Preparing for international financial reporting standards

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ABSTRACT

The accounting profession is on the precipice of one of the biggest changes to face it since the 1930s. In the very near future, there is a strong possibility that United States generally accepted accounting principles (GAAP), as it is known today, will cease to exist. In its place will be a global standard encompassed by the International Financial Reporting Standards (IFRS). This paper will provide a history of IFRS and discuss the timeline of convergence, along with advantages and disadvantages. This paper will also address the future impact on accounting education.

Keywords: IFRS, history, timeline, advantages, disadvantages, classroom impact

A HISTORY OF IFRS

In 1973, an organization known as the International Accounting Standards Committee (IASC) was formed to address the need for standards that could be used by smaller nations in creating their own accounting standards. This group was succeeded by the International Accounting Standards Board (IASB) in 2001. The IASB is based in London and is the private sector standard setting body for non-government and not-for-profit entities. All fifteen members are selected based on technical skills and background from many different countries. At this time, four of the members are American. Two of the sitting members are always part-time. The IASB is primarily funded by fundraising activities. One of the challenges facing the conversion to IFRS is ensuring that the IASB has a stable source of funds for the future. The primary purpose of the IASB is to promulgate IFRS. The governance structure is very similar to the Financial Accounting Standards Board (FASB) in the United States. The IASB reports directly to the IASC Foundation. The sitting IASB Chair is Sir David Tweedie and the sitting IASC Foundation Chair is Gerrit Zalm (AICPA, *backgrounder*, 12/11/08, AICPA, *online video* 12/09/08).

As a result of growth of global markets, the desire of multinational companies for one set of financial statements, and the demand for one common global reporting language, the FASB and the IASB issued the Norwalk Agreement in 2002. This agreement marked their commitment to develop a single set of high quality standards that would decrease cost, increase efficiency and provide better information for investors. Beginning in 2005, the European Union required its listed companies to prepare consolidated financial statements under IFRS. During 2006, the FASB and the IASB embarked on a number of joint major projects. Two actions by the Securities and Exchange Commission (SEC) during 2007 accelerated the timeframe of potential conversion from GAAP to IFRS. In November, an SEC Final Release allowed foreign filers in the U.S. to prepare for submission financial statements in accordance with IFRS without a reconciliation to GAAP. A Concept Release was then issued in December by the SEC seeking feedback on allowing all U.S. public companies the option of using IFRS instead of GAAP. When the AICPA Council updated Rule 203 of the Code of Professional Conduct in May of 2008 to recognize the IASB as an international accounting standard setter, all private companies and not-for-profit entities were given the option of following IFRS (AICPA, *backgrounder*, 12/11/08, AICPA, *online video*, 12/09/08).

IFRS, as it is known today, consists of nine IFRS and forty-one IAS, of which some have been superseded. As with the FASB, a strict code of due diligence is employed during the promulgation process. When IASB considers issuing a new standard, they often use previous FASB debates on the same topics (AICPA *online video*, 12/09/08). Today, more than 12,000 companies in almost a hundred countries have adopted IFRS. These countries either require or permit IFRS as the basis for financial statement preparation by public companies. Most of the countries have local standards that are based on IFRS. Those countries that have adopted IFRS include Australia, New Zealand, Israel, Canada, and the European Union states. Japan has adoption efforts underway for the near future (AICPA *backgrounder*, 12/11/08).

SEC TIMELINE/ROADMAP

On November 14, 2008, the SEC issued a roadmap outlining its strategy for IFRS convergence. From this date until 2011, the convergence project will continue between FASB and IASB. During 2011, the SEC will decide whether to proceed with the conversion of GAAP to IFRS or to abandon the project. If the decision is made to convert to IFRS, U.S. issuers would be required to use IFRS beginning in 2014. The transition would be conducted in stages. Large accelerated filers would use IFRS for their filings for fiscal years ending on or after December 15, 2014. The remaining accelerated filers would begin using IFRS for fiscal years ending on or after December 15, 2015 with all others beginning for fiscal years ending on or after December 15, 2016. All public companies would be required to use IFRS as soon as December 15, 2016. This roadmap was issued originally with a ninety day comment period (SEC, 2008). In early February 2009, the comment period was extended to April 20, 2009.

In response to convergence issues that have arisen to date, the SEC approved a new timeline in February of 2010. The new timeline extends the original requirement of 2014 to 2015, prohibits early adoption, and leaves the door open for a possible choice for issuers between IFRS and U.S. GAAP. It appears that the SEC will still make a decision on conversion in 2011 as planned (DeFelice & Lamoreaux, 2010).

SEC Road Map for Transition to IFRS Available (2008) offers this summarization:

> The roadmap spells out seven milestones that would influence the SEC's 2011 decision on whether to move forward. The milestones are:
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> - Improvements in accounting standards
> - The accountability and funding of the International Accounting Standards Committee Foundation
> - Improvement in the ability to use interactive data for IFRS reporting
> - Education and training in the U.S. relating to IFRS
> - Limited early use of IFRS, beginning with filings in 2010, where this would enhance comparability for U.S. investors. Eligibility would be based on both the prevalence of the use of IFRS and the significance of the issuer in a given industry. The SEC estimates that a minimum of 110 companies could be eligible.
> - The anticipated timing of future rulemaking by the Commission
> - Implementation of the mandatory use of IFRS, including considerations relating to whether any mandatory use of IFRS should be staged or sequenced among groups of companies based on their market capitalization.

To ensure comparability during transition, there are two proposed alternatives for disclosing GAAP information under IFRS for those companies that elect to use IFRS. Companies may use IFRS 1 guidance for providing reconciling information from GAAP to IFRS as a footnote to audited financial statements. Alternatively, companies may provide the IFRS 1 reconciliation and disclose certain unaudited supplemental GAAP financial information covering a three-year period on an annual basis. Uniformity will be the main consideration in the decision (SEC, 2008).

The future role of the FASB remains unclear. One option would allow the FASB to remain the designated standard setter. Its job would be to establish GAAP by first incorporating IFRS provisions from the convergence and then maintaining it for all future changes to IFRS (SEC, 2008).

ADVANTAGES AND DISADVANTAGES

There are many advantages and disadvantages of converting from GAAP to IFRS.

Advantages

- The use of one common global reporting language (Flynn, 2008).
- It will allow for comparability over all financial markets, regardless of the country of origin (Flynn, 2008).
- Investors will have better information for decision making (SEC, 2008).
- Companies will have more flexibility for applying accounting principles. IFRS is more principles based, whereas GAAP is more rules based. Transactions will be required to be reported using substance over form criteria. More professional judgment will be exercised which will lead to better disclosure to support those judgments (Flynn, 2008).
- There is the potential for reduced financial reporting complexity, especially for large, multinational companies that currently prepare many different sets of financial statements in many different forms (Flynn, 2008).
- All levels of management, including the audit committee, will have to be more involved in financial reporting and aware of transactions (AICPA *online video*, 12/09/08).
- In the end, companies should be more efficient and have the advantage of cost-savings (AICPA *online video*, 12/09/08).

Disadvantages

- Small companies that have no dealings outside of the United States have no incentive to adopt IFRS unless mandated (Olson, 2008).
- Incompatibility may arise as companies claim to have converted to IFRS but in reality have only selected the portions that best fit their needs (Olson, 2008).
- There is an extremely high price-tag – "…the SEC estimates the costs for issuers of transitioning to IFRS would be approximately $32 million per company and relate to the first three years of filings on Form 10-K under IFRS. Total estimated costs for the approximately 110 issuers estimated to be eligible for early adoption would be approximately $3.5 billion" (SEC, 2008).
- Although it is unlikely, Commissioners have three years to change their minds. A definite decision will not be made until 2011. There is no incentive for early adoption due to the fact that it could be a colossal waste of time and resources. Also, companies would be required to have two sets of records, one GAAP, one IFRS, during this time just in case IFRS is not adopted (Johnson & McCann, 2008).
- Many feel that during this financial crisis that the world is currently experiencing, a conversion of this magnitude is too much to ask of executives and management (IFRS, 2008).
- A minimum of two years of financial information prior to conversion would need to be maintained on two sets of books, both GAAP and IFRS, to meet the requirement of financial statements to contain three years of financial data (IFRS, 2008).

In spite of the many disadvantages of converting to IFRS, this appears to be the path the United States is on. Ultimately, the hope is that by converting to IFRS, all of the above advantages will come to fruition in a single set of high quality standards that would decrease cost, increase efficiency and provide better information for investors.

SURVEY RESULTS (PRACTICE AND ACADEMIA)

As IFRS conversion looms on the horizon, many organizations are conducting surveys to determine extent of preparedness, understanding, fears and expectations.
"Seventy-one percent of chief financial officers surveyed by California-based Robert Half Management Resources, a temporary staffing agency for the accounting profession, said international experience will be necessary for accounting and finance professionals five years from now" (Olson, 2008). As shown by the surveys below, this expectation will be hard to meet.

The AICPA conducted an IFRS Preparedness Survey from September 22 to October 2, 2008. Of the 1,495 respondents, 87.4% were from public practice and business and industry. Of the respondents, 30% had no knowledge of IFRS. Only 10% had adopted IFRS or were actively preparing for adoption. The survey, in its entirety, can be retrieved from http://www.aicpa.org/Press/PressReleases/2008/DownloadableDocuments/IFRS_Poll_Results.pdf.

A survey conducted by PriceWaterhouseCoopers during a webcast sponsored by the firm yielded similar results (Cole, 2008). Of the respondents, 33% were in the process of doing a preliminary study, 24% were planning a preliminary study after 2009, and 43% had not even considered doing a preliminary study. The major concerns cited for the initial implementation of IFRS were time and cost, complexity of conversion, and lack of in house talent-knowledge.

KPMG-AAA polled 535 university professors concerning the readiness of the academic community for the coming conversion. As with public firms and industry, only a very small number are truly prepared (University, 2008).

- Only 22% can significantly incorporate IFRS into their curricula this year. Sixty-two percent have not taken any significant steps to be prepared.
- Thirty percent stated that the first class to have significant IFRS exposure will be the class of 2011; 24% indicated 2012.
- Five percent expect the class of 2009 to have substantial knowledge and 17% expect the same of 2010.
- Forty-two percent of professors do not expect textbooks to be ready for IFRS until the 2010-2011 academic year.
- Support needed for teaching IFRS included textbooks and case studies.
- The two key challenges indicated by the survey are developing a curriculum and making room for IFRS in the current curriculum.
- Sixteen percent indicated that their schools will provide funding for IFRS training, while 49% felt that the responsibility would be with the individual professor.
- Many respondents felt that their university's administration did not appreciate the changes needed, did not have an understanding of the efforts needed and did not see the need for allocating resources.
- Thirty-four percent of the professors felt that the CPA exam would include coverage of IFRS in 2011 and 29% in 2012.

- Once convergence is complete, 56% will focus on comparing and contrasting GAAP and IFRS standards, 37% will compare and contrast GAAP and IFRS foundational concepts and 26% will teach IFRS standards and conceptual framework only. Thirty-three are still undecided.

IMPACT ON THE CLASSROOM

With conversion to IFRS likely but not certain, many professors are having difficulty discerning the how, when, and what of incorporating IFRS into today's accounting curriculum (Nilsen, 2008). Students need to be prepared for what they will face outside of academia in their careers and for the CPA exam. Many believe that IFRS related questions could be incorporated into the exam as early as 2011.

With firms like PriceWaterhouseCoopers expecting sophomores to have a basic understanding of the future importance of IFRS and internship and job applicants to know the sources of GAAP and IFRS, have a familiarity with IFRS financial statements, and be able to identify specific differences, accounting professors must begin exposing students now so that they will be competitive in the job market. That exposure will most likely begin at the principles level. Many professors are concerned that an already full curriculum will pose problems. Covering required topics within a specified time frame can be difficult without the added strain of teaching IFRS. There is the question to what extent IFRS should be layered onto the current curriculum. One alternative is to add additional IFRS courses. Many concepts are similar under GAAP and IFRS with only minor differences, which would make additional courses unnecessary at this time. A time may come when an increase in the number of courses required for accounting majors may be necessary. Although the SEC will not make a decision as to conversion until 2011, IFRS still needs to be incorporated into the curriculum in some form now. Given that this decision will only affect requirements for public companies, students will need to know both GAAP and IFRS. The effect on non-public, governmental, and not-for-profit entities is yet to be seen. One professor from North Carolina offered the possibility of one day having GAAP offered as a specialty or elective course (Nilsen, 2008).

In *On the Verge of an Academic Revolution: How IFRS is Affecting Accounting Education* by Nilsen (2008), several academic leaders from different universities offer these insights:

> (The University of) Alabama's Stone said the key to making all of the pieces fit within existing resources is making sure that students have a strong foundation in finance and economics.
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> The University of Missouri is considering combining fair value accounting and IFRS in a conceptual-based course "because of the need for students to develop more expertise in how to make good judgments regardless of the topical area," said the university's Loren Nikolai.
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> I suspect that we will have a course in valuation, related to fair value accounting, before all this is over," said Bel Needles of DePaul University. "Forensic accounting is another area that's becoming important. Ethics/professional responsibility is another area. All of these are important areas, and it's hard to say, 'OK, we're going to cut that one back and do something else here.' So, I think there's going to be a period of transition over the next

several years in which we'll see a lot of pressure to increase the amount of courses for accountants.

Large, multinational firms have already compiled large amounts of IFRS resources, begun training their staff in IFRS, and pushing accounting professors to incorporate IFRS into the classroom. Accounting departments need to start now developing curriculum changes as they look toward the future. The most difficult tasks for professors will be finding and assimilating all of the resources available, developing a curriculum that works in their classrooms, and educating themselves in all of the potential changes as convergence continues. Course work will need to be adapted to ensure that students are exposed to all the information they will need to succeed and that they are able to communicate, analyze and utilize critical thinking skills. However, professors should be mindful of the fact that as the profession moves toward conversion, IFRS should not be the main focus of the curriculum as it could all change before a destination is reached.

CONCLUSION

The convergence process that may ultimately lead to the conversion of GAAP to IFRS has been underway for several years. The culmination of these efforts is expected beginning in 2014. Regardless of the many advantages and disadvantages of the conversion, IFRS appears to be the reporting standard that will be required for the future. As indicated from the surveys presented, both the profession and academia are not prepared. All accountants must prepare themselves and become fluent in IFRS, along with GAAP. The impact on the accounting classroom is potentially great. Today's students must be made aware of IFRS, its principles, and its impact on the accounting world as we know it.

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