

IFRS CONVERSION: ROADMAP OR ROADBLOCK?

By Tom Visotsky, CPA



BLOCK?

The U.S. Securities and Exchange Commission (SEC) has issued its proposed roadmap for International Financial Reporting Standards (IFRS). Or has it? And if it has, it reserves the right to change its mind.

Officially, the SEC released its much delayed roadmap for continuing progress toward IFRS adoption on November 14, 2008. The SEC indicated that it “has long expressed its support for a single set of high-quality global accounting standards as an important means of enhancing ... comparability ... [and that it] believe(s) that IFRS has the potential to best provide the common platform on which companies can report and investors can compare financial information.”

The roadmap, however, leaves considerable uncertainty as to the ultimate destination for U.S. public companies.

The SEC has put up seven hurdles for the profession to clear. If, in the opinion of the SEC, these seven milestones have been met, the SEC will determine in 2011 whether or not it should proceed with rulemaking to require U.S. issuers to start using IFRS in 2014.

There are really four relevant milestones and, unfortunately, some are rather vague. See below for details.

Improvements in accounting standards

The SEC references the Norwalk Agreement, which marked the October 2002 memorandum of understanding issued jointly by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB).

The SEC notes ongoing work on significant standards such as revenue recognition and financial statement presentation; whether the standards are established through an independent process; and whether the new standards are an improvement to financial reporting relative to those they are replacing.

IASC Foundation accountability and funding

The International Accounting Standards Committee (IASC) Foundation has been largely funded through voluntary contributions from “... firms in the accounting profession, companies, international organizations, central banks and governments.”

The SEC wants a mechanism in place by 2011 that realizes the “IASC Foundation’s goal of receiving open-ended funding commitments from a broad base of constituents and that are compulsory (which) would encourage the independent functioning of the IASB in the standard-setting process.”

Clearly, the SEC is concerned that if the IASB’s funding is conditional upon individual governmental or organizational decisions, there could be undue influence applied in the standard-setting process. ▸





Improvement in using interactive data for IFRS reporting

XBRL, the interactive data format using eXtensible Business Reporting Language, was developed to provide detailed information for investors. The SEC issued rules in May 2008 to require companies to use XBRL on their websites and in SEC reports.

XBRL allows investors, investment advisors and other interested parties to review this data in an interactive format, and it is dependent on a list of tags for interactive data reporting. The SEC will consider “the state of development of an IFRS list of tags” in determining whether to move to IFRS. The IASC Foundation has published a complete list of tags since 2004 and publishes annual updates, with the most recent published in July 2008.

IFRS education and training

The SEC roadmap states the obvious by indicating that “the main benefits to investors of a single set of high-quality globally accepted accounting standards would be realized only if investors more fully understood the basis for the reported results.” Investors, accountants, auditors, actuaries, valuation experts, bankers and others would need to become familiar with the new standards. This would also require colleges

and universities to add IFRS to their curricula, and the American Institute of CPAs (AICPA) Board of Examiners to add IFRS to the Uniform CPA Examination.

The SEC acknowledges that “the private sector may also respond to any increase in demand for education about IFRS by making educational materials available.” It’s hard to imagine that the private sector wouldn’t respond with offerings to bridge any knowledge gap, particularly if there is a more definitive timetable on the convergence to IFRS.

Other objectives

The other three items mentioned by the SEC don’t really fit the definition of “milestones.” The roadmap lists:

- The limited early use of IFRS, which allows some of the largest companies to adopt early and may help inform the SEC as to whether it should mandate IFRS for all other companies
- The anticipated timing of future rulemaking, which simply states that they’ll complete a study and review the roadmap again in 2011, and if they do move forward, they will require three years of audited IFRS financials to be included in the statements
- The implementation of the mandatory use of IFRS by U.S. issuers, which indicates that the SEC is considering a staged transition based on the status of

large accelerated, accelerated and non-accelerated filers, and may even review their transition rules to expand the eligibility rules for early adopters

IFRS adoption concerns

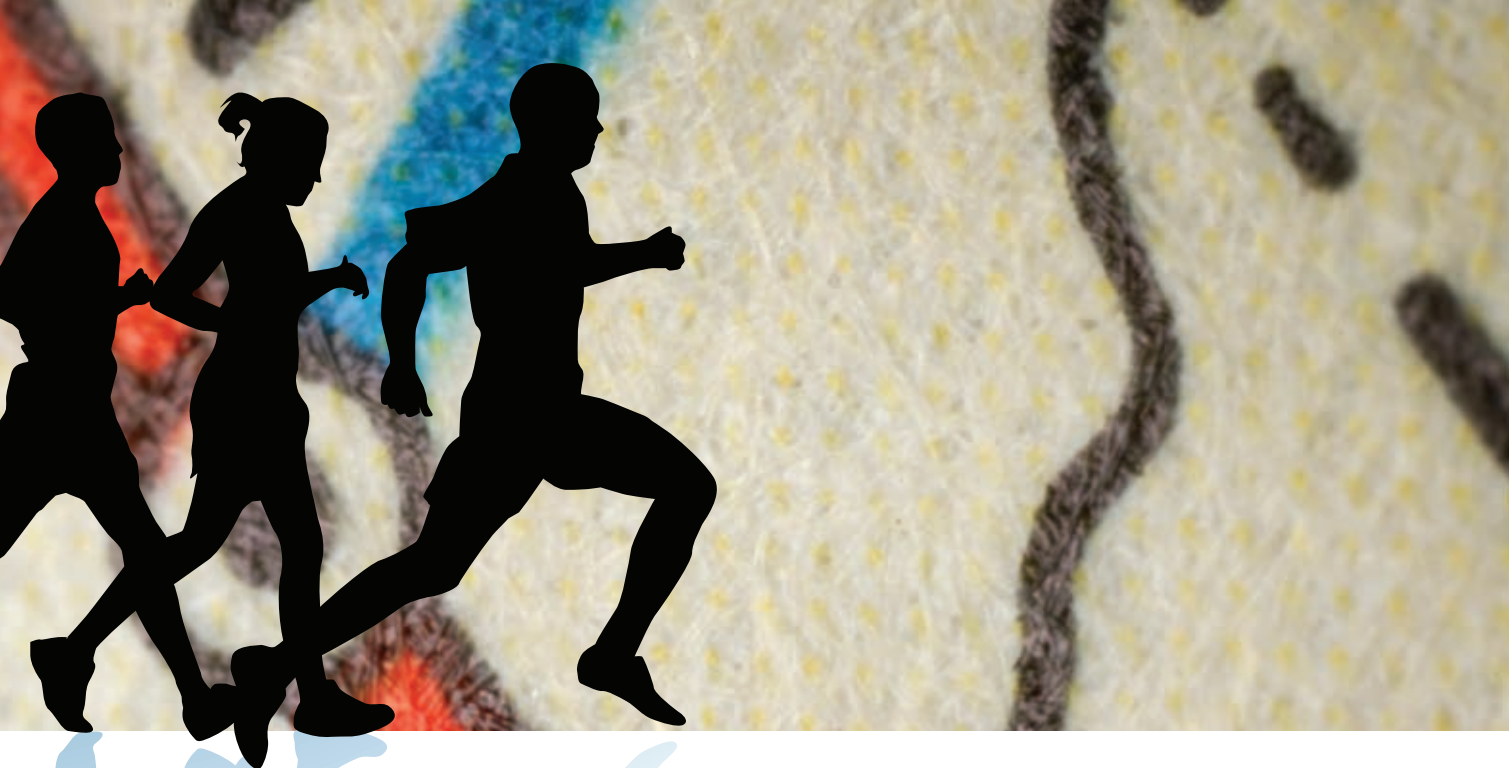
The new chairman of the SEC, Mary Schapiro, in her January 15, 2009, nomination hearing to the U.S. Senate Committee on Banking, Housing and Urban Affairs, indicated a number of concerns about IFRS adoption. Her greatest concern was the independence of the IASB.

She also stated other issues, including a lack of consistency in applying the standards worldwide; limited detail provided in the standards as compared to U.S. Generally Accepted Accounting Principles (GAAP); and the costs to convert. She indicated that she would “take a big deep breath and look at this entire area again carefully,” further stating she would not necessarily feel bound by the existing roadmap currently out for comment.

In February, the SEC extended the comment period on its proposed roadmap, at the request of many registrants, to April 20, 2009.

Hurdles to early adoption

The roadmap permits some companies to early adopt IFRS. Keeping with the



SEC's theme, however, there are some additional hurdles to clear if you want to adopt early.

First, you must be in an industry where IFRS is the predominate method of financial reporting for the top 20 companies worldwide. The SEC estimates that 34 of the 74 industry classifications it identified would qualify as IFRS industries.

Next, you must be among those 20 largest companies in terms of market capitalization. You'll have to do this research yourself and, if you think you qualify, you'll have to submit a request to the SEC, along with your supporting data, and receive a letter of no objections. You'll have up to three years to adopt IFRS once you receive the letter, or the exemption will expire.

Based on these criteria, the SEC estimates a minimum of 110 U.S. issuers would qualify for early adoption.

Theoretically, a company that obtained a letter of no objections could file IFRS statements for the year ended December 31, 2009. However, even though IFRS only requires two years of audited financials, the SEC is inclined to require three. As such, a calendar year 2009 IFRS filer would have to present audited IFRS financials for the years ended December 31, 2007, and 2008 as well. That would be a pretty tall order for almost all companies.

The tone from the SEC seems to play up the negative. As Schapiro indicated in her testimony, the roadmap provides an

estimate of the costs of conversion. For the 110 issuers that believe they will qualify for early adoption, the SEC estimates the costs to be \$32 million per company. Of course, this is a three-year estimated cost, up to 75 percent of which will be borne internally. The 25 percent or so that represents outside professional assistance is estimated to cost companies \$400 per hour. Perhaps companies can negotiate a better rate than \$400 per hour, and \$10.7 million per year for three years sounds different than \$32 million.

It's still a lot of money, but we are also talking about companies that, by definition, are among the 20 largest capitalization companies in the world in their industries. Many of these companies want to early adopt because they already report under IFRS in other countries, and having a consistent worldwide financial reporting system will save money. No effort seems to have been made to account for the offsetting benefit that at least some companies would achieve through this standardization process.

IFRS 1 only requires a one-time reconciliation from GAAP financial statements to IFRS statements. However, the SEC has floated what is perhaps a trial balloon in its roadmap, called "Proposal B." Under this proposal, companies would continue to disclose, on an unaudited basis, reconciliation from IFRS to GAAP for all three years in the initial IFRS filing, as well as on an ongoing basis. ▶



SOUND OFF: IFRS inevitable?

What is the fate of IFRS, given recent changes at the SEC? Is early adoption worthwhile? Is convergence inevitable, or will the U.S. be the only industrialized country not using international standards? Check out Visotsky's blog post on the VSCPA's new blog, www.CPACafé.com, and let us know what you think will — and should — happen with IFRS.



Perhaps most stunning is one of the reasons noted: “Consequently, were the Commission to determine not to continue to permit or require U.S. issuers to use IFRS, those issuers who had elected to report under IFRS could more easily return to reporting in accordance with GAAP.”

Is IFRS really set in stone?

To summarize, the SEC issued its proposed IFRS roadmap, but it could recall it. The SEC will also try to be more definitive in 2011 if various milestones are met — but some of those are vague.

Should you determine you’re eligible to convert, and the SEC agrees, you can spend \$32 million and thousands of man-hours and, if it changes its mind, it will make your life easier when you re-convert back to GAAP because it may require annual reconciliations between GAAP and IFRS.

Of course, you may also need to implement a whole new system as well. With that in mind, I asked some experts to find out what companies were planning to do regarding IFRS.

Industries respond

The consensus seems to be that the biggest impediments to a transition from GAAP to IFRS are the SEC and the current state of the economy.

Wendy Hambleton, partner and national SEC director for BDO Seidman, LLP, indicated that “without a date certain, there are substantial disincentives to early adopt IFRS.” She went on to state that a “firm date would increase the likelihood of successfully

achieving the milestones as well.” BDO Seidman is the U.S. member firm of BDO International, the fifth largest worldwide network of public accounting firms with offices in 110 countries.

According to Tom Wohlfarth, senior vice president and chief accounting officer of Dominion Resources, Inc., “Dominion will still be ready for implementation as necessary, but at this point we really need to see where Schapiro is going to go with IFRS before we put any significant amount of effort or resources into it.” Dominion is a diversified utility with more than \$16 billion in annual revenues.

Tredegar Corp., a \$900 million manufacturer of plastic films and aluminum extrusions, falls in the same camp. “The company continues to monitor the differences between IFRS and GAAP,” said Drew Edwards, vice president, treasurer and CFO. “But we don’t expect to adopt IFRS sooner than it is required by the SEC, which at this point might be 2014.”

The cost of conversion was also cited as a factor by some companies.

Representative of these was James Bierman, senior vice president and CFO of Owens & Minor, Inc., who said: “Clearly the costs of this initiative must be reconsidered by the new administration. To the business community, it is apparent that the costs of conversion significantly exceed any reasonable expectations of future benefits.” Owens & Minor is a medical equipment wholesaler and provider of supply chain management services with annual revenues in excess of \$7 billion.

Scott Faison, senior vice president of

finance and CFO of Colfax Corp., reiterated this view, saying Colfax had its units keeping books in GAAP already. “So there is no pay-back for us to convert until it is required,” Faison said. Colfax doesn’t plan to make any investments toward IFRS until it is required and the path is clear, he stated. Colfax designs, manufactures and distributes fluid handling products and has revenues of nearly \$600 million.

Michael Walworth, co-founder of GAAP Seminars, a training and consultancy firm specializing in tailored IFRS and GAAP training, believes that “the SEC is just hesitant to pull the trigger now given the economy. SEC can delay the comment period all they want, but IFRS will eventually be required by public companies in the U.S.

“Since foreign filers are already allowed to use IFRS when filing in the U.S.,” Walworth continued, “it seems only fair that the SEC would allow U.S. companies to do the same should they choose to do so.”

Leslie Murphy, president and CEO of Murphy Consulting, former chair of the AICPA and member of the audit committee of the board of directors of Kelly Services, believes “a single set of global standards for public and private companies is inevitable.” She also believes that IFRS will evolve to become that standard.

However, she doesn’t expect that many public companies will invest the resources to convert to IFRS until the SEC affirms plans to change to IFRS and sets a firm transition date. “There is simply too much uncertainty, and resources are too constrained in the present economic environment,” she said. Kelly Services is a provider of staffing solu-



tions with revenues of \$5.5 billion.

The AICPA supports IFRS and its “goal of a single set of high-quality, comprehensive accounting standards to be used by public accountants in the preparation of transparent and comparable financial reports throughout the world,” according to Arleen Thomas, AICPA senior vice president of member competency and development.

While recognizing the many benefits of IFRS, Arleen said the AICPA acknowledges that the implications of switching from GAAP to IFRS would be sweeping and would require revisions to “law, regulation, standard-setting, corporate reporting systems, accounting and audit practices, professional education, academic preparation and the CPA Exam.”

The AICPA will help lead the accounting profession and financial community through this transition if, and when, the SEC issues a rule,” Thomas said. She encouraged those interested to visit the AICPA’s dedicated website at www.ifrs.com.

Future uncertain for IFRS conversion

In summary, the SEC and the economy have delivered a one-two punch to proponents of IFRS. Unless strong comments are received by the end of the comment period in April, and the SEC revises some of its positions and public statements, IFRS is likely to wander aimlessly, searching for direction.

As long as Mary Schapiro keeps talking about “Proposal B,” or the possibility that the SEC might not approve IFRS in 2011, or might require companies that had converted

to revert back to GAAP, it’s unlikely that many, if any, companies will risk the money and resources it will take to convert.

Without a firm date certain, and unequivocal forward movement with no turning back, it is possible that IFRS could become accounting’s version of the metric system. In case your memory is short, Congress passed the Metric Conversion Act in 1975. It’s now 34 years later and the U.S. is the only industrialized country in the world that is not on the metric system.

According to the SEC, approximately 113 countries currently require or permit IFRS, and others have plans to adopt it. They say that those who don’t study history are destined to repeat it.

Will the U.S. be the only industrialized country in the world that doesn’t utilize IFRS? Will the SEC be talking of a new convergence plan 34 years from now? Stay tuned.

By the way, what’s the temperature in centigrade today? □



Tom Visotsky, CPA, is a past chair of the VSCPA Board of Directors and former member of the AICPA Governing Council. He is business development director at BDO Seidman, LLP, in Richmond. Contact him at tvisotsky@bdo.com.



LEARN ABOUT IT: IFRS CPE

For more information or to register for the below VSCPA courses, visit the “CPE & Networking” section of the VSCPA website at www.vscpa.com or call (800) 341-8189.

- **8th Annual VSCPA Industry Conference**
May 28–29
The Williamsburg Lodge
“IFRS Update” session,
May 29
- **Are You Ready for IFRS? Moving Beyond the Basics**
September 21
Richmond CPA Center
October 26
Waterford at Fair Oaks,
Fairfax
- **International vs. U.S. Accounting: What in the World is the Difference?**
November 12
Waterford at Fair Oaks,
Fairfax