

BANK SYSTEMS & TECHNOLOGY

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IT Must Play a Key Role in Adapting to IFRS

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In late November 2008, the Securities and Exchange Commission (SEC) released for comment its proposed roadmap of the steps required for conversion from US Generally Accepted Accounting Principles (US GAAP) to International Financial Reporting Standards (IFRS). Its release takes us closer to a single set of high-quality, globally accepted accounting standards, but implementation of IFRS will require significant changes in business processes and systems in order to amend accounting treatment and satisfy reporting requirements.

Modifications to accounting standards, policies and procedures are rarely simple for financial services firms. Just this past year, we saw how the implementation of a single new accounting standard, namely Statement of Financial Accounting Standards Number 157, Fair Value Measurement

(FAS 157), could have a sweeping impact on operations and information systems. The complexity and inflexibility of legacy accounting and technology infrastructure, coupled with the challenges of managing product and accounting data, resulted in time-consuming and costly implementations for many institutions. This experience – and others like it – should provide some insight into the systems, data and reporting difficulties organizations may encounter during a conversion to IFRS.

Given such experiences, many US financial services institutions have already begun to analyze the likely effects of a conversion to IFRS. Organizations with forward-thinking CIOs and IT leaders have also come to realize that the change to IFRS will provide an opportunity to strategically enhance systems and processes, execute on mandates to reduce costs and drive out inef-

iciency and redundancy. These firms are already exploring how the proposed conversion requirements and timeline can be used as a catalyst to strengthen financial reporting infrastructures by accelerating transformation initiatives, to correct enterprisewide deficiencies in data flow and data quality, and to create new centralized accounting rules repositories by removing the years-old GAAP accounting patchwork from legacy systems.

However, they are also discovering that there are formidable obstacles standing in the way of conversion-driven technology and process improvements. In converting to the new accounting standards, many institutions will struggle with the necessary changes to their financial reporting infrastructure. IFRS disclosures (e.g., IFRS 7, Financial Instruments: Disclosures and

IFRS 4, Insurance Contracts) require more detail and transparency than financial disclosures under US GAAP. More specifically, risk and transaction details that once resided in front- or middle-office systems will need to flow through the financial reporting process. To further complicate matters, this detailed data will need to be of the highest quality because it forms the basis of audited financial statements. IFRS conversion, as presently outlined in the proposed SEC roadmap, should include a period of parallel accounting under both US GAAP and IFRS in order to generate prior year/quarter comparative financials. Thus, IT must play a role in deciding how an institution should handle US GAAP and IFRS data flows in order to determine if its current infrastructure can effectively support the new requirements.

Another potentially significant stumbling block concerns the core of the financial reporting process: the general ledger systems. Outdated chart of accounts design, disparate global ledgers and legacy technology will all complicate the conversion process and limit reporting capability. These inefficiencies will result in the need for increased manual conversion workarounds (e.g., spreadsheet solutions, top-side entries), at a minimum, and will likely lead to escalating operating costs in future periods because of the additional accounting personnel who will be required to generate manual entries and perform

further reconciliations and adjustments.

As ledger replacements and upgrades are expensive, time consuming and disruptive, CIOs and IT leadership will need to discuss the merits of making these capital investments now versus the longer term and potentially higher costs of tactical solutions. Making the right choice for the organization requires a proactive and thorough analysis of how spending on improvements will benefit not only IFRS conversion goals but also IT projects that are planned or already underway.

But IFRS conversion issues will not be limited to the general ledger and financial reporting systems. IT application groups will likely be required to enhance or modify front- and middle-office product systems. In many financial institutions, the general ledger serves as a repository and aggregator of accounting data. The physical act of generating accounting entries (e.g., valuing certain derivative products, calculating the interest income on financial instruments, determining the amount of loan loss reserve to book) is performed by sub-ledgers via embedded accounting rules. Thus, it will be necessary to capture and configure an additional set of processing and posting requirements to meet the new accounting needs effectively.

IT must also factor in the IFRS conversion hurdles related to reporting within statutory locations and the consolidation

of this information. Any company with local statutory reporting requirements may have to comply with local tax and regulatory rules, which may include different accounting interpretations, implementation timeframes and reporting requirements. Simply developing a global policy or layering on additional logic to meet local needs may not be feasible based on existing system capabilities.

An IFRS conversion should spur an institution to examine IT strategy holistically and make the necessary additions and adjustments. With advanced planning and scoping, some phases of an implementation can leverage projects already in progress or be sequenced within scheduled initiatives. A good early step is to identify the difficulties in conversion and align the changes to planned or in-flight programs such as the creation of shared-services centers, development and deployment of global policies and procedures, execution of performance management solutions and upgrades to enterprise resource planning systems.

Those who face the shift to IFRS head-on will be able to take advantage of the opportunity to develop a transformative agenda that will help drive forward IT strategy and business results.

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