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International Financial Reporting Standards

Over the past year a lot has been written in financial publications about IFRS, or International Financial Reporting Standards. IFRS is a comprehensive set of accounting standards that has been written by the International Accounting Standards Board (IASB), and which have been offered around the world as a replacement to each country's individual accounting standards. In the United States accounting standards are written by the Financial Accounting Standards Board (FASB), and most developed countries have something like it to write their own accounting rules.

The IASB's goal is that companies in every country will report their financial results under one set of accounting rules – instead of using accounting rules that are unique to a particular country. The FASB and the American Institute of CPAs (AICPA) agreed with this goal, as did our Securities and Exchange Commission (SEC). Things began in earnest in 2002 when the leaders of the FASB and IASB met and agreed to "converge" the accounting standards that each group writes. As a result, the FASB has been consistently changing our accounting rules to make them similar to international rules. Under their plan US accounting standards would eventually be replaced by international standards. The leaders of the IASB, FASB, AICPA and SEC started using the exact same catch-phrase when saying their goal was to establish:

> *"One single set of high quality, understandable and enforceable global accounting standards"*

The people that support international accounting standards list a number of benefits, including enhanced comparability between companies in different countries, improved functioning of capital markets (as an example the stock market) and simplified accounting systems for multi-national companies (which use different accounting standards in different countries).

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So Why Aren't We Already Using It?

The turning point for IFRS was in 2005 when it was adopted as the controlling accounting standard in the European Union. At that time 7,000 publicly-traded

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European companies began reporting their financial results under IFRS. However IFRS has not been uniformly adopted. Some countries have created local "flavors" of the standards, which removes one of the stated benefits of adopting them – comparability between countries.

There are a number of major differences between US accounting standards and IFRS, the most important being the basic philosophy underlying them. The international standards have been written as a principles-based system; meaning that they are fairly broad guidelines which rely heavily on the judgment of the accountant applying them. In America our standards have been written as a rules-based system; meaning that they are quite detailed and try to limit the range of differences in judgment between accountants. Just using the weight test the difference is quite large – US accounting standards fill 25,000 pages, while IFRS fills only 2,500 pages.

These differing philosophies result in big, practical differences in interpretation of the standards. In addition, many specific differences remain between US and international accounting standards. As an example international accounting standards do not allow last-in-first-out ("LIFO") accounting for inventories. Also, international standards use fair value accounting techniques much more broadly than in America (which will be the subject of the next newsletter).

Despite these differences the AICPA announced that it had selected the IASB as a recognized standard setter on May 18, 2008, which "gives AICPA members the option to use IFRS as an alternative to" US accounting standards. So American CPAs can use IFRS right now, but there are important reasons why they aren't just yet. As examples: it is not clear whether banks will accept financial statements prepared under IFRS; it is not clear what position the Internal Revenue Service will take regarding IFRS.

The Winds are Changing

Until recently the heads of the FASB, AICPA and SEC were united behind the idea that US companies should use IFRS. The SEC even issued a preliminary plan that would have every publicly-traded company in the US reporting under IFRS by 2016, with the largest US public companies having the option to use it as early as 2010. But the new head of the SEC, Mary Schapiro, has been reluctant to endorse a switch to IFRS. Recently she slowed down the plan to shift companies over to it. Other voices in the Obama Administration are more supportive of IFRS, but so far the message is mixed.

It is not likely that things will be settled quietly or quickly. Switching to IFRS will have a broad impact on the way we do business, and could have a number of side-effects. For the time being the best approach seems to be to keep updated on developments and be prepared to react if IFRS is eventually adopted in America. There are a number of resources available to learn more about IFRS, including a web site devoted exclusively to the subject, www.ifrs.com.

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