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IFRS: International methods on convergent path

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As globalization in the business and financial sectors continues apace, more U.S. companies will be facing the challenge of dealing with accounting rules and reporting requirements spelled out in the form of the International Financial Reporting Standards (IFRS, commonly pronounced "eye-fers").

For the moment, domestic companies are not facing an urgent deadline to switch from Generally Accepted Accounting Principles (GAAP) to IFRS, which is rendered by the 15-member, London-based International Accounting Standards Board (IASB), unless they are planning on expanding operations abroad.

Regardless, some financial advisory firms are encouraging clients to consider adopting IFRS in anticipation of an official announcement. That day might come as soon as June, which is when the Securities and Exchange Commission is scheduled to provide an update on its stance regarding the adoption of IFRS.

In December 2010, SEC Chairman **Mary Schapiro** told attendees at the American Institute of Certified Public Accountants (AICPA) National Conference on Current SEC and PCAOB Developments that the SEC will give public companies a minimum of four years to facilitate the transition. Subsequent reports have quoted Schapiro as saying that the agency is "not committed to a June 2011 decision date."

At the very least, the business community can breathe a little easier now that the 2014 deadline, which was originally included in the proposed "road map to IFRS" issued by the SEC in 2008, no longer looms so close at hand. Meanwhile, though, the Financial Accounting Standards Board (FASB) in the U.S. and the IASB are sticking to an aggressive schedule designed to accelerate the convergence of U.S. GAAP and IFRS standards.

According to **Davin W. Williams**, CPA and senior manager of audit services at Grant Thornton LLP, one of the primary focus areas for U.S.-based companies studying the impact of IFRS is the initial adoption elections made by their foreign subsidiaries.

"Under certain circumstances, the decisions made upon adoption of IFRS by the subsidiary can limit the parent company's ability to make future changes to those policies," Williams said.

The secondary concern is the time and expense that will be required by U.S. companies to adopt IFRS when the SEC ultimately signs off on an implementation schedule.

"Some companies have been more proactive than others in examining IFRS and have even considered creating hypothetical financial statements in order to compare them to U.S. GAAP," said **Andrew Owen** of Schwartz International, an Atlanta-based company that specializes in offering tax advice, tax consultancy and tax compliance services.

"Our tailored client advice in large part depends on the posture of each client, many of which prefer delaying serious IFRS consideration until absolutely necessary, whether that means a mandate from a foreign shareholder or a formal switch in the U.S. rules," Owen said.

In general, most of the griping about U.S. GAAP centers on the preponderance of "rules-based" guidelines. Basic principles end up serving as a foundation upon which minutely detailed thematic variations are constructed, which in turn become unwieldy and complex to the point where unscrupulous (and even scrupulous) businesses can easily structure transactions in such a way as to circumvent, to one degree or another, almost any reporting requirement.

"The quest for 'bright line' accounting rules has shifted the goal of professional judgment from consideration of the best accounting treatment to concern for parsing the letter of the rule," Owen said.

One of the notable differences between GAAP and IFRS involves companies that use the LIFO (last in, first out) method for accounting, which is prohibited under IFRS. Some companies, especially those with large historical inventories, use LIFO because it offers a cash flow advantage (resulting from decreased tax payments) when inventory costs rise. However, a company that adopts LIFO for inventory valuation is required by law to use LIFO for financial reporting purposes.

"If a manufacturing company has steel on its books at 1930s prices, because that's when it was purchased, they are going to see a significant tax advantage," said **Rob Casey**, a partner at Habif, Arogeti & Wynne LLP.

Under IFRS, that same company would be required to switch to FIFO (first in, first out), which assumes that the cost of items sold in a period be reflective of the oldest cost in inventory just prior to the sale.

"Unless the IRS changes their rules for reporting, that company is going to be looking at a significant tax impact," Casey said.

After describing numerous scenarios that illustrate the differences between GAAP and IFRS, which range from fair valuation guidelines to accounting standards for leases, Casey reiterated the point that, despite the presence of significant gaps, the two accounting tracks were on a convergent path.

“In recent years, both sides have been checking with the other before issuing new guidelines, mostly to minimize the impact when the U.S. converts to IFRS,” he said.

Like it or not, IFRS is coming, sooner or later, to an accounting department near you.

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