother internal operations while meeting regulatory requirements.

To manage the transition to IFRS, SAP identified some key factors that the company believed relevant for a successful project:

Clear Definition of the Strategy Of the Project

While initiation of the IFRS implementation project arose due to legal requirements, SAP had to decide the extent to which this project should be restricted to the bare legal minimum or whether the scope should be extended to include other improvements.

The implementation of new accounting regulations could be restricted to accounting only, or it could be accompanied by business process improvements and changes in information technology systems. Furthermore, it is important to decide whether old accounting policies should be retained and IFRS added to the company's internal reporting, or whether the old reporting rules would be replaced.

rized in IFRS 1.1, are also the key benefits when transitioning to IFRS, because the ideas is that through the application of IFRS 1 the resulting IFRS financial statements:

- Are transparent for users and comparable over all periods presented;
- Provide a suitable starting point for accounting in accordance with IFRS); and
- Can be generated at a cost that does not exceed the benefits.

Furthermore, application of IFRS 1 allows entities to define their new accounting policies according to IFRS, without being bound by previous accounting policies under accounting rules that are currently relevant (e.g. U.S. GAAP).

CONVERGENCE. Over the last few years, the idea of convergence has been followed. It implies that over a period of time the differences of the accounting and reporting standards under U.S. GAAP and IFRS would be minimized to the point where the U.S. would be adopting IFRS almost automatically or be very close without the application of IFRS 1. Within the past few months, a significant number of converged standards have been issued, either by IASB or FASB. Among those are Statement of Comprehensive Income, Fair Value Accounting and Accounting for Joint Ventures.

Currently, both FASB and IASB are revisiting projects deemed "priority" where convergence is the goal. The most challenging convergence projects on the agenda are those on revenue recognition, financial instruments and leases, as well as insurance contracts, which will change accounting rules for all entities significantly. Final standards for these major topics are expected next year.

Due to the significant convergence activities, the concept of adoption has recently lost momentum, particularly because there are those who say U.S. GAAP has been and should remain the gold standard, as GAAP acceptance in the U.S. capital markets is critical to the efficient flow of capital throughout the global economy, and convergence of the standards is a natural process that should be continued.

This view argues that the continuing natural convergence of the two sets of standards through joint FASB/IASB efforts should arrive at the point of immaterial difference; at that point, financial statements would be comparable regardless of what set of standards are used.

ENDORSEMENT. Endorsement is the activity of reviewing new standards after adoption or convergence, which is currently also applied in Europe after its initial adoption of IFRS. As a result, any

> When comparing the condorsement method of transition to the "big bang" of adoption, some have questioned both the cost and disruption that a longer term (five to seven years) would bring to the marketplace.

How SAP Managed Its Own IFRS Transition

SAP A.G. went public in Germany in 1988 and followed in the United States 10 years later. When International Financial Reporting Standards were made mandatory by the European Union, from 2005-07 SAP undertook the process of adding IFRS to its U.S. GAAP reporting. To complete this project, SAP outlined the following steps:

DEFINITION OF IFRS STRATEGY

- Multi-GAAP
- Definition of
- Communication Focus
- IFRS Start Date
- Management Reporting

WHAT DID SAP DO? SAP first chose the accounting strategy and then the transition timing. The accounting strategy was to maintain the existing accounting policies and minimize the differences between U.S. GAAP and IFRS whenever possible, but to consider the impact of this decision for future years in case U.S. GAAP was abandoned.

For European entities listed in the U.S. and applying U.S. GAAP, there was an option to start application of IFRS on Jan. 1, 2007 rather than on Jan. 1, 2005, which was the general IFRS adoption date in the European Union.

Due to its decision to reduce the difference between IFRS and U.S. GAAP as much as possible and significant convergence projects expected to be finalized before 2007, SAP decided to adopt IFRS on Jan. 1. 2007.

Decision on External Support and the Extent

The strategy and scope of the project will determine the mix of cross-functional internal and external resources required. The type of support and the extent should be carefully evaluated. The decision should consider the requirement to build up internal IFRS-related know-how.

WHAT DID SAP DO? SAP decided to primarily drive the project internally, but also support its own project with external IFRS consultants. The main reason for this decision was that there were already some IFRS experts but none of them had been involved in transition projects from U.S. GAAP to IFRS. On the other hand, SAP had to ramp-up IFRS knowledge internally first and wanted to be able to discuss accounting policies, strategies and options with consultants other than its auditors.

Project Planning and Execution

The identification of the organizational and governance structure of the project, as well as the identification of the various work streams, is essential for success. A successful project execution is highly dependent on a well-defined project scope.

Since in the end all decisions and the implementation of the decisions must be audited and certified, it is essential to engage with the company's auditors during the project as decisions are taken.

new standard issued by IASB would be subject to review and not automatically apply to U.S. entities.

While local regulators continue to be able to control the accounting regulations, endorsement leads to potential different versions of IFRS being applied worldwide and the purpose of transparency and comparability is impaired.

CONDORSEMENT. An SEC staff paper issued on May 26 brought another means of transition and continued application of IFRS to the table. This is called "condorsement." By merging the ideas of convergence and endorsement, the staff paper outlined a process by which IFRS would be incorporated into U.S. GAAP through a process led by FASB instead of IASB. This process of incorporating IFRS into U.S. GAAP would be slower than the current process of convergence, would take at least five to seven years and would leave IFRS transition completely controlled by U.S. regulators.

FASB would incorporate new and amended IFRS into U.S. GAAP through an endorsement process, which would give FASB the authority to modify IFRS before incorporating the standard. However, even under condorsement, the SEC prefers that FASB work closely with IASB to prevent the need for U.S. modification.

It appears that the SEC thinks the advantages of condorsement are the retention of FASB's authority over U.S. GAAP and a more gradual transition to IFRS. When comparing this method of transition to the "big bang" of adoption, some have questioned both the cost and disruption that a longer-term transition period — five to seven years — would bring to the marketplace.

At the SEC roundtable in June, Mark LaMonte, managing director at Moody's Investor Services, said he sees a definite need for investors to be able to compare U.S. companies to their foreign counterparts, but did not feel exceptions to the international standards for U.S. companies was the direction to go.

Early adoption by U.S. accelerated filers was not mentioned in the staff paper, which walked the political tightrope of maintaining FASB as the U.S. standard setter.

The paper also suggested one of its charges would be to develop a plan to address existing IFRS and U.S. GAAP differences and outline FASB's future participation in the development of new standards. The staff paper outlined the ongoing role of the SEC as the overseer of FASB and its active sharing of standard-setting objectives with IASB, while the SEC would contribute to the oversight and governance of IASB through a seat on the IFRS Foundation Monitoring Board.

Conversely, there are those who feel there is no need for the U.S. to transition to IFRS regardless of the method. On the Regulatory Panel at the SEC roundtable, Gaylen Hansen, a partner at

PROJECT EXECUTION

- Identification and Classification of U.S. GAAP/IFRS Differences (presentation, valuation or disclosure difference)
- Engagement of IT Where Required
- Discussion of IFRS Policies with External Support

WHAT DID SAP DO? SAP identified the gathering of IFRS know-how as one of the most important activities and consequently assigned most of the projects resources initially to its IFRS Know-How Workstream. The workstream covered the analysis of all applicable IFRS accounting standards and their impact on SAP.

The analysis always culminated in a management decision by the steering committee on how to implement a given standard based on IFRS-allowed accounting treatments, IFRS 1 transition rules and an impact analysis on the income statement compared to SAP's then-current U.S. GAAP accounting. The roll-out team was tasked with managing the involvement of a broader group of affected stakeholders and the training regarding upcoming changes.

KEY SUCCESS FACTORS

- Early start of the project
- Early and precise definition of IFRS strategy
- Early determination of IFRS first time adoption approach
- Top management attention
- Dedicated project lead and centralized approach
- Involvement of all levels in the organization
- Detailed documentation and training material
- Trainings for financial community

DIFFICULTIES

- Complexity of alignment efforts of two sests of financial statements in two languages underestimated
- Teaching accountants in the company to embrace principal-based thinking
- Risk of non-endorsement of individual IFRS in European Union not manageable

accounting firm Ehrhardt Keefe Steiner & Hottman and incoming chair of the National Association of State Boards of Accountancy, said: "IFRS is not better than U.S. GAAP," and that "FASB should not become a mere conduit to import IASB standards."

To be sure, each entity is unique, with its own "accounting history" and policies, but as they make their plans, companies can benefit from the experiences of those who have gone this route.

The globalization of accounting and the worldwide application of IFRS can greatly improve the efficiency of administrative tasks, make processes more transparent across entities and within the same entity, and allow for harmonization of tasks.

The AICPA survey cited earlier reflects the current situation inside corporate America. Chief financial officers know that in order to be ready for IFRS usage in the 2014-16 timeframe, they need to increase their planning cycles now, and they need to begin assessing their IT system landscape and its readiness for IFRS.

This could require an upgrade or replacement of their current accounting systems or simply an adjustment to current customizing. Many are aware that their processes, systems and software platforms are a conglomeration of disparate systems pieced together over the years that will either not support a massive change nor allow for the efficient implementation of global accounting standards and reduction of future administrative efforts through the use of global templates and processes.

These multinational companies might consider how systems can communicate and support cross-border consolidation, minimizing manual efforts around accounting and reporting processes.

Christiane Ohlgart led SAP A.G.'s transition project (2005-08) from U.S. GAAP reporting to full utilization of IFRS in 2010. Steve Ernst, CPA, leads the SAP CPA Adviser Program. SAP is a market leader in enterprise application software and helps companies of all sizes and industries run better. For more on IFRS, visit www.sap.com/irj/bpx/ifrs and *www.sap.com/us/ifrs*.

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