topdown CONSULTING

A Look Ahead: How to Plan for U.S. Adoption of IFRS

This edition published November 2011

Table of Contents

About the Author

Mike Arnoldy has over twenty years of experience in all phases of design, development, and implementation of financial applications. He has exceptional problem solving and architecting skills with a strong technical background. He specializes in financial consolidation applications that include complex calculations, foreign currency translation, inter-company/ equity eliminations and varied reporting requirements to satisfy both external and management reporting needs. Mike is also a Certified Public Accountant.

About TopDown Consulting

Founded in 2000, TopDown Consulting is the preferred Hyperion/EPM solution partner for many of the largest and best performing Global 2000 companies. TopDown's repeatable, scalable engagement methodology specifically considers an organization's unique business requirements and accommodates them through technology, process, and best practices gathered from years of working with leading companies across all industries. As an Oracle Certified Advantage Partner, TopDown Consulting is a recognized leader in strategy, assessment, implementation, and optimization of Hyperion solutions. TopDown's exclusive focus on client self-sufficiency and commitment to client success is why hundreds of industry leaders consider TopDown Consulting to be trusted advisor and indispensible partner for addressing all EPM challenges.

Executive Summary

As the Securities and Exchange Commission (SEC) contemplates the U.S.'s transition to IFRS (International Financial Reporting Standards), companies must consider the impact it could have on their monthly reporting. While the SEC is still deliberating and collecting comments, companies are left to wonder what the final verdict may be. Mike Arnoldy, TopDown Consulting Principal Architect, takes step-by-step look into the future and offers some insight and tips on how to plan, what to consider now, and what to consider when we finally hear from the SEC. And he frames the discussion with key questions such as:

- Will just a few processes need to be added on at month's end?
- Will you need an entire overhaul of your reporting system?
- Is this the time to upgrade from Hyperion Enterprise to the more robust Hyperion Financial Management system?

Beginning with "IFRS at a Glance", Arnoldy gives a brief overview of exactly current international reporting practices, what IFRS is, why it is needed, and the U.S.'s role in its international adoption and continuation.

"Have You Thought About What IFRS Means to You?" asks some probing questions on how its adoption could impact your organization, not only the financial and accounting teams, but business companywide and worldwide. He takes into consideration the time, money, and effort needed in the months ahead as implementation processes are discussed.

"IFRS and Its Impact on Hyperion Financial Management" takes a look at applications built with a very granular level of detail in the accounts. If your base accounts are rooted directly on the transaction system with a one-to-one relationship, how much work will be needed? What types of changes should be considered? How much time might it take?

"IFRS and Summarized Accounts" considers another type of application–that of one built with a summarized chart of accounts. What can we look forward to in making sure these applications meet IFRS? What steps can be implemented now? What might the conversion process look like?

Finally, "Thoughts on Preparing for IFRS" gives a four-step summary of considerations. What can you do now? How do you plan for this change?

With more than 20 years of experience in all phases of design, development, and implementation of financial systems, as well as being a Certified Public Accountant and HFM consultant, Mike Arnoldy provides some direction on what to expect in the coming months. Though there is no way to predict exactly what the SEC will do in terms of IFRS, there are steps everyone should consider moving forward.

IFRS at a Glance

By now, many of you have heard of IFRS. But how many of you have actually given some thought to the profound impact it could have on your consolidation application? This simple acronym has the potential to require as much if not more time and resources then either SOX or Y2K. An IFRS adoption project could take years—most companies who have adopted it have indicated that it took more time and resources than they anticipated.

Did that get your attention?

Looking at IFRS and its potential impact cannot be covered in a single sentence, so this is the first of five chapters on the topic. We will start by discussing the what, why, and when of IFRS. We'll follow this with a discussion of the impact on the applications that feed your consolidation application. Then we'll take a look at what everyone cares about: the impact on the consolidation applications. This is where the problem begins.

What is IFRS? It stands for International Financial Reporting Standards. We live and work in a global economy. The shares of multi-national companies are traded on multiple stock exchanges around the world. And today's investors invest in companies around the world. Traditionally, each country has had its own accounting standards. Companies prepare their financial statements to comply with these local standards. That is where the problem begins.

How do you compare the financial statements of a company in the U.S. that is using U.S. GAAP with a company in India that is using Indian GAAP with company in Australia that is using Australian GAAP? It is not a question of which standards are more correct or present a fairer picture of the company; it is just a question of comparability. How do you compare an apple and an orange without being an accountant with knowledge of the differences in every country's accounting standards? IFRS is focused on addressing this by developing "a single set of high-quality, globally accepted accounting standards."

Countries around the world are or have been in the process of adopting IFRS for some time now. So what is the U.S. doing?

Studying

The various regulatory bodies in the U.S. have been looking at IFRS for years. FASB has been working with IASB (International Accounting Standards Board) to address the differences between U.S. GAAP and IFRS. The SEC has been studying how other countries have adopted IFRS and is seeking comments on various approaches. These approaches range from complete adoption of IFRS by a certain date to a phased approach where, over a period of five to seven years, U.S. GAAP is brought into convergence with IFRS. The timeline for deciding on if, how, and when to adopt IFRS was 2011. Will the decision be made this year?

Who knows?

What I do know is the U.S. will be under tremendous pressure to adopt IFRS. There has been speculation that IFRS could fall apart without U.S. adoption. It is safe to say that IFRS is probably coming—it is just a matter of knowing the how and when.

Have You Thought About What IFRS Means to You?

Imagine that it is December 2011 and the SEC has just announced their decision that the U.S. will be adopting IFRS.

Now what?

When I first started hearing about IFRS, many of the discussions with my colleagues centered on just completing the financial consolidations as we do today and then layering on a series of IFRS adjustments. As I have learned more about IFRS, I do not think this is an adequate approach—the changes required to do it correctly without adding time and resources to the monthly are much greater.

Without boring you with the minute details of the differences between U.S. GAAP and IFRS, I'd say IFRS adoption will need to start with the transaction systems. IFRS has different approaches for things such as revenue recognition, valuation of assets, and depreciation. Depending upon the results of the convergence efforts, these differences could remain or be resolved. My money on some of the differences remaining. These items involve hundreds or thousands of transactions each month for a company. It may be acceptable for the very short term to book an IFRS adjustment on top, but the long term solution needs to have these transactions recorded in the source systems correctly using the new accounting principles.

Think about all of the processes that feed data from the sub systems—e.g., order entry or fixed assets. An IFRS project should include reviewing and possibly modifying these to conform to the new accounting principles. Think about all of the people in your company responsible for recording transactions in these sub systems or booking journal entries in the ledger systems. They all need to be educated and trained on the new accounting principles and how they impact the entries they are responsible for. The scope of this is not just the relatively small group of people in the corporate consolidation team; it includes hundreds of people across the company and around the world.

Because there are so many source systems involved and they are used by so many people, this will probably be the largest part of the IFRS adoption effort. There will be a lot of resources used to determine what to change, how to change it, when to change it, and to actually implement the changes.

The bottom line is: I would not want to record all of my transactions using one set of accounting standards, then do my reporting using another, relying on top side adjustments to handle the differences. I can think of no better to way to slow down my monthly close process then to have to add time and resources to do the analysis and make these adjustments.

At some point in the IFRS adoption process, the source systems need to be addressed. The best time to do that will vary from company to company and will be influenced by the method and timing the SEC chooses for IFRS adoption.

IFRS and Its Impact on Hyperion Financial Management

The last chapter discussed the potential impact of IFRS on the transactions systems. Now let's take a look at how IFRS impacts Hyperion Financial Management. Not surprisingly, the impact is different for each application, depending primarily on how that application is designed.

If you have not paid much attention to IFRS, I would suggest you take a look at what the financial statements look like. Compare these statements with your current financial statements. IFRS financial statements have different line items from our U.S. GAAP statements. A well designed Hyperion Financial Management application is built to support creating the required financial statements with efficiently designed reports. This is mainly done with the chart of accounts. If the financial statements change, the chart of accounts most likely needs to change. You may be able to create the new reports by cherry picking accounts in your application and building subtotals into the reports, but this approach results in poorly designed reports that require substantial maintenance going forward.

So if we accept that the chart of accounts has to change in your application, what is the impact? This is where the application design enters the picture.

When I think about implementing IFRS, I think there are really two types of applications. The first type is those applications that are built with a very granular level of detail in the accounts. The base accounts may be based directly on the transaction system with a one-to-one relationship. With this application design, most likely, the application will not need to be rebuilt. That is not to say that there is not work to be done.

To make this application IFRS ready, you would build an alternate hierarchy in the account dimension. All of the base accounts will be rolled up into new parents to support the lines on the IFRS financial statements. There will most likely need to be some additional rules added to the application that are based upon this new account hierarchy. You may need to add some custom dimension members to have the ability to make GAAP-to-IFRS adjustments or vice versa, depending upon how IFRS is being adopted. A completely new set of reports will need to be developed. The current data loads will probably not need to be changed unless this is required by changes to the transaction systems. The data validation for the new chart of accounts should be relatively painless. The application will be using the same base level data, just rolling it up differently. The validation will primarily be focused on the correctness of how the base level accounts are placed on the new hierarchy.

If you have an application that falls into this category, you should not have a particularly difficult time adopting IFRS. You will be able to have a single application that supports both U.S. GAAP and IFRS concurrently. There will be some additional overhead on the application as long as you are running both the U.S. GAAP and IFRS rules. And of course there will be maintenance of both the U.S. GAAP and IFRS account hierarchy and reports. Presumably at some point in the future, the U.S. GAAP components could be removed.

The next chapter will look at the second type of application: those that have a summarized chart of accounts.

IFRS and Summarized Accounts

Now let's take a look at the changes required for an application that has a summarized chart of accounts. If you have this type of application, adopting IFRS is going to require a substantial amount of work and will probably result in a completely new application.

Many companies have designed their Hyperion Financial Management application with a summarized chart of accounts. There are two main reasons for developing a summarized chart of accounts:

To reduce the size of the application. A large company may have thousands of accounts in their transaction system. This level of detail may not be needed for the consolidation so a smaller chart of accounts is developed.

In a large company, there may be multiple transaction systems each with their own unique chart of accounts. The Hyperion Financial Management application is then developed to contain one common chart of accounts so that the data from these multiple transaction systems can be combined.

In this type of application, the summarized chart of accounts was designed to support U.S. GAAP financial statements. The base accounts in HFM represent multiple accounts from the transaction systems. Since the application does not have the base level accounts from the transaction systems, a new account hierarchy will need to be built with the new base HFM accounts representing a different set of accounts from the transaction system. This change in what a base account represents in HFM will result in changes being required to all of the data load processes. The current load processes, whether in FDQM or some other tool, utilize a map to direct transaction system accounts to the HFM accounts. These maps will need to be changed. With a new chart of accounts, the rules will need to be rewritten. In addition to this substantial amount of work, the changes to the reports we mentioned in the previous chapter will also need to be done. It is the magnitude and scope of these changes that lead me to believe that a complete rebuild of the application will be required.

With any build of an application, we have to address one of my favorite topics: data validation. Generally I would view the validation of a rebuilt HFM application to the original application to not be very painful. But in this case, this validation will be difficult at best. Having to validate that mappings are correct always adds time to a data validation effort. Depending upon how IFRS is adopted, there may be a need to load more history than normal to support comparisons to prior years. In sum, it is going to be very challenging to find the common points when validating a U.S. GAAP chart of accounts to an IFRS chart of accounts. I hope that I am wrong, but until we actually do some of these validations, we have to assume the worst. To be on the safe side, you should also assume the worst when looking at a project like this.

If your application has a summarized chart of accounts, most likely you are looking at a major project to implement IFRS. I would plan on a complete rebuild of the application and I would allow a lot more time than you expect for the data validation effort.

Thoughts on Preparing for IFRS

Over the past few chapters, we have taken a brief look at what IFRS's possible impact on consolidation applications. Now it is time to look at what can you do now to start preparing. The current answer is not much. Until the SEC decides on the "if, when, and how" of the U.S. adopting IFRS, there are not a lot of concrete steps you can take. There are, though, some things you can do to prepare.

First

Start monitoring developments. Some useful websites are www.sec.gov, www.fasb.org, and www.ifrs.org. The SEC is scheduled to decide this year but, of course, there is no guarantee they will.

Second

Start learning about IFRS and how it differs from U.S. GAAP. We have all been preparing financial statements with the same rules for years so it has become second nature. With the introduction of IFRS, those rules may be changing. My accounting knowledge is a skill that sets me apart from my fellow consultants. It helps me guide clients in building a consolidation application. I know I will include IFRS in my CPE for the next few years so I am ready if and when it comes to the U.S.

Third

Start thinking about how the differences between IFRS and U.S. GAAP could result in changes to your consolidation application—i.e., what will you need to change in the application to report in IFRS? Keep in mind that IFRS will also result in changes to the transaction systems. This impacts the data that flows into the consolidation application. As such, how might the interfaces need to be changed? What about your planning process? Does that need to be updated for IFRS?

When you think about IFRS right now, there is really nothing but questions lacking any clear answers. But thinking about these things now will help prepare for the effort to implement IFRS. I remember when SOX was being implemented and one company I was working with got a very late start. It was a chaotic effort to say the least and they expended a lot more effort than would have been required if they had shown some foresight and planned ahead. Thinking about how IFRS impacts applications is something we at TopDown Consulting will be looking at over the coming months. Our goal is to be prepared to guide our clients successfully through this process, whatever form it may take.

Fourth

If you are using Hyperion Enterprise, this is probably the catalyst to move to Hyperion Financial Management. There are several reasons why I say this, but most important is: if you have to rebuild an application to implement IFRS, do you really want to do that in a technology that is 20 years old? Enterprise has been a wonderful tool for many companies. But it will not give you the same flexibility that Financial Management will give you to build an IFRS application. This is the opportunity to do one implementation that addresses two issues at once.

Estimated SEC Timeline for IFRS Implementation

(for public companies only)

2010 Early adoption can begin for the largest companies

2011 Schedule based on IFRS adoption

2014 Mandatory use of IFRS begins in FY 2014 for large accelerated filers

2015 Mandatory use of IFRS begins in FY 2015 for accelerated filers

2016 Mandatory use of IFRS begins in FY 2016 for non-accelerated filers

Final Thoughts for Now

I am sure my thoughts on IFRS will evolve over the coming months as I learn more about it and we hopefully get some decisions from the SEC. And I will continue to provide updates as more information becomes available.

TopDown Consulting, Inc. serves clients nationally and internationally from our San Francisco headquarters. For more information or to inquire about our services, please contact us.

TOPDOWN CONSULTING, INC.

236 West Portal Ave #390
San Francisco, CA 94127

Phone: (888) 644-8445 (Calls from within US and Canada)
Phone: (617) 576-8445 (Outside US and Canada)

Email: info@topdownconsulting.com
Web: www.topdownconsulting.com