November 2013

IFRS Foundation® Adoption Guide

Introduction

We are often asked whether the IASB has a standard approach that adopting countries can follow. The simple answer is “no”. Every country is different. Each has its own mix of expertise, professional infrastructure and regulatory interests. Adopting IFRS is not like an iPad application that is easily downloaded and applied.

That said, we have identified some common steps and approaches that work, together with some common pitfalls. This document outlines those steps, approaches and pitfalls, which we hope will help adopting officials in adopting countries. It is aimed at jurisdictions that have not yet completed the move to full adoption of IFRS.

With that in mind, there are some other resources that you may find instructive.

The first is the collection of *Jurisdiction Profiles* that we are assembling on the IASB website. We have completed 81 profiles so far, each ranging from four to six pages. The profiles show the variety of approaches that countries have taken and the status of each country’s journey to adoption.

The second is *IFRS Adoption and Implementation in Korea, and the Lessons Learned*. This short book is a joint product of the Korea Accounting Standards Board (KASB) and the Korean Financial Supervisory Service and is available on the KASB website. There is no universal model for adoption, but our Korean colleagues have documented a well-considered and successful example.

Jurisdiction Profiles on the IASB website:

http://go.ifrs.org/iasb-profiles

IFRS Adoption and Implementation in Korea, and the Lessons Learned on the KASB website:

http://go.ifrs.org/KASB-KFSS-PDF

Step one—the policy decision

You need to get this one right. Everything flows from the initial policy decision.

Adopting IFRS is like starting a family. It is best done with careful planning, commitment and a complete understanding of the implications. Setting these priorities and plans is the first step towards adopting IFRS. We have found that decisions that are not made at the beginning either have to be made later, with more difficulty, or go unmade and cause the adoption process to flounder.

Recommendation 1A—somebody needs to be in charge and everybody needs to know who it is

In our next recommendation, we are going to emphasise that adoption is a team effort. Every team needs a captain, though, and IFRS adoption is no exception.

Countries that have managed a successful adoption all seem to have identified a single organisation that drives the process. This should ideally be the statutory authority that has the responsibility to set the applicable accounting standards. Whatever organisation fills the role; all participants need to agree that this body is the team leader.

We have observed situations in which the leadership role is unclear. In some, no obvious leader exists. In others, several groups think that they are leading the process but none has the wherewithal to do so. A team without a captain is rarely successful.

Step one—the policy decision continued

Recommendation 1B—build consensus

Few countries and few team leaders have the power to mandate the adoption of IFRS. In most cases, reaching a decision requires consensus. For some countries the decision is obvious. They lack the resources to develop local standards. Even if they develop local standards, they find that their financial reporting framework is not recognised in international markets.

For others, consensus is more difficult. They may have strong accountancy bodies and a professional history of standard-setting. Individual groups may resist the inevitable costs of change.

Building consensus requires a clear articulation of why a country should adopt IFRS, how the adoption process will proceed and which companies should apply them.

The "why" question and its answer are different for every country. Most focus on the importance of recognition in international markets, but the answer is often more subtle:

- some countries focus on the credibility of their capital markets. They find that adopting IFRS helps to eliminate the 'country discount' that can arise from investors' uncertainty about local accounting standards.
- some see the adoption of IFRS as a means to ease local companies' access to foreign capital markets.
- others seek to minimise the costs borne by local companies that have foreign subsidiaries in countries that have adopted IFRS.
- nonetheless, others conclude that the costs of maintaining a high-quality national standard-setting process exceeds any benefits, be it tangible or intangible.

Whatever the rationale, and it often includes several of the points raised previously, it needs to be clearly articulated. Critics will emerge as the process evolves and difficulties arise. They often ask, not unreasonably, "why are we doing this?"

The jurisdiction profiles show the wide variety of approaches to the "how" question. We turn to the specifics of an adoption plan in the next section. Here, we are speaking about the strategic decision to adopt in a single 'big bang' step or to follow a path of 'convergence' for a period before full adoption. The big-bang approach needs little description. A jurisdiction commits to adoption on a single date or, perhaps, a series of dates applied to companies of different sizes. The convergence approach is a more difficult topic.

Some jurisdictions follow a convergence approach to move towards IFRS gradually. (The jurisdiction profiles mentioned earlier document the countries that have chosen this approach.) This is a useful strategy when a country needs to build professional capacity. Converging a few local standards to IFRSs each year can allow local preparers and auditors to learn a few topics at a time rather than immersing themselves in the full set of IFRSs. A convergence approach can also allow time for necessary changes in local legal frameworks (see Recommendation 1A). Other countries have adopted convergence as a more or less permanent strategy with no stated intention to move to full adoption.

Step one—the policy decision continued

The decision about an adoption approach is a sovereign choice and we respect that each country will make that decision in its own way. That said, we have observed several problems posed by a convergence approach:

- it is expensive. A convergence programme requires almost as much time, effort and cost as the creation of free-standing local standards.
- it does not eliminate the country discount.
- it does not provide comparability from one year to the next. IFRSs are always changing, although many of the changes are small. In contrast, a country that adopts a few IFRSs each year makes it difficult for users of financial statements to compare one year to the next.

In February 2012, the IFRS Foundation Trustees published *IFRSs as the Global Standards: Setting a Strategy for the Foundation's Second Decade*. In that report they observed:

> As the body tasked with achieving a single set of improved and globally accepted high quality accounting standards, the IFRS Foundation must remain committed to the long-term goal of the global adoption of IFRSs as developed by the IASB, in their entirety and without modification. Convergence may be an appropriate short-term strategy for a particular jurisdiction and may facilitate adoption over a transitional period. Convergence, however, is not a substitute for adoption. Adoption mechanisms may differ among countries and may require an appropriate period of time to implement but, whatever the mechanism, it should enable and require relevant entities to state that their financial statements are in full compliance with IFRSs as issued by the IASB.

The "which" question is equally important. The IASB has concluded that IFRS is not equally useful to all companies. That's why it created the *IFRS for SMEs*.

We have also concluded that IFRS is appropriate for all companies that have public accountability. This includes companies listed on stock exchanges and which, as a result, have a responsibility for reporting to shareholders. It also includes banks, insurance companies, mutual organizations, and similar organizations that accept funds from the public.

Small and medium-sized companies that have no public reporting obligation (although there may be a local requirement for audited financial statements) often find that the cost of understanding and complying with IFRS exceed the benefits and thus is better served by the *IFRS for SMEs*.

Some countries have adopted IFRS for commercial companies but not for regulated banks and insurance companies. We think IFRS is equally useful for all companies with public accountability. Regulation and financial reporting are separate processes with different objectives. That said, we recognise that the decision to adopt IFRS is a sovereign decision and that each country can and should make the choice in its own way.

IFRSs as the Global Standards: Setting a Strategy for the Foundation's Second Decade:

http://go.ifrs.org/Trustees-Feb-2012

Step one—the policy decision continued

Recommendation 1C—adopt everything

We understand that business and professional organisations in many countries have a vested interest in particular accounting issues. They can, and will, push for carve-outs from IFRS.

Accounting for agriculture (IAS 41), revenue recognition (IAS 18 and IFRIC 15), foreign currency translation (IAS 21) and rate-regulated activities (ED/2013/5 *Regulatory Deferral Accounts*) are frequent topics for proposed carve-outs. So why shouldn't a jurisdiction modify IFRS to meet demands from local constituents?

Because every carve-out diminishes the credibility of the assertion that the jurisdiction has, in fact, adopted IFRS. Adopting IFRS is difficult and expensive. The reward comes from the credibility gained by local companies when they make the unreserved statement of compliance required by IAS 1 *Presentation of Financial Statements*.

Pundits often say, "If you are explaining, you are losing." The same holds true for financial reporting. A jurisdiction that needs to explain why its standards are almost IFRSs is losing much of the benefit that it set out to achieve.

There is an important exception to this recommendation. IFRS often includes options, including the option for companies to adopt a new Standard before the mandatory date.

The IASB has long acknowledged that individual jurisdictions may decide to eliminate some of those options. This is particularly true today, as some new Standards include long transition periods. A local jurisdiction may decide that local financial reporting would be better if all companies adopted a new Standard at the same time.

If a jurisdiction decides to prohibit early adoption, can it still assert that it has adopted IFRS?

Yes, it can. The assertion about compliance with IFRS is made by an individual company in an individual set of financial statements. If a jurisdiction provides a framework that allows the company to make that assertion, then the jurisdiction can be said to have adopted IFRS. The company in Jurisdiction X might be prohibited from early adoption. The company's financial statements are not different from a company in Jurisdiction Y that could have adopted early but chose not to do so.

Step one—the policy decision continued

Recommendation 1D—deal with copyright and a plan for translation now

Because IFRSs are original standards created by the IFRS Foundation through its standard-setting body, the IASB, the IFRS Foundation owns the worldwide copyright to IFRSs in all languages and therefore owns the exclusive right to reproduce, or authorise others to reproduce or translate, IFRSs. The IFRS Foundation enters into a variety of different copyright agreements, each based on the legal framework surrounding a country's adoption strategy.

The IFRS Foundation recognises the central role of providing IFRSs and supporting material in other languages. It therefore seeks the close co-operation of jurisdictions and organisations interested in producing translations of IFRSs and related material. Moreover, the translation of IFRSs is often also an important component in a country's decision to adopt IFRS.

It is in the interest of any country adopting or using IFRS or the *IFRS for SMEs* that the translated IFRSs are of a high quality. Countries adopting or permitting the use of IFRS will only be able to benefit from the comparability and transparency that the use of IFRSs provides if they are rendered accurately and completely into each language.

For more information on copyright and translation, please refer to the *IFRS Foundation Translation, Adoption & Copyright Policy*:

http://go.ifrs.org/TAC-Policy

Step two—the plan

Nothing gets done without a plan.

This is, or should be, a truism. Without a plan, the policy decision discussed in the previous section is an aspiration and has little chance of ever being anything more than that. No company would build a factory, install new software or launch a new product without a plan. The same rule applies when adopting IFRS.

In this section, we discuss some elements that are present in jurisdictions that have been successful in adopting IFRS.

Perhaps it is regrettable, but a successful plan has targets and deadlines that establish accountability. Without them, there is a natural human tendency to defer and delay.

Building in targets and deadlines, and making them public, helps to identify obstacles that must be overcome. Many countries have accomplished this by publishing a road map, complete with time tables and destinations, for the adoption of IFRS.

Recommendation 2A—form a committee

Everyone knows the popular criticisms of committees, and many are true. However, adopting a new system for financial reporting is hard work; problems will arise. Many successful jurisdictions have formed a committee that monitors the process and addresses those problems.

An ideal adoption committee should include all the parties that were involved in building the initial consensus around adoption. It should include, at a minimum:

- representatives of audit firms, because the firms see many companies and are often involved in designing a company's adoption plan. They have access to the firms' international networks and can tap the networks for experience in other jurisdictions.
- representatives of company organisations, because the companies are the ones who bear much of the costs of adoption. Company organisations can act as collecting agents for questions that the adoption committee should address.
- the local standard-setter, because the interaction of local and international standards is especially important.
- securities and prudential regulators, because they are the organisations that will enforce the application of IFRS.
- accounting academics, because they will design the curriculum for upcoming generations of students and the training for today's accountants.
- users of financial statements, because they know what they consider to be important in the financial statements of local companies.

Step two—the plan continued

We are not suggesting that each jurisdiction form a local version of the IFRS Interpretations Committee (more on that committee later).

The value of IFRS comes from the fact that it is a *single set* of Standards rather than 100 different versions. If every country interprets it in its own way, then it is inevitable that two jurisdictions will arrive at opposite answers to the same question. Instead, we see an adoption committee playing several roles:

- it can be a collection centre for identifying problems;
- it can be a distribution centre for sharing experiences, both local and international; and
- it can be an analysis centre for articulating problems and the characteristics of local law and business practice. That analysis is the first step in engaging people at the IASB and others about problems encountered in the country's adoption.

Specialists in many fields are familiar with the term 'feedback loop'. The Oxford English Dictionary defines feedback as "information about reactions to a product, a person's performance of a task, etc, which is used as a basis for improvement". The monitoring process creates the loop and allows those in charge of the adoption plan to adapt and react.

We have found that all successful adoption programmes include a mechanism to collect feedback and adapt their plan for adoption. Indeed, this is one of the key roles of the adoption committee.

No matter how careful the plan, unexpected events always occur. Perhaps planners did not anticipate the effects of an IFRS requirement on local companies. Perhaps a particular industry was omitted from the planning process.

Monitoring progress creates a means to identify surprises and respond to them quickly.

Step two—the plan continued

Recommendation 2B—identify issues in local legislation

The legal framework in most jurisdictions requires implementing legislation or regulation before a country can adopt IFRS.

The jurisdiction profiles show a wide variety of implementing plans, ranging from incorporation by reference, so that each new Standard is automatically part of the local law and regulation, to endorsement processes that require specific actions by local officials. The policy document mentioned in Recommendation 1d provides a description of different approaches.

One of the important obstacles to IFRS adoption often rests outside of the financial reporting community and implementing legislation. We have seen many countries in which the most difficult and time-consuming task is obtaining necessary changes in local company laws.

For example, in one country there are over 100 laws that refer to financial reporting and local standards. The country's legislative framework does not allow a single omnibus amendment to those laws. In another country, only a single change was required. That change took several years to accomplish.

We at the IASB are not experts in the law, in general, or local laws, in particular. We can share the experiences of other countries, but dealing with local legal issues is a local problem. Here we return to the importance of consensus. Legislators and makers of national policy rarely have expertise in accounting and financial reporting. They appropriately rely on the advice of those who are, and a consensus view can be persuasive.

Step two—the plan continued

Recommendation 2C—plan for IFRS 1

IFRS 1 *First-time Adoption of International Financial Reporting Standards* is the gateway Standard through which every jurisdiction must pass before its companies can make an unqualified statement of compliance with IFRS. This is true even if a country's local standards are identical to IFRSs. IFRS 1 provides a mechanism to reboot the financial reporting system and a set of disclosures that explain the results of the change from local standards to IFRSs.

Many question why companies in a jurisdiction should have the burden of applying IFRS 1. If the local standards are identical to IFRSs, what's the point?

Firstly, we have found few situations in which local standards are, in fact, identical. More often, the description "identical except for" is more apt. One major difference can be found in transition provisions. Amounts reported in financial statements are path dependant.

Put more simply, history matters. If local standards have different effective dates or transition, the amounts reported under them may be different from those that would result from following IFRS, even though the text of the standards is otherwise identical to IFRSs. IFRS 1 provides a means for dealing with differences in transition.

Secondly, IFRS 1 is designed to make the change to IFRS easier, not harder. It eliminates or reduces difficult measurement issues that companies would encounter in its absence.

Thirdly, the IASB has shown that it is willing to consider amending IFRS 1 to meet local needs. We encourage adopting jurisdictions to share issues with us early on in the process so that we can respond as necessary.

Step three—the resources

Identify what you have and what you need.

If you haven't recognised it by what we've said so far, adopting IFRS is a resource-intensive exercise. Many of those resources are highly specialised and technical. This can be especially challenging in developing economies.

Recommendation 3A—identify local professional resources

Officials in many local jurisdictions are concerned that they lack the resources to adopt IFRS. Trained actuaries (pensions and insurance) and valuation specialists (financial instruments, investment properties, agriculture, and business combinations) are often in short supply. The pool of available specialists may be very shallow.

The problem may not, however, be as acute as it once was. As IFRS has gained worldwide acceptance, the number of local professionals who know and understand the Standards has grown as well.

This is true even in countries that have not adopted IFRS, because local companies may have prepared IASB-compliant financial statements for use in security offerings elsewhere. So, knowing what you have is the first step towards understanding what you need.

Step three—the resources continued

Recommendation 3B—build capacity

Capacity building is an issue for any country that aims to participate in a global economy. Unfortunately, it is a problem for which the IASB has a limited ability to help.

The IASB has some resources that many countries have found helpful, but capacity building is an effort that demands continuous support. We will discuss that in Recommendation 3C.

Fortunately, there are other organisations that are active and can help. Those include:

- the World Bank and International Monetary Fund;
- the United Nations Conference on Trade and Development;
- local and regional development banks;
- the Asian-Oceanian Standard-Setters Group; and
- professional and standard-setting bodies in valuation and actuarial practice.

The capacity needed to adopt IFRS is not limited to financial statement preparers and auditors. Securities and prudential regulators too are part of the picture.

Confidence in a country's financial reporting system rests firstly on the standards that govern reporting—IFRSs—and secondly on the perceived quality of regulation and enforcement. We at the IASB are not in the business of regulation and enforcement, but we are in regular contact with those who are and we are always willing to support their efforts.

Step three—the resources continued

Recommendation 3C—reach out to the IASB

The IASB's resources are limited, but it has several departments that are there to assist you. Those include:

The IASB Education Initiative

The Education Initiative's primary objective is reinforcing the IFRS Foundation's goal of promoting the adoption and consistent application of IFRS. Consequently, a significant part of this effort is directed to countries that are in the process of adopting or that have recently adopted IFRS. The Education Initiative's work includes conferences and 'train the trainers' workshops sponsored by a variety of organisations, including the World Bank's Centre for Financial Reporting Reform and regional development banks.

Local technical workshops

We have been very successful in some jurisdictions with local workshops that consider issues raised by practitioners. The goal is not to provide authoritative answers to questions but to explore the differing views and to consider how to move an issue forward. In some cases, a consensus emerges from the discussion and no more needs to be done. In other cases, a local issue moves to the IFRS Interpretations Committee for discussion.

This activity is not cost free for either the local jurisdiction or the IASB. The local jurisdiction (usually the standard-setter) needs to organise the meeting and ask its constituents to prepare papers that can form the basis for discussion. That is not an insignificant effort. The IASB in turn incurs travel costs and the time spent researching in advance of the meeting.

Technical inquiries

The IASB does not operate a formal technical inquiry service. However, it has a long-established policy of responding to questions from local standard-setters, securities regulators, and bank and insurance regulators. Staff responses are not official positions of the IASB, but they can help local officials who are trying to resolve questions.

Step three—the resources continued

The IFRS Interpretations Committee

The IFRS Interpretations Committee (the 'Interpretations Committee') is the interpretative body of the IASB. It comprises 14 voting members appointed by the Trustees and drawn from a variety of countries and professional backgrounds.

The mandate of the Interpretations Committee is to review, on a timely basis, widespread accounting issues that have arisen within the context of current IFRS and to provide authoritative guidance on those issues.

During the past two years, the Interpretations Committee has considered a number of issues raised by countries that are in the process of adopting IFRS and those that have recently adopted. We expect that the number of such issues will continue to be a significant part of the Interpretations Committee's work.

Summary

In this document we have cast the adoption of IFRS in three steps—the decision, the plan and the resources.

We have not tried to provide a comprehensive discussion because, as said earlier, each jurisdiction's adoption poses its own challenges.

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