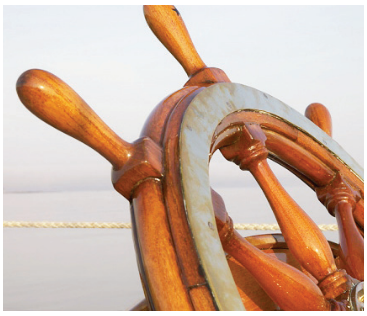
From VAS to IFRS:

Building business efficiencies and greater competitiveness for Vietnamese companies



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Executive summary

Regulatory authorities are on track to build new accounting standards based on the International Financial Reporting Standards (IFRS), the compliance to which is already required in listed companies and state-owned banks. For many, the adoption of 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 to accommodate both Vietnamese Accounting Standards (VAS) and 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. We believe there are distinct competitive advantages that can be realised as part of the IFRS adoption process.

In this whitepaper, we discuss the business process changes that Vietnam-based companies will have to make in adopting IFRS alongside VAS. And we show how these business process changes can make companies operating in Vietnam 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.

Closer to Vietnam, countries in South East Asia have applied IFRS or have plans to convert to IFRS. For instance, Philippines has adopted IFRS with some local modifications, whilst full conversion to IFRS in Thailand is expected in 2013.

Although the exact timetable for IFRS conversion in Vietnam has not been set, The Ministry of Finance (MOF) is currently working on a number of Vietnamese Accounting Standards which are based on IFRS. Currently all the Vietnamese Accounting Standards are based on the old version of IAS. Commercial joint stock banks will likely be required

to prepare their IFRS financial statements in addition to the financial statements prepared under local GAAP. Currently they are only encouraged to do so (PwC, 2011).

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 globalisation. 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.

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.

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 recognised any time the carrying cost of an asset is greater than the recoverable costs through sale or disposal.

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 recognised 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 MOF or investors in public companies.

The major differences between IFRS and VAS

The MOF has been working to converge the content of IFRS and VAS, with a goal of eliminating most, if not all, of the key differences by the time the Government 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.

In summary, some notable differences include:

Presentation of financial statements – VAS does not require disclosure of management's key assumptions and other key sources of estimating uncertainty, and requires an analysis of changes in equity in the notes rather than as a primary financial statement.

Business combinations – Under VAS, goodwill is amortised over its estimated useful life of no more than 10 years after acquisition, and is not subject to compulsory annual impairment review.

Intangible fixed assets - These assets must be amortised over a useful life of no more than 20 years and be recognised at cost less accumulated amortisation under VAS. Revaluation or write down for impairment is not allowed. Under VAS, certain pre-operating costs are charged to income statement, not expense as in IFRS.

Inventory - Companies using LIFO (last-in, first out) and average cost methods for valuing inventory, as permitted by VAS, 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 VAS. Under IFRS, interest paid and dividends received must be classified as operating cash flows. Dividends must be classified as financing cash flows. By contrast, VAS allows companies more flexibility in how they treat dividends, interest, and overdrafts.

Income taxes - VAS does not address temporary differences and deferred tax recognition, in respect of:

- Business Combinations
- Goodwill
- Asset carried at fair value
- Government grants

Financial instruments - IFRS introduces the concept of "fair value", which is unfamiliar to companies complying with VAS. For instance, financial assets, financial liabilities are evaluated at fair value. IFRS also requires the disclosure of the nature and extent of risks arising from those financial instruments.

Consolidated and separate financial statements - VAS only allows investments in subsidiaries in the parent's separate FS to be carried at cost. VAS is less strict by allowing exemptions from consolidation for parents and subsidiaries if certain conditions are met.

Events after the balance sheet date - IFRS provides guidance on the determination of the date the financial statements are authorised for issue which will vary depending on the management structure, statutory requirements and procedures to follow in preparing and finalising the FS.

The effects of changes in foreign exchange rates – IFRS requires each individual entity included in the reporting entity to determine its functional currency and measure its results and financial position in that currency, which is not stipulated in VAS. IFRS also recognises exchange differences in profit or loss.

Discontinuing operations - IFRS mandates that companies meet detailed disclosure requirements for operations that are being sold or discontinued. There is no equivalent VAS requirement.

Related party disclosures – The definition of related party under IFRS is broader, e.g. close members of the family of an individual.

Employee benefits – IFRS requires that companies record, measure and explain each type of employee benefits, including short-term, long-term, post-retirement etc.

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 adoption of IFRS alongside VAS 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

The process for adopting IFRS

Adopting IFRS alongside VAS 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 adoption process can best be completed if a company employs a methodical and strategic approach.

The adoption process should include three major phases:

1. 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 specialised 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 adoption of 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 adoption, 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?

2. 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.

3. 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.

Reporting. 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 adoption of 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 technology can help you adopt IFRS

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

Financial management solutions should provide specific support for the requirement of companies reporting in both IFRS and VAS. By supporting multiple charts of accounts, fiscal calendars, and accounting currencies, they should deliver fully automated capabilities to comply with multiple accounting practices. The ability to have multiple representations of core financial data will make it possible to understand the impact of IFRS on their businesses without imposing a significant burden on the financial teams.

Here are some capabilities that enterprise solutions should have to cater for specific IFRS requirements:

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

Segment reporting. They should allow companies to record and report information for segments using a variety of dimensions, including geography, service, and product. They should also enable 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, they should have the capabilities

to specify by account and/or statement which currency and exchange rate sets apply.

Minority interests. They should enable consolidation adjustments such as share of associated entity profits, minority interests, and intercompany and recurring adjustments. They should also dynamically book journal entries at the proper proportional value for subsidiaries and generate full audit trails on adjustments.

Financial reporting in hyperinflationary economies. They should provide built-in currency intelligence that eliminates time-consuming and error-prone manual conversion processes. They should also support consolidation using multiple sets of exchange rates for multiple currencies and enable a company to track information in a business unit's local currency, functional currency, and reporting currency.

Discontinuing operations. They should provide analytical tools and support for multi-organisation structures to show the consolidated effect of the disposition.

Multiple reporting requirements. They should support a variety of consolidation and reporting processes within the application, and simplify data collection from multiple remote transaction systems and charges of accounts.

Electronic output of financial and business data. They should support 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.

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