

White Paper



IFRS | Transition Strategy for E- Business Suite

Abstract

Acceptance of International Financial Reporting Standards (IFRS) is gaining momentum across the globe. IFRS transition program for any organization will have multi-dimensional effect because of differences which exist between IFRS and Local GAAPs. The objective of this paper is to highlight the nature of such differences with examples. Also, to emphasize on the need for a detailed and well thought transition strategy from Oracle E-Business Suite Perspective.

Target Audience:

It is assumed that reader has basic understanding of Oracle E-Business Suite Financial Modules including General Ledger fundamentals.

IFRS Introduction

Foreign trade is probably the most important aspects of current global economy. Organizations are always exploring new shores for better sourcing and selling opportunities. This includes sourcing of cheaper finances. One of the key activities in evaluating a potential foreign trading partner is to review its financial statements. Such trading partners prepare the financial statements as per their national GAAP. The provisions of national GAAP applicable to the organization can be significantly different from the provisions of national GAAP applicable to the foreign trading partner. Hence the knowledge of national GAAP applicable to the trading partner is essential to correctly interpret and analyze its financial statements. Since organizations may work with multiple foreign trading partners resident in different countries, the country specific national GAAPs were considered a barrier for global trade and need for a global GAAP was felt.

International Financial Reporting Standards (IFRS) is an initiative towards a global GAAP. IFRS standards consist of 41 International Accounting Standards (IAS) and 9 IFRS Standards. IAS standards were issued by International Accounting Standards Committee (IASC) between 1973 and 2001. IFRS standards were issued by International Accounting Standards Board (IASB) which was founded in 2001 as successor of IASC.

At present more than 100 countries require or permit the use of IFRS or has a roadmap in place for IFRS adoption/convergence. Countries which have adopted IFRS include EU Countries and Australia. Countries for which an IFRS adoption/convergence road map is in place includes USA, India and Japan.

IFRS Implementation Approach

There are two approaches for implementation of IFRS – Adoption and Convergence. Each country's national accounting body selects the one of the two approaches.

Adoption means dropping the existing national GAAP and adopting IFRS. IFRS-1 on First Time Adoption implies two years of dual reporting between Transition Date and Reporting Date. The Reporting Date is the balance sheet date of the first financial statements that explicitly state that it comply with IFRS (for example, March 31, 2012). The Transition Date is the date of the opening balance sheet for the prior year comparative financial statements (for example, April 1, 2010, if the reporting date is March 31, 2012). Hence for these two years, Organizations will have to process their transactions and accounting as per IFRS as well as national GAAP. Hence two set of books will have to be maintained. After reporting date, national GAAP book can be discontinued.

Convergence means revising Local GAAP and IFRS Standards so that difference between them can be reduced. At the end of the process there may be some differences which are unresolved. In case of convergence, organizations will continue to report as per their local GAAP but with converged standards. Relevant business processes and accounting processes will be changed as and when the converged local GAAP standard comes into force.

Objective

Irrespective of the implementation approach, the implementation of IFRS may have an organization wide impact. IFRS Implementation program will not be just a simple accounting program. It will be a business transformation exercise impacting many aspects of business. Though on its core its truly is an accounting project but its implementation will have wider impact on different functions within an organization. For example areas like compensation planning, taxation, stock options, fixed assets, debt agreements, definition of subsidiary company etc need to be relooked into in context of IFRS definition.

Broadly the program will impact people, processes and IT applications. The extent of impact will depend on the horizontal (geographic) and vertical (line of business) spread of an organization.

Fixed Assets is one of the areas which will have a significant impact on IT applications (in our case Oracle E-Business suite). This document outlines the challenges which an organization may face due to the differences in the accounting treatment of fixed assets between IFRS and national GAAP and provides a solution strategy for the same.

Differences in Accounting Treatment of Fixed Assets

IAS 16 on Property, Plant & Equipment primarily covers the tangible fixed assets. The following are the generic differences about accounting treatment of fixed assets between IAS - 16 and respective national GAAP standards:

Topic	IFRS	National GAAPs
Componentization	IAS - 16 mandates that each part of a tangible Fixed Asset having cost that is significant in relation to its total cost and having a different useful life than the mother asset, should be depreciated separately. As a result, cost of replacing such component is also capitalized and carrying amount of replaced component is derecognized.	National GAAPs, in general, leaves the componentization decision on organizations. Hence organizations may depreciate the full assets using the life of mother asset even though components are depreciated and replaced during this life time. Cost of replacing components being treated as expense.
Inspection Cost	IAS - 16 requires that the cost of major inspections should be capitalized with consequent de-recognition of carrying amount of any previous inspection	As per National GAAPs, in general, Organizations have the option to either capitalize or expense such inspection costs.
Depreciation	IAS - 16 requires that the assets should be depreciated over the useful life of the assets.	However in some countries depreciation rates are fixed by Government Authorities which can be different than the rate as per useful life of asset.

Inventory

Cash Discount. One of the key differences between IFRS and national GAAP is about the treatment of Cash Discount. IAS – 2 on Inventory requires that cash discounts should be reduced from inventory/purchase cost.

However as per Local GAAPs cash discount is booked as income.

LIFO. IFRS does not allow LIFO method whereas some national GAAPs do allow LIFO.

Transition and Switch-over Strategy for Adoption Approach

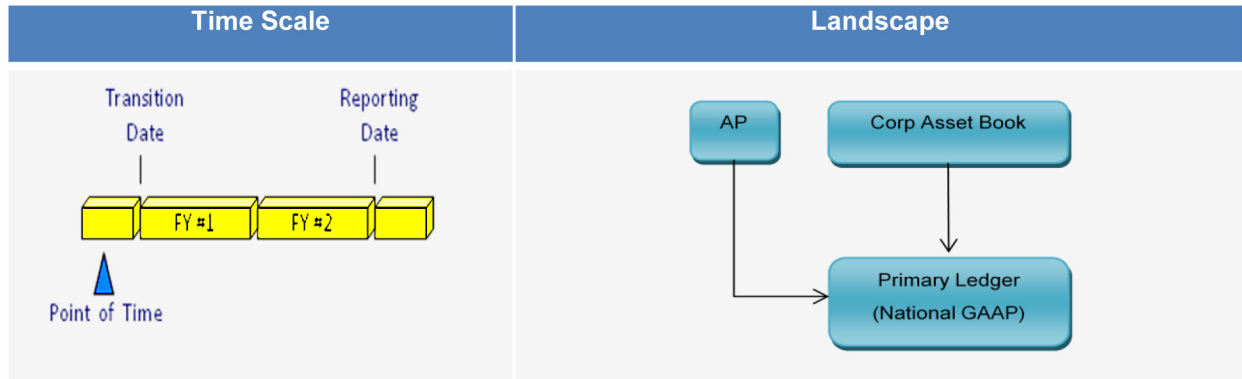
(The strategy demonstrated below is for illustration purpose and limited to the Fixed Assets differences mentioned above. In an IFRS transition program this strategy should be validated and further refined for all such differences which are applicable to an organization. This strategy is applicable for Oracle Application E-Business Suite Release 12.)

Assumptions

The strategy is based on following assumptions:

- Property plant & equipment are carried forward at historical cost leveraging the exemptions allowed in IFRS 1
- The organization is on R12 of Oracle E-Business Suite
- The organization pertains to an asset intensive industry

The Pre – IFRS Landscape



In the pre IFRS landscape, Assets are maintained in corporate asset book. Asset purchase accounting entry flows from AP to primary ledger in GL. Capitalization, depreciation and other asset related entry flows from corporate asset book to primary ledger.

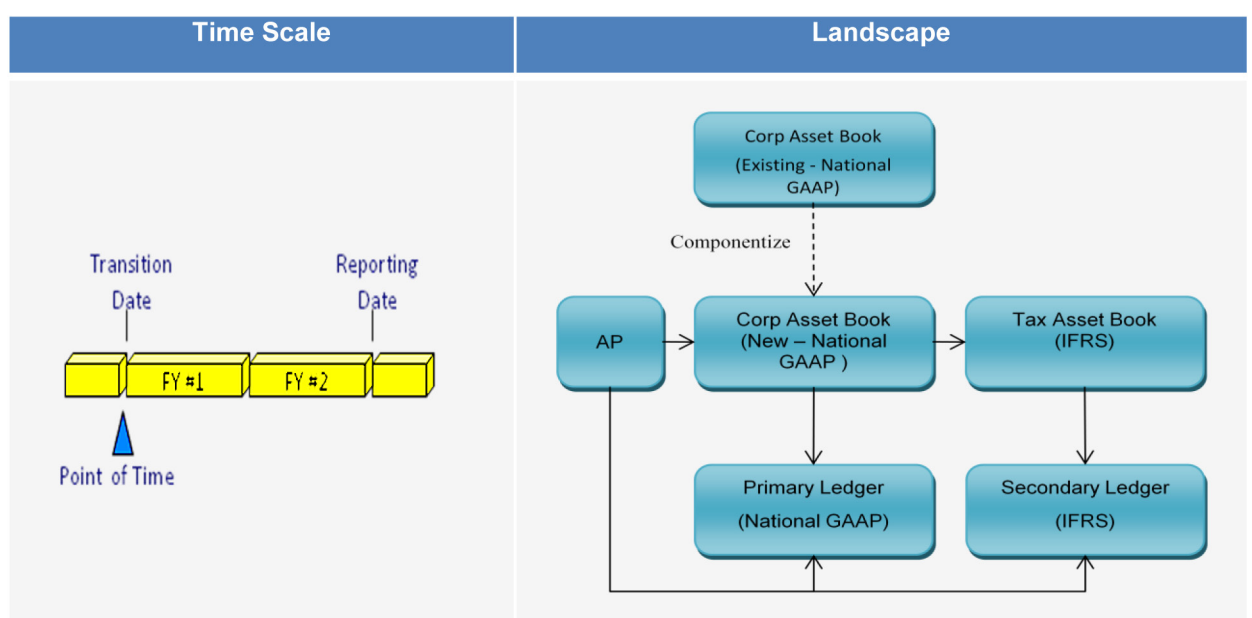
The Dual Reporting Challenge

IFRS - 1 requires two years of dual reporting as per national GAAP and IFRS. The depreciation rate of assets as per IFRS will be different than as per national GAAP because of componentization principal in IFRS and its emphasis on useful life of asset. Moreover some assets may exist only in one asset book e.g. capitalized inspection cost will exist only in IFRS. Hence the carrying amount of asset will be different under national GAAP and IFRS.

Therefore two asset books will be required to maintain assets as per both standards. The challenge from E-Business suite perspective is on how to

1. Build the IFRS asset book at the transition date,
2. Maintain assets in both asset books through the dual reporting period, and
3. Switch-over to IFRS only asset book at the reporting date

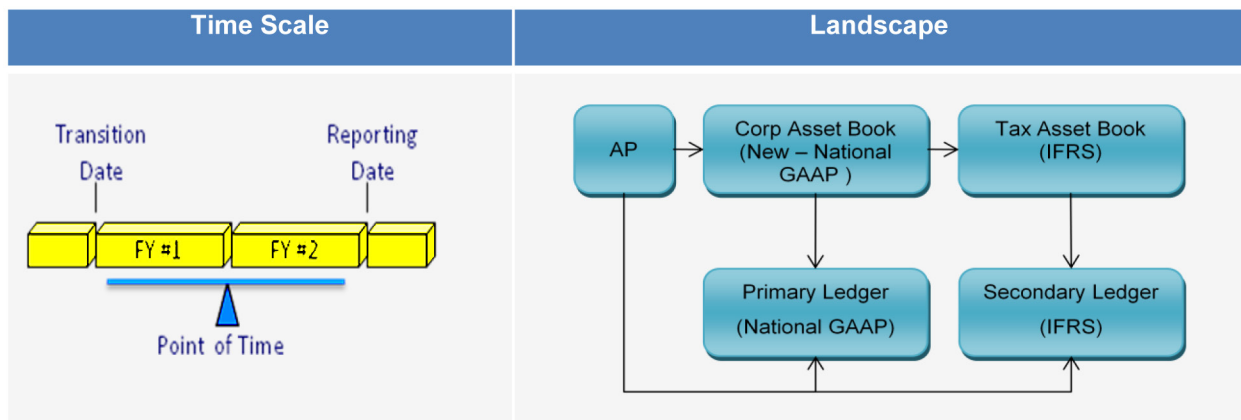
(a) Building the IFRS Asset Book at the Transition Date



As on the transition date, following steps need to be executed to build the IFRS asset book and to facilitate dual accounting/reporting of fixed assets:

- Configure a new corporate asset book with same primary ledger as that of existing corporate asset book. The new corporate book is meant for national GAAP and not for IFRS.
- Componentize assets and load them in new corporate asset book. There is no standard feature to split assets in FA (after 'post mass additions' is run). Hence assets need to be componentized out of FA module and migrated to new corporate asset book. The parent – child asset feature will be used to maintain the link between components of a same mother assets. The 'create accounting' program will generate asset addition journal entries which will be reversed in general ledger.
- Maintain the existing depreciation rates in new corporate asset book for componentized assets.
- Configure secondary ledger for IFRS reporting.
- Configure a tax asset book and link it to secondary ledger and new corporate asset book (Refer Metalink note 429009.1 for configuration details). Copy componentized assets from new corporate asset book to the tax book. Since assets copied from corporate book cannot be split in tax book, which is why a new corporate asset book was created with componentized assets in the earlier steps.
- Adjust the accumulated depreciation of asset components in tax book, if required. Based on assumption that historical cost method is being followed, the accumulated depreciation amount can only be apportioned among the components. It cannot be revised.
- Update the useful life / depreciation rate of the asset components in tax book since the life of components can be different than the parent assets.
- Disable existing corporate asset book.

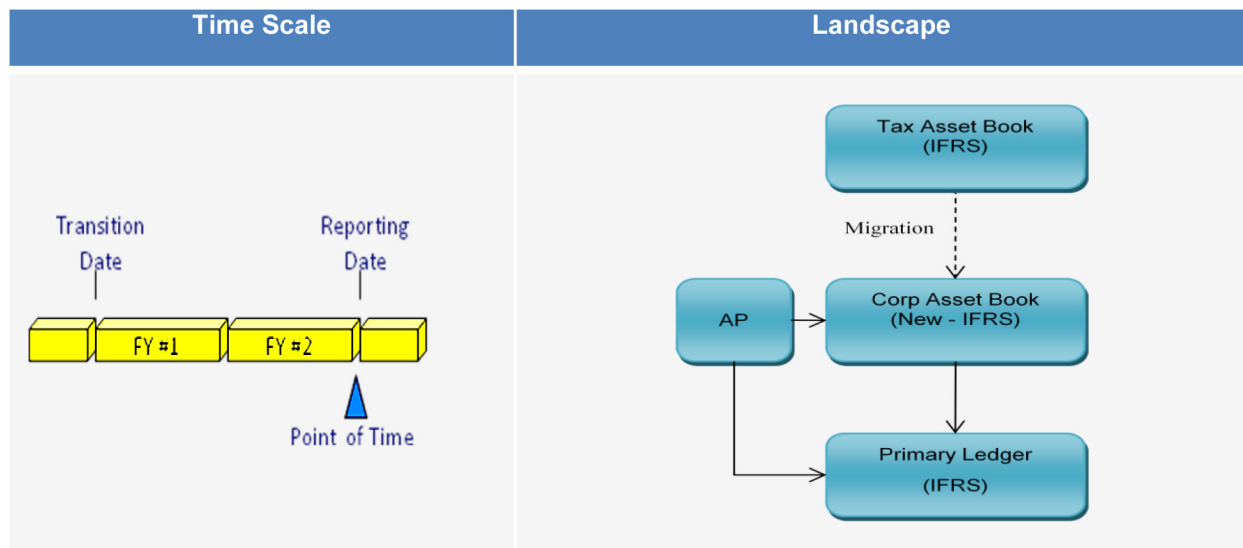
(b) Maintaining assets in both asset books through the dual reporting period



During transition period capitalize new assets with components in corporate book (because copied asset cannot be split in tax book). Components will have same useful life in corporate book and different useful life in tax book.

Process inspection cost as an asset addition in AP. It will result in the capitalization of inspection cost in both corporate asset book and tax asset book. Since inspection cost need not be capitalized for national GAAP reporting, it can be fully depreciated in the period of its addition in corporate asset book. In tax asset book, inspection cost will be depreciated over the estimated duration between current inspection and next inspection.

(c) Switch-over to IFRS only asset book at the reporting date



After reporting date if the organization needs to report only in IFRS and it wants to discontinue reporting as per national GAAP then following steps can be followed:

- In order to avoid the overhead of maintaining two ledgers, the organization can start using primary ledger as IFRS ledger. To use IFRS as primary ledger the accounts, which have balances in primary ledger different than the secondary ledger, should be squared out in primary ledger by passing a journal. The other side of the journal will debit/credit a control account. After that another journal can be booked to build the balance as per secondary (IFRS) ledger. This journal too will debit/credit the same control account. The resulting balances in that control account may be adjusted against equity or retained earnings. Creation of a new Primary ledger is also an option however it will be costly and time consuming since it will require mini re-implementation
- From Asset perspective only, as mention above, pass a journal in primary ledger to zero the balance of existing asset accounts. Then pass another journal in primary ledger to build balances as per IFRS (secondary) ledger. Use a control account to balance both journals.
- Configure a new corporate asset book linked to primary ledger.
- Migrate all assets from IFRS (tax) asset book to new corporate asset book. Reverse the 'create accounting' journals in GL.
- Disable existing corporate book and tax book
- Ensure the balance as per Fixed Asset module matches with account balances in primary (IFRS ledger).

Transition and Switch-over Strategy for Convergence Approach

(The strategy demonstrated below is for illustration purpose and limited to the Fixed Asset differences mentioned above. In an IFRS transition program this strategy should be validated and further refined for all such differences which are applicable to that organization. This strategy is applicable for Oracle Application E-Business Suite Release 12.)

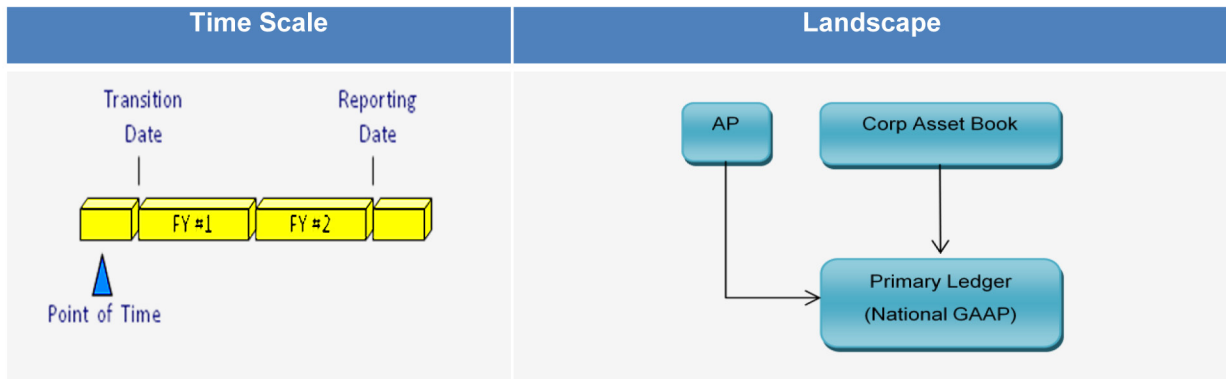
This section outlines the strategy for handling fixed assets in convergence approach. In convergence approach, the national accounting authority determines the 'switch-over' date after which revised (converged) accounting standards are followed. Till the switch-over date, the existing standards are followed. Hence there is no requirement of dual accounting and reporting in this approach. The Scope of work at switch over will depend on the mandate given in the revised standards about its retrospective or prospective application.

Assumptions

Let's assume that revised standard and government notifications, mandates the following regarding Fixed Assets:

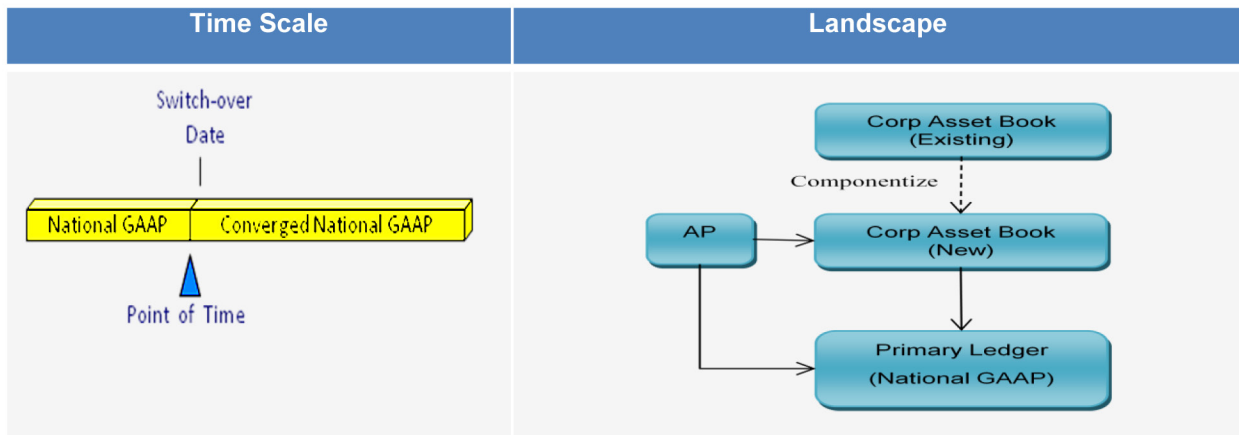
- Fixed depreciation rates mandated by government regulations will be scrapped and depreciation will be computed based on use full life of assets as required by IAS – 16
- Optionally componentize existing assets but mandatorily componentize all applicable future Asset purchases
- All future inspection cost should be capitalized

The Pre – IFRS Landscape



In the pre IFRS landscape, as mentioned earlier in this document, the assets are maintained in corporate asset book. Asset purchase accounting entry flows from AP to primary ledger in GL. Capitalization, depreciation and other asset related entry flows from corporate asset book to primary ledger.

The Switch-Over Strategy



In convergence approach, same primary ledger will continued to be used. If organization does not opt for componentization of existing assets then same corporate asset book can continued to be used. Depreciation method and Rates will have to be updated as per revised mandate.

If organization opts for componentization of existing asset then a new Corp Asset Book will be set up. Assets will be componentized, for applicable assets, and migrated with updated depreciation method and rates to new corporate asset book.

Conclusion

From Oracle Application perspective, Fixed Assets will be one of the focus areas in an IFRS implementation program. Depending on the IFRS implementation approach – adoption or convergence, the solution strategy will differ. The solution for Adoption approach will be more complex than the same for convergence approach. The organizations would need to carefully design the detailed solution considering the complexities involved.

Ending Notes

Example of Fixed Assets and Inventory was taken to drive the idea that there can be many such differences between IFRS and national GAAPs. Organizations should carefully study such differences and their impact on business application as part of IFRS Implementation Strategy.

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