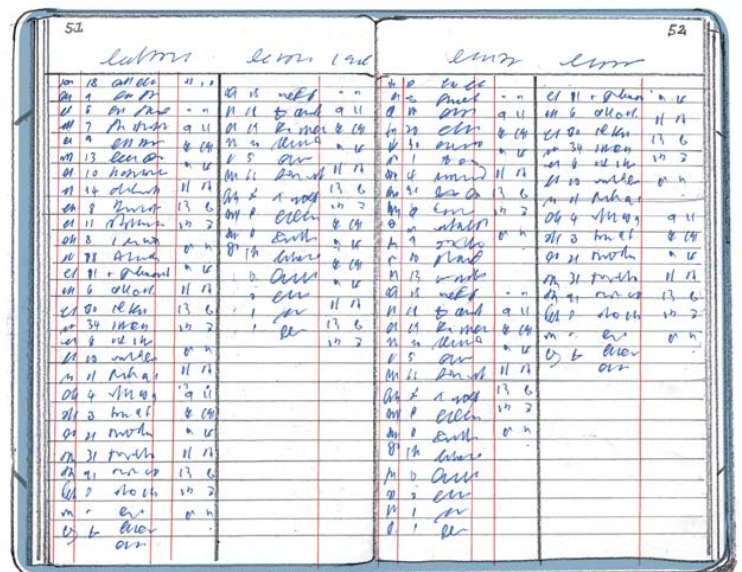


The Current State of IFRS

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The image shows an open notebook with two pages of handwritten accounting entries. The pages are numbered 51 and 52. The entries are organized in columns, with dates and descriptions on the left and numerical values on the right. The handwriting is in blue ink on lined paper.

51		52	
debit		credit	
10/18	ad. lco	11/11	ad. lco
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10/20	ad. lco	11/13	ad. lco
10/21	ad. lco	11/14	ad. lco
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11/4	ad. lco	11/28	ad. lco
11/5	ad. lco	11/29	ad. lco
11/6	ad. lco	11/30	ad. lco
11/7	ad. lco	12/1	ad. lco
11/8	ad. lco	12/2	ad. lco
11/9	ad. lco	12/3	ad. lco
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12/2	ad. lco	12/26	ad. lco
12/3	ad. lco	12/27	ad. lco
12/4	ad. lco	12/28	ad. lco
12/5	ad. lco	12/29	ad. lco
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What is IFRS?

The International Accounting Standards Board (IASB)

History and structure

The original international standards setter was the predecessor to the International Accounting Standards Board (IASB). The International Accounting Standards Committee (IASC) was formed in 1973, soon after the formation of the Financial Accounting Standards Board (FASB). Over the course of approximately 28 years, the IASC had issued 41 standards, called International Accounting Standards (IAS). Its interpretive arm, the Standing Interpretations Committee (SIC), had issued 33 interpretations. Several of the standards and interpretations have since been superseded or withdrawn, and several others have been modified. During its existence, the IASC had difficulty getting anyone to follow its rules. It was criticized for simply endorsing accounting methods that were in use at the time, rather than providing quality standards. It was also considered by some to be the lowest common denominator because it allowed for many alternative accounting treatments.

In 2001 the IASC was disbanded. A new structure, similar to the structure used in the U.S. for the FASB, was put into place. The IASC Foundation oversees the IASB, an advisory group called the Standards Advisory Council provides additional input, and the International Financial Reporting Interpretations Committee (IFRIC) was formed to provide interpretations of the standards similar to the previous SIC. The IASB has so far issued eight new standards called International Financial Reporting Standards (IFRS), in addition to modifying many of the IAS of its predecessor. The IFRIC has issued 15 new interpretations. The IASB has largely focused on improving the quality of existing standards, providing standards in areas where they did not yet exist, and converging accounting standards around the world. The Board's approach has been to provide guidance more in the form of general principles rather than rules. Partly that involves less interpretive activity on the part of the IFRIC, especially compared to the Emerging Issues Task Force (EITF) in the U.S., for example. Partly that involves resistance to providing industry-specific accounting guidance. One of the IASB's current projects, which is a joint effort with the FASB, is revising its current conceptual framework.

Current state of IFRS

The following table lists the eight IFRS that are in effect at September 1, 2008.

IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments

The 29 IAS that remain in effect at September 1, 2008 are listed below.

IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Statement of Cash Flows
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events After the Reporting Period
IAS 11	Construction Contracts
IAS 12	Income Taxes
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 31	Interests in Joint Ventures
IAS 32	Financial Instruments: Presentation
IAS 33	Earnings per Share
IAS 34	Interim Financial Reporting
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IAS 41	Agriculture

The following 26 interpretations of the IFRIC and its predecessor, the SIC, are in effect at September 1, 2008.

SIC 7	Introduction of the Euro
SIC 10	Government Assistance – No Specific Relation to Operating Activities
SIC 12	Consolidation – Special-Purpose Entities
SIC 13	Jointly Controlled Entities – Non-Monetary Contributions by Venturers
SIC 15	Operating Leases – Incentives
SIC 21	Income Taxes – Recovery of Revalued Non-Depreciable Assets
SIC 25	Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders

SIC 27	Evaluating the Substance of Transactions Involving the Legal Form of a Lease
SIC 29	Service Concession Arrangements: Disclosures
SIC 31	Revenue – Barter Transactions Involving Advertising Services
SIC 32	Intangible Assets – Web Site Costs
IFRIC 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities
IFRIC 2	Members' Shares in Cooperative Entities and Similar Instruments
IFRIC 4	Determining Whether an Arrangement contains a Lease
IFRIC 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
IFRIC 6	Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment
IFRIC 7	Applying the Restatement Approach under IAS 29, <i>Financial Reporting in Hyperinflationary Economies</i>
IFRIC 8	Scope of IFRS 2
IFRIC 9	Reassessment of Embedded Derivatives
IFRIC 10	Interim Financial Reporting and Impairment
IFRIC 11	IFRS 2: Group and Treasury Share Transactions
IFRIC 12	Service Concession Arrangements
IFRIC 13	Customer Loyalty Programmes
IFRIC 14	IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements, and Their Interaction
IFRIC 15	Agreements for the Construction of Real Estate
IFRIC 16	Hedges of a Net Investment in a Foreign Operation

Differences and similarities

Principles vs. rules

Many within the profession have asserted that IFRS are principles-based, while U.S. generally accepted accounting principles (GAAP) are rules-based. Both U.S. GAAP and IFRS are based on sound, well thought-out principles; both U.S. GAAP and IFRS have plenty of rules. IFRS take up approximately 2,900 pages currently; U.S. GAAP are estimated to comprise about 10 times that amount. Having only a small fraction of the total content of a rules-based system doesn't automatically make something principles-based, however, and it is hard to argue that 2,900 pages are needed for a primarily principles-based system. Similarly, having thousands of pages of guidance doesn't mean a system is without principles. U.S. GAAP have a clear conceptual framework articulated in the Concepts Statements that have been around for decades. One of the ongoing convergence projects of the FASB and the IASB is to develop a common conceptual framework. The result will be common underlying principles in both systems that are of high quality.

The principles vs. rules debate can be represented as a continuum, with a pure rules system on one end, and a pure principles system on the other end. No system today falls at either extreme. On the continuum, IFRS probably fall closer to the principles-based side than U.S. GAAP, which fall closer

to the rules-based side. Perhaps the two systems are closer together on the continuum than some pundits would have us believe.

The myriad rules in U.S. GAAP have evolved over time. U.S. GAAP have been around for nearly 70 years, about twice as long as IFRS, which began to be issued about 35 years ago. What's more, over the years many preparers and auditors have pressed for more interpretations from standard setters and regulators, partly as a result of the legal and regulatory environment in the U.S. Interpretive guidance provides comfort to both preparers and auditors who are afraid of having their decisions second guessed by the SEC, the plaintiff's bar, or competitors eager for business. Rules are believed to provide a clear interpretation of a standard, which leads to consistent application, which leads to improved comparability between companies in the same circumstances.

The main problem with a system of rules is that companies find ways to structure transactions to avoid the rules. Structuring transactions solely to achieve a desired accounting result by definition results in financial reporting that departs from economic reality. Comparability is reduced, both between companies and between transactions. In the U.S., for instance, if one company estimates that it has purchased 89.9 percent of the value of an asset in a leasing transaction while a competitor with identical circumstances estimates that it has purchased 90.1 percent, the two companies must account for the identical transaction differently. The first company would have an operating lease (off balance sheet); the second would have a capital lease (on balance sheet). The same would hold true if either company made different percentage estimates for essentially similar transactions in different periods. Unless analysts or other users of the financial statements make adjustments to the reported amounts, the financial statements of the two companies (or between periods) would not be comparable.

The issue then becomes whether switching to a principles-based system provides a better result. If the accounting for the lease in the previous example were determined based on the principle that a finance lease exists if "most of the value" of an asset is acquired during the lease term, then theoretically each company would report its transaction the same way. It would be hard to justify that 89.9 percent of estimated value is not "most of the value." On the other hand, some would say that companies would have even more discretion to determine what the accounting should be. Without a bright line, you end up with different interpretations of what "most of the value" really is. Comparability of companies and transactions is not achieved, and the economic reality is not accurately reflected. Further, if a company concludes that 89.9 percent is not "most of the value," where is the authority to say this is wrong? Does the proper accounting then become a function of the force of argument in the dynamic between preparers, auditors and regulators? In that case the best we could hope for is that the system of principles would devolve into a system of precedents—but is that really better than a system of rules?

From a litigation perspective, the issue is whether you are better off with bright line rules or professional judgment. As long as plaintiffs have a financial incentive to sue—that is, the estimated settlement exceeds the cost to bring the suit—the profession may not be better off with either rules-based or principles-based accounting standards. Bright line rules can be a strong defense if you correctly apply them, but a bright line can leave you no real defense if you do not. In contrast, a standard of proof that relies on professional judgment makes it hard for a plaintiff to carry the day

where the issue is whether the principle was correctly applied. The prohibitive cost of litigation in the U.S. environment further clouds the debate. Since the preparer or auditor has already lost, in an economic sense, once a lawsuit is filed, the real issue becomes whether a plaintiff is more likely to sue when the standard is rule-based or principles-based. One could theoretically argue that a standard of proof that relies on professional judgment would deter a plaintiff from filing suit, as it would be a more difficult case to prove in court. While that makes intuitive sense, in practice, plaintiffs have filed cases where the accountant was clearly on the right side of a bright line rule, which implies that whether the case can be won is not necessarily a factor in a plaintiff's decision to sue.

Further considerations in discussing principles vs. rules are the skill requirements and job satisfaction criteria for accountants. In a rules-based environment, the required skills involve applying the rules to a specific transaction or event. Much of the analysis focuses on determining which rules apply in the particular circumstances. After that determination, the actual application of the rules is often straightforward. Consideration of whether the result appropriately reflects the underlying economic reality is not necessary and is sometimes not even allowed. In a principles-based environment, the proper reporting of the economic reality of a transaction or event is the objective. The required skill set is more business-oriented, taking into consideration the utility of the information to the financial statement user. Even so, it remains an issue whether accountants actually prefer operating in a principles-based environment as opposed to a rules-based one. This could be an area where additional research would be beneficial.

A by-product of convergence activities is the increasing belief that, at least conceptually, accounting standards should be moving toward a principles-based system. The IASB has resisted moving toward a rules-based approach, in part by limiting the activities of the IFRIC, its official interpretive arm. In the U.S., the SEC and the FASB have issued papers that indicate a preference to moving toward a more principles-based regime. Evidence of this trend includes recent efforts to reduce both the EITF's influence in interpreting GAAP and the AcSEC's activities in providing industry-specific guidance.

The commentary from the FASB and the IASB demonstrates a clear intent to move toward more principles-based standards, that is, with fewer bright-line rules. Their recent joint activities in developing standards for business combinations have shown that many practical difficulties remain in agreeing on what "principles-based" means. Because the recent revised standard on business combinations did not overcome all areas of disagreement, it was issued in slightly different form by the IASB in London and the FASB in Norwalk. The IASB's revised standard on borrowing costs, which was to be a simple adoption of the U.S. model, includes a list of its continuing differences with U.S. GAAP.

Industry accounting

Some industry-specific areas of accounting have not been adequately addressed by IFRS. Two commonly mentioned areas are the accounting for insurance contracts and for extractive activities. As a result, there is diversity around the world in the accounting and reporting by companies in those industries. The IASB is making some progress toward standard setting in these areas. Although flagged during the recent debate over whether the SEC should eliminate the reconciliation requirement for foreign private issuers (discussed in "U.S. convergence" below), the lack of industry

guidance in IFRS, even though it exists in U.S. GAAP, did not persuade the SEC to back away from its acceptance of IFRS. The SEC has addressed certain industry-specific issues, such as its decision to continue to require the disclosures in FASB Statement 69, *Disclosures about Oil and Gas Producing Activities*, for foreign issuers filing with the SEC using IFRS.

No IFRS equivalent

Some experts have expressed concerns that, especially in the U.S., companies will simply default to U.S. GAAP if IFRS are sanctioned for U.S. issuers, potentially affecting the move toward IFRS as the one set of globally accepted accounting standards. Included in IFRS is guidance for when a standard or interpretation does not address an accounting matter. The guidance in IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, paragraph 12, includes consideration of pronouncements issued by other standard-setting bodies. Under IAS 8.10-12, in the absence of a standard or interpretation that specifically applies, management should use judgment in developing and applying its accounting policy, which should not conflict with the IASB framework. Management may also consider other GAAP. While IFRS standards should be considered first, it is appropriate to consider the guidance of “other standard-setting bodies that use a similar conceptual framework to develop accounting standards, to the extent that these do not conflict with [other IFRS and the Framework]” (IAS 8.12). Clearly, the IASB’s guidance does not call for an automatic default to U.S. GAAP.

Convergence

Definition

Convergence between IFRS and U.S. GAAP does not mean that the accounting standards become identical. Convergence means that where transactions are the same or similar, the accounting should likewise be the same, or there should be enough transparency in the disclosures to allow the reader to understand the differences. It also requires a continued effort by the standard setters to try to reduce differences in the systems over time.

Movement toward one set of standards

Benefits

Having one set of high-quality, globally accepted accounting standards provides a number of benefits. In capital markets, the enhanced communication that results from using one set of accounting standards translates into increased investor confidence and understanding, which means reduced risk. Lower risk reduces the risk premium that investors demand, which for companies translates to lower cost of capital. One set of standards brings greater transparency, credibility, and comparability of companies, regardless of political boundaries. The resulting increase in investor confidence and understanding provides for the free flow of capital across borders. These cross-border capital flows allow for the most efficient allocation of capital to the benefit of all participating economies.

In addition to the reduced cost of capital, a single-set of accounting standards is likely to create direct cost savings as well. Companies would not need to keep multiple sets of books to operate in multiple jurisdictions. Costs to reconcile the home-country GAAP of a subsidiary to the GAAP used by the parent in consolidation would be eliminated. Companies would not have to incur education costs to

train and keep their personnel current in different accounting standards. IT systems would be more readily integrated globally. One set of standards facilitates consolidation and equity method accounting, as well as the review of financial information of customers, suppliers, subsidiaries, and others. Management and corporate governance would be streamlined. In fact, at least one multinational company estimated that using one set of standards would trigger cost savings totaling tens of millions of U.S. dollars by eliminating duplicative costs.

Investors whose understanding and confidence is increased by one set of accounting standards will have more options. They may confidently invest in foreign companies without reconciling foreign GAAP to other GAAP with which they are familiar. Comparing similar companies from different jurisdictions would be easier. Analysts, credit rating agencies, regulators, and others would not need to know multiple GAAPs and be able to reconcile them to a single set of standards for comparison and other purposes.

Obstacles

Several obstacles remain that work against moving to one set of high-quality, globally accepted accounting standards. National pride plays a role. Historically, accounting standards have been promulgated on a national level. Resistance to changing from established national standards to a different set of globally accepted standards stems in part from the belief that the familiar is likely to be superior to the unknown. There is often resistance to the notion that a foreign set of standards could be better overall. The United States is not exempt from this dynamic, nor are many other countries with significant economies, such as Japan and India. In fact, Europe still has not completely accepted IFRS in its refusal to sanction certain elements related to hedge accounting.

In Europe, approval of IFRS comes only after a complicated endorsement process. Only standards coming from the IASB are considered for endorsement by the Commission of the European Communities (the Commission). First, the European Financial Reporting Advisory Group (EFRAG) provides technical endorsement advice. Then the Standards Advisory Review Group (SARG) issues an opinion on whether the EFRAG's technical advice is objective and balanced. The Commission then decides whether to propose the standard for endorsement. If the Accounting Regulatory Committee (ARC) votes to endorse the standard, it must also be confirmed by the European Parliament. Once all that happens, the Commission decides whether to endorse the standard and publish it in the *Official Journal*. The same procedure is followed for interpretations of the standards.

In some jurisdictions, legal issues act as an obstacle. The local authorities must approve the standards used, or accounting standards must be codified into local law. The process for national approval can result in delays or partial acceptance, neither of which serves to facilitate the move to one set of global accounting standards.

Standard setters and regulators have similar issues of sovereignty. Political pressures and legal barriers to information sharing among regulators has not made acceptance any easier for various national regulatory agencies. Relinquishing standard-setting authority in favor of, at best, influencing the standard-setting process of another group, especially one that is perhaps geographically and ideologically distant, has met with some resistance. Regulators who have an interpretive role also must be willing to allow for different interpretations that have evolved in other jurisdictions.

Language can be an obstacle as well. Not just in the translation to or from English, but also the use of similar terms that have different meanings in different countries. Terms like *turnover*, *stocks*, and *schemes* can have different meanings in accounting depending on the country where they are used. In the U.S., we might refer to those same concepts instead as *revenue*, *inventories*, and *share-based payment plans*.

Finally, whether or not we will ever really have one set of high-quality, globally accepted accounting standards depends on how they are interpreted and applied. If the single set of rules is interpreted 20 different ways, all you have is 20 different standards that happen to have the same label. Preparers must attempt to faithfully portray the economic reality of the transactions and events that they are reporting. Auditors and regulators need to allow for reasonable interpretations of principles and rules and the manner in which they are applied.

U.S. convergence

FASB/IASB

The objective of convergence is to have one set of high-quality, globally accepted accounting standards. The FASB and the IASB decided that the best approach would be to evaluate existing standards to determine whether the existing FASB or IASB standard meets that objective. If it did, then it would be selected as the standard for both. If neither standard would, then the Boards would start a joint project to come up with a preferred standard.

The first major project the Boards completed was the project on business combinations. The Boards were unable to reach complete agreement, so some differences remain between the IASB standard and the FASB standard. Although the actual accounting for business combinations is largely the same under either standard, it does highlight that word-for-word agreement in accounting standards remains elusive.

U.S. convergence really began in earnest a number of years ago. In 2002 the FASB and the IASB signed what came to be known as the Norwalk Agreement. (The FASB's offices are located in Norwalk, Connecticut.) Both Boards pledged to work together to converge their standards. That agreement was reaffirmed in a February 2006 Memorandum of Understanding (MOU), which put forth a plan of actions to be taken through 2008. In September 2008 the Boards issued an updated MOU, which included their plans for convergence through 2011. The MOU discusses plans for short-term convergence and major joint projects.

For short-term convergence, the Boards note that some convergence has already been accomplished. The FASB has moved to the IFRS approach for the fair value option and for research and development assets acquired in a business combination. The IASB has moved to the U.S. approach for borrowing costs and segment reporting.

For ongoing short-term convergence, the IASB has an exposure draft on joint venture accounting that would eliminate the use of proportionate consolidation. The Board expects to have a final standard in 2009. The IASB has plans for a proposed standard on income taxes that would both improve IAS 12, *Income Taxes*, and remove some differences between IFRS and U.S. GAAP. The

FASB plans to issue a proposed standard on subsequent events in 2008. The FASB intends to solicit comment on the IASB's income tax proposal. The FASB will also be considering investment properties and research and development.

The Boards have decided to defer convergence work in the areas of government grants and impairment.

For the major joint projects, the Boards are either working jointly on areas identified for improvement or are at different stages in the development of their approach. These are summarized in the tables that follow.

Current joint projects on areas identified for improvement in IFRS and U.S. GAAP

Convergence topic	Current status	Next steps
Financial instruments	IASB Discussion Paper issued in 2008 FASB Invitation to Comment issued in 2008 FASB Exposure Draft issued in 2008 to simplify hedge accounting	Decision by late 2008 with respect to the nature and scope of any proposed improvements
Financial statement presentation	IASB issued a revision to IAS 1, <i>Presentation of Financial Statements</i> , in 2007; joint board deliberations ongoing	Preliminary Views/Discussion Paper to be issued in third quarter of 2008
Leases	Project added to the joint agenda with ongoing Board deliberations	Preliminary Views/Discussion Paper to be issued in the second half of 2008
Liabilities and equity distinctions	Preliminary Views/Discussion Paper issued in the first half of 2008	Exposure Draft to be issued in 2009
Revenue recognition	Joint Board deliberations are ongoing	Preliminary Views/Discussion Paper to be issued in the fourth quarter of 2008

Areas identified for improvement where the Boards are at different stages in standard development and are seeking a common standard

Convergence topic	Current status	Next steps
Consolidations	Both Boards to issue Exposure Drafts in 2008	Decision in 2008 on a strategy to develop a common standard
Derecognition	Both Boards to issue Exposure Drafts in 2008 or early 2009	Decision in 2008 on a strategy to develop a common standard

Convergence topic	Current status	Next steps
Fair value measurement	FASB issued Statement 157, <i>Fair Value Measurements</i> , in 2006 IASB issued Discussion Paper in 2007	FASB to review Statement 157 IASB to issue Exposure Draft in first half of 2009
Post-employment benefits (including pensions)	FASB completed first stage of its project IASB Discussion Paper issued in March 2008	IASB to issue Exposure Draft in 2009

The Boards noted that the major joint projects will include the ongoing work of both Boards to improve and to bring convergence to their respective Conceptual Frameworks.

SEC

The SEC's mission requires a balance between the protection of U.S. investors and providing them with choices. The SEC wants to ensure that U.S. investors are provided with the same quality of information, regardless of where a company is located or what accounting system it uses. At the same time, investors are better served if they have additional choices that include foreign companies, so the SEC should not automatically discourage foreign companies from listing in the U.S. just because they use a different accounting model. Simply layering on U.S. rules won't work. If the regulatory burden on the foreign company gets too high, it will list elsewhere, potentially to the detriment of the U.S. investor. In that case, if U.S. investors want to invest in the foreign company, they must transact in foreign markets, where the information requirements may be less robust than what would be provided in the U.S.

The SEC has generally been very supportive of the movement toward one set of global accounting standards. From the late 1980s, the SEC encouraged the movement through its influence in the International Organization of Securities Commissions (IOSCO). In 2000, the SEC issued a Concept Release seeking comment on the move to international accounting standards. Many of the comment letters received were critical of the IAS in force at that time, which was just prior to the 2001 restructuring of the IASB. No significant action on the part of the SEC took place in the aftermath of the Concept Release.

A strong boost towards acceptance of IFRS in the U.S. came from what came to be known as the "Roadmap." Published as an appendix to an April 2005 article in the *Northwestern University Journal of International Law and Business*, entitled "A Securities Regulator Looks at Convergence," the Roadmap is a timeline set out by then SEC Chief Accountant Donald Nicolaisen, which details the necessary steps to eliminate the reconciliation requirement. At the time, if a foreign private issuer (FPI) filed with the SEC in either its local GAAP or IFRS, it would also include a footnote reconciling the differences between those statements and statements prepared under U.S. GAAP. The Roadmap's milestones and dates led to the conclusion that the reconciliation requirement would be eliminated by 2009 or sooner.

In 2007, activity at the SEC picked up steam. In March 2007, the SEC held a roundtable discussion on the Roadmap. A panel of experts expressed their views, which for the most part held that it was time for the SEC to eliminate the reconciliation requirement. In July, the SEC issued a Proposing Release, seeking comment on whether the reconciliation to U.S. GAAP required of FPIs should be eliminated if they file IFRS financial statements. After receiving many comments and with some minor adjustments to its proposal, the SEC in December 2007 issued final rules eliminating the reconciliation for FPIs that use IFRS as published by the IASB.

In August 2007, the SEC took another step toward accepting IFRS by issuing a Concept Release seeking comment on whether U.S. companies should be allowed to use IFRS in their SEC filings. As discussed at the March roundtable, a fundamental notion of fairness would suggest that if foreign issuers are allowed to use IFRS, then U.S. issuers should be allowed to do so as well. Comments on the Concept Release were received through November 2007. In December 2007, the SEC held a series of roundtables. Both the roundtable participants and comment letter authors were generally in favor of extending the option to use IFRS to U.S. companies. Many believed the optional period should be followed by a mandatory implementation date, although they disagreed on when that date should be.

A few weeks after holding a roundtable on IFRS during recent market turmoil, on August 27, 2008 the SEC voted to issue a roadmap proposal and a rule proposal. The roadmap proposal would set a timetable and milestones for allowing the use of IFRS by U.S. issuers. The rule proposal would allow certain U.S. issuers to use IFRS as early as 2009.

The SEC will propose seven milestones along the path to mandatory use of IFRS in the U.S. The first four are items that would take place prior to any transition to IFRS; the last three relate to that transition. The milestones are:

1. Improvements in accounting standards
2. Funding and accountability for the IASCF
3. Improved ability to use XBRL for IFRS
4. Education and training on IFRS in the U.S.
5. Limited early use by eligible entities
6. Anticipated future SEC rulemaking
7. Potential implementation of mandatory use

The limited use by eligible entities would begin for fiscal years ending on or after December 15, 2009. Such entities must be in the top 20 companies in their industry based on global market capitalization, and for those 20 largest companies IFRS must be used by a plurality. The SEC estimated that 110 companies in 34 industries would qualify.

The anticipated future rulemaking would take place in 2011, when the SEC would evaluate the first four milestones and the early use by eligible U.S. companies. At that time the SEC would decide whether to make IFRS use mandatory, and whether to expand the group of companies permitted to early adopt.

For implementation, the roadmap proposal envisions a transition approach. For fiscal years ending on or after December 15, large accelerated filers would use IFRS in 2014; accelerated filers in 2015; and non-accelerated filers in 2016.

The SEC envisions requiring three years of financial statements in the 10-K reports of companies using IFRS. The Commission is requesting comment on whether to require a reconciliation to U.S. GAAP for all the periods in the 10-K, or to simply follow the IFRS requirement to reconcile the latest year in the year of transition only.

Global convergence

As of September 19, 2008, 113 countries either permit or require the use of IFRS. This amount is expected to grow to over 150 countries within the next few years. Below is a table that features the status of IFRS adoption in some major global economies.

Country	Status
Europe*	Required (as adopted by EU)
Argentina	Required for listed companies 2011 (waiting for approval)
Australia and New Zealand	National standards described as IFRS equivalent Include unreserved statement of compliance
Brazil	Required starting 2010; optional before
Canada	Required starting 2011
Chile	Required starting 2009
China	Required to use Accounting Standards for Business Enterprises, which are similar to but not exactly IFRS; companies listed in Hong Kong required to use either IFRS or HK FRS
India	Required starting 2011
Japan	Japanese GAAP to converge to IFRS by 2011
Peru	Required
Russia	Required for banks
Singapore	Singapore IFRS, which changed several IFRS and did not adopt others
South Africa	Required
South Korea	Required starting 2011; permitted 2009
Switzerland	Permitted
Turkey	Permitted
Uruguay	Required use of IFRS in existence at May 19, 2004
U.S.	Not permitted except FPIs; Roadmap proposal expected that calls for use by some large U.S. issuers

* The 30 European Union countries are Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Liechtenstein, Lithuania, Luxemburg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the U.K.

The European Commission gave international standards a large boost in June 2000 when it announced an initiative to require all listed companies throughout the European Union to use IFRS

beginning in 2005. The measure, which did not affect Europe's non-listed companies, was approved by the European Council of Ministers in June 2002. About 7,000 companies made the change on January 1, 2005. About 6,500 of those had been reporting in their home-country GAAP, with about 3,000 of that total located in the U.K. alone.

However, the EU did not endorse three paragraphs of IAS 39, the standard that deals with the recognition and measurement of financial instruments. The potential volatility of earnings related to those paragraphs' macro hedge accounting and the fair value option sent the standard setters back to the drawing board more than once, but no silver bullet appeared. To this day, the EU has not endorsed the full set of IFRS as promulgated by the IASB.

The failure of the EU to endorse the full set of IFRS as issued by the IASB is a significant issue for several reasons, not the least of which is the requirement in IAS 1, *Presentation of Financial Statements*, that a company explicitly state that its financial statements comply with IFRS. Further, companies are not allowed to describe financial statements as complying with IFRS unless they comply with the whole body of IFRS. (IAS 1.16) The Europeans managed to work around this with the phrase, "IFRS as adopted by the EU."

For accounting standards to garner worldwide acceptance, they must be universally applied so that financial statements will be comparable. A set of financial statements prepared using Country A's GAAP is not comparable to another set prepared using Country B's GAAP simply because the statements say IFRS across the top. Consistent application is definitely a key priority for U.S. regulators. The SEC generally endorses IFRS, but the Commission does not like what Ethiopis Tafara, director of the SEC Office of International Affairs, once referred to as "nationally-tailored versions of IFRS" that will "plunge us back into a Babel of national GAAPs."

If the phrase "in accordance with IFRS" means that the same or similar transactions are accounted for the same way everywhere, producing financial statements in accordance with IFRS will add value. Investors would no longer need to waste time and effort to reconcile financial information as they compare similar companies from different countries. Capital would flow more efficiently, at less cost to more companies in more places.

In addition to the FASB in the U.S., there are active convergence programs involving standard setters in other countries. In July 2007, the Council of the Institute of Chartered Accountants in India (ICAI) decided to fully converge with IFRS as of April 2011. Listed companies, banks, insurance companies, and large entities would all be affected. In August 2007, the Accounting Standards Board of Japan (ASBJ) and the IASB agreed to converge Japanese GAAP with IFRS, eliminating major differences by June 2011. In December 2007, the standard setters in Hong Kong and the People's Republic of China signed a Joint Declaration on Accounting Standards where they agreed to converge their two standards, which effectively means China will be following IFRS. They agreed that Hong Kong Financial Reporting Standards (HKFRS, virtually identical to IFRS) and Chinese Accounting Standards (CAS) have only two substantive differences compared to IFRS. The differences relate to related party disclosures and the reversal of impairment losses. In April 2008, the FASB and the Chinese Accounting Standards Committee (CASC) signed an MOU to strengthen cooperation and communication between the two Boards.

One place where convergence has stopped moving forward is Russia. Although IFRS is required there for banks, legislation that would require the use of IFRS stalled in the Duma in 2005. It is unclear whether or when the legislation will be reintroduced.

Application

Jurisdictional variations

Some companies prepare financial statements in accordance with a locally authorized version of IFRS. For example, European companies' financial statements must be in accordance with IFRS as endorsed by the European Union. Other jurisdictions have laws that require financial statements in accordance with those laws, whether or not they are the same or similar to IFRS. The SEC believes that to allow "jurisdictional adaptations" of IFRS is and will be problematic. Different adaptations do not promote acceptance of a single set of global accounting standards nor foster transparency and comparability. In the U.S., to eliminate the reconciliation requirement, FPIs must state unreservedly and explicitly that their financial statements comply with *IFRS as published by the IASB*. However, this statement can, if true, be in addition to any statement about compliance with another set of standards. In other words, a company could say it is in compliance with IFRS as published by the IASB in addition to stating compliance with a jurisdictional variation of IFRS.

Different interpretations

Outside of the standard-setting process, regulators influence the way companies account for transactions that are not clearly addressed in the literature or by precedent. Circumstances inevitably arise in which a transaction or event is not clearly covered by the accounting literature. Since they go through a very deliberative process, standard setters may not be able to address the proper accounting before the time companies must produce financial reports. These circumstances call for the use of professional judgment. Generally, standards that are written with room for professional judgment allow for application of that judgment to produce financial reporting that is most reflective of the underlying economics. But allowing room for judgment also carries the risk that others may have different views, potentially leading to materially different outcomes.

Without a clear precedent, preparers and their auditors sometimes turn to regulators for interpretive guidance, either actively through pre-filing consultations or passively by including a judgment that will be reviewed by the regulator. National securities regulators have already begun developing protocols for sharing confidential information and determining which jurisdiction should address the issue in a multijurisdictional filing. These efforts should continue, although there is a concern that transparency must surround the process or we run the risk of regulators issuing *de facto* accounting standards without sufficient due process. Even worse, regulatory second guessing or improper exercise of authority could diminish the use of professional judgment, with undesirable outcomes. It will be important for regulators and standard setters to work together with preparers, auditors, and users to provide consistent application guidance. Arguably, this process has worked well enough in the U.S.; we would expect that over time, it will work well internationally as well.

Grant Thornton International's IFRS Interpretations Group (IIG)

Grant Thornton International has convened a committee of technical partners from among the member firms around the world. The objective of the IFRS Interpretations Group (IIG) is to provide for uniform application of IFRS throughout the GRANT THORNTON INTERNATIONAL network of firms. The IIG meets quarterly in person, with monthly teleconferences scheduled between meetings or as issues arise. Gary Illiano, Partner-in-charge of international and domestic accounting, is the U.S. partner representative on the IIG, which is chaired by Andrew Watchman, Executive Director of IFRS reporting, based in London. The IIG has a financial instruments working group, also comprised of GRANT THORNTON INTERNATIONAL member firm partners, that meets periodically to address the IFRS implementation issues surrounding financial instruments. Other international accounting firm networks have similar IFRS committees.

Small and medium-sized entities (SMEs)

Note: although the name for the proposed standard was recently changed to IFRS for Private Entities, IASB deliberations are ongoing, so the original "SMEs" has been preserved here.

The IASB is attempting to address the burden created by IFRS on smaller reporting companies. The Board has a project to develop international financial reporting standards for small and medium-sized entities (SMEs). SMEs are entities that do not have public accountability, meaning they have not issued debt or equity securities in a public market and do not hold assets in a fiduciary capacity for a broad group of outsiders. Entities that hold assets in a fiduciary capacity for a broad group of outside investors include banks, insurance companies, broker-dealers, pension funds, mutual funds, and investment banks. Because those entities have public accountability, they should use full IFRS.

SMEs publish general purpose financial statements for external users, which include owners who are not managing the business, creditors, credit rating agencies, vendors, and suppliers. In many jurisdictions, entities have a statutory obligation to prepare financial statements that conform to a specified GAAP and to have those financial statements audited.

Full IFRS meets the needs of investors and creditors of listed companies, whose needs may be different than for the users of financial statements of smaller, privately-held entities. Because IFRS cover a wide range of issues and include disclosures appropriate for public companies, they are becoming increasingly lengthy and complicated. The users of the SME financial statements may have different needs, such as assessing short-term cash flows, liquidity, and solvency. The result is that full IFRS create a burden on preparers at SMEs by requiring information that does not meet the needs of their financial statement users. Also, some jurisdictions, particularly in Europe and Asia, have already developed simplified GAAP for their SMEs, which doesn't help foster comparability or the move toward a single set of accounting standards.

The IASB project aims to produce a single, self-contained standard for SMEs that is based on the concepts and principles in full IFRS, only with simplified recognition, measurement, and disclosure requirements. The exposure draft, organized topically, consists of 254 pages in the main text, plus 80 pages of implementation guidance and 48 pages of basis for conclusions, compared to almost 3,000

pages in the full IFRS. In developing the guidance, the Board used as “typical” an SME with about 50 employees. That is not to say that larger, or especially smaller, entities couldn’t use the SME standard. Rather, that norm was more of a drafting convention used to prepare guidance on transactions and events which that sized entity would likely encounter. If management of an SME cannot find the guidance for its accounting issue in the stand-alone SME standard, it would need to make an accounting policy choice that appropriately reflects relevant and reliable information. In making that choice, management would first consider the SME standard’s requirements for related or similar issues. If that doesn’t work, they would consider the guidance in the section on *Concepts and Pervasive Principles*. They could, although they’re not required to, look to full IFRS, including Interpretations, that deal with similar and related issues.

In drafting the SME standard, the Board started with the fundamental concepts from the IFRS *Framework for the Preparation and Presentation of Financial Statements*. Board members looked at IFRS to determine which areas should be modified for SMEs. The Board eliminated some topics as irrelevant, simplified some methods for recognition and measurement, deleted some disclosure requirements, and then redrafted portions of the standard into plain English. Topics omitted include interim reporting, segments, and EPS. An SME that presented that information would need to explain the basis used to prepare the data. Where the full IFRS allows an accounting policy choice, only the simpler option is included in the standard for SMEs, although SMEs are permitted to use the other option, which will be included in a separate appendix to the SME document. For example, the simpler options in the SME exposure draft are the cost model for investment property, cost model for PP&E, expensing borrowing costs, and the indirect method for cash flows.

Individual jurisdictions can decide whether or not to allow IFRS for SMEs or even part of the SME standard. For example, an individual jurisdiction could allow the options listed above for investment property, PP&E, and borrowing costs, but disallow the other choice included in the full IFRS.

The exposure draft generated 161 letters of comment. A field test was conducted that included 115 SMEs from 20 countries restating their financial statements to conform to the guidance in the exposure draft. According to the IASB website, the Board intends to publish a final SME standard in the first quarter of 2009 under the revised title of *International Financial Reporting Standards for Private Entities*. Private entities are defined similarly to the definition of SMEs.

Next steps

What companies need to know

Companies will need to assess whether and when they should make the switch to IFRS. For non-U.S. registrants, the reconciliation to U.S. GAAP is no longer required, provided that they use IFRS as published by the IASB. There is a good chance that a subset of U.S. registrants will also be able to use IFRS financial statements in their SEC filings on a voluntary basis in the near term, and possibly on a mandatory basis some time thereafter. For private companies, the AICPA has recently recognized the IASB as a standard setter under its Rules 202 and 203. There are several things that companies should consider in evaluating IFRS.

Whether some of their operations will be required to use IFRS. Companies should determine whether their subsidiaries, equity investees, and joint ventures are or will be required to produce IFRS financial statements. Planned acquisitions and investments should be considered as well. For example, a U.S. client may be acquired by a foreign parent that uses IFRS. The parent may need an IFRS reporting package. A U.S. client may have investments in foreign subsidiaries that are required to produce IFRS financial statements in their home jurisdictions. At some point, it could make sense to have the consolidated entity reporting in IFRS as well. Some U.S. companies that want to enter foreign markets may need to produce IFRS financial statements for the purpose of conducting operations or raising capital in the new market.

Competitive pressures. Some companies, particularly larger companies in certain industries, may want to switch to IFRS reporting to match the predominant reporting of their peer group. Analysts covering a particular industry may already be using IFRS as the benchmark. The increased comparability from using IFRS generally has a positive effect on investor understanding and confidence. Some industries where this may be a consideration include banking, insurance, pharmaceuticals, and telecommunications.

Whether the benefits of converting to IFRS will exceed the costs. Companies need to assess the differences between their current accounting policies and IFRS. They need to understand how the switch to IFRS would impact their reported results. It would be helpful to completely understand what would be involved in applying the new standards, in other words, exactly what would be needed to make the change. The standards will not all be the same for a company to adopt, so it may be significant to the decision which standards would affect the company.

If a company is currently reporting in U.S. GAAP as well as IFRS, a switch might provide some benefits to the company. For example, it may be able to standardize its accounting policies and systems. Training and keeping current would be focused on one set of standards rather than on two or more. Controls may be easier to design and implement. For some companies with subsidiaries in many foreign locations, cash planning may be easier, especially where dividend payments are a function of local reporting.

This assessment needs to be made in the context of current and future developments. Planned convergence activities may influence when a company chooses to switch to IFRS. To the extent that convergence has occurred for standards that impact the company, the transition to IFRS would be easier. If convergence of a particular standard is planned, timing the switch to IFRS may be less significant because the company would have already addressed this change.



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