THE ROAD TO IFRS: CHALLENGES AND CONCERNS

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ABSTRACT

This paper investigates the complications associated with convergence of GAAP with IFRS as well as ultimate IFRS adoption. The authors conclude that while the adoption and use of a principles based, common financial reporting language is an attractive goal, the achievements of success is complicated by a number of factors; including: A. Many of the countries which adapted IFRS use carve-outs of the original statements which will impact comparability B. The absence of an international enforcement agency to be sure that the standards are followed as expected C. There is a lot of political influence on the IASB, especially from the EU. D. The lack of the funds available to finance the IASB operations. The authors also conclude that further work on convergence between IFRS and US GAAP should be the focus of the US for the time being. Adoption must not be considered before the completion of the Joint Projects between the two boards.

Keywords: Convergence, adoption, IFRS, IASB

INTRODUCTION

As capital markets have become increasingly global, US investors have seen a corresponding increase in international investment opportunities. In addition, US companies have increasingly turned to foreign investors to access capital.

However, if investors seek to compare the performance of US companies with others of different nationalities in the same industry, the task is made difficult by the use of different accounting standards. This led many groups to call for the adoption of one single set of global standards.

Since 2005, when the EU required all publicly listed firms to use the International Financial Reporting Standards (IFRS) and many other countries adopted these standards. Now the total is 113 countries. However, one noticeable absence from the "Global IFR Team" has been the United States.

In November 2008, the SEC issued for public comment a roadmap for implementing IFRS in the US. In the interim, since the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) signed the first Memorandum Of Understanding on September 18, 2002 (known as the "Norwalk Agreement") both bodies have been working diligently on the development of high quality compatible accounting standards that could be used for both domestic and cross border financial reporting. In January 2009 a new administration took over and a new SEC chair was chosen. The new chair indicated that she will determine the fate of the roadmap in the first quarter of 2010.

The aim of this paper is to determine the most important variables that may affect the SEC's decision to implement or not implement the roadmap. The paper does discuss the challenges that may face US issuers and investors if the SEC decides to implement the roadmap. The paper employs literature review technique to analyze these variables and challenges.

The findings of this paper show that while the use of a single set of global standards has some theoretical benefits, these benefits are not proven empirically for US investors.

THE ROADMAP

In August 2008, the Advisory Committee on Improvements to Financial Reporting to the SEC stated: "We proudly support the continued move to a single set of high quality global accounting standards, compiled with enhanced international coordination to foster their consistent interpretation and to avoid jurisdictional variants. Further, we encourage the development of a roadmap to identify issues and milestones to transition to this end state in the US, with sufficient time to minimize disruptions, resource constraints and the complexity arising from such a significant change."

On November 21, 2008, the SEC issued the "Roadmap for the Potential Use of Financial Statement prepared in accordance with International Financial reporting standards by US issues." The SEC's proposed plan was designed to provide a level accounting playing field on which US investors may make their investment decisions. If adopted, the roadmap will require IFRS to replace US GAAP as the basis for financial reporting by US issuers by as early as 2014 assuming certain implementation milestones are deemed to have been achieved by 2011.

These milestones relate to the following:

- Improvements in the current standards.
- Showing up the accountability and funding of the International Accounting Standards Foundation.
- Improvements in the ability to use interactive data for IFRS reporting (e.g. XBRL)/
- Improvements relating to IFRS in the education and training of investors, accountants, auditors, and other involved in the preparation and use of financial statements in the United States.
- Assessing the experience of US issuers who participate in the SEC's voluntary Pilot Program

The Benefits of Adopting IFRS

A common accounting and financial reporting language, applied consistently and rigorously world wide would:

- Increase comparability for investment analysis;
    - Enhance the efficiency of capital allocation on a global basis and decrease the overall cost of capital;
    - Increase the competitiveness of US companies and capital markets by eliminating barriers (costly requirements to report in or reconcile to, other accounting standards);
    - Improve the quality of financial reporting
    - Generate process and cost efficiencies for preparers, investors, auditors and other by operating in essentially a single accounting environment.

Concerns

The shift to IFRS affects a wide range of business functions beyond financial reporting. These may include changes to management's data gathering and information technology systems. The content of employee and executive pay plans, investor relations, changes to policies and procedures and internal control procedures will also change. The direct reporting and disclosure cost comes in many forms and includes the preparation, especially considering the opportunity cost for those involved in the process.

The SEC roadmap expects the cost per company to be around $32 million for a large company and in general the cost ranges from 0.125% to 0.13% of total revenue.

A number of tangential but significant costs will also result from changes in the rules. For example, a large number of companies consistently use LiFo inventory method which is not permitted under IFRS. For those companies, the current IRS regulation would require a tax payment for the accumulated difference between LiFo and FiFo.
Another example is the impact on identure covenants. Many issuers have issued debt securities under identure or have entered into audit agreements that may contain financial covenants based upon US GAAP, which could be violated under IFRS.
A further issue is the impact on litigation. The primary theoretical advantage of IFRS over US GAAP is the fact that IFRS is "principles-based" standards. This fact provides greater judgment by management and auditors and leaves both open to being second guessed later by plaintiffs in shareholders' class action cases.

Challenges in Education and Training

Reporting in accordance with IFRS by US issuers would increase the need for effective training and education about IFRS for investors, accountants, auditors and other involved in the preparation and use of financial statements. Colleges and Universities need to include IFRS in their curricula.

Funding of ISAB's Operations

The International Accounting Standards Committee Foundation (IASCF) has financed the IASB operations largely through voluntary contributions form a wide range of market participants from across the world's capital markets, including from a number of accounting firms companies, international organizations, central banks, and governments.
The foundation has a more difficult time to get the financial support that FASB enjoys in the US. Many have expressed their concerns about the ability of IASB to continue under the current funding model.

Limits to Comparability

The objective of using a single set of high-quality international accounting standards is simultaneously optimizing capital markets efficiently by having transparent, understandable, enforceable and rigorously applied standards. However, there are only a few countries that use IFRS as issued by the IASB. Most of the nations that currently use IFRS do not use them as issued but with local variations.
The authors discuss there reasons behind this fact.

A. Culture. Tsakumis (2007) posits that accountants are expected to apply accounting standards consistent with their cultural values.
B. Management Incentives. Many recent studies indicate that changing accounting standards alone can't make corporate reporting more informative or more comparable. This literature highlights the importance of firms' reporting incentives as key devices of observed reporting quality (lenz et al, 2006) Reporting discretion allows managers to use their private information to produce reports that are more impacted by the incentive to achieve certain financial targets.
C. Independence. The independence of the IASB remains a concern to many.

CONCLUSION

Although the notion of achieving a single set of high-quality accounting standards has its own benefits and merits. There are a lot of concerns. The most important one is in order to achieve comparability. All the countries which use IFRS must use them consistently without modification and we must have an oversight organization to be sure of compliance. The second major concern is the outstanding major differences before IFRS and US GAAP and for that reason, the authors recommend that the IASB and FASB should complete all their Joint Projects before any decisions are made to require US firms to use the international standards. The third one is we must be sure that the IASB has a continuous stream of funds to operate efficiently and independently.

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Note: A set of references, may be obtained from the first author.