Considerations for the Automotive Industry

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International Financial Reporting Standards

Considerations for the Automotive Industry

Decibel levels continue to rise on the subject of International Financial Reporting Standards (IFRS), with frequent communications from many sources. As the volume increases, you may find yourself asking: How will IFRS impact my company? What triggering events would compel us to move more quickly to adopt IFRS? What obstacles might stand in our way?

IFRS is inevitable and will be the final destination for financial reporting for public companies in the U.S. and for most companies around the globe. Still unsettled, however, is the pace of the trip. Some companies will perceive benefits in embarking immediately. Others may adopt a more measured approach. Still others may choose to closely examine the roadmap before they take any steps.

Automotive original equipment manufacturers (OEMs) and suppliers often have significant international operations, multiple regulatory and capital market considerations, complex organizational structures (often including multiple subsidiaries and joint venture relationships), and global competitors who may already be reporting under IFRS. Automotive companies in these circumstances may discover compelling reasons to adopt IFRS even before it is mandated.

Of course, like any significant business decision, determining the timing and pace of an IFRS conversion requires an understanding of the potential costs and benefits. Regardless of your ultimate conversion plan, it is crucial to make an informed decision based on a thorough analysis.

Such analysis and planning is crucial, since a successful conversion will not happen overnight. Indeed, companies that have already converted to IFRS have found that the initiative can span several years, due to the surprisingly wide scope of the effort. A successful IFRS conversion project will involve not only technical accounting and financial reporting, but also issues around internal processes and controls; regulatory, statutory, and management reporting; technology infrastructure; as well as organizational issues, including tax, treasury, legal and contracts, compensation and human resources, and communication.

Suffice to say, conversion involves much more than reshuffling the chart of accounts.

Chart the Course

If you take only one action after reading this document, we suggest it be this: Develop an IFRS implementation roadmap.

To kick off this effort, ask yourself and your team a few preliminary questions to gauge the potential impact of IFRS on your company:

- Have we inventoried our current IFRS reporting requirements, if any?
- How many local generally accepted accounting principles (GAAPs) do we currently report under?

Key Impacts of IFRS Implementation

Technical Accounting	Process and Statutory Reporting	Technology Infrastructure	Organizational Issues
• Overall approach to IFRS implementation • First time adoption policy considerations, including reporting dates and use of exemptions • Ongoing policy considerations, including alternatives and approach to "principles"	• Internal controls and processes, including documentation and testing • Management and internal reporting packages • Global reporting packages • Statutory reporting, including "opportunities" around IFRS adoption	• General ledger and chart of account structure, including performance metrics • Global consolidation • Sub-system issues related to configuration and data capture • Capabilities to manage multiple GAAP accounting during transition	• Tax structures • Treasury and cash management • Legal and debt covenants • People issues, including education and training, compensation structures • Internal communications • External and shareholder communications

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- How many of our business units already prepare IFRS financial statements?
- How might our access to capital be impacted by an IFRS conversion?
- How many of our competitors have converted to IFRS? (See chart, "Competitive Landscape" on this page.) Is there an expectation that they would switch to IFRS, if given the choice in the U.S.?
- Do we have a major ERP or finance transformation project in the works?
- Are we involved in or considering a major acquisition?
- What is the level of IFRS knowledge within the company, both domestically and globally?
- What would be the impacts on our company of a possible IFRS requirement in the U.S.?
- Have we assessed the costs and benefits of adopting IFRS?

Of course, your IFRS implementation roadmap will be significantly more detailed than merely addressing these few questions. Given the far-reaching scope of IFRS, the roadmap may assess the impact on each department in your organization, including finance, human resources, tax, legal, information technology, and investor relations. Other stakeholders may also be involved, including the board, audit committee, shareholders, and your external auditor.

By determining your costs, benefits, and timing up front, you can avoid the rushed approach (and unnecessary expense) that some companies experienced through initiatives such as the Sarbanes-Oxley Act and the Year 2000 computer issues.

Competitive Landscape: Automotive Companies by Accounting Standard

Company	Headquarters	Accounting Standard
General Motors	U.S.A.	U.S. GAAP
Ford	U.S.A.	U.S. GAAP
BMW	Germany	IFRS
Daimler	Germany	IFRS
Porsche	Germany	IFRS
Volkswagen	Germany	IFRS
Bosch	Germany	IFRS
Fiat	Italy	IFRS
Renault	France	IFRS
Peugeot	France	IFRS
Toyota	Japan	U.S. GAAP
Honda	Japan	U.S. GAAP
Nissan	Japan	Japanese GAAP
Mitsubishi	Japan	Japanese GAAP
Suzuki	Japan	Japanese GAAP
Denso	Japan	Japanese GAAP

Source: Company annual reports.

A carefully designed roadmap may empower your company to convert on its own terms. By taking a measured and informed approach, you increase the likelihood of identifying value in an exercise that otherwise may be reactive and solely compliance driven. The value may show itself in the form of reduced costs of implementation, standardization and centralization of statutory reporting activities and related controls, greater consistency of accounting policy application, and possibly core finance transformation. Through your roadmap, you can independently validate perceptions and dispel misconceptions. And you can justify your decisions before the board, shareholders, other stakeholder groups, and the financial analyst community.

Why go through all this trouble? The answer is simple: sooner or later, you will have to. By 2011, it's likely that virtually every country in the world will either permit or require IFRS. Recent events suggest that reporting under IFRS will be allowed or required for most public companies in the U.S. and around the globe within the next few years. On November 14, 2008, the SEC issued its long-awaited proposed IFRS "roadmap" outlining milestones that, if achieved, could lead to mandatory transition to IFRS starting in fiscal years ending on or after December 15, 2014. The roadmap also contains proposed rule changes that would give certain U.S. issuers the early option to use IFRS in financial statements for fiscal years ending on or after December 15, 2009. The SEC believes that "the use of a single, widely accepted set of high-quality accounting standards would benefit both the global capital markets and U.S. investors by providing a common basis for investors, issuers and others to evaluate investment opportunities and prospects in different jurisdictions." The roadmap also notes that IFRS has the potential "to best provide the common platform on which companies can report and investors can compare financial information." The SEC is seeking comments on numerous questions raised in the proposed roadmap. The comment period is expected to run until mid-to-late February 2009.

The proposed roadmap outlines seven milestones. Milestones 1–4 discuss issues that need to be addressed before mandatory adoption of IFRS:

1. Improvements in accounting standards.
2. Accountability and funding of the International Accounting Standards Committee Foundation.
3. Improvement in the ability to use interactive data for IFRS reporting.
4. Education and training on IFRS in the United States.

Milestones 5–7 discuss the transition plan for the mandatory use of IFRS:

5. Limited early use by eligible entities: This milestone would give certain U.S. issuers the option of using IFRS for fiscal years ending on or after December 15, 2009.
6. Anticipated timing of future rule making by the SEC: On the basis of the progress made on milestones 1–4 and experience gained from milestone 5, the SEC will determine in 2011 whether to require mandatory adoption of IFRS for all U.S. issuers. Potentially, the option to use IFRS could also be expanded to other issuers before 2014.
7. Implementation of mandatory use: The roadmap raises many questions, including whether the transition to IFRS should be phased in. According to the roadmap, large accelerated filers would be required to file IFRS financial statements for fiscal years ending on or after December 15, 2014, then accelerated filers in 2015, and nonaccelerated filers in 2016.

Under the proposed roadmap, U.S. issuers that meet both of the following criteria would be eligible to use IFRS earlier in financial statements for fiscal years ending on or after December 15, 2009:

- The U.S. issuer is globally among the 20 largest listed companies worldwide in its industry, as measured by market capitalization.
- IFRS, as issued by the IASB, is used as the basis for financial reporting more often than any other basis of accounting by the 20 largest listed companies worldwide in the U.S. issuer's industry, as measured by market capitalization.

An issuer that meets these criteria and chooses to use IFRS (an "IFRS issuer") must prepare its financial statements in accordance with IFRS as issued by the IASB. Issuers electing to file IFRS financial statements with the SEC would be required first to do so in an annual report and would not be able to file IFRS financial statements with the SEC for the first time in a quarterly report, registration statement, or proxy or information statement.

Investment companies; employee stock purchase, savings, and similar plans; and smaller reporting companies, as defined by the SEC, are excluded from the definition of an "IFRS issuer" in the proposed roadmap and therefore would not be eligible to early adopt IFRS.

For more information on the SEC's action, visit www.deloitte.com/us/ifrs.

Timing is Everything

IFRS adoption is no longer a question of "if," but only of "when." The more thought and planning you put into the process now, the easier your task will likely be down the road.

Don't be lulled into a false sense of security by the forward-looking focus of the conversation. Under the SEC's proposed IFRS "roadmap", dates such as 2009 for optional early adoption and 2014-2016 for mandatory conversion may give the misleading impression that you have plenty of time. For a more realistic picture, subtract three to five years from your planned rollout date. That is, if you plan to report under IFRS in the December 31, 2014 financial statements, you will need opening balances as of January 1, 2012, which means you will need an appropriate accounting and reporting infrastructure in place by 2011. In other words, since your conversion effort will require proper planning and adequate time to put your infrastructure in place, you may fi nd you need to start planning now for dates that previously seemed far off into the future.

In mid-2008, the American Institute of Certifi ed Public Accountants (AICPA) concurred with this assessment by announcing that it considered a 3-5 year timeline to be reasonable for transitioning to IFRS. Other organizations have made similar determinations.

Time is becoming even shorter as the IFRS discussion gains momentum. Many companies would have previously argued that a change to IFRS was probably a decade or more away. But recent developments involving the SEC, Financial Accounting Standards Board (FASB), and International Accounting Standards Board (IASB) have made the movement to IFRS more likely within a much shorter timeframe.

Which Approach Will Work for You?

Generally speaking, two approaches to IFRS conversion predominate: all-in and tiered. The former is characterized by a relatively short timeframe; simultaneous conversion of all reporting entities; dedicated project teams; and commitment of significant resources. The latter is conducted over a more extended period; with phased conversion of reporting entities; with at least some personnel retaining their "day job" duties; and with a spreading out of project costs.

When the European Union converted to IFRS in 2005, it was, for most companies, an all-in effort driven by the tight timelines imposed by the European regulators. Without the luxury of time to convert on a staggered basis, most companies were forced to rush through the process, leading to inevitable inefficiencies and ineffectiveness.

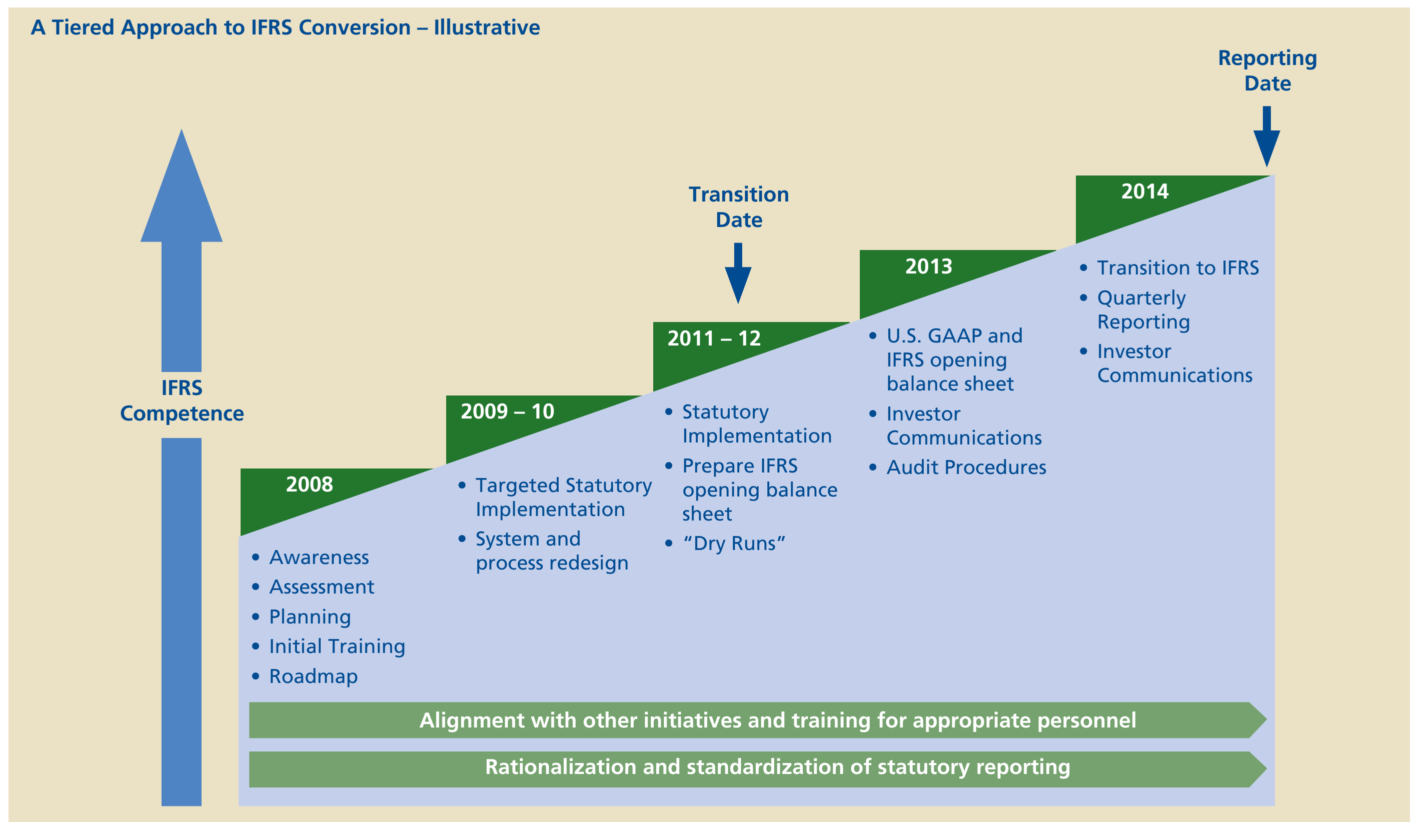
A tiered approach – staged, rational, and measured – to IFRS conversion will likely provide better results. This comes with a seemingly self-contradictory caveat: You'll have to act fast if you want to go slow. That is, if you want to reap the potential benefits of phasing in your conversion, you'll need to start planning soon.

Companies that choose a tiered strategy should consider staggering their conversions on a country-by-country or region-by-region basis. As each group moves through the stages (see graphic, "A Tiered Approach to IFRS Conversion," on this page), the processes developed and lessons learned are applied to the next group. Many automotive companies will choose Canada for the first conversion, given that country's 2011 mandate for conversion to IFRS, as well as its significant industry presence.

Technical Accounting Issues for Automotive Companies

U.S. GAAP and IFRS differ in key ways, including their fundamental premise. At the highest level, U.S. GAAP is more of a rules-based system, whereas IFRS is more principles-based. This distinction may prove more vexing than it initially appears, because most accounting and finance professionals in the U.S. have been schooled in the rules of U.S. GAAP. The overriding lesson from their years of study and work is this: If you have an issue, look it up. Under U.S. GAAP, voluminous guidance attempts to address nearly every conceivable accounting problem that might arise. And if that guidance doesn't exist, it generally is created. On the other hand, IFRS is a far shorter volume of principles-based standards, and consequently requires more judgment than American accountants are accustomed to.

Beyond the issue of rules versus principles, IFRS also can pose particular technical accounting challenges to companies in the automotive industry. The table on page 4 highlights a number of these issues. A more detailed discussion of a select few U.S. GAAP/IFRS differences follows.



Selected IFRS/U.S. GAAP Differences

Potential Differences	Potential Implications		
	Financial Statements	Process/Systems	Other
Inventory	IFRS does not permit LIFO.	May be potential changes to inventory valuations and associated systems.	May have tax considerations relative to different inventory valuation and related tax deduction amounts.
PP&E and Impairment	IFRS requires componentization approach; major maintenance expense treatments may differ.	Systems modifications may be necessary to track components and separate depreciation amounts; depreciation and consideration of reversal of impairment.	May cause potential difficulty in initial componentization exercise depending on age of assets, previous acquisitions. Also, may have potentially significant tax implications.
Financial Instruments	IFRS derivative accounting guidance is less prescriptive. In addition, internal costs related to loan originations are expensed under the IFRS effective interest rate method.	May lead to potential policy changes and related changes to derivatives database and valuation systems/processes.	Differing definitions may necessitate an extensive contract "re-review."
Revenue Recognition	IFRS contains limited guidance for multiple element arrangements.	May result in potential changes to revenue or gain recognition systems/processes.	Lack of specific accounting rules for multiple element arrangements could result in change in future contract development.
Research and Development	Under IFRS, development costs are capitalized when the technical and economic feasibility of a project can be demonstrated and further prescribed conditions are satisfied.	May lead to system implications around data capture for development costs to be capitalized.	Potential increase effort/ resources to track development costs as well as tax implications.
Pension and Other Postretirement Benefits	IFRS limits pension assets and recognizes termination benefits and curtailment gains and losses at commitment.	May need to develop process around asset ceiling test as well as judgment around actuarial gains and losses.	Change in funding requirements as well as tax implications.

Inventory: If one issue has many automotive companies holding IFRS at arm's length, it's LIFO. Under U.S. GAAP, companies can apply LIFO rules to their inventory balances. In periods of rising commodity prices, this accounting method leads to higher recognized costs of sales, and thus reduces taxable income. However, LIFO accounting is not allowed under IFRS, so companies will need to recast recorded inventory balances under either weighted average or FIFO rules for financial reporting purposes.

Asset Componentization: Under IFRS, the major components of an asset must be separated and depreciated over their estimated useful lives. Identifying the significant components of large manufacturing assets represents a major challenge. For components that typically require replacement during the working life of the overall asset, depreciation may be calculated on a units of production basis.

Companies that convert to IFRS can expect a complex and potentially lengthy process to componentize their property, plant, and equipment; identify the applicable components; and to adjust the depreciation calculations of fixed assets.

Asset Impairment: Two major differences exist between U.S. GAAP and IFRS on asset impairment:

1. When assessing for impairment under U.S. GAAP, a "two-step approach" is applied. First, the carrying value of the asset is compared with the undiscounted value of the expected future cash flows to be generated from the asset. Second, where the carrying value is higher, the asset is written down to fair value. Under IFRS, the carrying value is compared with the asset's "recoverable amount" (defined as the higher of the asset's value in use, which is based on discounted future cash flows and fair value less cost to sell); and if higher, the asset is written down to the recoverable amount. The ultimate effect is that impairment may be recorded earlier under IFRS.
2. Under U.S. GAAP, reversals of previous impairments are not permitted. However, under IFRS, where the indicator that led to the impairment loss no longer exists, the previously-recognized impairment charge is reversed. (Goodwill impairment is an exception. Even under IFRS, goodwill impairment may not be reversed.) Under IFRS, you will have to track your asset impairments even after you initially write them down, to determine whether there is a need for a reversal.

Differences also can arise in areas such as determination of cash generating units for impairment analysis and the determination of fair value. You should consult your professional advisors for guidance in these areas.

Financial Instruments: Under U.S. GAAP, 100% effectiveness of hedging instruments can be assumed if the critical terms of the instrument and the underlying hedged item are the same or if certain conditions are met. This approach is prohibited under IFRS; rather, effectiveness must be continuously assessed and measured, requiring significantly more monitoring and documentation of derivative instruments.

Several differences exist between IFRS and U.S. GAAP on the topic of the effective interest rate method, particularly the definition of components of direct costs between the two standards frameworks. Ultimately, the impact of the differences means that internal costs related to loan originations will be capitalized and amortized under U.S. GAAP but expensed under IFRS. The impact of these differences could be significant for automotive companies, particularly those OEMs with captive finance entities.

Revenue Recognition: IFRS guidance with respect to revenue recognition is much less detailed than U.S. GAAP. One area with potentially significant effect is the guidance around accounting for multiple element arrangements (e.g., subscriptions to in-vehicle telematics systems). While U.S. GAAP specifically addresses these arrangements and provides detailed guidance and rules around the accounting, IFRS is largely silent on the topic. The implications of this difference extend beyond the accounting of specific transactions and could potentially impact the future design of contracts as well.

Research and Development: U.S. GAAP requires all costs related to research and development be expensed as incurred, with few exceptions. IFRS differentiates between "research" and "development" costs, with development costs capitalized when the technical and economic feasibility of a project can be demonstrated and further prescribed conditions are satisfied.

Pension and Other Postretirement Benefits: With the significant number of current and future retirees in the automotive industry pipeline, pensions and post-retirement benefits represent a significant component of the industry's financial statements. Under U.S. GAAP, actuarial gains and losses are required to be reflected in equity when they arise. While IFRS permits this approach, it is not required. Additionally, IFRS sets a ceiling on recognition of pension assets based on specific criteria; U.S. GAAP does not impose any such restriction.

More Than Accounting and Financial Reporting

Without question, IFRS will impact the general ledger, and financial statements. But in a relative sense, the accounting and financial reporting may be the easy part. How you handle the nonfinancial aspects of the transition to IFRS may be a far more accurate indicator of your success. Some of the areas warranting your attention are included below.

Tax Issues: It is important to address the tax consequences of the pretax differences between IFRS and U.S. GAAP upon a conversion to IFRS, including methods, tax accounting, planning, and systems. Companies may need to reevaluate their existing tax accounting methods to determine if the new book methods are permissible, preferred, or prohibited. Any changes to book or tax may also require an evaluation of systems used for collecting tax data.

Global tax planning, such as structure, repatriation, and transfer pricing, will need to be updated to capitalize on the operational, technical accounting, and tax accounting changes associated with an IFRS conversion to ensure such changes are executed in a tax-efficient manner.

Tax planning may further involve an analysis of whether to implement a certain tax strategy before or after a conversion to IFRS. Also, to the extent a tax result depends on the pretax statutory books, consideration should be given to whether there are additional tax benefits to be obtained under one standard over the other.

Also, standardized accounting policies may have to be developed to ensure consistent tax accounting throughout an organization. Understanding the future ramifications of these policies will be paramount to generating the most favorable tax consequences in the greatest number of jurisdictions.

For more information, see "IFRS for U.S. Companies: Tax Implications of an Accelerating Global Trend" at www.deloitte.com/dtt/cda/doc/content/us_tax_ifrs_pov_061708.pdf.

A Taxing Concern?

Current tax law requires companies reporting inventories on a LIFO basis for tax purposes to also report inventories on a LIFO basis for financial reporting purposes. As a result, the adoption of IFRS could result in a violation of this conformity requirement and, under current law, a significantly higher tax bill.

Consequently, automotive companies with substantial inventory balances may be reluctant to convert to IFRS due to this negative tax consequence. Some business observers speculate that the U.S. Congress and the Internal Revenue Service (IRS) will be compelled to address this issue should IFRS be mandated, perhaps by offering a one-time conversion opportunity that limits the tax liability. However, with billions in tax revenue at stake, there will be enormous pressure on all sides of the issue, making final resolution difficult to predict. Automotive companies should closely monitor developments in this area.

The HR Factor: As noted, IFRS involves much more than reorganizing the chart of accounts. It represents a change that cascades well beyond the finance department.

Consequently, human resources issues may be a major concern. A conversion project will place increased demands on your personnel, which may come at a time when you are least able to handle it. Finance organizations have streamlined in recent years, downsizing accounting functions through reduced hiring, layoffs, and attrition, as well as outsourcing or offshoring key functions. Unfortunately, these personnel reductions may mean that the people who could best help with your IFRS efforts are no longer available.

Recruiting may pose another challenge, particularly in the United States. College accounting programs across the country represent an important pipeline for keeping finance functions staffed and operating. Yet, most U.S. university accounting programs are only now beginning to develop comprehensive instruction on IFRS.

This issue can be addressed through training programs in the U.S. and internationally, to help key personnel become proficient in both IFRS and U.S. GAAP.

Contract Management: An IFRS conversion will potentially impact your existing contracts. Consider involving your legal team as part of the remedy.

Many contracts may need to be reviewed to make sure the proper accounting treatment is followed under IFRS. To improve the efficiency of this process, a contract database could be created (if not already in place) to better monitor the IFRS conversion and tracking of effects.

The IFRS conversion may trigger the need to amend contracts with financial institutions and joint venture partners in regards to financial accounting information to be supplied by your company. You may have to reword certain sections to address regulatory or third-party requirements to replace U.S. GAAP information with IFRS information.

Technology Issues: IFRS is expected to have wide-ranging impacts at different levels of the IT systems architecture. The realignment of the company information systems will pose a real challenge for IT (along with the rest of the organization). Virtually all applications and interfaces in the system architecture can be affected, from the upstream or source of data to the farthest end of the reporting tools. As such, time and resource needs may be significant.

As you plan changes to your IT systems, you will need to take into account external factors such as local and international regulations, financial consolidation of subsidiaries, stock markets, and external auditors. This business transformation should not be considered a one-step project. It may be necessary to implement short-term initiatives strategically designed to institute an effective long-term solution for the organization.

Potential Technology Impacts

Upstream Source Systems and Transformation Layer	General Ledger and Financial Applications	Reporting Data Warehouse Planning and Calculation Engines	Downstream Reporting Capabilities
Differences in the accounting treatment between current accounting standards and IFRS will create a need for new input data.	Differences in the accounting treatment between current accounting standards and IFRS will likely drive changes to general ledger design, chart of accounts, as well as sub-ledgers and feeds.	IFRS has much more extensive disclosure requirements, requiring regular reporting and usage of financial data that may not be standardized in current data models.	The differences that arise in the accounting treatment between current accounting standards and IFRS will create a need for changes in reporting.
Data and transactions that are captured, stored and ultimately sent to the financial systems may not have all the needed attributes or qualities.	Multinational companies may ultimately realize a need to re-develop general ledger platforms or additional sets of books to ensure compliance with multiple financial reporting requirements.	Increased need for documented assumptions, sensitivity analyses; potential factors that could affect future development may expand the scope of information managed by financial systems.	Assumption changes from period to period can introduce significant volatility and require detailed support for derivation and rationale for changes, requiring design of additional reports.
Sub ledgers within the ERP may have additional functionality to support IFRS that is currently not being utilized but could be implemented.	Multi-ledger accounting functionality within newer releases of ERP's may be considered for long-term solutions.	Reporting warehouse feeds to calculation engines may need to be adjusted in a standardized way to support reporting processes.	External reporting templates will likely require revisions to reflect IFRS requirements.
Transformation layer not likely to have been designed with IFRS in mind; data sender/receiver structures may need to be adjusted.	Changes to IFRS will likely necessitate redesigned accounting, reporting, consolidation, and reconciliation processes, which may impact configurations of the financial applications.	Data governance functions and meta data repositories (potentially including data dictionary, ETL & business intelligence tools) may need to be adjusted to reflect revised data models.	Increased disclosures such as sensitivity tests and roll-forwards may require additional ad hoc query capabilities.
Over time the potential for acquisitions of companies using IFRS will increase; altering source systems and Extract, Transform and Load (ETL) tools to provide all needed data elements will make integrations significantly more efficient.	Differences that arise in accounting treatment between current accounting standards and IFRS may create a need for new expense allocations and other calculations.	Current valuation systems may not have functionality to handle IFRS requirements.	

The European Experience

In July 2002, the European Parliament passed legislation requiring listed companies to convert to IFRS by 2005. The short timeframe and extensive reach of the directive had many companies scrambling to comply. Anecdotal reports suggest that the conversion placed significant resource pressure – human and financial – on finance teams and their companies at large.

A more tangible measurement of the effort can be found by comparing the length of European companies' 2004 (local GAAP) and 2005 (IFRS) financial statements. The latter averaged more than 50 percent longer than the former; in some instances, reports doubled in length. Much of the increase can be attributed to an increased level of disclosure in the financial statements in areas such as judgments made and assumptions used.

Certain accounting issues proved especially vexing during the transition, including asset impairments, financial instruments, lease accounting, and emission rights.

Among the lessons learned from the European experience were the following:

The effort was often underestimated. The original misconception that conversion was solely an accounting issue was replaced with a growing realization that the initiative was larger and more complex.

Projects often lacked a holistic approach. Because of the limited view cited above, companies frequently did not take the collateral effects into consideration, such as the impacts on IT, HR, and tax.

A late start often resulted in escalation of costs. Those few companies that anticipated conversion and took steps to prepare for it were in much better shape than those that did not. Companies that delayed their response paid a price for it, in terms of higher costs and greater diversion of resources.

Many companies did not achieve "business as usual" state for IFRS reporting. The highest quality financial data is obtained when companies fully integrate IFRS into their systems and processes. The compressed timeframes often precluded this possibility; instead, first-year financials were often produced using extraordinary, labor-intensive, and unsustainable measures.

Several companies are only now starting to explore benefits from IFRS implementation. Due to multiple constraints, the first-year effort in the EU was focused more on "getting it done." Potential benefits in terms of reducing complexity, increasing efficiency, decreasing costs, and improving transparency had to be deferred.

Regulatory Rewards?

The opportunity to reduce local GAAP reporting and coalesce around a single standard will be appealing to many automotive companies. The change may be dramatic. For example, until recently, companies doing business in Western Europe had to track financial information using up to 21 different GAAPs. The EU's 2005 conversion to a single standard harmonized and simplified compliance, and today there is more cross-border consistency in the application of rules and standards.

A fringe benefit of conversion may be the promise of collaboration among various regulatory bodies. The model for this was provided by the Committee of European Securities Regulators (CESR), an independent body that works to improve coordination among EU securities regulators. This group, formed in 2001, played an important role in the IFRS conversion effort by bringing together regulators from across the EU to discuss issues, smooth over differences, and reconcile complex points of view.

As other countries across the globe adopt IFRS, the prospect of additional regulatory bodies (such as the SEC) interacting with their counterparts increases. Thus, the movement toward IFRS is changing the regulatory dynamic, forcing regulators to think globally, instead of nationally, in how they treat these issues.

Smoothing the Transition

If you decide an accelerated IFRS conversion is desirable, here are a few considerations for smoothing implementation:

Leverage existing projects: If you are already going through — or have recently completed — an enterprise resource planning (ERP) or finance transformation project, now may be the time to consider IFRS adoption. Recent versions of major ERP systems are designed to accommodate IFRS, which can be mapped in, usually with significant cost savings.

Conduct a trial run: Implementation might be easier if you take a bite-sized approach starting with a single country or reporting entity. Use existing reporting requirements and local country IFRS requirements to your advantage. For example, subsidiaries in countries adopting IFRS over the next three years may be good candidates for your trial run. Learn from this initial conversion exercise, and apply the lessons learned to your global rollout down the road.

Consider shared services centers: IFRS provides a compelling reason to establish shared services centers, to potentially consolidate dozens of local GAAPs down to a single reporting standard. Geographically-dispersed finance offices could be drastically reduced or even eliminated in favor of a central finance function, strategically located to take advantage of tax incentives, payroll savings, and facilities cost reductions. In many cases, this concept is already aligned with the strategic direction automotive companies have taken or are currently considering relative to their finance function.

Strengthen controls: Many automotive companies have operations that are located in developing areas such as Africa, Russia, the Middle East and South America. A decentralized structure can sometimes lead to reduced oversight and weakened controls. IFRS offers the opportunity to implement standardized frameworks and processes to enhance the overall control environment.

Refresh your policies: Conversion to IFRS drives a need to revisit fixed asset componentization, inventories, derivatives, revenue recognition, and other accounting policies (as discussed on page 4). In other words, IFRS provides a refresh exercise for accounting policy implementation, with the aim of more accurate and timely financial reporting.

Improve your access to capital: Capital is migrating away from the U.S. for a number of reasons, including the weakness of the dollar, the credit crisis, and the growth of foreign financial centers in Europe and Asia. Regardless of the cause, when it comes to raising capital, trends are clearly global. IFRS can potentially improve liquidity and access to capital by offering greater transparency, in the form of full and better disclosure, to investors.

Access to capital may also be enhanced by virtue of aligning with a common standard. Markets and investors have been demanding a common standard for years, and IFRS has increasingly served that need. As such, companies reporting under IFRS may have an improved ability to access other capital markets that have adopted the standard.

Getting It Right

IFRS will present major challenges even before you get to the nuts and bolts of the conversion process. For example, just deciding when to tackle IFRS represents a hurdle in itself. That’s where the development of a comprehensive IFRS implementation roadmap comes into play. There are simply too many variables to allow for a back-of-the-envelope assessment. You need to assemble your best minds in finance, HR, tax, legal, IT, investor relations, and other constituencies. You should call upon your board, audit committee, and other stakeholders. And you will need to assess the competitive landscape to understand what your competitors are doing.

Don’t allow yourself to be distracted by the rising decibel levels around IFRS. The benefits of a reasoned and deliberate conversion defined by a thorough plan may be substantial.

Resources

Deloitte has extensive experience in the Automotive industry. With thousands of IFRS-experienced professionals in our global network, we provide a comprehensive array of services related to IFRS. As a multidisciplinary organization, we can help companies address a wide range of IFRS issues.

Deloitte offers companies assistance with:

- Evaluating the potential effects of IFRS
- Assessing readiness for IFRS conversions
- Implementing IFRS conversions, providing support with technical research, project management, and training
- Addressing the implications of IFRS in such areas as tax, finance operations, technology, and valuation

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