

IFRS: Globalization's New Frontier

By Trish Harris

It's a small, small world. That is a fact, at least, from a business perspective. Many factors, such as the advancement of technology, have altered much of the business landscape from local to global. And today's high-level discussions about globalization are hardly considered to be futuristic in nature.

It's not surprising, therefore, that standardization of various aspects of business would be considered desirable by many. Certainly, that is the case in regard to financial reporting, as is evidenced by the momentum of International Financial Reporting Standards (IFRS) all around the world. Listed companies in more than 100 countries are now adopting IFRS.

Change on the Horizon

IFRS will bring a number of changes to the way organizations conduct business and report on their financials. Here are a few examples of the far-reaching implications:

- More entities—such as joint ventures, special purpose operations, and franchises—may be consolidated.
- Liabilities will be recognized and measured differently
- Development costs will be deferred and amortized.
- Impairment charges will be recognized earlier and measured differently.
- Financial assets and liabilities will be measured differently.
- Depreciation computation will be more complicated.
- There will be a need to focus more on the economics underlying transactions and events.

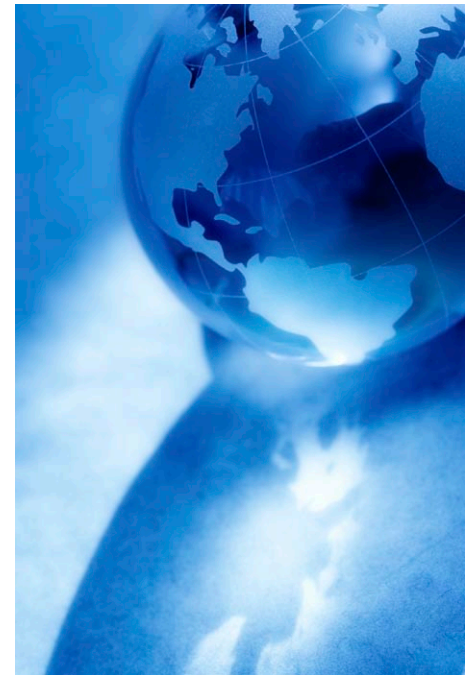
Principle-based and at a higher level than the U.S. GAAP, IFRS leaves more areas open to professional judgment and interpretation than do more detailed and restrictive standards.

By the end of 2009, the U.S. Securities Exchange Commission (SEC) will offer approximately 110 U.S. companies the option to use IFRS. Then, in 2011, the SEC will evaluate the progress participating companies have made in achieving proposed milestones, and will determine whether to mandate IFRS adoption. If it is adopted, roll-out will take place in stages, beginning with the largest publicly traded companies; and the first wave of reports based on IFRS will be filed in 2014. If IFRS is, indeed, adopted in 2011, all listed companies will be required to use it by 2016.

Far-reaching Implications

Given the timeframe for implementation, should it be adopted, now is not a moment too soon to learn about the changes IFRS might bring and what those changes will mean throughout the organization. This is not only about accounting. In fact, it is difficult to think of a business activity that IFRS will not affect.

Those involved in R&D and production will be involved in defining inventory capacity and measurement, determining components of property, the physical plant, and equipment; and clarifying phases of research and development. The communications function will help ensure that financial communications are appropriate and clear, and that they accurately reflect fair value accounting and its impact on key performance



indicators. The legal staff will need to interpret IFRS contractual terms and conditions, which might result in the organization's need to revise processes and systems for entering into, drafting, approving, or monitoring contracts. The need for detailed hedge documentation and effectiveness testing will impact those responsible for treasury, and the tax department will have to work closely with the accounting staff to examine the impact IFRS might have on new financing structures. Human resources might be required to adjust the calculation base for certain types of compensation, such as profit sharing and bonuses. Marketing and sales might be confronted with issues related to branding and trademarks, net value of inventory, revenue recognition, conditions of sale, and embedded derivatives.

Because IFRS is so broad and has the potential to impact so many aspects of a business, at least a cursory understanding of it by all management and governance entities is critical.

Internal Audit Roles and Responsibilities

An important role played by the internal auditors is that of educator to management and the audit committee of the board. In addition to understanding the changes that IFRS will bring to the way the organization is run and governed, management and the board should have a clear grasp of the internal auditors' roles. The chief audit executive (CAE) is integral to ensuring that this is the case.

Although the accounting or finance department is in charge of the entire IFRS project from initiation through execution, the internal audit activity has various responsibilities throughout the process. The internal auditors should review the IFRS project plan to ensure the organization is prepared appropriately, the project is designed and scoped adequately, and the process is managed effectively and efficiently. During this pre-implementation phase, the internal auditors should:

- Ensure proper controls are in place.
- Perform readiness testing.

Research Article

Developed by The Institute of Internal Auditors Research Foundation (IIARF), "IFRS: What Internal Auditors Need to Know," helps inform and prepare internal audit practitioners and their organizations for the potentiality of IFRS being adopted in the U.S. To review the full research article, visit <http://www.theiia.org/research>.

- Review the communication plan.
- Test the adequacy of the change management plan.
- Review management's budget to ensure necessary expenditures are included.

The internal auditors should work closely with the external auditors throughout the implementation process. They should help identify all affected areas and ensure all process documentation is updated. They should test internal controls, ensuring any necessary adjustments are made to the monitoring processes and that all controls function properly in the new IFRS environment.

Following IFRS implementation, the internal auditors should test, at a minimum, high-risk areas for accuracy and make sure certain controls are in place for the continuous monitoring of IFRS regulatory changes. They then should provide assurance to management

that the revised internal control structure is working properly and feeding into accurate financial reports.

Internal auditors should determine when their organization might be required to comply and step forward to initiate conversations with senior management, accordingly. They should make sure they are included in preliminary discussions on the conversion process, covering such topics as IT system upgrades, additional accounting and audit expertise, and obtaining board or audit committee support to ensure the needs for the project will be met.

It is evident that globalization's new frontier—IFRS—is already a reality worldwide. As listed companies anticipate its arrival in the U.S., being proactive will prove invaluable in ensuring both proper preparedness and long-term success. **NP**

Contributed by Trish Harris, freelance writer and editor with The Institute of Internal Auditors. The Institute of Internal Auditors (IIA) is the internal audit profession's global voice, recognized authority, acknowledged leader, chief advocate and principal educator worldwide. Established in 1941, The IIA serves members from all around the world in internal auditing, governance, internal control, IT auditing, education and security. For more information about The IIA, please visit www.theiia.org.



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