

Helping companies deliver fast and accurate financial statements in the face of changing international standards

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1 IFRS as the global platform for financial reporting

Companies in more than 100 countries now issue their financial information in line with the International Financial Reporting Standards (IFRS). The IFRS have rapidly gained popularity in the 27 EU member states and other major capital markets around the world, apart from in the US, where the Generally Accepted Accounting Principles (GAAP) hold sway. But the growing impact of the IFRS as a global platform for financial reporting was confirmed in November 2007, when the US Securities and Exchange Commission (SEC) removed the requirement for foreign listed companies to reconcile to US GAAP when using IFRS, as issued by International Accounting Standards Board (IASB).

1.1 Living with changing standards

The rapid convergence of IFRS and US GAAP has led to a lot of amendments to the existing standards. This has created added challenges for everybody reporting under IFRS, because these amendments impact on financial consolidation, data collection and the presentation of financial statements. But just as harmonization should be delivering greater transparency, companies' annual statements are getting heavier and more complex to understand, making it more and more difficult for investors and analysts to find the key information they need to understand a company's business performance.

Those preparing financial statements have been living with continuous change and moving targets for years, even though the IASB announced a "period of calm" following complaints from EU-listed companies (especially in the UK) after major IFRS changes in 2005. But that bedding in period is now ending and the next wave of amendments to the IFRS will take effect in January 2009. For most of these standards the comparables need to be restated and all the changes should be implemented by the end of this year.

1.2 Changes to IT will be revolutionary

The bodies setting the IFRS do not regard the upcoming changes as fundamental. The aim is simply to promote convergence with US GAAP and reduce the number of different accounting options. Even so, the changes will be revolutionary for the people preparing reports and the IT systems they use. All the changes will have to be applied to existing financial consolidation systems and chart of accounts. Even the primary financial statement reports will have to be modified, because of revisions to the financial presentation standard (IAS 1).

As financial statements become more complex, so the processes and systems for ensuring that they are full and accurate become more important. The biggest fear among preparers relates to the risk of submitting inaccurate financial statements or publishing something that does not fully comply with IFRS.

1.3 Removing the IFRS compliance bottleneck from IPOs

In fast-growing markets like Russia, many companies are currently seeking Initial Public Offerings (IPOs) on a foreign market. It is common for companies to underestimate the challenges that this presents in terms of financial reporting. For instance, making the transition to IFRS will require three years of restated comparables. All the existing financial control systems and procedures must be critically evaluated to ensure the high quality and reliability of financial information. Any flaws in such systems or a lack of financial transparency can present a serious bottleneck in a company's IPO plan.

2 Fast close goes hand-in-hand with IFRS compliance

Not only do companies need to provide more information, they also have to report more quickly, which is known as achieving a fast close. On the positive side, more transparency and faster reporting give companies a better corporate image than their peers. Timely, detailed, accurate information comforts investors and analysts and ultimately has a positive effect on a company's stock price.

Let's take a look at the financial consolidation process, especially from the perspective of financial consolidation systems and the ways in which companies can use increased automation and standardization to improve their closing cycles.

The main phases of financial consolidation typically comprise:

1. data collection from general ledgers
2. adjustments to subsidiaries' accounting principles (for example, from Russian Accounting Principles (RAP) to IFRS)
3. intercompany matching and eliminations
4. other group eliminations (equity eliminations, minority interest calculations and so on)
5. reporting.

2.1 Data collection and standard processes are critical

The first step in financial consolidation is to collect data from different subsidiaries all over the world using a single group chart of accounts. The benefit of using a dedicated financial consolidation system is the ease with which it combines data from different general ledger systems, such as SAP, Oracle, Scala and 1C. Financial data can be loaded automatically from different general ledgers to the financial consolidation system using mapping tables. In a mapping table each of the reporting entity's general ledger accounts is connected to the appropriate group account and all the data is summarized and categorized according to the group accounting principles. Analytical dimensions of the general ledger system are needed to identify intercompany transactions and other allocations. Automated data input improves data quality, reduces the amount of collection errors and speeds up the consolidation process.

Primary data collection is usually done according to primary GAAP in the functional currency of the reporting entity. Any currency conversions should be automated in the financial consolidation system when reporting data in the group presentation currency. It is important to have a clear audit trail to the original currency amounts, especially when reporting the effects of currency differences in various disclosure reports and in the changes of equity reports, as well as for the cash-flow statement.

It is important that the group chart of accounts includes all the necessary accounts related to the presentation of IFRS financial statements, including the disclosures. Data collection should be harmonized across reporting cycles in order to achieve a faster close and better quality of data. If the same information is required each month, this approach usually avoids discrepancies and speeds things up, because the increased volumes of data typically force subsidiaries to automate and standardize their own systems.

2.2 Managing multiple accounting practices

Primary data collection should reconcile with the total figures in general ledgers. All the additional adjustments needed to convert the entity's data into that needed for group accounting (for example, from RAP to IFRS) should be well documented and fed into the same financial consolidation systems. It should be possible for each reporting entity to input different IFRS adjustments in addition to the primary GAAP financials.

From the auditing and internal control point of view it is important that the original data from the general ledger is easily traceable and that the additional IFRS adjustments can be followed up separately. Data entry and the validation of manual IFRS adjustments are key to the success of the whole consolidation process. Reporting entities should not be able to report technically non-reconciling information to the system. This can be prevented by adding check accounts and other controls to the data input sheets. For example, from a group perspective it might be worth locking the opening amounts of the balance sheet reconciliations at the same levels that were used as closing balances for the previous accounting period. This prevents entities reporting non-reconciling balances in the first place.

2.3 Intercompany matching and reconciliation

From our experience two thirds of companies could speed up their closing process considerably by improving the intercompany process. First, the intercompany information must be available in the general ledgers with separate accounts and/or analytical dimensions. The responsibility for matching intercompany items should be pushed-down to the individual entities, where the information related to missing invoices is more easily traced and solved. Matching should also take place earlier in the reporting period. Automation can speed up this critical and time consuming part of the matching process. From the consolidation point of view, there should be automatic features for reconciling the minor differences between specified accounts (for example, currency differences). Systems can easily support the elimination of intercompany margins related to inventories and non-current assets, and ensure the continuity of equity from one period to another.

2.4 Automating group eliminations with ready-made templates

It is important to handle business combinations properly in accordance with IFRS 3. The more sophisticated financial consolidation systems can carry out equity eliminations, fair value allocations and minority interest calculations automatically. IFRS 3 requires entities to allocate the purchase price to the identifiable assets and liabilities of the acquired entity. New, intangible assets are often recognized at the group level and only the minor part of the acquisition cost should remain as goodwill. All group-level allocations of fair value differences and goodwill should be valued in the functional currency of the acquired entity. Automated functions should include built-in intelligence for defining calculation rules for related depreciations, impairments and deferred taxes. These types of elimination templates should be ready-made in the system so that the company doesn't have to waste time reinventing the related logics all over again.

2.5 Do not underestimate the IFRS reporting requirements

Once the reconciliations are made, the final stage is to prepare the financial reports and disclosures for publication.

Presentation is important, because it brings together all the information in the financial statements so that investors, creditors and other stakeholders can analyze the company's performance. So it is important not to underestimate the challenges related to the closing stages of financial consolidation and presentation. They are not minor issues.

Many European companies were surprised by the volume of disclosures required by the IFRS transitions in 2005. Most companies focused first on the changes in accounting principles, only to find later that they had to deal with a huge amount of disclosure.

2.6 Build in a financial presentation model

The best way to cope with the ever increasing number of disclosures and the late changes and iterations that inevitably crop up in the closing process is to have a financial presentation model built into the consolidation solution, together with a central database. This enables all the tables in the financial statements to be linked together, so if there is a change to one figure, the system automatically makes all the related changes to other parts of the financial statements. The effects of changes should be easily traceable and checked in all critical sections. A ready-made IFRS financial presentation model helps users to ensure that time does not run out in the final stages of the analysis and that all the information is double-checked and accurate.

It is very important to have all the final presentation formats ready before starting the actual consolidation process, and it is preferable for the top management and auditors to approve them up front. This makes it easier to guarantee the quality of the financial information and reduce unnecessary iterations and time-consuming reconciliations. As a result, there should be no unpleasant surprises at the very late stages of financial consolidation.

The financial presentation model should be easy to maintain within the consolidation system. If new accounts are needed in the group chart of accounts, the resulting changes to corresponding reports should be managed automatically, without having to change all the existing reports manually. Sophisticated financial consolidation systems have advanced functionalities that will manage these types of change.

3 Revised IAS 1 in practice

Let's look at the practical implications of the revised financial reporting standard, IAS 1 (Financial presentation). First, there will be new non-mandatory titles for the primary financial statements:

1. Statement of financial position (balance sheet).
2. Statement of comprehensive income (income statement and non owner-related changes from the changes of equity report).
3. Statement of changes in equity (including only owner-related changes in equity and the effects of IAS 8 restatements).
4. Statement of cash flows.

Non owner-related changes (for example fair valuation gains on available-for-sale financial instruments or cash-flow hedges) can no longer be presented in the statement of changes in equity. Entities are required to present a third statement of financial position for the opening balance of the comparables, where restatements have occurred and also when applying IFRS for the first time in accordance with IFRS 1 (First time adaptation of IFRS). They must also disclose "reclassification adjustments" and the income tax related to each component of other comprehensive income.

3.1 Challenges with other comprehensive income

The biggest change in practice relates to the incomplete presentation of income. First, an entity must decide for each different reserve of equity whether the changes should be reported as other comprehensive income or in the changes in equity report. Those items that are presented in the IASB example are easy, but the example is not complete and the guidance is not clear enough regarding all the possible items currently included in the equity. For example, should the tax effects related to the restatements (IAS 8) be reported only in the statement of changes in equity or in the other comprehensive income (OCI)? What about the transfers between equity reserves and so on? The upcoming IAS 27 revision will require entities to report changes in the interests of their subsidiaries (when control is not lost) on the face of changes in equity report. They must also add these items to the changes of equity report.

There may be added technical challenges related to the presentation of minority interests. All the items in the OCI are to be presented as gross amounts, excluding minority interests. But the total comprehensive income should be allocated to the equity holders of the parent, as well as minority interests, in the same way as it is currently allocated for the profit and loss. If the current reconciliation of minority interests in the changes in equity report has been challenging, the new presentation format will probably bring more technical challenges.

The chart of accounts for all the equity accounts must be on a detailed enough level in order to facilitate the following:

- 1) The reporting of unrealized gains and losses.
- 2) Reclassification adjustments of the same items to profit and loss.
- 3) The tax effects of each category of other comprehensive income.

The preparer will also have to consider the currency translation methods of these items. It seems logical that all items on the statement of comprehensive income should be converted using the same method and the same weighted average rates that are currently used for the income statement in the group consolidation systems. The situation might be challenging if the same items have previously been translated using the balance sheet closing rates, which has been common practice in many companies.

In the basis of the conclusions in the revised standard, a lot of effort is put into explaining whether an entity should be allowed to present the statement of comprehensive income with a single statement or

with two separate statements. However, other aspects are more important in practice, such as how to handle minority interests, currency conversions or adding new accounts for the tax effects in each category of OCI in the chart of accounts.

Bear in mind that the revised IAS 1 is just the first, “easy” part of the financial presentation project. A more revolutionary standard will follow and this will have a lot of practical implications.

In financial presentations, it is also important to follow up the development of XBRL (eXtensible Business Reporting Language). In the XBRL the company needs to produce only one set of financial information in XBRL format that the users can view according to their individual requirements. When the company reports using XBRL, the tag associated with each piece of information is looked up in the IFRS taxonomy, which is continuously maintained by the IASC Foundation.

4 Implementation of IFRS 8 operating segments

4.1 The management approach for segment reporting

IFRS 8 will replace the old standard of segment reporting (IAS 14) starting from financial periods commencing on 1 January 2009. The new standard is more clearly based on the management approach and the company's internal reporting to the entity's chief operating decision maker. The new standard will enable investors to assess the company's business performance from the same perspective used by the management in making decisions about operating matters.

4.2 IASB predicts cost savings with IFRS 8

The IASB takes the view that the new standard will reduce the costs of providing disaggregated information for many enterprises. No additional work needs to be done solely for external reporting purposes. The board also believes that most of the new enterprise-wide disclosures about products and services, such as revenues from external customers, non-current assets or major customers, are usually provided already in current financial reporting, or can be prepared with minimal incremental costs. Since the information should already be available for internal management reporting, it will be possible to provide more segment information for the interim reports under IAS 34 (Interim Financial Reporting).

4.3 IFRS 8 requires information for individual foreign countries

From our point of view, even if the IFRS 8 does not require the disclosure of two sets of segments, business and geographical, these additional disclosure requirements are in many cases more demanding. Under IAS 14, for example, if the company has chosen geographical segments as secondary segments, it has previously been possible to define the segments much more broadly and report external revenues and assets aggregated to much bigger groups of countries. The new requirement for publishing data for individual foreign countries is therefore more demanding.

4.4 Reporting sales by major customers is a system issue

In practice, reporting the company's reliance on its major customers and the total revenue from major customers is a system issue. This new requirement is easily accomplished if the company has integrated ERPs in each of its subsidiaries or an entity-wide data warehouse. However, many companies are still operating with multiple ledgers and separate debtor systems and in those cases this kind of information has to be collected manually for the financial consolidation by adding new accounts for the consolidation group chart of accounts.

4.5 Does IFRS 8 support uniform accounting principles and integrated solutions?

The good thing about the old IAS 14 was that it required IFRS measures to be used for segment reporting and therefore encouraged companies to have uniform IFRS-based accounting principles for external and internal management reporting. In many cases companies were encouraged to streamline their reporting processes and integrate their external and management reporting in a single financial consolidation solution including the segment point of view.

The worrying thing about IFRS 8 is that it does not require companies to use the same accounting policies in the segment disclosures as in the amounts recognized in the IFRS financial statements. The amounts disclosed for each segment should be those measures reported to the chief operating decision maker. If the segments are not measured in accordance with IFRS, the reconciliations of revenues, profits, assets and liabilities have to be listed on the consolidated financial statements as mandatory disclosures. The trouble is that this could encourage companies to have two different reporting systems, complete with their own rules, for management information and for IFRS-based financial consolidation. In many cases this would be a major setback in the path to fast close, because it generates a lot of extra work by running two systems in parallel. It might also confuse the management with two sets of figures and endless reconciliations between them.

In Europe the easiest route to saving time and money has always been to integrate management and external reporting and get rid of additional complexities. We are worried that the new standard will increase costs in the long run, if the two points of view are no longer integrated in a single financial consolidation system.

4.6 Need for more segments and transparency

The IASB believes that the primary benefits of the IFRS 8 are that enterprises will report more items of information about each segment and that at least some enterprises will report a greater number of segments. We agree that the number of reported segments is very likely to rise. For example, according to the latest survey of Finnish listed companies' 2006 IFRS financial statements (11 December 2007), nearly a third of all listed companies reported only one primary segment. This finding supports the view that many companies have not adopted an open approach to segment reporting and some companies need to enhance their segment reporting to achieve higher transparency when implementing IFRS 8.

4.7 Adding more segments means restatements

Adding more segments is always a big issue for systems, because the comparables must be restated (unless immaterial) and data conversions are therefore needed. Identifying more segments may also mean splitting up the balance sheets of legal entities and restating the comparables. This can, of course, be risky for internal controls. Adding new segments will typically increase the number of intercompany transactions and the process of matching and eliminating of these items should be automated and organized properly. Intercompany revenue between segments must be disclosed (IFRS8.23b).

The allocation rules for reportable segments should also be confirmed. Some items are allocated to segments on the income statement but not on the balance sheet. For example, a company may allocate depreciation but not the depreciable assets to one segment. The nature and effect of these asymmetrical allocations should be disclosed. To maintain balance sheet continuity and data consistency, we recommend that companies should try and stick to the symmetrical allocation principle. So if something is reported in the income statement, the corresponding assets and liabilities are also allocated to that segment.

The management approach means that companies are more likely to change their operating segments or segment accounting principles from one year to another, and more restatements and data conversion will be needed in future. This in turn means that more flexibility is required from IT systems, with improved internal controls to keep track of these restatements.

5 Basware implementation

The Basware IFRS Consolidation system combines a powerful group consolidation engine with ready-made IFRS content and a reporting toolkit. Automating the reporting process saves time and frees up valuable accounting resources. Ready-made content also guarantees fast implementation.

The Basware IFRS Consolidation system supports fast and efficient preparation of full IFRS financial statements, including disclosures, changes in equity, and key figures. It is flexible and easy to use. The system allows using several different accounting principles simultaneously, while multi-currency features allow data to be entered and reported in several different currencies. The common database ensures that the reports are always based on the latest data.

Basware's ready-made IFRS content facilitates the management of IFRS conversion and actual group reporting. The IFRS reporting toolkit offers many standardized templates that allow selecting the reporting method best suited for the organization. The ready-made IFRS content is constantly updated and fully complies with the latest IFRS requirements.

5.1 Ready-made IFRS content and a powerful reporting toolkit

The Basware IFRS Consolidation system contains IFRS group charts of accounts, input sheets for entering adjustments, and reports that conform to the official IFRS presentation model. The Basware IFRS content embeds the latest IFRS standards and the special reporting demands of different types of businesses.

Even though the Basware IFRS Consolidation system contains standardized IFRS content, it is possible to customize the input sheets and reports. It is possible to modify the default layout, change fonts and colors, and customize the existing calculation formulas.

Conclusions**6 Conclusions**

Anyone preparing financial statements has had to cope with more or less continuous changes in international accounting standards in recent years. The next wave of amendments to the IFRS will take effect in January 2009. At the same time the management of changes in data systems has become more crucial. Companies are being required to make more disclosures, while the time available for preparing financial statements is shrinking rapidly to meet the demand for fast close.

In our opinion, only a combination of professional modeling of IFRS financials and a financial consolidation solution can lead to success and high quality in financial statements. The days of complex, non-controllable spreadsheet solutions in IFRS consolidation are numbered.