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## IFRS and the Impact on Today's CFO

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JULY 16, 2009  
CORPORATE AND EXECUTIVE EDUCATION  
DREXEL UNIVERSITY, LEBOW COLLEGE OF BUSINESS



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## **Executive Summary**

### The Road to IFRS

In 1973, a single global set of standards for accounting and reporting was developed by the International Accounting Standards Committee (IASC). Until 2001, this set of standards was known as the International Accounting Standards (IAS). Subsequent to 2001, these standards have been designated International Financial Reporting Standards (IRFS) by the International Accounting Standards Board (IASB), the international standard setting equivalent of the U.S. based Financial Accounting Standards Board (FASB).

As a general rule, IFRS standards are broader than their U.S. counterparts, US GAAP, with limited interpretation. The IASB has generally avoided defining the principles of IFRS, preferring to leave interpretation to preparers, and its official interpretive body, the International Financial Reporting Interpretations Committee (IFRIC).

#### Hierarchy of Standards

1. IAS/IFRS or IFRIC (interpretations) when applicable to specific transactions
2. Absence of direct standard(s), use judgment
3. If not possible to use judgment, look to recent announcements of other standards setters (US GAAP)
4. If all else fails, look to IASB framework

### Where are we – and why are we here?

Ten to fifteen years ago, IAS was not widely used and few preparers in the US were even familiar with IAS. If you worked with an international organization using those standards and had questions, you had to contact someone in the UK to get answers. Today, all major non-U.S. markets have adopted IFRS or are quickly moving in that direction.

IFRS uses a principles-based approach rather than rules-based; preparers are expected to make more judgment calls (IFRS has 2,500 pages versus US GAAP's 25,000 pages). Sir David Tweedie, Chair of IASB, has been quoted as saying, *"I don't think you have to use a search engine to do accounting.... The profession is about making a call, not looking up page 17,493 to see what the answer is."*

The U.S. Securities and Exchange Commission (SEC), however, is not comfortable with judgment calls, particularly with the explosion of new financial products that have come from Wall Street in the past 10 years; it prefers to have the rules spelled out. In 2007, the SEC proposed and ultimately adopted a rule change to allow

foreign companies with U.S. based divisions to file financial statements prepared using IFRS as published by the IASB without any reconciliation to US GAAP.

### The U.S. Dilemma – converge or adopt?

It is not surprising that many people who follow the development of worldwide accounting standards might be confused. Convergence – a term that suggests elimination or coming together of differences - is a high priority on the agendas of both the U.S. FASB and the International IASB.

In 2002, the FASB and the IASB announced they would work together to make their existing financial reporting standards fully compatible as soon as is practicable. In a subsequent memorandum of understanding, the FASB and the IASB agreed that a common set of high quality, global standards remained their long-term priority and established a plan to align the financial reporting of U.S. companies under US GAAP with that of the international companies using IRFS.

In the long-run, adoption will be less expensive. The costs for conversion to IFRS are enormous. Last fall the SEC proposed to make IFRS mandatory, for certain US filers, starting in 2014. It will also allow a select group of early adopters to voluntarily start filing statements using IFRS as soon as 2009. The SEC expects to use the outcomes of those early adopters in making the determination to implement mandatory acceptance of IFRS in the U.S. There is, however, no incentive to “early adopt” since the decision for mandatory adoption will not be made until 2011 and could result in the SEC deciding against implementation.

### Regulatory issues (aka SEC)

In November 2008, the SEC acknowledged the value of a single set of standards:

*“The Commission recognizes that the use of a single, widely accepted set of high quality accounting standards would benefit both the global capital markets and U.S. investors by providing a common basis for investors, issuers and others to evaluate investment opportunities and prospects in different jurisdictions. U.S. investors would be able to make better-informed investment decisions if they were to obtain high-quality financial information from U.S. companies that is more comparable to the presently available information from non-U.S. companies operating in the same industry or line of business. Capital formation and investor understanding would be enhanced if the world’s major capital markets all operated under a single set of high-quality accounting standards that elicit comparable, high-quality financial information from public companies.”*

With the publication of the SEC’s proposed “Roadmap,” the adoption of IFRS is becoming a more likely possibility in the United States. The SEC’s decision on whether to require adoption of IFRS mandatory will be based on following milestones and conditions:

1. Improvements in accounting standards (convergence activities between IFRS AND US GAAP)
2. Accountability and funding of IASCF (International Accounting Standards Committee Foundation) and IASB
3. Improvement in the use of interactive data (XBRL) for IFRS
4. Progress on IFRS education and training in U.S.
5. Limited early use option for eligible issuers: The SEC will permit certain U.S. companies meeting specified criteria to voluntarily file IFRS financial statements with the SEC for years ending on or after December 2009. Based on a preliminary assessment, the SEC stated that approximately 110 companies across 34 industries would qualify for this provision.
6. SEC to determine mandatory use based on Milestones 1-4 and experience gained from Milestone 5
7. Implementation of mandatory use

It is anticipated that IFRS reporting would be required and phased in as follows for filings for the years indicated:

Large accelerated filers – 2014

Accelerated filers 2015

Non-accelerated filers 2016

The SEC mandated that three years of audited financial statements would be required in the first year of IFRS reporting. Assuming a 2014 conversion date, this means a calendar year, large accelerated filer would need to include in its filings for 2014: balance sheets as of the end of December 2014 and 2013 and income statements, cash flow statements, and statements of changes in equity as of the end of December 2014, 2013, and 2012. In addition, First time Adoption of IFRS would require the inclusion of the “opening balance sheet” as of the date of transition to IFRS (in this example – the first of January 2012).

## Impact of adoption of IFRS

Key differences between IFRS and US GAAP:

### **US GAAP**

#### Long-lived assets

PP & E carried at historical cost less accumulated depreciation

#### Subsequent events

Waiver of debt covenant violation after balance sheet date may “cure” default for purposes of determining classification of debt

#### Income taxes

Deferred tax assets are always recognized gross – with val allow

Deferred taxes are classified as net current or net non-current by jurisdiction

#### Goodwill impairment

Two-step Process

#### Provisions

Recognize when “probable” meaning likely (75-80%)

Range of outcomes – use low end if no single amount is most likely

#### Leases

Uses “criteria” to determine if lease is

capital/finance lease

Economic life > 75%

Fair value > 90%

#### Inventory

LIFO method allowed

Reversals of write downs are prohibited

### **IFRS**

#### Long-lived assets

PP&E historical cost or revalued amount, however, the Company must revalue to fair value on a regular basis

#### Subsequent events

Waiver of debt covenant after balance sheet date does not cure default and debt is classified as current

#### Income taxes

Deferred taxes are recognized only when “probable”

Deferred taxes are always classified as non-current

#### Goodwill impairment

One-step process

#### Provisions

Recognize when “probable” meaning more likely than not (> 50%)

Range of outcomes – use mid-point in range if no single amount is most likely

#### Leases

IAS 17 looks at “substantially all the risks and rewards incident to ownership”

No bright lines – consider all factors

#### Inventory

LIFO method not allowed

Reversals of write downs are required subsequent recoveries

## Conclusion

The conversion to IFRS will have an all-encompassing effect on the U.S. capital markets requiring changes in the way preparers prepare, and users use, financial statements, as well as more fundamental changes in the way the U.S. educates future accountants and business people. The success of a uniform set of global accounting standards will also depend on the willingness of national regulators and industry groups to cooperate and to avoid issuing local interpretations of IFRS and guidance that provides exceptions to IFRS principles.

The conversion to IFRS for at least public companies in the U.S. is a matter of “when and how” and not “if.” At first glance, 2014 may sound like it’s a long way off; however, many companies have already taken the first steps towards preparing for the inevitable conversion to IFRS. Adopting IFRS is not just another technical accounting exercise. Its impact is far-reaching and will affect many, if not all, of a company’s business units. The complexities are enormous, and a comprehensive implementation program will take time to implement. It is important that companies begin now to plan and address all pertinent issues surrounding conversion to or adoption of IFRS.

#### Additional Resources

SEC Roadmap: <http://www.sec.gov/rules/proposed/2008/33-8982.pdf>

IFRS: <http://www.iasb.org/Home.htm>

IFRS for SME’s: <http://www.iasb.org/News/Press+Releases/IASF+publishes+IRFS+for+SMEs.htm>



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