10Minutes on Transitioning to IFRS*

What you need to know about emerging topics essential to your business. Brought to you by PricewaterhouseCoopers.

September 2008

Thinking about it now is a good idea

Highlights

- Transitioning to IFRS is likely to impact how management communicates with investors, as well as how some companies conduct business with customers and vendors.
- The new financial reporting regime will affect internal operations and may cause companies to change the form in which some employees are compensated.
- The transition requires sophisticated planning due to the many interrelated changes it will entail within an organization. Company-specific modifications are needed—a cookie-cutter approach won't work.
- The earlier a company plans strategically for this transition, the better.

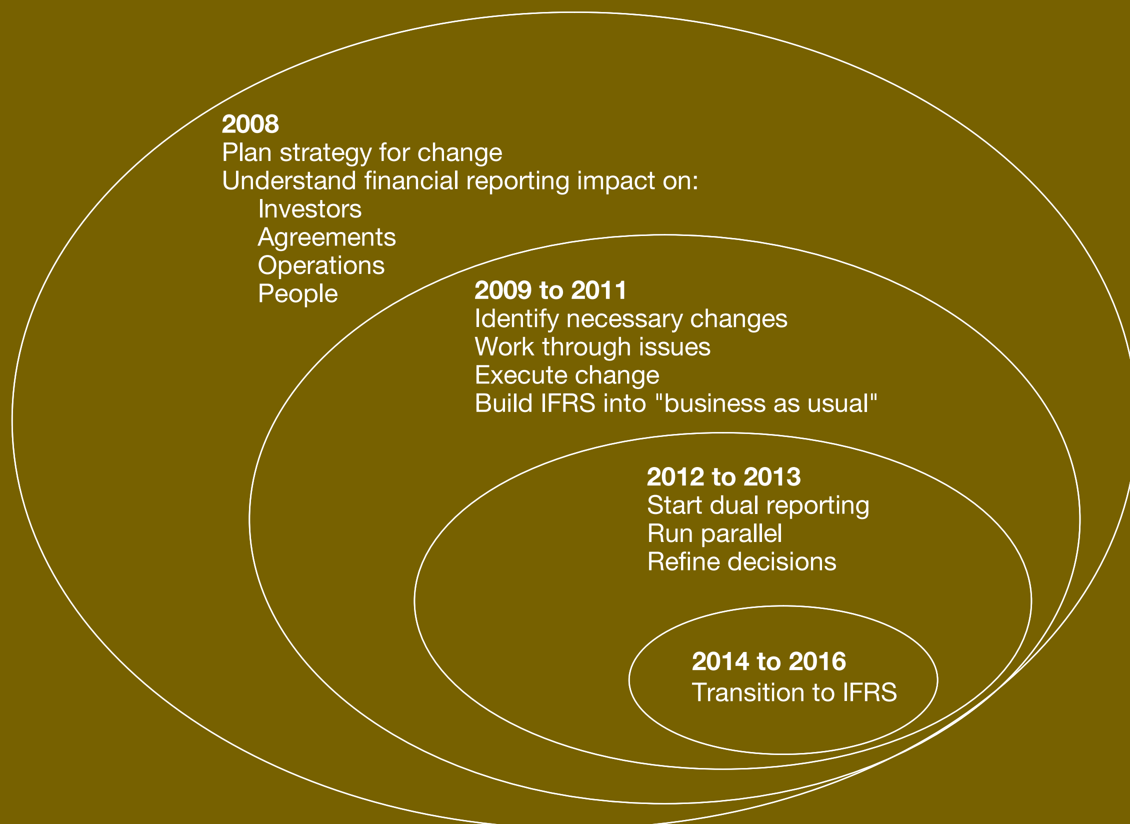
Switching to IFRS will be a bigger change for some companies than for others. With mandatory transition proposed to begin in 2014 (and voluntary adoption permitted for some companies as early as 2009), it makes sense for management to start sizing up the volume and variety of financial, business, tax, and operational changes—the objective being to avoid a resource-intensive effort at the eleventh hour. Perhaps just as important, sufficient lead time will allow companies to see where the transition to IFRS can deliver substantial benefits, as some Fortune 50 companies are already doing.

Impact and opportunity

1. **Investor communications:** Financial performance may look different going forward. To mitigate potential confusion, companies need to assess the impact on key performance metrics and rethink how those are communicated.
2. **Business relationships:** IFRS may affect how companies report the economics of business arrangements that extend beyond the next few years. Assessing these arrangements beforehand will allow management to minimize post-conversion complications.
3. **Daily operations:** Key business processes such as sales and information technology may need to be altered, offering the potential for greater efficiency in a number of areas.
4. **Employees:** Transition-related modifications in business operations could change employee responsibilities. Compensation may change as well, both in the form it takes and in the underlying performance targets.

At a glance

The SEC has proposed that mandatory adoption of IFRS start in 2014. Companies should begin assessing the impact now. Doing so will allow them to take a thoughtful and measured approach to their conversion efforts. In the event that early adoption is allowed—something the SEC is proposing for 2009 for some companies, and may allow in 2011 for others—management might want to accelerate their conversion efforts.



01

Interpreting the roadmap

Several factors suggest that mandatory IFRS reporting will become a reality in 2014:

- The SEC has issued a roadmap. It does not specify final conversion dates, but the Commission has indicated that IFRS reporting is targeted to begin in 2014 for the largest US companies.
- Standard setters are actively working to bring US financial reporting standards closer to IFRS (an effort that should facilitate transition).
- Market forces driving greater globalization are keeping US capital markets under pressure to convert to IFRS.

These factors are fluid. Companies should monitor them to keep their planning aligned with the latest developments. In particular, companies should be prepared to react to the decisions the SEC will be making about IFRS in 2011, which could range from expanding availability of early adoption to setting a mandatory transition date.

Executing change

The new financial reporting regime's impact on a given business might be narrow and focused, or it could range across most functional areas: Making this determination is critical to devising an appropriate transition plan. In our experience, such a plan is likely to entail modifying internal processes, business practices, information technology systems, and financial reporting policies to accommodate and optimize the new reporting framework.

Taking steps early to ease transition later

To improve the likelihood that current and contemplated business arrangements will produce their intended financial result several years out, management should begin assessing them in the context of the new reporting framework. Once that goes live, US public companies will have to file IFRS-compliant financial statements for that year, plus the previous two years, consistent with existing regulations, which are unlikely to change.

Companies may want to run IFRS and US GAAP financial reporting in parallel before filing IFRS financial statements, to detect and correct potential problems, and to fine-tune reporting decisions.

02

Managing the impact on external relationships

Communicating changes to investors

Companies need to understand where and how reporting changes are likely to occur under the new framework, advising investors about them well in advance. Doing so will enable companies to appropriately frame their reported results so that they are not misinterpreted.

For instance, the baseline for each of the many key performance indicators that investors and analysts look to when assessing and comparing companies is likely to change. Companies may need to explain the changes when they discuss their performance, comparing old numbers to new—making it clear, for example, that although their net income may have changed due to IFRS accounting, there has been no corresponding change in the company's actual performance. Likewise, financial institutions and other companies may need to explain that debt-to-equity ratios have changed because the new reporting framework requires bringing more assets and liabilities onto the balance sheet.

Companies should also be prepared to disclose how their numbers compare to those of their peers post-transition, as well as why the transition's impact might be more or less significant for their competitors.

Reassessing business relationships

In the near term, companies may need to renegotiate financing agreements and adjust debt covenants, which could be costly or difficult. And because more companies will have to consolidate other businesses under the new financial reporting requirements, some may prefer to substantively restructure ownership of their investees. Management should also consider the implications for other long-term contracts, such as leases, derivative arrangements, and sales contracts, so that they can address any consequences.

03

Sizing up the in-house effect

Employees

Various aspects of corporate culture have long conformed to the necessities of US GAAP, with more than just financial reporting being impacted. Take sales strategies: Although companies might not have explicitly designed their sales processes around US GAAP requirements, many compensate their sales staff based on revenue recorded or product shipped, essentially molding their sales commission program around financial reporting considerations. The new reporting framework could throw that off kilter. Consequently, some businesses might want to make certain modifications upon transition, to maintain a well-controlled environment.

Businesses may also decide to revisit their general compensation structures before transitioning, especially if compensation is equity-based or primarily driven by performance. In considering potential changes to stock option plans, sales commission formulas, and the like, management will need to weigh both employee morale and company expense in the balance.

Daily operations

Internal operations may need to change as companies begin to weave the new reporting scheme throughout the fabric of the business—in other words, the various operations and processes that simultaneously feed and are affected by a company's financial reporting. For instance, control over processes and information may need to be revisited, new treasury strategies devised, and information technology systems upgraded. To accomplish this, companies will need to enhance resources by hiring new personnel or begin retraining in-house staff. The second alternative is likely to be more economical but will require additional time.

Taxes

For most companies, the new accounting and reporting will also impact cash taxes paid and effective tax rates. The interrelationship of the long lead time for tax planning and the follow-on operational issues generated by post-transition changes may mean that companies will have to widen the window for transition planning and execution.

Seizing the day

Companies need not launch a full-blown transition effort today, but they do need to determine how much preparation time is advisable. This involves assessing the breadth and depth of the transition's likely impact on the company. Management can begin that assessment by taking the following steps:

- Understand which performance measures will be affected, how they will compare with those of competitors, and how to translate them properly for investors and analysts
- Consider the future impact on transactions initiated today (e.g., vendor and customer agreements, financings, and M&A deals) and determine what the agreement structure should be, given the new reporting
- Evaluate the operational implications for tax planning, information technology systems, internal controls, business processes, and other daily activities to establish sustainable processes
- Size up the impact on employees, taking into consideration potential changes in roles, responsibilities, and forms of compensation

Two birds, one stone

As several multinational Fortune 50 companies have already discovered, transition-related changes have the potential to deliver future dividends, such as streamlined operations and reduced costs. With this outlook, companies can approach their conversion efforts strategically (e.g., overhaul an inflexible information technology system or rethink accounting choices), not just treat them as a compliance exercise. The earlier they begin, the greater the benefits are likely to be.

For further information on IFRS conversion, please see our publication *Mapping the Change: IFRS Implementation Guide,* which is available in print and online: www.pwc.com/10minutes.

Upcoming 10Minutes topics:

Why climate change matters today

Concerns over energy security and costs are heating to uncomfortable levels, both at the gas pumps and in the boardrooms. Meanwhile, consumers, employees, and communities are increasingly expecting action from businesses. Climate change has become a matter of managing risks, costs, and reputation. 10Minutes explores how you can link your response to climate change more strongly to your business strategy and your corporate performance.

Protecting information and intellectual property

The risk of data and identity theft is on the rise. Greater data mobility and collaboration between global networks have made information systems easier to infiltrate. Regulatory compliance alone won't arm businesses against increasingly sophisticated breaches of sensitive information. 10Minutes explores new ways of thinking about the protection of this intangible, but critical, asset.

The changing face of financial reporting

The income statement and balance sheet—foundations of public financial reporting and financial analysis—are not optimally serving investors and analysts. This has caught the standard setters' attention and they are considering major changes to basic form and content. 10Minutes provides an update on the state of play.

Competing for knowledge workers more intelligently

A limited pool of knowledge workers means that organizations need to find smarter ways to compete for these professionals. 10Minutes looks at how companies are redefining their approach to people management by not only looking outward to find the best and brightest, but also looking inward to create an environment where they can thrive.

How PwC can help

To have a deeper discussion about transitioning to IFRS, please contact:

Dennis Nally
US Chairman and Senior Partner
PricewaterhouseCoopers LLP
Phone: 646.471.7293
Email: dennis.nally@us.pwc.com

Dave Kaplan
International Accounting Leader
PricewaterhouseCoopers LLP
Phone: 973.236.7219
Email: dave.kaplan@us.pwc.com

Steven O. Swyers
US IFRS Leader
PricewaterhouseCoopers LLP
Phone: 704.344.7657
Email: steve.swyers@us.pwc.com

Tell us how you like 10Minutes and what topics you would like to hear more about. Just send an email to: 10Minutes@us.pwc.com

10% total recycled fiber

This publication is printed on Cougar recycled paper. It is a Forest Stewardship Council (FSC) certified stock using 10% post-consumer waste (PCW) fiber and manufactured in a way that supports the long-term health and sustainability of our forests.