

Global accounting harmonization – A challenging change

Introduction

The old adage “with change comes challenge” is certainly proving true as many countries, including all 25 members of the European Union, require adoption of International Financial Reporting Standards (IFRS) – formerly known as International Accounting Standards (IAS) - for the first time in 2005. For example, some 2,000 listed companies in the UK alone will need to convert from UK GAAP to IFRS this year using special transition rules covering past transactions and opening balances.

Adding to this challenge, approximately 10% of the companies listed on the NYSE and NASDAQ are non-U.S. companies. These include some of the largest corporations in the world, and the SEC requires them to submit either:

- Financial statements that conform to U.S. GAAP, or
- Financial statements prepared using other GAAP (e.g. IFRS) accompanied by a reconciliation of earnings and net assets to U.S. GAAP figures.

Sarbanes-Oxley has however contributed significantly to the decrease in new listings on the U.S. markets, due to the added cost of compliance. The result has been more listings in Europe and therefore a greater use of IFRS.

Conclusion: Cross-border accounting issues are here to stay.

The Challenge for U.S. Companies

With an economy that has never been more global than it is today, the challenges (as well as the benefits) of international accounting aren't only for foreign companies. U.S. subsidiaries of foreign entities must follow the same accounting standards as their corporate parents – and for many, that means IFRS. Likewise, U.S. multinational entities seeking to enter new markets or to expand operations abroad may need to provide IFRS financial statements in order to obtain an operating permit or to raise capital. They will also find it increasingly easier to recruit local staff that are familiar with IFRS rather than with U.S. GAAP.

Even without an explicit requirement for IFRS reporting, some U.S. companies may choose to supplement their current U.S. GAAP reporting in order to make their financial results comparable with those of their foreign competitors who report under IFRS. International analysts will increasingly expect corporate results to be reported on a common basis.

The Challenge for Standard-Setters

In 2002, the FASB and the International Accounting Standards Board (IASB) reached agreement on a project to eliminate major differences between IFRS and U.S. GAAP (see http://www.fasb.org/intl/convergence_iasb.shtml). No doubt, this challenge has been more difficult than many expected, but it is important to note that several other major countries (including Japan, Russia, and Australia) have made similar decisions to harmonize their accounting standards with IFRS, now considered the international benchmark.



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Some of the signposts in the convergence of U.S. GAAP with IFRS include:

- SFAS 151 brings U.S. GAAP in line with IFRS in accounting for unused capacity and spoilage, as a result of the joint convergence project;
- SFAS 153 brings U.S. GAAP in line with IFRS in accounting for non-monetary exchanges;
- SFAS 123R requires fair value accounting for employee stock options using comparable methods to IFRS 2; and
- SFAS 146, on restructuring specifically refers to IAS 37 as justification for that standard.

Although considerable progress has been made thus far, convergence of IFRS and U.S. GAAP is far from complete. Some of the differences still under review include accounting policies; construction contracts; investments in joint ventures; interim financial reporting; and research and development costs.

Stable Platform

Beginning in 2005, all 7,000 EU publicly-traded companies are required to apply IFRS in the preparation of their consolidated financial statements. This represents yet another challenge as preparers of financial statements from Latvia to Portugal and from Poland to Sweden grapple with unfamiliar requirements. In preparation for this sweeping change, the IASB completed its “stable platform” of standards in March 2004. New and revised standards included five new IFRSs and seventeen amended IASs, resulting from the IASB’s Improvements Project and Phase I of its Business Combinations Project. Some of the more significant revisions to IFRS that resulted from these projects include:

- The LIFO method for costing inventories is no longer allowed;
- The concepts of “fundamental error” and “extraordinary items” are eliminated;
- Trading securities are now included in a larger defined category of financial instruments “at fair value through profit or loss” and entities may designate any financial asset or liability into this category (commonly referred to as “the fair value option”);
- Fair value hedge accounting may now be used more readily for a portfolio hedge of interest rate risk;
- Guidelines for share-based payments have been added;
- The pooling of interests method for business combinations is no longer allowed;
- Goodwill is no longer amortized, and negative goodwill is not recorded in a business combination; and
- New requirements for non-current assets held for sale and discontinuing operations have been provided.

Current IASB Considerations

Since completion of the “stable platform”, the IASB has issued IFRS 6, “Exploration for and Evaluation of Mineral Resources”, and several Interpretations of IFRS and amendments to current standards.



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In addition to the continuing Convergence Project with the FASB, the IASB currently has numerous other accounting issues on its agenda, including:

- Insurance contracts – Phase II of the IASB project;
- Financial reporting by small and medium-sized entities;
- Business combinations – Phase II (purchase method procedures);
- Disclosures for financial instruments;
- Standards and guidance for management commentary;
- Financial guarantees and credit insurance;
- Cash flow hedge accounting of forecast intra-group transactions; and
- Reconsideration of the “fair value option”.

Your Challenge

Whether you are the CFO of a multinational company or a CPA who has never heard of IFRS (and never wanted to), the fact remains that IFRS is coming and it will change your job. Your challenge is to acknowledge that the global accounting environment is on the move, and that your profession is being affected by factors beyond your borders.

Are you ready to be proactive? If so, then take the time to understand the differences between IFRS and U.S. GAAP, since these will be the focus of future standard-setting. Are you ready for the challenge?

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About the author

Susan Thetford is an international instructor for IASeminars in Europe and the USA, as well as a consultant specializing in the implementation and application of International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA). An expert in bank accounting issues, she has presented conferences, seminars and workshops in the USA, the UK, Mongolia, Central Asia, Ukraine, and the Balkans. In addition to teaching for IASeminars and others, Susan is currently writing IFRS technical material for a major US publisher. She is a CPA and was formerly the Midwest Regional Accountant for the Office of Thrift Supervision.

