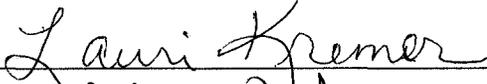
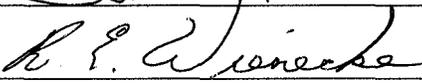
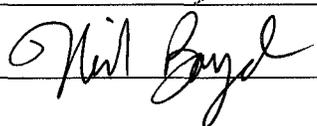


International Accounting Standards:  
An Analysis of the Effects on U.S. Companies and Industries

Presented to the faculty of Lycoming College in partial fulfillment  
of the requirements for Departmental Honors in  
Accounting

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April 30, 2010

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## *I. Introduction*

Financial reporting in the United States has traditionally been governed by the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC). The purpose of the FASB is “to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information (“Facts about FASB,” 2009).” Similarly, the SEC has sought to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation (“The investor’s advocate,” 2009).” Together, these two forces create the set of standards used in the accounting profession in the United States, known as Generally Accepted Accounting Principles (GAAP). Now, one of the key issues facing financial reporting is the adoption of International Financial Reporting Standards (IFRS). Issued by the International Accounting Standards Board (IASB), these standards were created “to develop, in the public interest, a single set of high quality, understandable and international financial reporting standards (IFRSs) for general purpose financial statements (IASB, 2009).” More than 100 countries currently require or allow IFRS as the reporting standard (“An AICPA backgrounder,” 2008, p. 2). Therefore, pressure has increased for the U.S. to either align current standards with IFRS (convergence), or fully adopt IFRS (conversion) (“Five ways,” 2008, p. 2).

## *II. Environment of the Convergence*

The idea of convergence developed as early as 1988 with encouragement from the SEC (“An AICPA backgrounder,” 2008, p. 3). In 2001, the IASB was officially established (“An AICPA backgrounder,” 2008, p. 10). The commitment to follow through with convergence was solidified with the Norwalk Agreement of 2002 between the IASB and FASB, in which both standard setters agreed that convergence was essential for global economic well-being (Ernest &

Young, 2009, p. 5). The European Union required public companies to report their financial statements using IFRS in 2005. Canada, Japan, and Mexico have all announced their planned convergence. Canada and Mexico plan on requiring the use of IFRS by 2011, and Mexico, by 2012. Currently in the U.S., the SEC allows foreign private issuers to prepare financial statements in accordance with IFRS without reconciling to GAAP. Public companies may be required to report in accordance with IFRS in 2014 (“An AICPA backgrounder,” 2008, p. 2-3).

The pressure to adopt these standards has been driven by several factors. Globalization of businesses has been the primary force, demanding consistency in financial reporting standards. If adoption does not occur in a timely manner, the U.S. could be at a disadvantage concerning non-domestic investment. Furthermore, multinational companies such as McDonald’s already conduct more than half of their business outside of the U.S. Another key factor is the increased costs of using GAAP. Standards and interpretations issued by the FASB have become so detailed and complex that costs of compliance have increased as well as the risk of mistakes. GAAP documentation now covers over 25,000 pages of material while IFRS only covers about 2,500 pages. Thus, the adoption of IFRS may stimulate a “fresh start” for U.S. companies (Levine, 2008, p. 10).

### *III. Differences between U.S. GAAP and IFRS*

#### *a. Preexisting Similarities*

While adoption may be necessary, there are several obstacles that stand in the way of the process. Therefore, it is necessary to understand the key differences between GAAP and IFRS. There are some preexisting similarities between GAAP and IFRS. For instance, under both systems a balance sheet, statement of income, statement of cash flows, and notes and disclosures to financial statements are required for financial reporting. Also, the accrual method of

accounting is required for financial reporting with the exception of the statement of cash flows. Both systems also tend to agree on the concepts of materiality and consistency (Ernest & Young, 2009, p. 7).

*b. Nature of the Standards*

Nonetheless, there are several key differences between IFRS and GAAP. The natures of the standards differ in that IFRS is considered more “principles-based” while GAAP is considered “rules-based.” IFRS has limited guidance for application while GAAP has many publications dedicated to specific guidance on application. The IASB has chosen to limit the interpretation of the standards, leaving it to auditors, preparers, and the International Financial Reporting Interpretations Committee (IFRIC) (“IFRSs and U.S. GAAP,” 2008, p. 6). The matrix of the organization of the standards also differ in that operating segments are identified based on the principle of the standard in accordance with IFRS, while segments are identified based on products and services in accordance with GAAP (“IFRSs and U.S. GAAP,” 2008, p. 12).

*c. Classification*

There are also many differences in classification of financial statement items. Group transactions of awards for employees given by a subsidiary that are settled by the parent company are classified as a liability under IFRS. However, under GAAP, they are classified as equity. The classification of interest received and paid in the statement of cash flows may be classified as either operating or investing activities in accordance with IFRS, but must be classified as operating activities in accordance with GAAP (“IFRSs and U.S. GAAP,” 2008, p. 14). Also, under IFRS, non-derivative debt instruments may be classified as held-to-maturity securities as long as they are quoted in the active market. Otherwise, such an instrument is classified as a loan or a receivable. On the other hand, under GAAP, held-to-maturity securities

must meet the definition of a debt security. Also, these securities do not have to be quoted in the active market to have this designation (“IFRSs and U.S. GAAP,” 2008, p. 54).

Lease classification also differs between IFRS and GAAP. Under GAAP, leases may be classified as operating leases or capital leases. Under IFRS, however, leases may be classified as either a capital lease or a finance lease. Despite the terminology differences in reference to operating or finance leases, such leases are accounted for in the same manner under both methods. That is, an operating (GAAP) or finance (IFRS) lease should be recognized on a straight-line basis unless another systematic method is more representative. The definition of a capital lease, however, differs between the two methods. Under GAAP, the lease term of a capital lease should account for at least 75% of the economic life of the asset. Under IFRS, however, the lease term should be a “major part” of the economic life of the asset. Under GAAP, the present value of the minimum lease payment should account for at least 90% of the fair value of the asset at inception. Under IFRS, however, this amount should entail “substantially all” of the fair value of the asset. When a lease involves land and a building, GAAP specifies that if the land comprises less than 25% of the combined fair value, then it can be treated as if it were one unit. IFRS, on the other hand, simply says that if land is “immaterial,” it can be treated as one unit (“Retail industry”, 2008, p. 4).

#### *d. Recognition*

There are also differences in recognition. For example, under IFRS, recognition of performance-based awards for non-employees is based on the performance condition. However, following GAAP, such an award is based on the lowest aggregate amount within the range of potential values. Also, in regards to the recognition of payroll taxes, no guidance is provided under IFRS, but they are generally recognized when the compensation cost is recognized. Under

GAAP, however, they are recognized when the “obligating event” or “award” occurs. Contingent liabilities are recognized at fair value if a reliable measurement is readily available. If so, then the liability is measured at the higher of the originally recognized fair value, or the value recognized in accordance with IAS 37. On the other hand, GAAP measures contractual contingencies at fair value, and non-contractual contingencies at the higher of the original fair value or the amount in accordance with FAS 5. Contingent assets are not recognized for IFRS, but they are measured at the lower of fair value or an estimated settlement amount following GAAP. However, contractual contingencies are only recognized as a contingent liability or asset if they are likely to meet the definition of an asset or liability at the acquisition date (“IFRSs and U.S. GAAP,” 2008, p. 8-9)

*e. Measurement*

Measurement differences are also apparent. For example, measurement of awards to non-employees differ in that IFRS assumes that the fair value of the goods or services received is more reliable than the fair value of the equity that is issued. GAAP, on the other hand, requires the use of the method in which the fair value can be measured more accurately (“IFRSs and U.S. GAAP,” 2008, p. 8).

Valuation of property, plant, and equipment also differs. Under IFRS, the cost or revaluation models may be employed. The cost model reflects the GAAP historical cost model in which the acquisition cost is recorded initially and depreciated over its useful life in a manner that reflects the pattern of the expected benefit. Also under the cost model, assets can be written down if impairment occurs under both GAAP and IFRS (Epstein & Jermakowicz, 2009, ch. 8).

However, IFRS also allows the revaluation model. Using this model, property, plant, and equipment are revalued by class on a regular basis. Increases in fair value are charged against

equity. Losses are charged against any surplus, then become income (“Retail industry,” 2008, p. 6). The residual value of property, plant, and equipment may be adjusted up or down under IFRS, but only down under GAAP. Also, the residual value is normally based on the current net selling price under IFRS, but is determined as the discounted present value of future cash flows of expected disposal under GAAP (“IFRSs and U.S. GAAP,” 2008, p. 20). Under IFRS, the impairment of goodwill is calculated using a one-step approach in which the greater of fair value less the cost to sell and the value-in-use is compared to the carrying amount. GAAP, on the other hand, requires a two-step approach in which the fair value of the reporting unit is compared to its carrying amount. An impairment loss is calculated only if the fair value is greater than the carrying amount. An impairment loss cannot be reversed under GAAP. However, this is permitted under IFRS (“IFRSs and U.S. GAAP,” 2008, p. 40-41).

*f. Inventory*

There are also differences concerning inventory. The carrying amount of inventory is valued at the lower of cost or net realizable value under IFRS (“IFRSs and U.S. GAAP,” 2008, p. 13). Under GAAP, however, the carrying value is determined based on current replacement cost, which is the lower of cost or market (Bloom & Cenker, 2009). When applying cost formulas, the same cost formula must be applied to all items that are of similar nature and use using IFRS. It is not required to use the same formula following GAAP (“IFRSs and U.S. GAAP,” 2008, p. 13). The most distinct difference, and most debated, is that LIFO is prohibited under IFRS. Such a change could affect U.S. companies, many of which currently use LIFO. Such a change would result in accelerated income, which results in increased income tax liabilities. Furthermore, the use of LIFO lowers income for financial reporting purposes. Therefore, income would most likely increase during the year of the change. Currently, companies are not required to use the

same inventory method for both tax and financial reporting purposes, so companies have traditionally been able to take advantage of this (Bloom & Cenker, 2009).

*g. Presentation*

Additionally, differences occur with presentation. For instance, discontinued operations are reported post-tax in other comprehensive income under IFRS. Under GAAP, however, discontinued operations are reported on the face of the income statement as pre-tax and post-tax income. Line items are specified following IFRS, whereas GAAP does not require specific line items to be reported on the face of the financial statements. The SEC, however, does require public companies to report specific line items. Subtotals, such as operating profit, are required by the SEC. Furthermore, SEC registrants are prohibited from reporting non-GAAP performance measurements in the financial statements or notes. Comparative financial statements are required for IFRS, but there is no requirement under GAAP. However, the SEC does require at least a two-year comparison for SEC registrants (“IFRSs and U.S. GAAP,” 2008, p. 12). Also, IFRS requires income statement expenses to be based on function, such as cost of sales or administrative expense, or nature, such as salaries expense or depreciation expense. The SEC, however, requires that expenses be based on function (“IFRSs and U.S. GAAP,” 2008, p. 7). Extraordinary items are prohibited by IFRS. However, GAAP allows items that are considered unusual and infrequent to be classified as extraordinary items (“IFRSs and U.S. GAAP,” 2008, p. 8).

*IV. Effect of IFRS on Industry*

A transition to IFRS by U.S. companies imposes a wide range of consequences. The impact can be either detrimental or advantageous depending on the methods used by the

company, or the industry it is operating in. Therefore, the following discussion considers the impact on the retail, banking and capital markets, oil and gas, and shipping industries.

*a. The Retail Industry*

The retail industry will be affected by the transition. In areas where IFRS has already been adopted, the transition has proved to be advantageous. For instance, there was an overall increase in the transparency and consistency in financial information. There was also an increased availability of global resources. Moreover, there was evidence of improved cash management (“Retail industry,” 2008, p. 2).

Globalization as a driving force has also affected the retail industry. Retailers in foreign countries are beginning to become globalized. While most U.S. retailers are not global, it is likely that they will follow the trend apparent in their industry. Another incentive is that global companies are amongst the top 250 retailers based on revenue (“Retail industry,” 2008, p. 2).

The greatest impact on the retail industry will be on inventory. Cost of inventory under both standards are similar in that they include such costs as direct expenditures, overhead, and any costs that get the inventory ready for use. However, IAS 2 requires that the FIFO or weighted-average method be used to value inventory. However, under GAAP, companies have the option of using LIFO to value their inventory. During periods of rising prices, this method is generally advantageous for retailers. Thus, if LIFO is no longer accepted, then companies may suffer increased tax liabilities.

Other inventory measurement differences are also apparent. IFRS does not allow retail and average cost methods, and unlike GAAP, they cannot use different methods for different groups of inventories. Also, the carrying value is determined differently under the two standards. This could affect retailers depending on how they calculate lower of cost or market. Reversals of

write downs are allowed under IFRS, as opposed to GAAP. Therefore, sales could be affected, since reversals increase the cost of sales (“Retail industry,” 2008, p. 3).

Revenue recognition will also be impacted. Under GAAP, delivery is a required component before revenue is recognized. Under IFRS, however, revenue may be recognized on bill-and-hold sales as well as lay-away sales (“Retail industry,” 2008, p. 7).

Customer loyalty programs are a common component of a retail business. GAAP does not offer any specific guidance. Therefore, retailers use a choice of several different approaches of accounting for their loyalty programs including the multiple element, accrual, and incremental cost approaches. IFRS, on the other hand, does offer some guidance. Any credit or award given is recognized at fair value and recorded as a liability. The liability is then reduced when the awards are given. In effect, the loyalty programs are treated as parts of the sales transaction because less profit is recognized immediately (Epstein & Jermakowicz, 2009, ch. 7).

Advertising costs are also measured differently. Under GAAP, they are expensed as incurred or capitalized and expensed when the advertisement occurs. Under IFRS, however, the timing of the expense may differ based on “facts and circumstances” (“Retail industry,” 2008, p. 7). Such “facts and circumstances” are not clearly defined under IFRS.

Lastly, store closings are impacted by IFRS. GAAP recognizes the costs associated with store closings only when the lot is vacated. Under IFRS, however, the costs may be recognized before the lot is vacated. Thus timing differences create an impact (“Retail industry”, 2008, p. 7).

#### *b. The Banking and Capital Markets Industry*

IFRS will also affect banking and capital markets. To begin, the banking industry has limited personnel to aid in the transition due to an increase in layoffs in the industry. Outsourcing and offshoring have resulted in the downsizing and availability of personnel that could have

aided in the transition. Moreover, new entrants into the banking profession are not well-versed in IFRS (“Banking and capital markets industry,” 2008, p. 6).

In the legal department, existing contracts will need to be reevaluated and modified to comply with IFRS. This is particularly critical to the banking industry because banks and capital markets are deeply involved with joint ventures, structured investments, and collaborative arrangements. All of these items will need to be considered under IFRS (“Banking and capital markets industry,” 2008, p. 6).

Regulation and compliance will also be a key issue under IFRS for the banking industry. Despite the advantage that IFRS eases compliance burdens, financial institutions will be put in a difficult situation. Currently, this industry has local, national, and international regulations under the Sarbanes-Oxley Act, Foreign Corrupt Practices Act, Anti-Money Laundering Act, and others. Considering IFRS amongst the existing requirements could prove to be daunting (“Banking and capital markets industry,” 2008, p. 6).

Nonetheless, IFRS from a global perspective shows an increase in consistency. The adoption of IFRS by the EU simplified compliance. Prior to adoption, as many as 20 local GAAPs had to be considered in cross-border transactions. However, it will be essential for U.S. banking regulatory agencies to take part in the negotiations of evaluating IFRS (“Banking and capital markets industry,” 2008, p. 6-7).

Differences between the standards will affect several key areas of the banking industry. For instance, banks will have to review debt covenants to make sure they comply with IFRS. Also, creditworthiness will need to be reevaluated since there will be a new view of the fair value of collateral (“Banking and capital markets industry,” 2008, p. 8).

The concept of control differs between GAAP and IFRS. Under GAAP, a financial asset must continue to be recognized until control is surrendered and consideration other than interest is received in return for the transfer of the asset. IFRS, on the other hand, does not require full surrender of control. If substantially all risks and rewards of ownership of the financial asset have been surrendered, then the institution may derecognize the asset. Also, the impairment of AFS securities is determined differently under the two standards. This could affect net income or equity (“Banking and capital markets industry,” 2008, p. 12).

*c. The Oil and Gas Industry*

IFRS could prove to be beneficial to oil and gas companies. Most oil and gas companies operate internationally. Their organizational structures are complex and include multiple subsidiaries and joint ventures. Also, most global oil and gas competitors are already using IFRS (“Oil and gas industry,” 2008, p. 1).

However, the oil and gas industry also faces many obstacles concerning IFRS conversion. For instance, accounting for exploration and development costs differs between the two sets of standards. Under GAAP, a company may use the “successful efforts” method in which the costs of locating, purchasing, and developing reserves of a particular field are initially capitalized. If the company proves discovery, then these costs will continue to be capitalized. Otherwise, the expenditures must be charged as an expense. Another approach, the “full cost” method, can also be employed. Under this method, costs are determined by a country or region basis (“Oil and gas industry,” 2008, p. 5). IFRS, on the other hand, does not have a universal method of accounting for these costs. Under IFRS, the full cost method is allowed for exploration and evaluation costs, followed by the successful efforts method following this phase of the cycle (“Oil and gas industry,” 2008, p. 5).

The oil and gas industry will also be affected by depreciation methods. Under IFRS, major components of assets are depreciated separately. This creates a particular challenge to the oil and gas industry. Specifically, identifying the significant components of refineries and offshore platforms will pose a significant challenge. Even more challenging will be accounting for refinery turnarounds since some of the costs may be capitalized while others may be expensed. Thus, the process of converting depreciation methods will prove to be complex for the oil and gas industry (“Oil and gas industry,” 2008, p. 5).

*d. The Shipping Industry*

The shipping industry will also be affected by IFRS. Large vessels and property, plant, and equipment are a significant part of the shipping industry. Therefore, similar to the oil and gas industry, the shipping industry will be affected by changes in depreciation methods, particularly since IFRS requires the component approach to depreciating assets. Furthermore, under IFRS, property, plant, and equipment can be valued based on the cost or revaluation model. While the cost method under IFRS is similar to that of GAAP, the revaluation method is specific to IFRS since entire classes of property, plant, and equipment can be adjusted to fair value regularly (“Shipping industry,” 2009, p. 5). These methods will have to be analyzed in regards to the shipping industry.

Maintenance and overhaul expenses also differ between the two standards. Under IFRS, major maintenance and overhaul costs are capitalized as part of the asset and depreciated until the next overhaul. Under GAAP, however, these costs can be expensed as incurred, deferred and amortized until the next overhaul, or capitalized as part of the asset. Again, these differences will affect the fixed assets of the shipping industry (“Shipping industry,” 2009, p. 5).

#### *V. The Effect of IFRS on Tax*

Efforts have been made on behalf of the IASB and the FASB to eliminate differences between accounting for income taxes. As part of a joint project, the IASB and FASB worked together to eliminate differences between FAS 109, *Accounting for Income Taxes*, and IAS 12, *Income Taxes*. In effect, IAS 12 was developed according to the temporary differences method used by the FASB. However, in 2008, FASB decided to suspend the project. Nonetheless, the IASB is still taking strides to converge the two standards (McGowan & Wertheimer, 2009, p. 844).

On March 31, 2009, the IASB published an exposure draft with the intent of eliminating IAS 12. Within this document, the IASB proposed several changes that would clarify and improve IAS 12 as well as eliminate many of the differences between FAS 109 and IAS 12. The exposure draft considers redefining temporary differences and eliminating the exception to the temporary difference approach. This would allow deferred tax assets to be recognized when they arise rather than denying recognition when the asset or liability is initially recognized (McGowan & Wertheimer, 2009, p. 844-845).

The exposure draft also considers uncertain tax positions. The draft requires that a description of the uncertainty and an indication of its possible financial effects and timing of effects be included in disclosures. FASB, on the other hand, requires that uncertain tax positions be recognized when appropriate. If so, then the tax position is measured as the largest amount of tax benefit that is more than 50% likely to be realized upon ultimate settlement. The exposure draft also considers other differences such as presentation of current and noncurrent deferred assets, recognition of deferred tax assets, and the calculation of deferred tax assets and liabilities (McGowan & Wertheimer, 2009, p. 845-846).

Adoption of IFRS for taxes would have several complications. Therefore, it is important that both the tax practitioner and the client are familiar with the standards. Questions that will need to be considered include whether the new accounting method is permissible for tax, if the new book method is preferable over the current tax method, if changes in accounting methods need to be filed, whether permanent and temporary differences will change, and how the computation of taxable earnings, foreign source income, and investments in subsidiaries will be affected (McGowan & Wertheimer, 2009, p. 842).

The calculation of pretax income may be different under IFRS. This could affect the effective tax rate in a positive or negative way. The extent of this difference will need to be evaluated for tax planning purposes (McGowan & Wertheimer, 2009, p. 844).

Accounting systems will also be affected. Since accounting systems produce data used for tax purposes, companies can evaluate the inefficiencies and correct them during the adoption process. They should also focus on automated information. The change will allow companies to produce information in a more automated fashion which should increase efficiency and reduce errors. Nonetheless, it is strongly suggested that the statements be produced in a trial run fashion prior to full implementation (McGowan & Wertheimer, 2009, p. 844).

The transition to IFRS will also require several book to tax adjustments. Since IFRS places more emphasis on fair market value accounting, there are more adjustments to the book income under IFRS. Thus, for tax purposes, IFRS will result in many Schedule M adjustments. For instance, income-producing assets are valued annually under IFRS. These adjustments will require separate records for tax purposes and a corresponding Schedule M adjustment. Property, plant, and equipment can be revalued under IFRS. Thus, separate calculations will be required for Section 1231 gains and losses as well as Schedule M adjustments. Also, since depreciation

for fixed assets can be calculated based on fair market value, Schedule M adjustments will be required. IFRS also allows fixed assets to be depreciated greater than their cost if the assets appreciate. Furthermore, intangibles that are revalued annually will require Schedule M adjustments for valuation and amortization (Stromsem, 2009, p. 322).

Inventory differences will also result in tax consequences. Under GAAP, the LIFO method can result in lower income and a lower tax liability. As required by the IRS, companies that conform to the LIFO method for tax purposes must also conform to LIFO for financial reporting purposes. However, LIFO is not permitted under IFRS for financial reporting. Therefore, it violates IRS regulation and companies would be expected to change their inventory methods. Conversion from LIFO could produce substantial tax consequences for companies. It is possible, therefore, that the IRS will provide certain limitations on liabilities that will lighten the tax burden imposed on companies forced to convert (“Retail industry,” 2008, p. 3).

Corporations will also be affected. Since financial accounting for corporations differs under IFRS it may be difficult to classify income for tax purposes. Therefore, companies will probably be faced with accounting system updates that will capture the tax detail necessary for the corporate tax return (Stromsem, 2009, p. 323).

The IRS may also be faced with implications since Form 3115 is required for companies requesting changes in accounting methods. Since many companies have tax methods that conform to their book methods, IFRS may encourage companies to reevaluate their tax methods. Thus, the IRS is likely to be flooded with Forms 3115 since there will likely be many requests for accounting changes (Stromsem, 2009, p. 323).

In general, tax practitioners will need to become more aware of the financial accounting aspect of determining income. They will also need to assist their clients in complying with the

tax law. It may also be necessary to assist clients with setting up accounting systems that capture the information required for tax purposes (Stromsem, 2009, p. 323).

#### *VI. The SEC Proposed “Roadmap” for Convergence*

The process of conversion has already begun. In effort to aid this process, the SEC issued a proposed “roadmap” that details the impending convergence with set objectives, goals, and various deadlines. This article, issued November 14, 2008, highlighted seven key milestones that, “could lead to the required use of IFRS by U.S. issuers in 2014 if the Commission believes it to be in the public interest and for the protection of investors (“Roadmap,” 2008, p. 1).” First, the SEC discussed improvements in accounting standards. Currently, IFRS offers limited guidance on insurance contracts and extractive activities that the SEC would like to consider. They would also like to amend revenue recognition and financial statement presentation. Also, the SEC wants to ensure that the IASB is committed to developing and converging standards that reflect the current issues of financial reporting, as well as address the accuracy and effectiveness of financial reporting. If significant improvement occurs, the SEC will consider mandating the standards as early as 2011 (“Roadmap,” 2008, p. 22-23).

The second milestone considers the accountability of the International Accounting Standards Committee (IASC) Foundation. It is necessary for the committee to function independently and focus on enhancing the IASB standard setting process. The SEC would also like to make sure that stable funding is available to the IASC to ensure further development of the standards (“Roadmap,” 2008, p. 25).

The third milestone considers the ability to use interactive data for IFRS reporting. In May 2008, the SEC proposed that companies be required to submit their financial statements via the web using XBRL. However, the use of XBRL may be limited for some issuers. Therefore,

the SEC would like to consider this before mandating IFRS for all companies (“Roadmap,” 2008, p. 27).

The fourth milestone addresses education and training. Formal education is essential for the smooth transition. However, materials are limited. Nonetheless, several large accounting firms have resources available to aid the process. Online modules and study tools are free and readily available. The SEC will, however, monitor the status of education programs regarding IFRS (“Roadmap,” 2008, p. 28-30).

The fifth milestone considers the limited early use of IFRS. The SEC intends to allow some companies to utilize IFRS prior to the mandated date; However, in effort to maintain comparability amongst U.S. company financial statements, the SEC determined that they would limit “the proposed option to use IFRS to a group of larger U.S. companies in industries in which IFRS is the most-used set of standards globally (“Roadmap,” 2008, p. 32).”

Milestone six considers the anticipated timing of rulemaking. The SEC plans to make the final determination to mandate IFRS by 2011. This would affect financial statements produced in 2014. Thus, companies would have sufficient notice of the change, and could begin to implement IFRS into their internal reporting in 2011. This proposal was made with the intent to mandate financial reporting (“Roadmap,” 2008, p. 34).

The final milestone discusses implementation and the mandatory use of IFRS. The SEC will consider a staggered transition to IFRS beginning with large companies in 2014. This would be followed by a mandate for accelerated filers in 2015, and 2016 for non-accelerated filers. The reason for this type of transition is that it is going to be costly but large companies are better able to absorb such costs. Also, it will lighten the demand for auditors and consultants during the transition period (“Roadmap,” 2008, p. 35-37).

### *VII. The SEC Roadmap Revisited – The 2010 Proposed “Work Plan”*

On February 24, 2010, the SEC released a statement that updated the position on global convergence of U.S. GAAP and IFRS. The statement emphasized continued support for a global set of accounting standards (“Commission statement,” 2010, p. 1). The SEC also discussed a “work plan” for IFRS adoption with several considerations. The work plan envisions 2015 as the earliest possible date that U.S. public companies would be required to use IFRS. Ideally, the SEC would like to make a definitive decision in 2011 as to whether the adoption of IFRS will be mandated. Under the work plan the SEC will continue to consider whether IFRS is sufficiently developed and consistent. It will also consider the independence of the IASB as well as investor understanding and education. Furthermore, the SEC will address the effect on U.S. laws and regulations outside of the securities laws and regulatory reporting. Finally, the SEC will consider the implications on issuers of financial statements and on preparers and auditors of financial statements (DeFelice & Lamoreaux, 2010). The work plan shows the SEC’s continued commitment towards developing a global set of accounting standards.

### *VIII. FASB Codification*

The FASB has also played a key role in the transition. FASB Accounting Standards Codification was released on July 1, 2009. This project revamped the existing GAAP hierarchy and reduced the existing standards to only two levels: authoritative and non-authoritative. While the change did not specifically change GAAP, it did reduce the complexity of the standards in order to better facilitate convergence. The codification is structured similarly to IFRS and includes real-time updates, with previous guidance moved to an archived section (Henry & Fleming, 2009).

Until now, GAAP was issued in various publications such as APB Opinions, Accounting Research Bulletins, AICPA Standards of Position, and SFAS Standards. The nature of these publications made research difficult and cumbersome (Henry & Fleming, 2009).

Under the new method, however, topics are discussed under four sections which include presentation, financial statement accounts, broad transactions, and industries. Under these four main topics are subsections which include a background and overview (Henry & Fleming, 2009).

While the new codification should ease convergence and make research easier over time, there are still many challenges present. For instance, many of the existing standards are simply outdated, and the new codification highlighted this issue. Therefore, the SEC recommended that several steps be taken to improve GAAP including amending outdated standards, rewriting the codification, and removing redundancies between SEC and FASB disclosures (Henry & Fleming, 2009).

#### *IX. The Role of the “Big Four” Accounting Firms*

The big-four global CPA firms have proven to be key players on the issue. For example, Deloitte’s website offers interpretations of IFRS and has a database of the articles highlighting the transition beginning in 2000. It also offers IFRS model financial statements and free modules. KPMG has also added modules and web-based learning tools to aid in the transition. KPMG is working with the IASB to develop a common methodology that can be used to apply the standards. Ernest & Young and PWC have developed similar features as well (Bukies, Masler, & Speer, 2009).

#### *X. Disadvantages of conversion*

While conversion seems inevitable, there are many hurdles yet to overcome. The most obvious are the associated costs. Systems will need to be updated to accommodate IFRS. For

instance, of major concern to Chief Accounting Officer, Arnold C. Hanish, of Eli Lilly is the current undertaking of several systems projects. Not only do these projects incur significant costs, but the timing and implementation of these systems is critical. The failure of the SEC to establish a definite timeline could prove too costly to companies such as Eli Lilly, who are in the process of performing system updates. Eli Lilly does not know whether it would be ideal to incorporate modifications now or wait until a specific date has been set (DeFelice & Lamoreaux, 2010).

There is also a sense of national pride that will need to be abandoned. Some control over financial reporting policies has to be surrendered (Levine, 2008, p. 10 -11). More importantly, education of current professionals as well as new accounting students is critical. This affects a wide range of individuals including SEC and PCAOB staff, financial analysts, CPAs, actuaries, and many others (Bukies, Masler, & Speer, 2009).

In Pennsylvania alone, there are over 50,000 accountants and auditors. Furthermore, over 1000 new licenses were issued in 2008. Still, there are others in related fields that will also need to be educated on the standards (Bukies, Masler, & Speer, 2009).

The biggest concern at this point is implementing IFRS into current curriculum. While many textbooks are beginning to consider IFRS, there are not many materials readily available that teach IFRS. Some professors are teaching IFRS as a comparison with GAAP, but little to no attention has been given across the board (Bukies, Masler, & Speer, 2009).

According to a KPMG survey of accounting faculty at U.S. universities, 70% of respondents claimed that the biggest challenge in teaching IFRS is creating room for it in the curriculum. Nonetheless, 70% of respondents admitted that they have taken steps to incorporate IFRS into the curriculum. Furthermore, 83% support implementing IFRS into the curriculum by

2011("Accounting educators," 2009). Education will remain a concern in the determination of the mandatory use of IFRS.

IT will also face significant consequences when transitioning to IFRS. Differences between IFRS and GAAP result in data recording differences within the IT systems. Data input and data collection differs under IFRS. IFRS requires more detailed and more frequent data. A 2009 survey of 2,000 IT personnel revealed that only 16% of respondents said that they were developing their IT systems in response to IFRS. When conversion does occur, costs for IT will most likely encompass about 50% of total conversion costs. These expenses will have to be properly budgeted and proper planning is essential. Therefore, it is suggested that upgrades to IT systems accommodate IFRS (Pratt, 2010).

#### *XI. Advantages of Conversion*

Despite the costs and other disadvantages associated with IFRS, there are several advantages to consider. A transition to IFRS produces an opportunity to analyze current accounting practices. Each company can look over current policies and procedures since the transition gives a fresh outlook on financial reporting. Thus, some current practices can be cleaned up ("Banking and capital markets industry," 2008, p. 2).

Furthermore, IFRS streamlines consolidation. Growth and acquisition activities result in an assortment of legacy and ERP systems. Thus, errors become prevalent. IFRS can help companies streamline these systems. Moreover, the vast and complex rules of GAAP have proved to be difficult and cumbersome. IFRS, as a principles-based accounting system will help to alleviate some of that frustration. Furthermore, it will facilitate standardization and improve the reliability of financial reporting. Most importantly, IFRS creates global opportunities. In

particular, foreign investors will have greater insight, and it will be easier to benchmark and compare using a global set of standards (“Banking and capital markets industry,” 2008, p. 2).

### *XII. Opportunities for Small and Midsize Firms*

Although IFRS-related work has predominated mostly in the major accounting firms, opportunities exist for small and midsize firms as well. Growing an IFRS client base and developing a niche can help to drive profits for these firms. There is a demand for IFRS knowledge and even more opportunities will develop when the SEC mandates IFRS for U.S. issuers (Deane & Heilman, 2009).

IFRS has opened doors for Malin, Bergquist & Company, an accounting firm with three offices in Western Pennsylvania. This firm has successfully developed a niche in the IFRS market. Its first experience with international work was with a U.S. subsidiary of the German manufacturer, Dräger. As this company grew internationally, Malin Bergquist was also able to develop its IFRS knowledge. Throughout this process, the subsidiary relied heavily on the work of Malin Bergquist. Thus, the firm continued to develop this niche. Currently, IFRS-related work comprises about 20% of the firm’s business (“Case study,” 2009).

In order for small and midsize firms to be successful, they must invest valuable time and resources. For instance, these firms must be willing to invest time and money into educating staff members. One way to effectively educate staff is to participate in technical reviews of IFRS engagements. In addition, it is helpful to have auditors in an IFRS engagement review the disclosure checklist to familiarize the auditor with the elements that must be addressed in IFRS financial statements. Yet, an even more basic process that can help these firms is sharing knowledge across the firm via meetings and in house training (Deane & Heilman, 2009). Despite

the investment required for small and midsize firms, the venture could prove to be successful and profitable if approached in just the right way,

### *XIII. Gaining Support of IFRS*

IFRS is also gaining support in the accounting profession. For instance, IFRS is supported by the AICPA. As stated by president and CEO, Barry Melancon, in response the February 2010 work plan, “The AICPA supports the thoughtful and concrete steps the SEC is taking as outlined in its plan today to prepare for this transition (DeFelice & Lamoreaux, 2010).” The AICPA plans to help members, students, and the public prepare for the shift and it will do its part to ensure that the shift is successful by 2015 (“AICPA issues statement,” 2010). A 2009 survey of CFOs and other finance professionals revealed that 70% of respondents supported the SEC’s motive to adopt IFRS under the proposed roadmap (WebCPA, 2010). Even accounting educators believe that IFRS is critical in order for the U.S. to remain competitive (“Accounting educators,” 2008). Standard & Poor’s chief account Neri Bukspan, CPA, stated that his company supported a single standard and supported the SEC’s determination in the interest of investors (DeFelice & Lamoreaux, 2010). Support for IFRS, for the sake of invertors, is gaining momentum and the trend is likely to continue.

### *XIV. Methods of Conversion*

The transition from GAAP to IFRS can be approached using two general methods. The first approach is referred to as the “all-in” approach. This approach is characterized by a short time frame of conversion, immediate conversion of all reporting entities, and a significant devotion of major resources. This approach was attempted by the European Union in 2005. Legislation was passed in 2002 and IFRS subsequently became effective in 2005 (“Retail industry,” 2008, p. 8). This tight timeline imposed by EU regulators proved to be rushed and inefficient. Furthermore, a

comparison of EU financial statements from 2004 to those issued in 2005 revealed that the 2005 statements resulted in additional disclosures about assumptions and judgments, many of which were nearly twice as long as previous disclosures. The transition also revealed that the change affected much more than the accounting. IT, human resources, and tax departments faced a significant burden. Furthermore, many companies that did not take steps to prepare for the transition found that first year financial statements were unnecessarily labor intensive (“Banking and capital markets industry,” 2008, p. 9).

Deloitte offers suggestions for companies that are forced to use the all-in approach. For example, the company should try to align IFRS implementation with other existing projects. For instance, if the company is considering a new ERP, then perhaps they should implement an ERP that is already compatible with IFRS. This will help smooth the transition later on. Also, it is suggested that they start with one entity or country as a trial run. Thus, the company can track the difficulties and preparations can be made for other entities. Furthermore, IFRS can be used as a way to strengthen controls since there was lack of standardization across borders prior to IFRS (“Banking and capital markets industry,” 2008, p. 9).

The second approach is referred to as a tiered approach. Under this approach, the transition occurs in stages. However, this approach is effective only if preparations are made long before the effective date. By using this approach, “lessons learned” can be passed on to various entities within a company. One suggestion is to stagger the implementation process on a country-by-country basis. For instance, companies may choose their Canadian operations as a starting point since Canada is adopting the standards in 2011 (“Retail industry,” 2008, p. 8). Despite the method chosen, however, the key to a successful transition is adequate preparation.

### *XV. Concluding Remarks*

The ability of the U.S. to compete in a global marketplace is critical. IFRS may be the key to encouraging nondomestic investment here in the U.S. Enhanced comparability and understanding by investors and financial statement users both here in the U.S. and in foreign countries is ideal.

IFRS is gaining support around the world and it continues to gain acceptance here in the U.S. It is also likely that banks and foreign investors will demand IFRS financial statements in future periods. Moreover, by 2011, more than 150 countries will have adopted IFRS as their standard of financial reporting. Thus, it is likely that the SEC will mandate IFRS for publically held companies.

Therefore, it is critical that companies, managers, professional staff, actuaries, auditors, accountants, and all others that will be affected by the transition, become aware of the differences in the standards, and how those standards will need to be addressed. Every step toward becoming more knowledgeable of IFRS is a step closer to a smooth transition. While the more obvious barriers are inevitable, proper training and education will help to aide the process. As the SEC has stated, IFRS application for U.S. public companies may be established as early as 2015. Therefore, the preparation for this landmark in the accounting profession needs to begin sooner rather than later.

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