



The Impact of IFRS on Technology

A Practical Introduction

ADVISORY





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Converting to IFRS poses a significant challenge to organizations globally. Many companies initially view the conversion process as solely an accounting challenge and fail to take into consideration the significant role played by IT systems and processes.

The impact on information systems from IFRS conversions arises from the differences between the accounting standards currently applied and IFRS. This creates a need for additional data and changed calculation tables. To facilitate these challenges, information systems may need to be modified, remapped, reconfigured or even newly implemented.

One of the major impacts of converting to IFRS is the increased burden placed on the organization to capture, analyze and report new data in order to comply with the new requirements of IFRS. The more automated the conversion process is, the less the impact on day-to-day operational activities is likely to be. One of the ways to achieve this is to understand fully what the potential impact on information systems will be, and to address this as an integral part of the conversion project.

The aim of this paper is to help companies facing the conversion to IFRS to better understand and prepare for the impact the project will have on their information systems.



Egidio Zarrella
Global Partner in Charge,
IT Advisory
KPMG in Hong Kong



Manfred Hannich
Global Partner in Charge,
Accounting Advisory Services
KPMG in Germany

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Executive Summary

The conversion to International Financial Reporting Standards (IFRS) is a challenge for companies of all sizes. This is a project with considerable impact on the business processes that makes a significant contribution towards better transparency and understanding of a company's financial ratios.

“Throughout the conversion process, organizations should seek to ensure they actively involve all affected areas of the organization in the development of strategies”.

Implementation of IFRS is far more than the adjustment of the numbers. IFRS conversion projects are often regarded exclusively as projects of the financial accounting department; at the same time, however, the implementation of IFRS also influences the IT systems and the supporting processes and areas, as well as the financial accounting department.

The effect of IFRS conversion on IT systems arises from differences in the accounting treatment between current accounting standards and IFRS. This can lead, for example, to the need for different or new data or information to comply with the new accounting regulations and to changes in measurement procedures and reporting standards. To facilitate these changes, information systems may need to be implemented, modified, remapped or reconfigured.



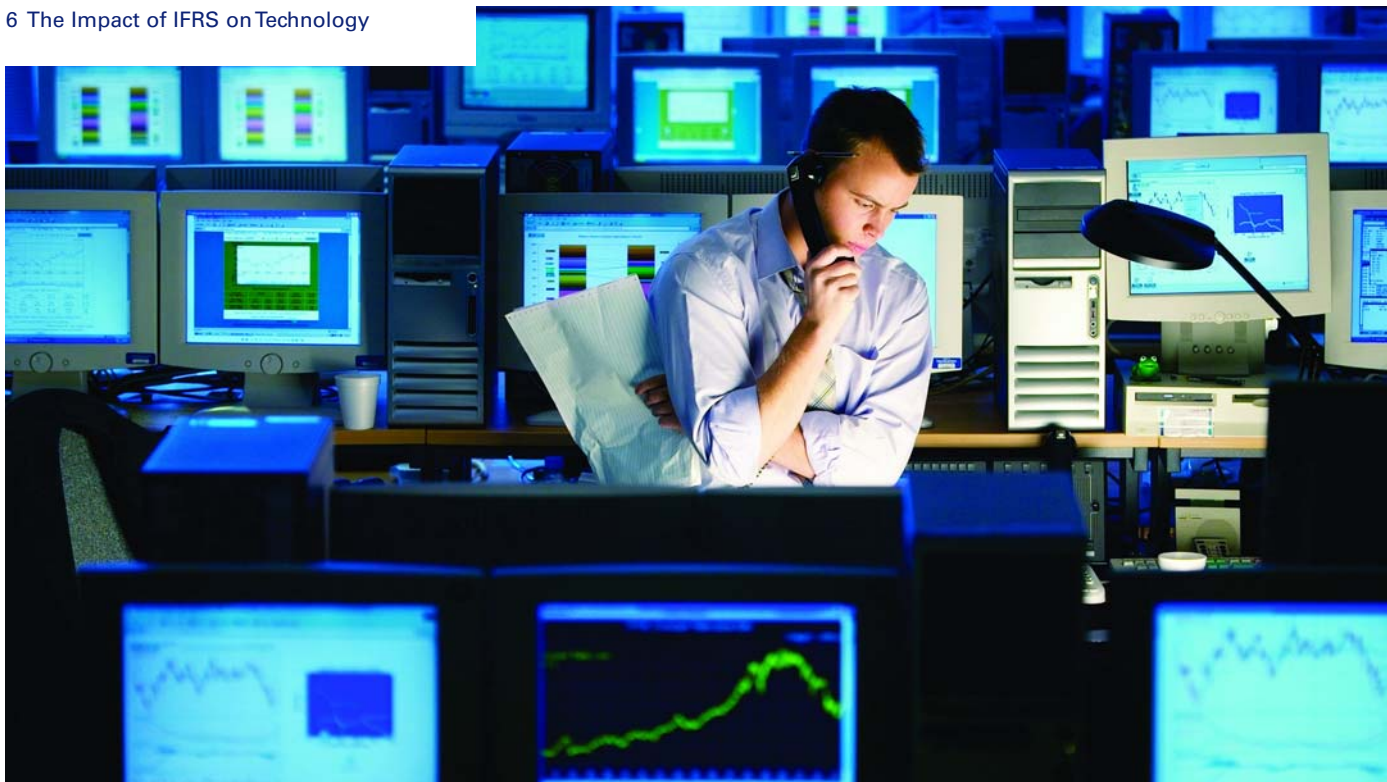
KPMG firms can support you in the conversion to IFRS accounting with a broad ranging approach, which, in addition to the financial accounting system, will also monitor the conversion of the necessary IT systems and processes, including key ratios, contracts, management reporting and corporate financing. Communication with stakeholders and employees (e.g. knowledge transfer, training courses, training of management) is also an important element in the conversion process. Professional project management can help to ensure the successful conversion throughout the organization to IFRS.

KPMG firms' IT Advisory professionals provide support in the following areas: presenting a selection of technical alternatives and estimating the required expenditure in terms of costs and time for the technical support of the conversion project; we offer strategies for the integration of the various systems (ERP systems and other IT systems) and develop models for the technical implementation of measurement procedures that conform to IFRS standards; we provide advice on the reorganization of the associated systems and processes.

Throughout the conversion process, organizations should seek to ensure they involve all affected areas of the organization in the development of strategies.

Fig. 1: KPMG's conversion approach





Introduction

The conversion to IFRS in many countries worldwide represents a major milestone for the global capital markets.

The importance of IFRS

With Regulation No. 1606 of 2002, the European Union decreed that entities listed in an organized stock market in the European Union will have to prepare their consolidated financial statements for financial years commencing on or after 1 January 2005 in accordance with IFRS. Entities not quoted in an organized stock market can prepare their consolidated financial statements in accordance with either local GAAP or IFRS. The preparation of stand-alone financial statements at the European level continues to be based on local GAAP.

More than 80 countries worldwide - from Australia, through China, South Africa and Venezuela to Zimbabwe - require, or allow on a voluntary basis, the preparation of financial statements in accordance with IFRS. Other countries, such as Brazil, Canada, India, Mexico and the USA, are currently holding discussions or are in the process of adopting IFRS. The worldwide trend towards the adoption of IFRS as the primary accounting standard continues.

Investors are active today at a global level. As a consequence, the capital markets expect financial information (which represents a significant determining factor for decisions on the granting of funds) to be available in an understandable, transparent and comparative format. The conversion to IFRS in many countries worldwide

represents a major milestone for the global capital markets. The financial data of business entities is available for the first time in a transparent and comparative format.

This improves the competition for available capital, and means that entities which are unable to present IFRS financial statements can expect tougher conditions in the capital markets.

The advantages of converting accounting and reporting standards to IFRS also go beyond the fulfillment of legal requirements, meeting the demands of the global capital markets and battling for potential stakeholders. The internal and external reporting processes can be harmonized and speeded up based on a uniform accounting standard used in all subsidiaries. It is also no longer necessary to perform additional work in preparing and interpreting the consolidated financial statements or reconciling local financial statements to the accounting standards of the parent company. This generally has a positive impact on the timeliness and quality of the information available for management.

Because IFRS can help deliver improvements in the efficiency of financial reporting, it can also lead to improved management decision-making processes.

The conversion to International Financial Reporting Standards (IFRS) represents a tremendous challenge for all business entities worldwide. The success of a conversion project mainly depends on whether its reach and impact are fully identified and understood. The range of objectives of the conversion determines the strategy and the scope of the project.



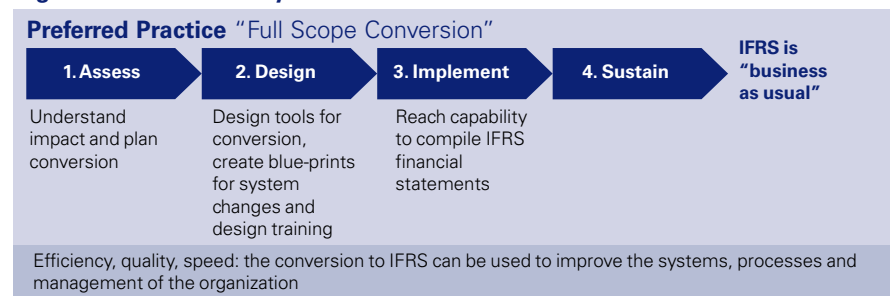
The conversion to IFRS will generally be associated with significant investments, unique risks and time pressure. For many organizations, IFRS conversion is a complex project that does not just affect the accounting function and systems. Supporting processes and functions and IT systems and data structures will also have to be amended, and employees will have to be trained on how to work with the new systems and IFRS.

Value proposition

KPMG member firms offer in-depth knowledge of IFRS alongside strong technology skills combined with years of experience gained through supporting many organizations in their IFRS conversion projects around the world.

KPMG has developed our own **Global Conversion Services Methodology** to help our clients perform IFRS conversions by advising on the assessment, design and implementation of conversions from the current primary accounting standard to IFRS. The Global Conversion Services (GCS) methodology is designed to approach the conversion in manageable phases:

Fig. 2: Procedures on system-oriented conversion to IFRS



The purpose of the **Assess phase** is to analyze the potential impact of the conversion from current GAAP to IFRS on the current accounting and reporting functions, systems and processes, business and people. This phase helps enable senior management to make informed decisions about the impact of the IFRS conversion and to determine a path forward that is cost effective and reduces disruption to the business.

The purpose of the **Design phase** is to learn and build the tools needed for the IFRS conversion. During this phase decisions on accounting and reporting issues are required, accounting manuals are drafted, system blueprints are created and training plans are drafted.

The purpose of the **Implement phase** is to conduct training, rollout reporting packages and guidelines, create opening balance sheet, comparative and interim financial statements and create the full set of financial statements at reporting date.

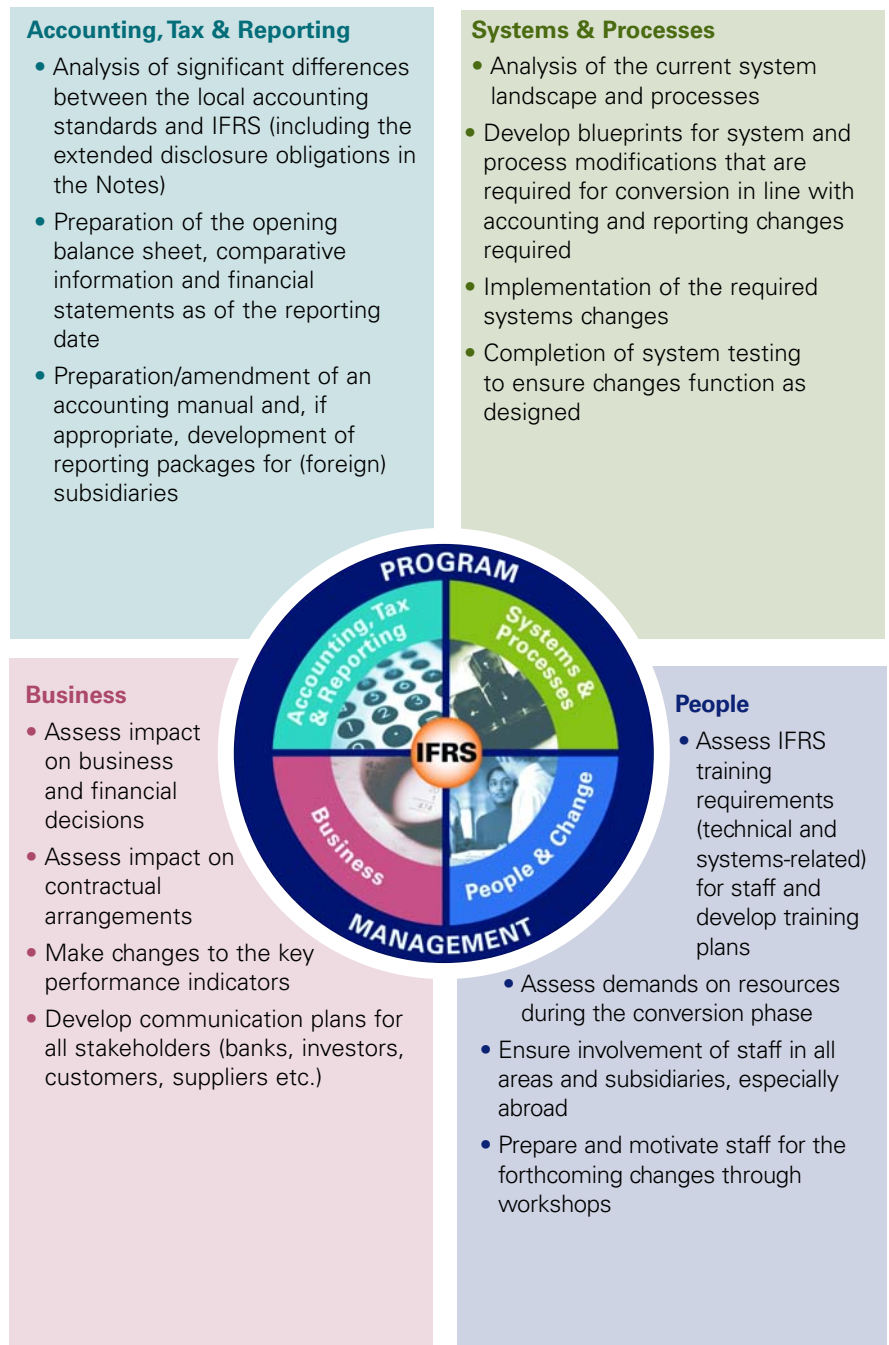
During the Design and Implement phases every conversion engagement is different. Factors that impact on the nature of the conversion engagement include:

- Timetable/ urgency
- Conversion strategy and objectives
- Conversion milestones
- The level of integration and complexity of the IT systems
- Skill level and availability of internal resources
- The nature and extent of accounting and disclosure gaps between the current GAAP and IFRS
- The organizational structure and reporting entities, among other factors.

Key Areas

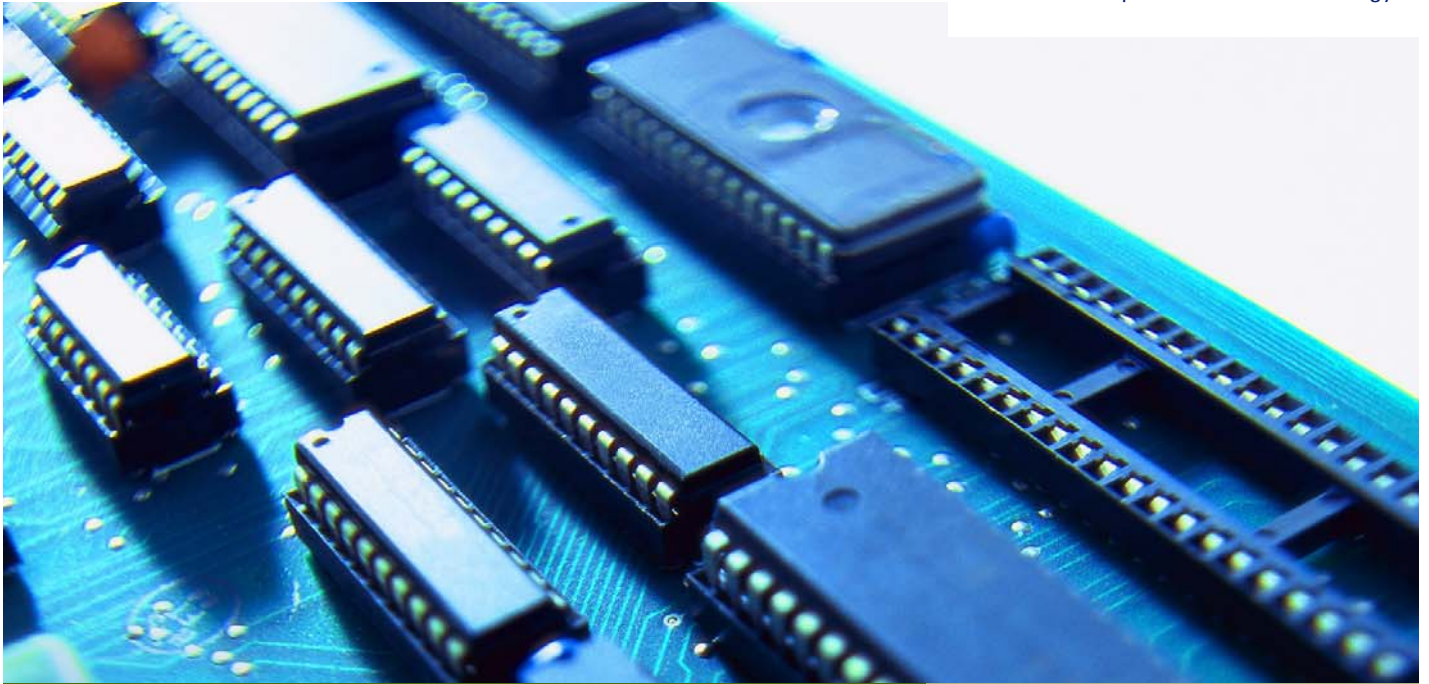
These phases are based around five key areas:

Fig. 3: KPMG's Global Conversion Services



The fifth key area is **Program Management**. Strong and consistent Program Management throughout all phases of the conversion process is a key element in ensuring the project's success.

In addition to the division of the overall project into the four sub-projects described above, it is also helpful to highlight areas of specific importance (e.g. consolidation, property, plant and equipment, provisions, leasing, segment reporting and cash flow statements). In effect, this results in a matrix project structure, with the added advantage that support can be directed towards the areas that are most critical to the success of the project.



Effects of the conversion to IFRS on Systems and Processes

The extent to which the IT systems are affected by the conversion to IFRS varies, depending on the size and business segment of the organization. Each organization should therefore carefully analyze the extent to which the changes being made to the accounting standards will impact on the IT systems that are in place.

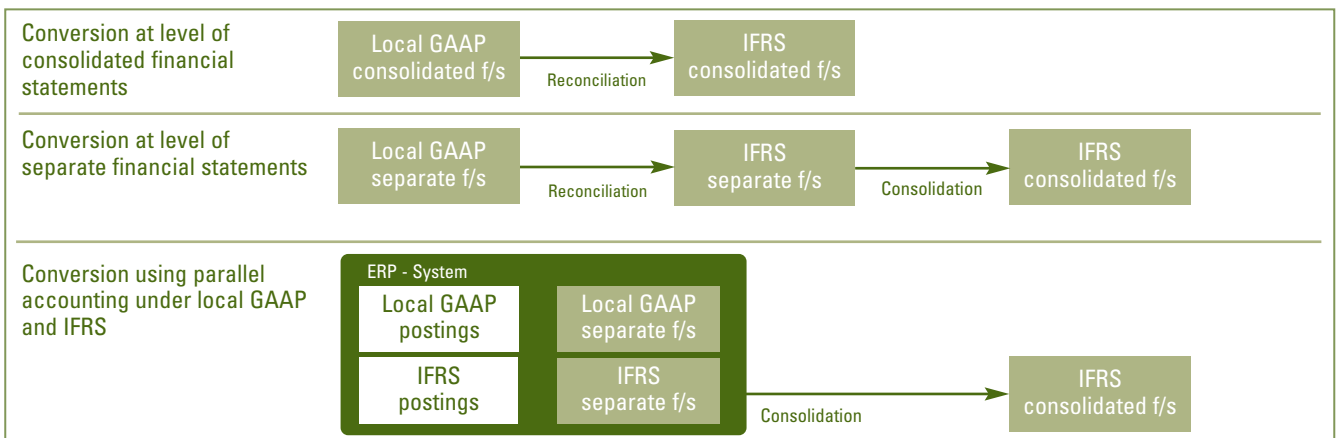
The following table provides an overview of changes that may be required to an organization's IT systems:

Type of Change Required	Description
New data demands	New accounting disclosure and recognition requirements may result in: more detailed presentation of information; new data elements or fields to be recorded; information to be calculated on a different basis. The flagging of the posting or master data with new characteristics, for instance for reporting (see segment reporting), can result in amendments.
Changes to the chart of accounts	There will almost always be a change to the chart of accounts due to re-classifications and additional reporting criteria.
Modifications to existing systems	If the existing bookkeeping or ERP system has the capability to produce reports in accordance with IFRS, amendments to the system parameters will be necessary, which will vary in scope depending on the chosen technical presentation options.
Selection and implementation of new systems	Where previous financial reporting standards did not require the use of a system, or the existing system is inadequate for IFRS reporting, it may be necessary to implement new software.
Interface and mapping changes	With the introduction of new source systems and the decommissioning of old systems, interfaces may need to be changed or developed and there may be changes to existing mapping tables to the financial system. Where separate reporting tools are used to generate the financial statements, the mapping to these tools will require updating to reflect changes made to the chart of accounts.
Consolidation of entities	Under IFRS, there will potentially be changes to the number and type of entities that need to be included in the group consolidated financial statements.
Amendment of the reporting data	It may be necessary to amend the reporting data if financial statement data is required from branches or subsidiaries that use a bookkeeping system which does not offer a possibility for reflecting parallel accounting and reporting and/or does not have an interface to the consolidation system.

Parallel accounting and reporting

A key issue for many organizations facing conversion to IFRS is whether to continue to prepare financial statements in accordance with local accounting standards (commercial law and/or tax law). This is likely to be the case in most countries. While the consolidated financial statements will have to be prepared according to IFRS, local accounting standards will continue to be used for the preparation of the separate financial statements and/or the financial statements as the tax measurement basis. The organization will have to decide whether these second sets of financial statements will be generated in parallel (in the ERP system) or in the form of a manual conversion (often outside the ERP system). The following alternatives are therefore possible:

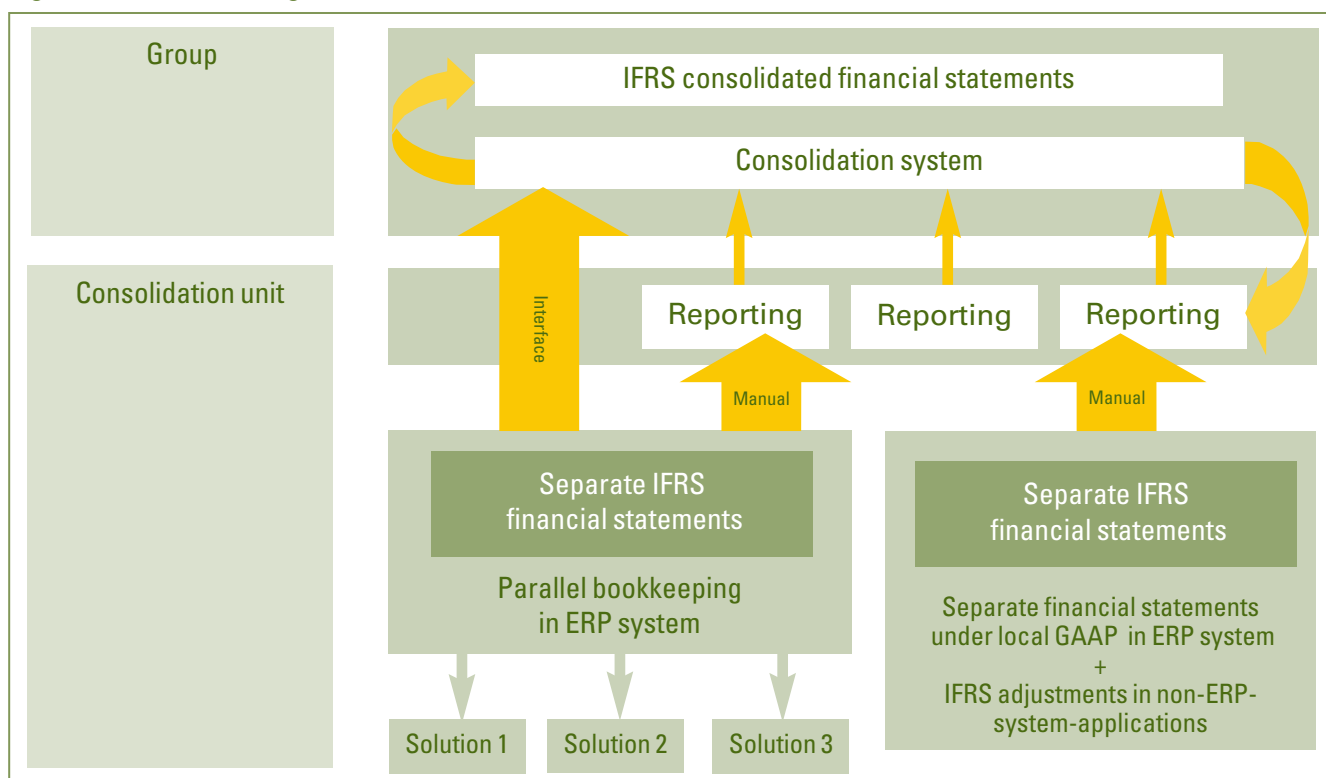
Fig. 4: Alternatives for the preparation of separate financial statements in accordance with local GAAP and IFRS



Parallel accounting, i.e. the simultaneous recording of the individual business transactions in accordance with both accounting standards (local GAAP and IFRS) implies the adoption of a 'system-oriented conversion' project approach (see Figure 4). It is also possible that a manual conversion at the level of the consolidated or separate financial statements can be prepared in conjunction with an express conversion, and that parallel accounting is implemented in a second step.

Figure 5 shows that the individual consolidation units within a group can also decide separately whether to employ parallel accounting or manual conversion.

Fig. 5: Parallel accounting versus reconciliation



Multi-GAAP reporting

In many countries further regulations for the preparation of financial statements (besides IFRS and local GAAPs) may apply (e.g. tax rules). In addition, companies (e.g. members of joint ventures) may have to report for various group companies in accordance with different accounting regulations (e.g. Group A prepares consolidated financial statements in accordance with IFRS, while Group B prepares consolidated financial statements in accordance with US-GAAP).

The decision to adopt Multi-GAAP reporting presents additional challenges. The primary task is to establish the multi-GAAP reporting capabilities of the current ERP systems. Other issues regarding ERP systems can also arise when using this approach, but will not be dealt with in this paper.

Management decisions

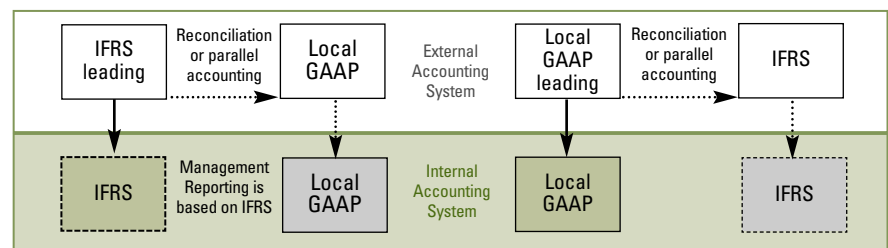
Many major decisions will have to be taken when converting to IFRS. Many of these decisions will have a significant impact on IT systems. These decisions should be identified and assessed during the analysis phase.

- Should/must parallel accounting systems be adopted? How can these be implemented in IT systems?
- Which primary accounting standard will be adopted in the future in the external accounting system?

In many countries, IFRS provides the basis for the preparation of the consolidated financial statements, while local accounting regulations or tax rules continue to be used in the preparation of the single financial statements or as the tax measurement basis.

In such cases, a decision will have to be made regarding which accounting framework to adopt for the primary recording of transactions. This will also affect the decision as to which accounting framework to follow in the internal accounting system and for management reporting.

Fig. 6: Alternatives for the primary accounting framework in the external accounting system and effects on internal accounting system/management reporting



- Which accounting framework will provide the basis for management accounting and management reporting? How can financial and management accounting be harmonized? Which key performance indicators (KPI's) should be used by management in the future and which ratios should be used for decision-making?

As a general rule, management accounting and management reporting, which in the past would have been calculated in accordance with local GAAP regulations, can continue to be maintained at this level. A significant benefit of the conversion to IFRS however, is the fact that the financial and management reporting processes of all consolidation units can be standardized in accordance with one uniform accounting framework.

Reconciliation and/or interpretation of the accounting data of foreign subsidiaries will therefore not be necessary.

- Which approach should be adopted for parallel accounting in the current ERP systems?

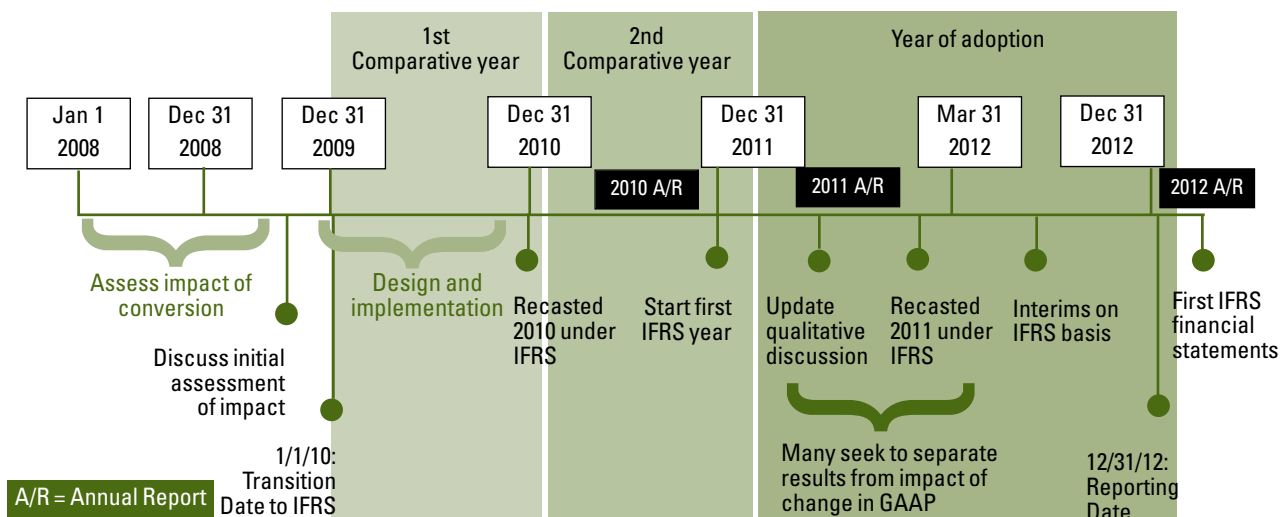
During the analysis phase, the current ERP systems should be reviewed to identify possible solutions for parallel accounting in accordance with local GAAP and IFRS requirements. Various options can generally be found, for example, the use of different accounts and the utilization of separate ledgers to record individual business transactions. The effect of this on front- and back-end IT systems (e.g. the consolidation system) must, of course, be taken into account.

Transition scenario

An organization has to prepare an IFRS opening balance sheet as of the date of transition to IFRS. The accounting policies under IFRS that apply as of the reporting date for the first set of IFRS financial statements will have to be applied to the IFRS opening balance sheet. At the same time, all assets and liabilities will have to be measured in the IFRS opening balance sheet in accordance with IFRS.

The following diagram shows the relationship between the IFRS opening balance sheet and the initial set of IFRS financial statements with comparative information:

Fig. 7: First-time adoption of IFRS with two comparative years



This requirement results in the necessity to develop a transition scenario. Two issues arising from this should be taken into consideration:

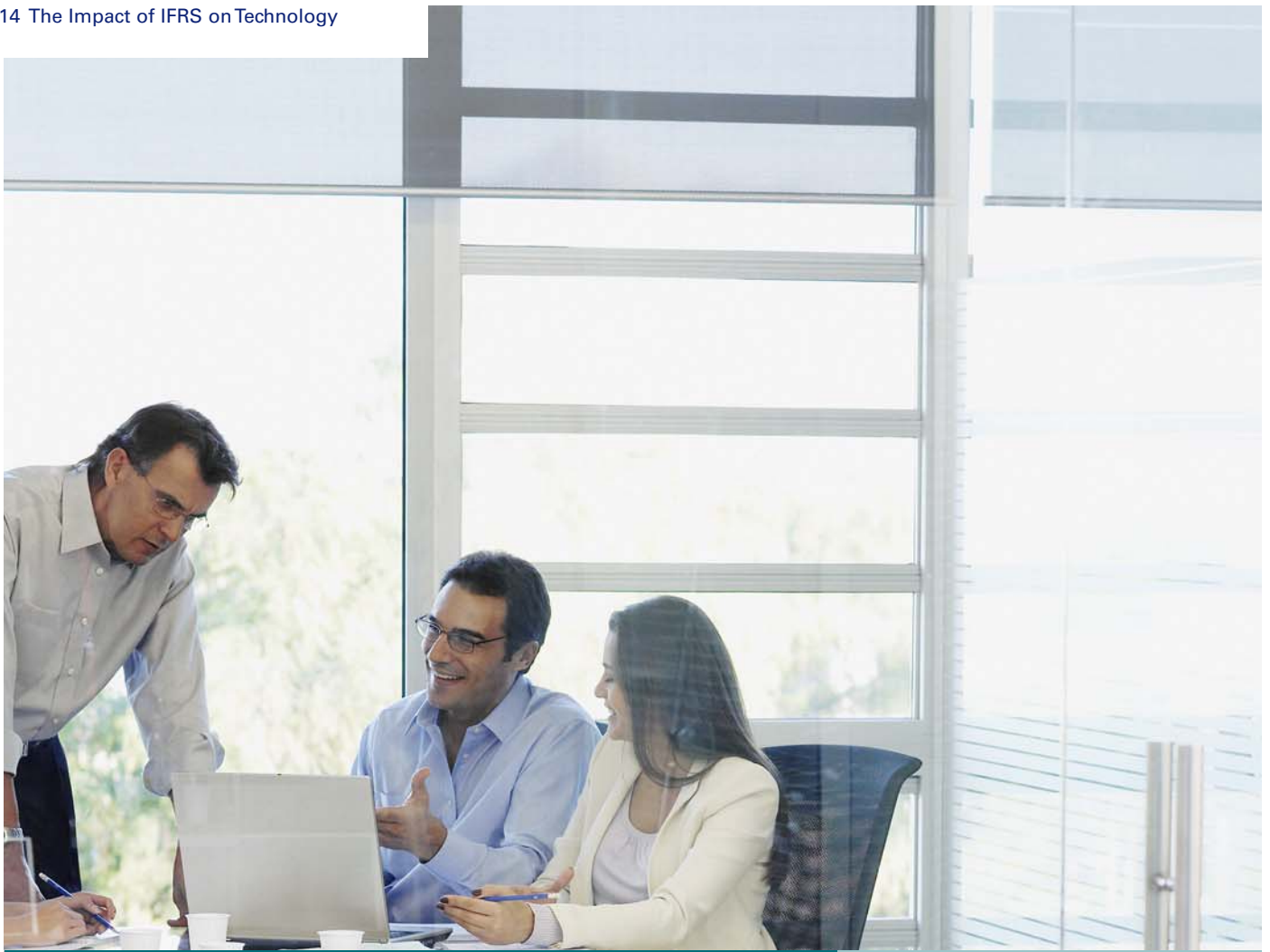
1. The recording of daily transactions in accordance with IFRS

This refers to the time at which all transactions should be recorded in the IT systems for the first time in accordance with IFRS. If this is a date during the current fiscal year, the transactions recorded so far during the fiscal year in the bookkeeping system in accordance with local GAAP will also have to be recorded in accordance with IFRS.

2. Retroactive accounting for, and measurement of, assets and liabilities in accordance with IFRS

Assets and liabilities have to be measured in the IFRS opening balance sheet and in the first complete IFRS financial statements in accordance with IFRS. In cases where the deemed cost exemption is not available, the data will have to be developed retroactively for assets and liabilities that were not recorded for the first time in the year of preparation of the IFRS opening balance sheet. In addition to this, assets and liabilities will have to be measured in accordance with IFRS from the date on which they are recorded for the first time. This will impact on the areas of property, plant and equipment and provisions, for example, additional time and costs should be included when planning an IFRS conversion project.

The data can be developed retroactively both within and outside the ERP system. If it is developed retroactively outside the ERP system, it will have to be transferred to the ERP system (for instance via an interface). If the data is developed retroactively within the ERP system, the IFRS financial statements can only be published for the first time following the retroactive development of the data.



Phases of the Systems & Processes conversion workstream



Assess – The first step is to carry out an analysis of the requirements and assumptions contained in the overall technical implementation plan. This will provide the basis for the detailed technical plan and will also highlight alternative available technology solutions. The analysis will focus on capabilities of the existing ERP system - interfaces, subsystems and process cycles will all be reviewed, and options prepared to present to management for decision making.

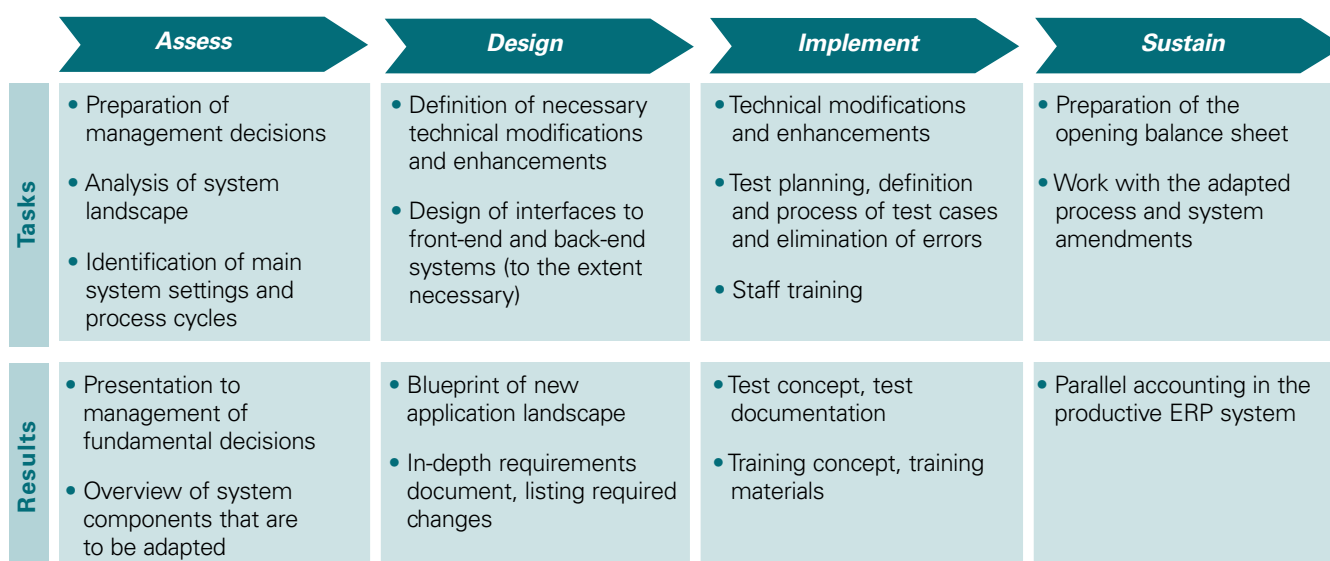
Design – The results of the analysis and decisions taken during the Assess phase will form the basis of the technical concept in the Design phase. Each individual client's particular needs and circumstances are taken into account during this phase. The technical concept endeavors to make as few changes as possible to the existing organization structure, data and processes while being designed to be as flexible as possible regarding future changes.

Implement – A test environment will be created based on the Design concept. Here all proposed changes to the IT systems will be tested – system settings, master and transaction data, new functionalities and effect on existing processes, along with function and integration tests. In this way, errors can be detected and corrected immediately. During this phase, end-users will be informed of developments in update meetings and training courses will be provided.

Sustain – Once all modifications to the system have been tested and approved, the system can go live. After the go live date, on-going monitoring will help ensure a smooth transition to "business as usual."

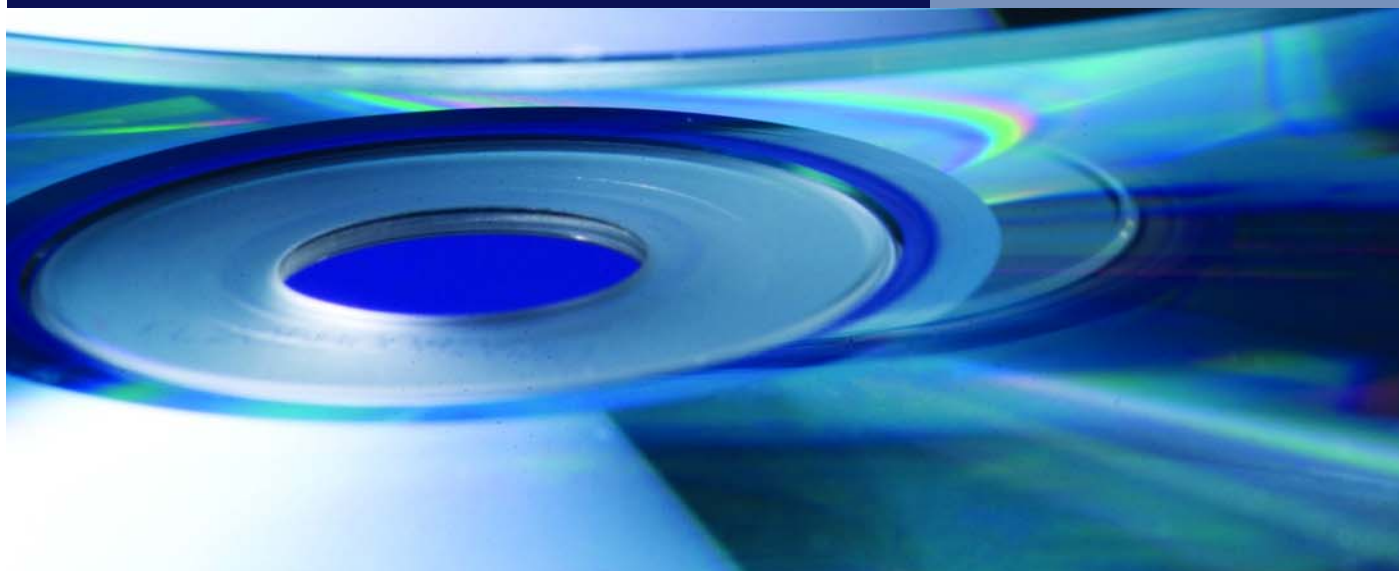
The following diagram summarizes the main features of the individual project phases.

Fig. 8: Main tasks and results of the project phases





Selected topics



Property, plant and equipment (IAS 16, IAS 23, IFRIC 1)

Property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and which are expected to be used in more than one period.

Because of the requirements on accounting for property, plant and equipment under IFRS, the differences with local accounting standards can have implications for how these procedures are handled, and how they are reflected in the system. The following issues require particular attention under IFRS and local accounting standards:

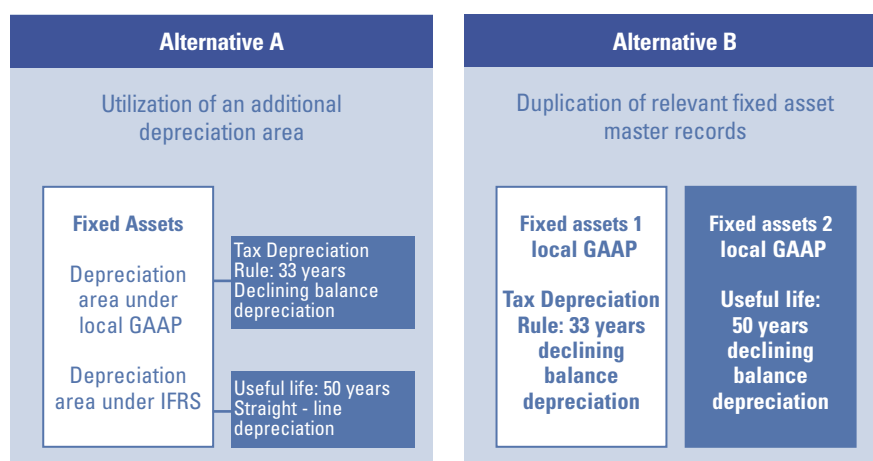
- Differences in the determination of cost (e.g. the inclusion of the costs of dismantling and removing the asset and restoring the site on which it is located)
- Differences in the definition of the useful life of assets and depreciation methods
- Performance of an impairment test, if there are indications of impairment
- Application of the component approach, if an item of property, plant or equipment is made up of different components with different useful lives.

The differences outlined above generally result in the development of an additional measurement area within the entity's plant accounting system. This will enable IFRS carrying amounts to be maintained, for parallel accounting purposes alongside the existing measurement areas (local accounting standards and/or the tax view). At the same time, IFRS amounts for the new IFRS measurement area (which has to be defined) must be determined retrospectively for each item from the date of original recognition (if deemed cost is not elected),

and established in the ERP system as the basis for subsequent measurement. This can be accomplished either manually or with a programmed conversion. It should, however, be noted that, depending on the number of fixed asset master records, manual conversion is not to be recommended due to the amount of time involved. If the existing ERP system is incapable of incorporating a further depreciation area as an additional view of the fixed assets, it is possible for all fixed asset master records with measurement differences to be duplicated. This should, however, be avoided if at all possible because of the significant amount of extra work involved in processing this.

The following diagram illustrates the two alternatives described:

Fig. 9: Parallel measurement of property, plant and equipment under local GAAP and IFRS



Impairment tests have to be carried out for individual assets. If this is not possible, assets are tested for impairment as elements of cash-generating units (CGUs). A system-supported procedure should be designed to carry out the impairment tests.

Leasing

(IAS 17, IFRIC 4, SIC-15, SIC-27)

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

A lease is classified under IFRS either as an operating lease or a finance lease. In the case of a finance lease, the lessor recognizes a receivable from the lease and the lessee recognizes the leased asset and a liability for the future lease payments. In an operating lease, the leased item remains in the lessor's statement of financial position and the lessee expenses the lease payments over the term of the lease.

Issues can arise regarding the procedural handling and recording of leases in the IT system in the event of parallel accounting under local law (commercial and/or tax law) and IFRS, where these regulations differ. This applies both from the point of view of the lessor and the lessee. A frequent example is the classification of a lease as a finance lease under IFRS and an operating lease under local law. The following issues then arise:

- Design of a system to calculate the present value of the minimum lease payments, taking into account differing lease payments and differing interest rates over the term of the lease
- Creation of a posting process for the recognition of the leased asset as an asset, and the recognition of the lease payments as a liability, whereby the amount and the timing of the lease payments recorded in the bookkeeping system should enable an automated payment process.

The recognition of leases classified as finance leases as assets in the books of lessees often results in a high volume of postings. The recognition of collective assets can be considered, provided these assets are in the same class, are of similar value and the date of recognition and the useful lives are the same. Existing leases should therefore be reviewed during the IFRS conversion with the aim of simplifying the accounting and recording processes.

Investment property

(IAS 40, IAS 17)

Investment property is property held to earn rentals or for capital appreciation or both.

Investment property shall be measured initially at cost. Following its initial recognition, all investment property shall be measured either in accordance with the fair value model or the cost model (amortized cost). Under the fair value model, gains or losses arising from a change in the fair value shall be recognized in profit or loss in the period in which they arise. The fair value of all investment property shall be disclosed, irrespective of the measurement model used. Investment property shall be reported separately.

While real estate companies generally measure their investment property for international comparison purposes applying the fair value model, other entities generally elect the cost model.

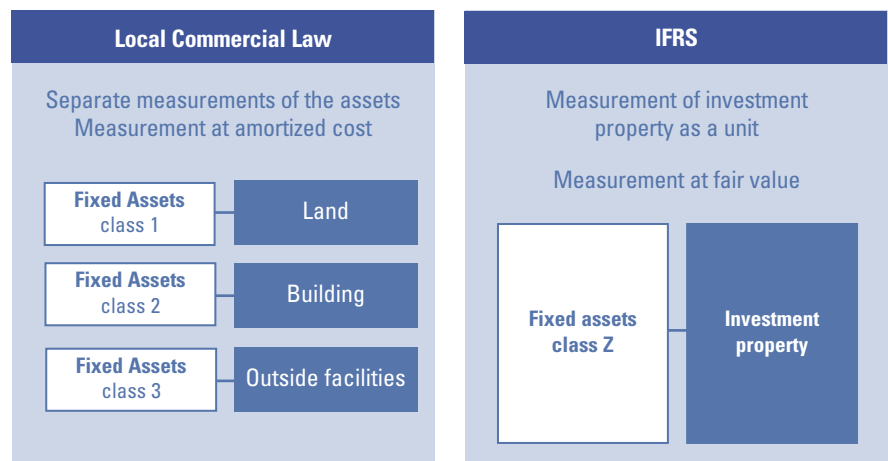
From an IT point of view, the fair value method in particular involves modifications to systems and processes.

The complexity of the reporting of investment property is increased in the event of parallel accounting under local commercial law (which frequently measures this property at amortized cost) and IFRS:

- Measurement of the investment property as a unit (i.e. the land, the buildings and the integrated equipment associated with the building are recognized and measured under IFRS as a unit, while these items have to be recognized and measured as separate assets under local commercial law),
- Measurement of the investment property under IFRS at fair value, and at amortized cost under local commercial law.

The following diagram illustrates this challenge:

Fig. 10: Comparison of the maintenance of the measurement and presentation of investment property in the IT system under local commercial law and IFRS



The different accounting and measurement methods of recording investment property under IFRS and local commercial law require a separate approach in ERP systems. Recording and posting costs should be kept to a minimum.

When applying the cost model for the measurement of investment property, the need to present these separately (alongside property, plant and equipment) should be taken into account. This usually involves the restructuring of the classification of fixed assets in the existing systems.

Payables / receivables

Entities must, as a matter of principle, present their statement of financial position and therefore all receivables and payables broken down by current and non-current assets and liabilities. A split of the receivables and payables is required between the categories, affiliated entities, joint ventures, associates and third parties. Presentation of the assets and liabilities in accordance with their liquidity is only permitted if such presentation provides more reliable and more relevant information.

If the existing ERP system does not offer automatic functionality for the accumulation of the receivables and payables by maturities (for instance, based on the maturity date), procedural adjustments have to be adopted in the form of a manual report. The reporting date for each legal entity, or the system for the automatic determination of the statement of financial position data, will have to be changed, which will usually result in an amendment being made to the existing chart of accounts.

Further accounting variance issues between IFRS and the local accounting standards can include the prohibition under local accounting standards of the discounting of long term receivables and payables that are interest free or at off-market interest rates and the performance of foreign currency transactions in accordance with local principles focusing more on prudence than IFRS.

Financial instruments

(IAS 39, IAS 21, IFRS 7, IFRIC 9, IFRIC 10, IFRIC 16)

A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instruments of another entity.

Financial instruments are classified on initial recognition into one of the following categories:

- at fair value through profit or loss,
- held-to maturity investments,
- loans and receivables,
- available-for-sale financial assets, or
- other liabilities.

Financial instruments are recognized initially at fair value.

The subsequent measurement of a financial instrument depends on its classification in one of the following categories:

- Financial instruments at fair value through profit or loss are measured at fair value; all changes in fair value are recognized immediately in profit or loss.
- Held-to maturity investments and loans and receivables are measured at amortized cost.
- Available-for-sale financial assets are measured at fair value; changes in fair value are recognized in other comprehensive income.
- Financial liabilities, apart from financial instruments at fair value through profit or loss, are measured at amortized cost.
- Derivatives are recognized in the statement of financial position and measured at fair value. Changes in fair value are recognized immediately in profit or loss, unless these stand-alone derivatives or separable embedded derivatives have to be classified as hedging instruments on a hedging of cash flows or a hedging of a net investment.

As a result of the complexity and the large number of differences between local GAAP and IFRS, the reporting of financial instruments in accordance with the financial instruments standards is generally accompanied by significant amendments to the organization's systems and processes, including the following:

- The need to design a process for the classification of the financial instruments, determination and roll-forward, and recording in the bookkeeping records of the current fair values in conjunction with the year-end and interim reporting.
- Amendment of the IT systems so that financial instruments can be measured differently under local GAAP and IFRS depending on their classification into one of the above categories. In addition, it must be possible to present the impairment test in the systems. This is frequently done by modifying the existing ERP system or by implementing a new treasury system. If the associated cost is too high or unreasonable, simple subsidiary records with a low level of IT support can be used.
- Further development of the IT systems regarding the possibility of reporting hedge relationships. This implies greater demands on the availability of and access to historical data, in order to substantiate hedge effectiveness in the future and retrospectively.
- Maintenance and usability of the required data to fulfill the disclosure requirements for financial instruments in accordance with IFRS 7 in the existing IT systems.

Construction contracts (IAS 11)

IAS 11 sets out special rules for recording and measuring contract revenues and expenses in long-term order-based construction. When applying the percentage of completion method, the profit attributable to the period will have to be determined. This will have to be recognized in profit or loss as of the reporting date, unlike the situation under the completed contract and zero profit margin methods.

In order to determine the profit attributable to the period, the costs and revenues have to be identified as of the reporting date based on the stage of completion. Various methods, such as the relationship between the costs incurred and the total costs, the assessment of the work already completed, or the completion and, if appropriate, acceptance of a physical part of an order, can be used. Under the methods mentioned above, information from different parts of the organization and systems or system components have to be linked, affecting cost accounting, production planning and control and sales.

The efficient automatic calculation of a work in progress (including recording it in the books) is one of the main focuses of the correct maintenance of construction contracts in the IT system. Therefore, all affected parts of the organization, such as the financial accounting system, production planning, controlling and sales and contract management, should be included in the development of the solution, both procedurally and from a systems point of view.

Deferred taxes (IAS 12, SIC-21, SIC-25)

Deferred taxes shall be recorded for estimated future tax effects on temporary difference, unused tax losses and tax credits, subject to recognition criteria for deferred tax assets. Temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position in accordance with IFRS and its tax base. According to IAS 12, the recognition of deferred tax assets and deferred tax liabilities is mandatory.

The offset of deferred tax assets and deferred tax liabilities is fundamentally not permitted under IFRS. An exception only arises if a legally enforceable right exists and the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same taxation authority.

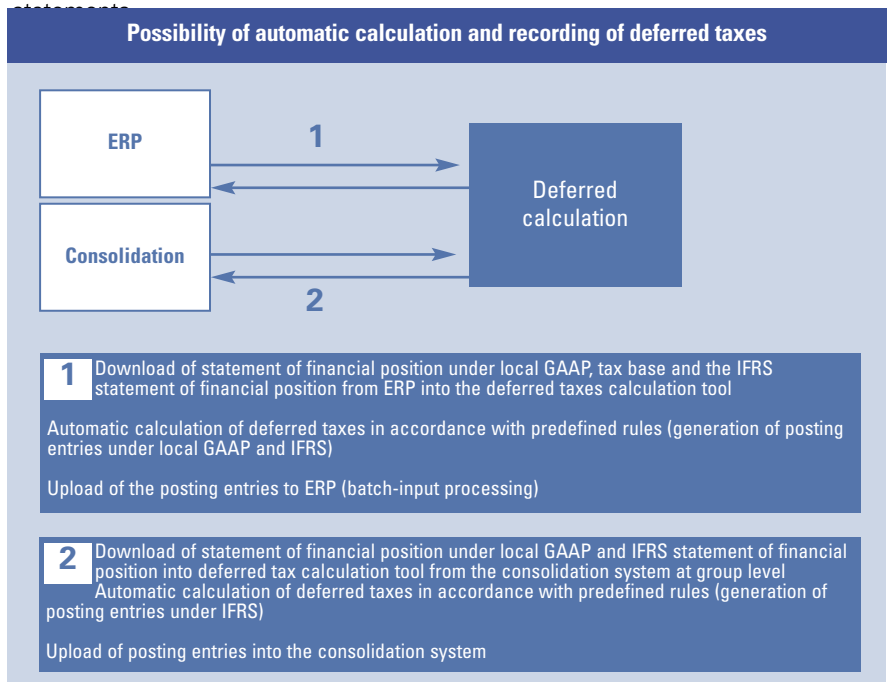
The recoverability of deferred tax assets shall be reassessed and, if appropriate, adjusted at every reporting date. Deferred taxes arise both at the level of the separate financial statements and at the level of the consolidated financial

The obligation to recognize deferred taxes as assets or liabilities in the IFRS financial statements requires the timely preparation of the tax statement of financial position so that the deferred taxes can be determined by comparing the carrying amounts in the statement of financial position in accordance with IFRS and the tax base. From a procedural point of view, it is possible to maintain the tax balance sheet parallel to the local accounting standards and the IFRS-based accounting standards either in the existing ERP system or outside the system.

Deferred taxes can also be calculated and rolled forward with the help of the system or they can be rolled forward manually. KPMG offers a tool for the automatic calculation and roll forward of deferred taxes.

The process for the calculation and recording of deferred taxes at the level of the separate company and the group should be set up as follows:

Fig. 11: Parallel measurement of property, plant and equipment under local GAAP and IFRS



Provisions / pensions (IAS 37, IAS 16, IAS 19, IFRIC 1, IFRIC 5, IFRIC 6, IFRIC 14)

A provision is a liability of uncertain timing or amount. A provision shall be recognized when

- a legal or constructive obligation exists as a result of a past event or if it is more likely than not that a legal or constructive obligation has arisen as a result of a past event and
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of that obligation.

If the existence of an obligation depends on future acts by the entity, a provision shall only be recognized when the obligation is unavoidable. As a general rule, no provisions may be recognized for obligations that may be incurred in future periods or for future operating losses (provisions for future expenses).

Procedural adjustments have to be made during an IFRS implementation to determine the various provisions for recognition and measurement and the posting logic to be applied under IFRS and local GAAP. Differences can result, for instance, from the reflection of future price increases or the discounting of long term provisions.

In addition, procedural and/or system-based amendments must be carried out if a schedule of movements on provisions is to be prepared automatically. Additional account coding information, from which a schedule of movements on provisions can be derived, must already be recorded at the level of the postings. If the movements (e.g. increase, utilization or reversal) cannot be flagged in the system, an organizational procedure must be set up that enables all relevant information for the preparation of the schedule of movements on provisions to be made available.

Provisions for long term employee benefits (pensions or provisions for pre-retirement part-time work) are generally set up on the basis of an external actuarial report. Since the parameters for the calculation under IFRS and the local accounting standards generally differ (e.g. a different interest rate and the reflection of future salary increases

under IFRS), a different provision can result. Here too, organizational rules must be established to define when provisions should be calculated and by whom.

Segment reporting (IFRS 8)

According to IFRS 8, segment reporting shall be disclosed as a mandatory element of the notes to the consolidated financial statements for entities quoted on a stock exchange and other public companies. IFRS requires an entity to adopt the ‘management approach’ to reporting on the financial performance of its operating segments. This means that the basis on which segment information is prepared is based on the company’s internal organization and reporting structure.

A measure of the profit or loss for each reportable segment shall be presented. This also applies to the measure of the liabilities, if such an amount is regularly provided to the company’s chief operating decision maker. The profit or loss for the period shall in addition be broken down by the following:

- revenues from external customers,
- revenues from transactions with other operating segments,
- interest revenue and interest expense,
- depreciation and amortization,
- material items of income and expense,
- the entity’s interest in the profit or loss of associates and joint ventures accounted for by the equity method,

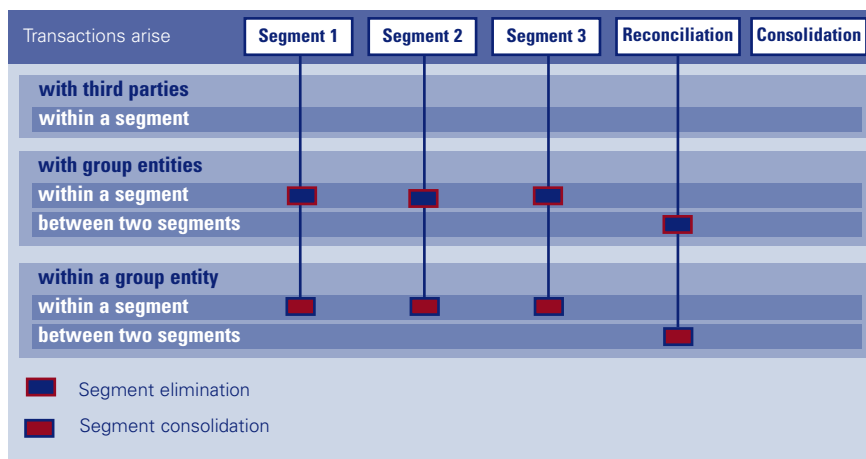
- income tax expense or income and
- material non-cash items other than depreciation and amortization.

If it is not possible to allocate all legal entities clearly to a segment (so-called ‘zebra’ companies because they include parts from several segments), the presentation of segment reporting under IFRS 8 will generally involve significant adjustments to the systems and processes.

When the positions in the statement of financial position and the statement of comprehensive income needed for the segment reporting are already recorded at the level of the legal unit (with additional account coding that allows an allocation to cost centers, business areas or profit centers), the allocation to the segments can generally be calculated from this. The necessary allocation of total asset amounts (and as, appropriate, liabilities) also requires additional account coding of the original posting, when the allocation is to be made automatically.

In addition, the segment revenues, segment earnings, segment assets (and as appropriate, segment liabilities) and segment amounts for other material items of information disclosed have to be reconciled to the combined positions in the consolidated financial statements. It should be noted that consolidation (reported in the reconciliation column) of the transactions between two segments and elimination of the transactions within a segment will have to be carried out. The following diagram sets out these relationships:

Fig. 12: Consolidations and eliminations when transactions arise



Depending on the ERP system and the consolidation software used, an analysis is required to decide whether the transfer of the segment reporting to the positions of the consolidated financial statements will be carried out automatically or manually. In the case of a manual transfer, all transactions within and between the segments have to be identified and combined outside the system. All the necessary information has to be made available by the legal entities for this purpose by means of a reporting package. After this, the segment reporting will then be prepared outside the system.

Cash flow statement (IAS 7)

The cash flow statement is always an element of IFRS financial statements and is intended to provide users of financial statements with information about the cash flows of an entity or a group. In the cash flow statement, the opening balance of cash and cash equivalents (cash funds) is reconciled with the cash funds at the end of the financial year, showing the cash flows during the period from operating, investing and financing activities.

In addition to the presentation of the cash flow statement in conformity with IFRS at the level of the individual entity, a decision has to be taken on whether the cash flow statement should be used as a management instrument. This involves either separate cash flow statements for internal company units and the consolidation of the individual cash flows relating to specific companies in the consolidated financial statements, or the allocation of the group cash flows to individual group entities. In addition, the cash flow statement (or the determination of the planned cash flows) can be used as a

basis for the impairment test in accordance with IAS 36.

Technical support of the cash flow statement represents a particular challenge, because cash flow information is not generally recorded in the accounting system in the form and detail that has to be reported in the cash flow statement. Even if all of the information is available, automated cash flow reporting must first create a link between cash flows and underlying business transactions. In many cases, information from various systems (ERP systems, bank offset systems, funds management systems, etc.) has to be combined for this purpose.

Consolidation (IAS 27, SIC-12)

The consolidation obligation under IFRS is based on the control concept. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

In conjunction with the preparation of the consolidated financial statements in accordance with IFRS, all subsidiaries and, if appropriate, special purpose entities (SPEs) shall be included in the consolidated financial statements.

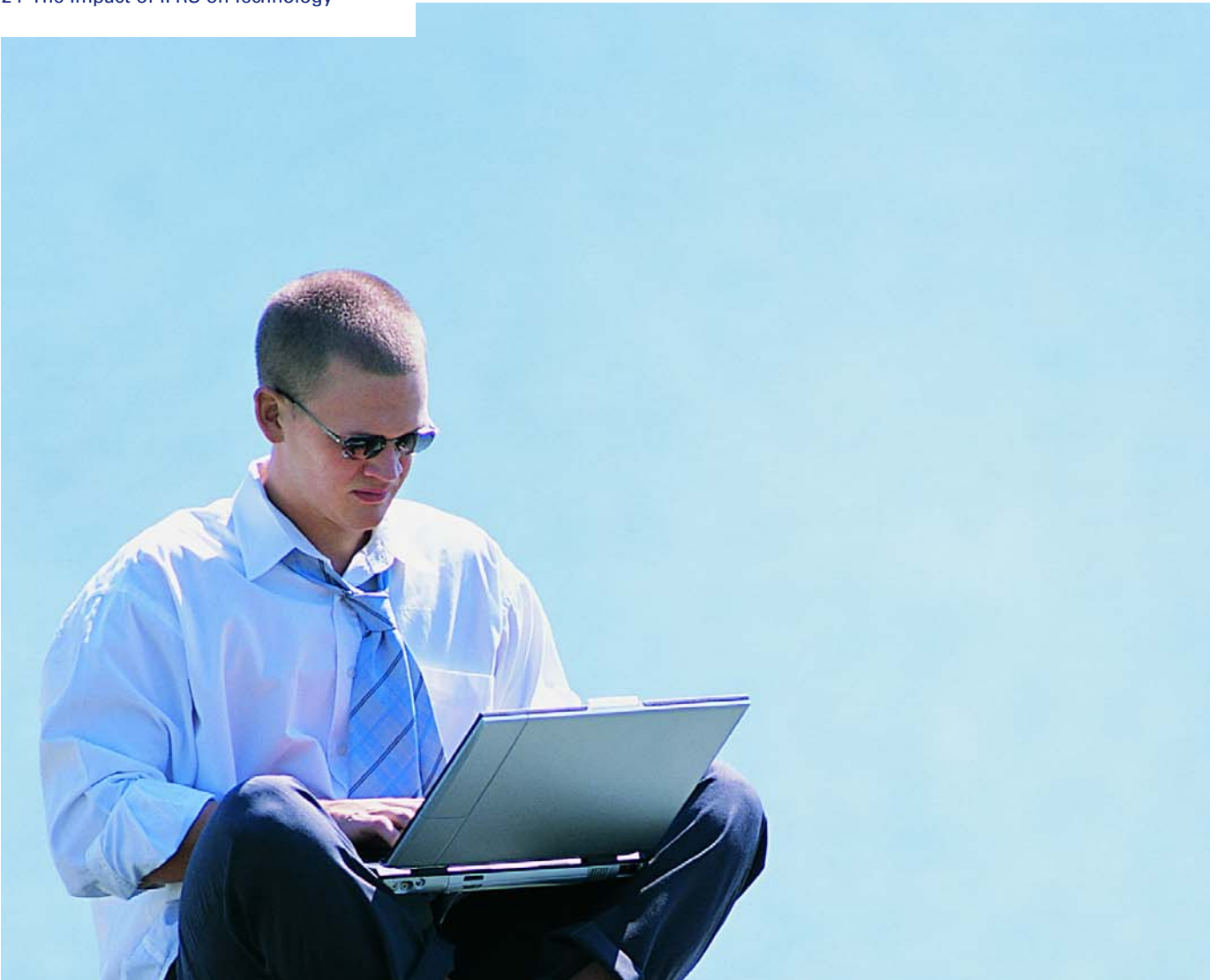
Differences in the composition of the entities included in consolidation within the position plan or group chart of accounts and in the translation of foreign currencies can necessitate amendments being made to the consolidation software used.

If it continues to be obligatory for local consolidated financial statements to be prepared in the future so that the consolidated financial statements in accordance with IFRS serve information purposes only, it will have to be analyzed whether the consolidation software used offers the functionality of preparing parallel sets of consolidated financial statements under both accounting standards. If this is not the case, reconciliation to the IFRS financial statements outside the system (for instance using a spreadsheet program) will be necessary. This generally results in additional manual work, which has to be taken into account in the timetable for the preparation of the financial statements. Commensurate procedures and aids for the reconciliation will have to be defined.

Why KPMG?

Numerous stumbling blocks may be encountered along the road to a successful implementation of new accounting regulations. Many organizations that have already undergone an IFRS conversion incurred additional unforeseen expenditure both in terms of costs and personnel due to underestimating the wide-reaching nature of the project. These additional costs and other pitfalls would almost certainly be avoided should further accounting regulation changes have to be implemented in the future, due to lessons learned this time round and “hard won” experience.





Global Conversion Services

With experienced practitioners sharing a common approach, KPMG member firms can provide tailored services for complex clients around the world.





One of the great challenges for multinational organizations like KPMG is to share existing knowledge. Although it would be possible to develop and implement methodologies on a centralized basis without leveraging this global knowledge management, only the involvement of experienced practitioners can result in the development of the most suitable tools and establishment of industry best practice.

KPMG's Global Conversion Services Methodology is a standard methodology which is updated annually, and which is designed to help our firms' clients perform IFRS conversions by assessing, designing and implementing conversions from their current primary accounting standard to the future accounting standard. The approach is standardized and therefore cost-efficient, but, because we are well aware that every conversion project is unique, it is also flexible and adaptable.

Global Lead Contacts

Gary Reader

KPMG in the USA
+1 212 954 8233
garyreader@kpmg.com

Manfred Hannich

KPMG in Germany
+49 30 2068-4125
mhannich@kpmg.com

Egidio Zarrella

KPMG in Hong Kong
+852 2847 5197
egidio.zarrella@kpmg.com.hk

Our firms' regional contacts

Americas

Regional IFRS Leader

Janice Patrisso
+1 212 872 5603
jpatrisso@kpmg.com

Latin America

Jason Anglin
+56 (2) 798-1336
jasonanglin@kpmg.com

Humberto Salicetti
+56 (2) 798-1500
humbertosalicetti@kpmg.com

USA

Bradley A Fisher
+1 212 909 5498
bfisher@kpmg.com

Kenneth S Gabriel
+1 312 665 5554
ksgabriel@kpmg.com

Brian Heckler
+1 312 665 2693
bheckler@kpmg.com

Aamir Husain
+1 212 954 2060
ahusain@kpmg.com

Canada

Bill Murphy
+1 416 777 8998
billmurphy@kpmg.ca

Yvon Audette
+. 416 777 8388
yaudette@kpmg.ca

Europe, Middle East and Africa

Regional IFRS Leader

Manfred Hannich
+49 30 2068-4125
mhannich@kpmg.com

Germany

Markus Kreher
+49 89 9282-4310
markuskreher@kpmg.com

Alexander Riedel
+49 89 9282-1210
ariedel@kpmg.com

Carsten Schiewe
+49 40 32015-5682
cschiewe@kpmg.com

India

Jamil Khatri
+91 (80) 3980 6300
jkhatri@kpmg.com

Prasad Kulkarni
+91 (22) 3983 6403
pkulkarni1@kpmg.com

Asia Pacific

Regional IFRS Leader

Ong Pang Thye
+65 6411 8001
pong@kpmg.com.sg

Australia

Adrian Fisk
+61 (2) 9335 7923
adrianfisk@kpmg.com.au

Kumar Parakala
+61 (2) 9335 7820
kparakala@kpmg.com.au

Japan

Hideki Amano
+81 (3) 3548 5160
hamano@kpmg.com

Hiromi Iwashita
+81 (3) 3266 7617
hiwashita@kpmg.com

Korea

Suh Won Jeong
+82 2 2112 0630
wsuh@kr.kpmg.com

In Soo Moon
+82 (2) 2112 0430
ismoon@kr.kpmg.com

Malaysia

Paul Bahnisch
+61 (8) 8236 3384
pbahnisch@kpmg.com.my

Lamsang Hewlee
+60(3) 7721 3388
hewlee@kpmg.com.my

Singapore

Brett Hall
+65 6411 8335
bretthall@kpmg.com.sg

Taiwan

Stanley Chang
+886 2 81016666 [07070]
schang@kpmg.com.tw

Thailand

Narisara Phatanaphibul
+66 2 6772786
narisara@kpmg.com

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