WHITE PAPER

THE TRANSITION FROM GAAP TO IFRS

Building business efficiencies and greater competitiveness for North American companies

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EXECUTIVE SUMMARY

Regulatory authorities are on track to make the International Financial Reporting Standards (IFRS) a requirement for all publicly-traded companies in the US, Canada, and Mexico over the next few years. For public companies in these countries, the transition to IFRS will be the most significant regulatory change in many years and one with potential to directly impact overall competitive position.

The impetus for the change is clear—create a consistent international approach to financial accounting so investors can better compare the financial performance of companies operating in different countries and, by doing so, foster deeper and more liquid capital markets that facilitate economic growth.

However, the specific implications for the companies who must transform their financial accounting from the applicable Generally Accepted Accounting Principles (GAAP) to IFRS are less clear. Will the adoption of IFRS simply mean companies must undergo a costly technical conversion of their internal accounting processes? Or will the change represent a more fundamental business transformation that leads to greater efficiency and a more competitive position, both domestically and internationally. Or will it be a combination of the two?

Since first becoming a mandatory requirement in European Union countries in 2005, IFRS has become the financial accounting standard in more than 100 countries. With more than 70,000 customers worldwide, many of whom have made the transition to IFRS, Infor™ has had considerable direct experience helping companies make the transition and in observing how the change has impacted their business. Based on our experience, we believe there are distinct competitive advantages that can be realized as part of the IFRS transition process.

In this whitepaper, we discuss the business process changes that US and Canadian companies will have to make in transitioning from their respective GAAPs to IFRS. And we show how these business process changes can make companies operating in the US and Canada more competitive, as well as compliant with the IFRS regulation.

IFRS: PAST, PRESENT, AND FUTURE

The International Financial Reporting Standards are the result of work begun in the early 1970s by the International Accounting Standards Committee (IASC). The slow evolution of IFRS acceptance was accelerated in 2002 when the European Union Parliament designated IFRS as the accounting standard for publicly traded European Union companies beginning on January 1, 2005.

Since 2005, numerous countries with highly developed economies, such as Australia and New Zealand, have adopted IFRS. Meanwhile, the adoption in Asia has been mixed. China and Japan have converged their GAAP with IFRS, effectively bringing their local financial accounting standards in line with the international standard. South Korea and Taiwan have not made the transition.

The US is by far the largest market yet to transition to IFRS, although the process has begun. Canada, another world-leading economy, and Mexico are also transitioning to IFRS.

Although the exact timetable for IFRS adoption in the US has not been set, in late 2008 the US Securities and Exchange Commission released a roadmap with a timeline and key milestones for adopting IFRS in the US beginning in 2014. Canada plans to require adherence to IFRS for publicly accountable entities in 2011. Mexico plans adoption in 2012.[1]

At this point, with more than 100 countries already using IFRS and the world's largest economy starting the process, the trend is clear. Over the next five to 10 years, adherence to IFRS will become a basic requirement for doing business.

IFRS is, in large part, an outgrowth of business globalization. While there are pockets of resistance in business and government, there is a clear consensus that IFRS will, on balance, facilitate global economic growth. For example, in a 2007 survey by the International Federation of Accountants (IFAC), 91% of the accounting leaders surveyed said that a single set of international financial standards was important or very important for economic growth in their countries.[2]

WHAT IFRS ENTAILS

The International Financial Reporting Standards establish 34 new accounting policies that in general affect how companies value their assets and report on their business performance. The regulation creates new, higher standards for transparency in business operations by requiring more detailed presentation of balance sheets and cash flow.

Based on an analysis by Infor™, we believe the impact of IFRS can be grouped into four high-level areas:

Reporting and disclosure. IFRS imposes new, more stringent requirements on the preparation and make up of a company's balance sheet and cash-flow statements. Individual balance sheet items will need to be shown as long-term or short-term assets or liabilities. A similar requirement for granularity applies to cash-flow statements where cash generated by financial activities, operations, and investment activities will have to be presented separately.

Financial metrics will need to be broken down by product, service, and geographical lines. For some companies, this will require major change because their financial systems are ill-equipped to produce this level of detail for standard metrics such as revenue; operating results; assets; liabilities; depreciation; and cost of acquiring property, plant, and equipment.

Assets and inventories. Under IFRS, companies will need to present assets and inventories in a way that reflects their actual value to the business as accurately as possible. Inventories will need to be presented using first-in, first out (FIFO) or average weighted cost methods, precluding the use of last in, first out (LIFO). The result will be a more accurate and fair value picture of the company's inventory management.

The value of property, plant, and equipment must be based on historical costs with subsequent expenses added to the carrying costs. Asset depreciation must be approached in a systematic way that accurately reflects how the asset is consumed and its residual value. An impairment cost must be recognized any time the carrying cost of an asset is greater than the recoverable costs through sale or disposal.

1 American Institute of Certified Professional Accountants, International Financial Reporting Standards (IFRS), An AICPA Backgrounder, 2008, p. 2.

2 American Institute of Certified Professional Accountants, International Financial Reporting Standards (IFRS), An AICPA Backgrounder, 2008, p. 2.

Intangible assets are to be measured at initial cost and are expressed as non-monetary assets that have anticipated economic benefits.

Foreign currency. IFRS requires more exacting treatment of how currency rates impact a transaction and how the transaction is recorded by the corporation. For example, the prevailing rate at the time of the transaction must be used in financial statements rather than the common practice of applying the prevailing currency rate at the close of the period. For companies doing business in a number of countries, there must be systems in place to capture the different rates of exchange between the local and the parent country currencies at month end for balance sheet and income statements.

Revenue recognition. Under IFRS, revenue must be recognized at fair value. In normal circumstances, this is easily accomplished by measuring cash received for goods and services. But IFRS addresses more complex circumstances in an effort to produce better transparency. For example, when an interest-free loan is part of the transaction, IFRS requires that at each stage of a construction project there is recognition of the potential revenue and also consideration for the costs to complete the project.

Steps to comply with IFRS must be taken with the overall business environment in mind. When the business environment is weak, there will naturally be a hesitation to invest in processes and supporting technologies that don't promise an immediate, bottom-line benefit. Since IFRS is a strategic transformation of accounting standards, it will pay to take a long-term, comprehensive view of the benefits and costs of the change. Improved visibility into business operations resulting from the transition may lead to improved bottom-line results. In other words, the benefits that accrue to a company after transitioning to IFRS may clearly outweigh the cost of the transition.

Of course, the converse also is true—not adopting IFRS may have significant adverse implications for a company. If your company fails to comply, the natural progression would be significant fines and other problems. For example, not producing your books (profit and loss statements) for others to view will adversely affect the value of the company as perceived by investors, partners, and customers.

For private companies that won't be required by law to comply with IFRS, making the transition may nonetheless prove to be beneficial. Investors in private companies—including banks, equity firms, and high net-worth individuals—will want the same comprehensive statement of a business' status as the SEC or investors in public companies.

WHAT US AND CANADIAN COMPANIES CAN EXPECT

As they transition to IFRS, the experience of US and Canadian companies is apt to be quite different because of the differences in US GAAP and Canada GAAP.

US GAAP is a prescriptive, rules-based standard, unlike IFRS which is principles-based and interpretative. For example, a financial controller who has a question about how to handle a specific transaction in US GAAP can research the issue and find a specific answer.

Because IFRS is principles-based, that same controller will need to apply his or her judgment to the more general IFRS requirements. There won't be a set of calculations as there are in US GAAP. This difference is illustrated, in part, by the fact that US GAAP textbooks have many more pages than IFRS textbooks, making it difficult, if not impossible, to "look up the answer" in IFRS. The greater subjectivity in IFRS provides a compelling reason for companies to implement a flexible performance management solution that provides the right framework for analyzing data, completing reports, and compiling supplemental information required by IFRS.

Although the exact milestones for the US GAAP to IFRS transition have not been established, the following general outlines are clear:

- 2008: US SEC issues roadmap for IFRS adoption in November
- 2009: US issuers will have the option to use IFRS for fiscal years ending on or after Dec. 15, 2009
- 2011:
  - – SEC will formally decide if adoption of IFRS will be mandatory and, if so, on what date it will become mandatory
  - – Qualitative comparisons of US GAAP and IFRS will be possible
- 2014:
  - – Expected conversion date to IFRS
  - – Large, accelerated filers to comply with IFRS after Dec. 15, 2014
- 2015: Accelerated filers to comply with IFRS
- 2016: Non-accelerated filers to comply with IFRS

Because Canada GAAP is principles-based like IFRS, the transition for Canadian-based companies will be less complicated and time consuming. Canada is taking a transitional convergence approach through which some IFRS regulations will go into effect before the official 2011 conversion date. 3 For Canadian companies, the deadline for taking action is looming larger because they have only until the end of 2009 to understand what is required and to prepare a transition strategy.

The timeline for Canadian companies:

- 2009:
  - – December 31: Qualitative disclosure of impact of conversion required
- 2010
  - – January 1: Date of transition, opening IFRS balance sheet date. Beginning of first year of comparative financial statements
  - – December 31: Quantitative disclosure of impact of conversion
- 2011
  - – January 1: Date of conversion, external reporting comments under IFRS with restated comparative financial information
  - – December 31: First audited IFRS statements with comparative financial statements.

THE MAJOR DIFFERENCES BETWEEN IFRS AND US GAAP

The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) have been working to converge the content of IFRS and US GAAP, with a goal of eliminating most, if not all, of the key differences by the time the SEC allows or mandates the use of IFRS. Progress has been made, but significant differences remain in inventory costing, impairment write downs, contingencies management, debt covenant management, and revenue recognition.[4]

Infor has analyzed the differences between IFRS and US GAAP on a more granular level. In summary, the differences include:

- **Inventory**—Companies using LIFO (last-in, first out) and average cost methods for valuing inventory, as permitted by US GAAP, will need to switch to the FIFO (first-in, first-out) or weighted average method to comply with IFRS.
- **Extraordinary items**—IFRS precludes the recognition of extraordinary items.
- **Cash flow**—IFRS is more restrictive in the way cash flow must be treated than US GAAP. Under IFRS, interest paid and dividends received must be classified as operating cash flows. Dividends must be classified as financing cash flows. Overdrafts can't be included in cash. By contrast, US GAAP allows companies more flexibility in how they treat dividends, interest, and overdrafts.
- **Net profit and loss**—IFRS allows both restatement of prior period or the passing of cumulative adjustments through to the current year.
- **Income taxes**—There are fundamental differences between the way IFRS handles timing differences and provisions compared to US GAAP. For example, due to timing differences between tax and accounting periods, US GAAP allows for partial provision of liabilities whereas IFRS requires full provision.
- **Segment reporting**—IFRS requirements for segment reporting are more extensive than US GAAP or Canadian GAAP. For example, IFRS requires not just Net Assets for reported segments, but also requires Total Assets, Total Liabilities, Capital Expenditures, and Cash Flow. Segments are defined in IFRS as geographical regions or business segments that constitute 10% or more of the business. IFRS also has specific rules that require companies to put segments in similar risk categories.
- **Legal instruments and covenants**—IFRS changes the way figures are compiled for financial statements, which may have an effect on financial ratio covenants. This could lead to a breach of covenant stipulated in an agreement with a bank.
- **Foreign currency transactions**—To comply with IFRS, a company's financial statement must be translated at average rates of exchange while the balance sheet must be translated at closing rates. By comparison, US GAAP is more lenient in the way a company times foreign currency conversions.
- **Discontinuing operations**—IFRS mandates that companies meet detailed disclosure requirements for operations that are being sold or discontinued. The requirements under US GAAP are less stringent.

4 American Institute of Certified Professional Accountants, International Financial Reporting Standards (IFRS), An AICPA Backgrounder, 2008, p. 5.

- **Employee benefits**—In some cases, statutory profit may change under IFRS. This will have an effect on employee remuneration where it is linked to company or subsidiary profit. US GAAP is similar, but some details differ.
- **Earnings per share (EPS)**—US GAAP is similar to IFRS, but provides more detailed calculations. With US GAAP, companies report basic and diluted earnings per share on continuing operations, discontinued operations, extraordinary items, and cumulative effect of change in accounting and income.

THE PROCESS FOR ADOPTING IFRS

Transitioning from GAAP to IFRS requires technical, strategic, and operational changes. There also will be an unavoidable impact on information technology (IT) systems, as companies change the way they manage and report on numerous business activities. With such inherent complexity, the conversion process can best be completed if a company adopts a methodical and strategic approach.

Based on working with many of the Infor customers who have already made the transition to IFRS, we believe the adoption process should include three major phases:

Diagnosis—In the initial phase a company should assess its readiness for IFRS. Since IFRS has impact far beyond the accounting department, the assessment should address all parts of the company that have a role to play in transitioning to IFRS and sustaining compliance. Some of the specific focus areas:

- **IFRS-specific skills.** Are there IFRS-specific skills available within the company and, if not, what is the best way to get access to the skills—good sources include your enterprise software vendor and specialized vendors, such as accounting firms and training firms, that have IFRS practices.
- **Training.** What training is required across the enterprise to support the transition effort? Many employees will have part-time responsibility for the transition to IFRS that stems from their primary responsibilities. Activities will include re-keying of information, creation of procedures, auditing, and test requirements.
- **External agreements.** What agreements are in place that have financial ratio covenants attached that may be affected by the introduction of IFRS?
- **Financial instruments.** What impact do the financial instruments have on your operation? With changes in a reportable position triggered by IFRS transition, will there be a business case for changing operations? In other words, will it make sense to change what you do to better align your operations with how you must report business results?

Development—With your company's readiness for IFRS adoption determined, the next step is to develop strategies that each part of the business will need to implement. This phase is more detailed and action-focused than the Diagnosis phase.

- **Financial management.** Specific plans for aligning hedging strategies, covenant ratios, etc. with IFRS need to be developed. Specific changes in account structures, analysis codes, integration changes, financial reporting, etc. also need to be developed.

- **Human resources.** The need to comply with IFRS can have a significant impact on a company's human resources. Bonus plans and other remuneration policies may need to change because of IFRS. Companies will have to segment geographies and business units that contribute more than 10% to bottom-line revenue. In keeping with this segmentation, companies may also believe it is prudent to ensure bonus payments for employees in these business units are more clearly defined. If the business model is volatile, companies can more easily keep remuneration in line with the performance of the individual business unit. The implications of IFRS on the Human Resources function may be reason to consider a more comprehensive performance management solution that addresses human resources as well as financial management.
- **Communications.** As with any change-management activity, prompt, clear, and comprehensive internal and external communications is essential. In addition to employees, you will need to communicate your progress in transitioning to IFRS to analysts, the press, banks, shareholders, and government regulatory officials. Your company's existing communications infrastructure should be involved early—in the Diagnosis phase—so communications strategies can be created and implemented as soon as the Development phase begins.
- **Review end-to-end business processes.** In addition to the targeted business processes of financial management, human resources, and communications, it is also useful to assess how IFRS will impact end-to-end business processes such as Order-to-Cash and Procure-to-Pay. For example, IFRS has implications for how assets are valued which, in turn, has implications on your company's reported profitability. This will have implications for your strategic business decisions. If IFRS guidance is more accurate, adherence may lead to better real-world business decisions.
- **Supporting technology.** Invariably major changes in financial management, human resources, communications, and other business processes will require modifications in your IT infrastructure. The Development phase is the time to determine the specific ways in which your IT systems will need to change and begin the process for implementing those changes.

Delivery—The development of specific IFRS-related business changes is followed by a Delivery phase. In the Delivery phase you begin implementing your IFRS compliance strategies. This requires several steps, including:

- **Testing.** It will be necessary to test modified business processes to ensure that the correct information is captured and processed correctly.
- **Comparatives.** During the transition to IFRS from either US GAAP or Canada GAAP, you will need to report business performance using both standards for a year or more. US and Canada regulators have outlined a formal comparative period as part of their respective transition approaches.
- **Reporting.** In our work with companies transitioning to IFRS in other countries, we have found that it is important to have reporting processes that are flexible. Rigid, spreadsheet-based reporting based on a prescriptive model will not support multiple reporting requirements. A performance management solution that has traceability and integration with the transaction systems may be the best approach to achieving the reporting flexibility required during and after the transition to IFRS.
- **Auditing.** The final step in the delivery phase is to have external auditors review and confirm that your process changes will lead to IFRS compliance.

HOW INFOR CAN HELP YOU TRANSITION TO IFRS

Infor has incorporated the insights gained by helping customers transition to IFRS into the company's long-term product strategy. By aligning the corporate product strategy with the requirements to adopt and sustain IFRS compliance, Infor is creating a way for companies in the US, Canada, and other regions to realize new overall business value while making the transition as efficiently and cost effectively as possible.

Infor PM, a flexible, easy-to-configure performance management solution, is the linchpin of Infor's strategy for helping US and Canadian companies transition to IFRS. A single-platform solution, Infor PM delivers capabilities for strategic management, planning, budgeting, forecasting, financial consolidation, and reporting and analysis. The solution maps many different books into a common consolidation environment which promotes consistent reporting.

In our view, companies are best served when they take an integrated approach to all IFRS-related requirements. Toward that end, Infor can deliver a fully integrated solution ideal for supporting the transition. A key element is the ability of Infor PM to work in conjunction with Infor financial management applications to meet a wide range of accounting requirements and processes mandated by IFRS.

In addition to Infor PM, a new advanced general ledger solution, Infor AGL, will provide specific support for the requirement that companies report in both IFRS and US or Canada GAAP during the transition period. By supporting multiple charts of accounts, fiscal calendars, and accounting currencies, Infor AGL will deliver fully automated capabilities to comply with multiple accounting practices. This ability to have multiple representations of core financial data will make it possible to understand the impact of IFRS on your business without imposing a significant burden on your financial team.

Here are some of the capabilities that Infor delivers for specific IFRS requirements:

Financial statement presentation. Infor PM provides the flexibility to present financial statements in multiple formats, use multiple currencies and exchange-rate scenarios, and use flexible accounting group headings.

Segment reporting. Infor PM allows companies to record and report information for segments using a variety of dimensions, including geography, service, and product. The solution enables multiple views into operational performance and multiple versions of the same structure, including budgets, targets, and actual results.

Foreign currency transactions. To comply with the IFRS requirement that companies report the effect of foreign exchange rates, Infor PM features capabilities to specify by account and/or statement which currency and exchange rate sets apply.

Minority interests. Infor PM enables consolidation adjustments such as share of associated entity profits, minority interests, and intercompany and recurring adjustments. The solution dynamically books journal entries at the proper proportional value for subsidiaries and generates full audit trails on adjustments.

Financial reporting in hyperinflationary economies. Infor PM provides built-in currency intelligence that eliminates time-consuming and error-prone manual conversion processes. The solution supports consolidation using multiple sets of exchange rates for multiple currencies and enables a company to track information in a business unit's local currency, functional currency, and reporting currency.

Discontinuing operations. Infor PM provides analytical tools and support for multi-organization structures to show the consolidated effect of the disposition.

Multiple reporting requirements. Infor PM supports a variety of consolidation and reporting processes within the application, and simplifies data collection from multiple remote transaction systems and charges of accounts.

Electronic output of financial and business data. Infor PM supports interactive data "tags" for all items in financial reports. This tagging allows companies to immediately capture the exact information they want and compare it in an electronic format to the results of other companies, performance in past years, and industry averages.

To clearly inform Infor customers of the IFRS-specific capabilities in their installed solutions, Infor is updating Statements of Direction for each financial product to address what Infor will do to help companies transition from GAAP to IFRS. These Statements of Direction will specifically cite what functionality will be needed to transition to IFRS. For existing customers, the Statements of Direction can be accessed on the Infor365 support website.

BUSINESS BENEFITS OF IFRS COMPLIANCE

As with virtually all major business transformations, the outcomes from IFRS adoption can vary widely. Even if the change is driven by a business requirement not directly related to bottom line performance, companies can approach the transformation to IFRS in ways that produce tangible business benefits. We believe the transition from US GAAP and Canada GAAP represents an opportunity to put companies on a more competitive footing. In addition to complying with a critical regulatory requirement, we believe adopting IFRS can help:

- Improve a company's attractiveness to investors.
- Reduce the cost of capital.
- Increase an international company's ability to finance operations locally.
- Streamline financial management processes and consolidate reporting for large international companies.
- Enhance a privately-held company's image among key stakeholders
- Reduce the cost of credit.

CONCLUSION

The significance of the impending transition to IFRS for US and Canadian companies is undeniable. Over the next few years, public companies in these countries will be required to meet a fundamentally different set of financial reporting standards. As they consider how they will change their business processes and supporting technologies, executives at these companies can be assured that there are ways to realize tangible business advantage from the transition. To gain the greatest advantage from their adoption of IFRS, companies should take a methodical, comprehensive approach that looks beyond simple regulatory compliance to a broader set of business challenges and opportunities.

There is a better way.

At Infor, we work with a core belief. We believe in the customer. We believe that the customer is seeking a better, more collaborative relationship with its business software provider. And a new breed of business software: created for evolution, not revolution. Software that's simple to buy, easy to deploy, and convenient to manage. Our 70,000 customers in more than 100 countries stand with us. We look forward to your sharing in the results of our belief. There is a better way. For additional information, visit www.infor.com.

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