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Transition – It's a reputational risk, not just a number

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Moving to the new standards is a process across several phases

Some companies have gone public with 'transition numbers', which quantify the expected impact of IFRSs 9 and 15. The numbers will provide insight into how the new standards are likely to affect future trends in revenue, margins and KPIs.

That's why analysts and investors are going to be paying close attention to this year's – i.e. 2017 – accounts, where the impact of the new standards will be disclosed.

If you're an audit committee member or management, you have a key role to play in getting the transition right.

The transition journey

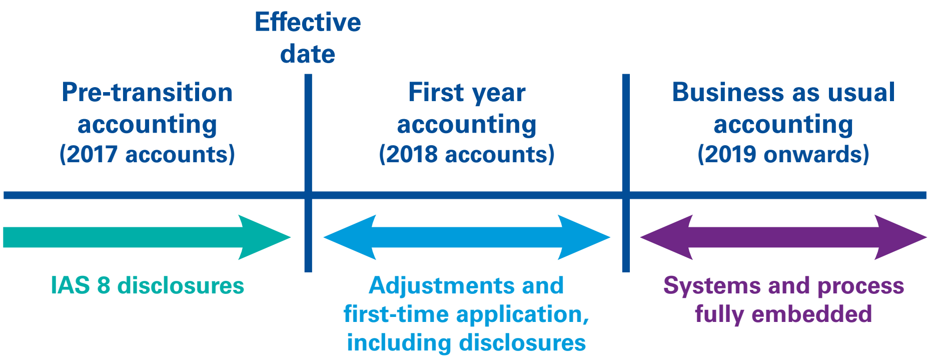
Transition is a journey full of moving parts. It happens in three main phases. First, you have to make your pre-implementation disclosures in your 2017 accounts, which involves reaching an estimate of the impact of the new standards.

The second phase is your first year accounting under the standards, in which you need to embed the accounting processes fully into your systems and come up with the detailed assessments that will be needed for your 2018 accounts.

Finally – assuming all has gone to plan (which can't be taken for granted!) – you'll start your 'business as usual' accounting from 2019 onwards.

The transition journey

Think about transition as three phases



Ideally, changes to systems and processes will be made before transition, but some companies will be using workarounds – e.g. spreadsheets – right into the BAU phase

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Different speeds

The reality is that different companies will be at different places at any one time and have very different journeys. Some will have the requisite systems in place early and will give specific numbers in their disclosures in the 2017 accounts. Others will not be quite there and will give high-level estimates or a range.

IAS 8 disclosures and the regulators

However, regulators are applying pressure for companies to provide good estimates with meaningful disclosures in the 2017 notes, so that investors have sufficient detail to make proper assessments of the impacts.

Unforgiving investors

Analysts and investors will focus keenly on the adjustment numbers. It's what everyone will want to know. What impact will IFRS 9 have on impairment provisions? How much in costs will need to be capitalised on the balance sheet due to IFRS 15?

These numbers will need to be solid. If you give an estimate of, say, 100m in extra provisions under IFRS 9 but then a year later in the 2018 accounts refine your estimate to 105m as a result of the deeper analysis you have undertaken during the year – that shouldn't be a significant issue.

But if it has doubled to 200m – that would be highly embarrassing and would create a negative market reaction.

Nobody likes uncertainty

If there's one thing investors react negatively to, it's uncertainty. So they will want to see clear estimates in the 2017 disclosures. No estimate or only a very broad and imprecise range won't impress them.

If you haven't got decent estimates, investors will ask why not? Is there something else going on that we should know that has been distracting management and the audit committee? Is the finance department understaffed or do they just have poor systems and governance?

And then, of course, if the numbers turn out to have been very wide of the mark a year later – investor reaction will probably be even worse.

Audit committee responsibility

If you're on the audit committee, you have a key role to play in terms of your oversight role to evaluate the finance function and management progress, and assess the robustness of the estimates and the controls around them.

Also remember that the auditors will need to review the IAS 8 disclosures and how they have been compiled. Although they are not part of the 2017 primary statements themselves, the disclosures and estimates will be subject to audit. So you will need to ensure that you build in sufficient time for that.

Reputation, reputation, reputation

Make sure you are asking the right questions – you have to get the transition journey right, because otherwise it becomes about more than technical accounting: it becomes a question of corporate reputation and the way you are perceived in the market.

About the authors

Peter Carlson and Martijn Huiskers are jointly responsible for the global accounting change project.

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