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Debunking IFRS Myths

Experts expose seven misconceptions about international financial reporting standards.
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Since 2008, the Financial Accounting Standards Board and the International Accounting Standards Board have been working to converge U.S. generally accepted accounting principles and international financial reporting standards. As expected, the project has sparked controversies — particularly in the United States, where many preparers believe that U.S. GAAP is the gold standard of accounting rules and should remain intact.

But the international rules have steadily gained U.S. support. In 2007, the Securities and Exchange Commission allowed private foreign issuers to report their results under IFRS without reconciling them to U.S. GAAP. A year later, the American Institute of Certified Public Accountants recognized the IASB as a standard-setter, which in effect allowed U.S. auditors to express opinions on financial statements prepared using IFRS. Meanwhile, at least 120 countries have signed up to replace their local GAAPs with some version of IFRS, and the Securities and Exchange Commission is contemplating doing the same in the United States.

Still, despite the increasing acceptance of the international rules, particularly among large organizations, misconceptions about them persist. Here, accounting experts debunk seven of the most common ones.

Myth no. 1: IFRS is a principles-based set of standards, while U.S. GAAP is rules based.
Critics routinely draw this faulty distinction, then make things worse by arguing about which mischaracterization is better, says Bruce Pounder, president of consultancy Leveraged Logic. In his book *The Convergence Guidebook*, Pounder points out that U.S. GAAP is also a principles-based set of standards. But because it is older, it has simply accumulated more guidance — rules — over the years. (The IASB sustains the myth when it touts the brevity of the 2,500-page IFRS rule book versus GAAP's 12,000 pages.)

Myth no. 2: U.S. GAAP is more rigorous than IFRS.
Not always, according to D.J. Gannon, a partner with Deloitte. He says that the nature of the discussions his firm has with clients has changed since IFRS entered the mix. Those discussions now focus on what a company is trying to accomplish with its accounting treatment, rather than address arcane paragraphs buried in the literature. "The rigor is there," says Gannon.

Gannon believes that the branding of IFRS as less rigorous than U.S. GAAP is likely driven by typical change-management complaints, which see old methods as being superior to new ones.

The international rules are more general and less prescriptive, and require more judgment — and "no one feels comfortable with that," he says.

A recent study, led by a researcher from the University of Massachusetts, also undercuts the notion of GAAP's superior rigor. The study, "Principles-Based Versus Rules-Based Accounting Standards," concludes that "CFOs are less likely to report aggressively under a less precise (more principles-based) standard" than under a more rules-based standard.

Myth no. 3: IFRS can be easily manipulated by management.
Critics of international standards "make a big deal" about the amount of judgment required for some accounting decisions, says Pounder. For instance, companies can choose whether they carry property, plant, and equipment at historical cost (less depreciation) or at fair value under IFRS. Such choices seem to support the common belief that the international rules are so lax that managers "can do pretty much anything they want" under them, says Pounder.

The real story, says Gannon, is that not only do companies have to adhere to the principles of IFRS, they are pushed to reach accounting outcomes that are more reflective of economic reality. That requires judgment and thoughtfully written disclosures to support the accounting treatment, he says.

Myth no. 4: Convergence is the same as adopting IFRS.
Convergence is not the same as adopting global standards, but rather just a stop along the way, says Gannon. Convergence certainly will make moving to IFRS easier for U.S. companies if the SEC requires them to do so. But if the United States doesn't move to IFRS, important differences will remain between international accounting rules and U.S. GAAP in the areas of impairment testing, financial instruments, inventory, and research and development.

Myth no. 5: If the United States doesn't adopt IFRS, American companies can return to the old ways of accounting.
"A lot of people think we can stay in our own financial-reporting environment" if the SEC doesn't require U.S. companies to adopt IFRS, says Dave Kaplan, a partner with PricewaterhouseCoopers. However, IFRS is already influencing U.S. GAAP through the convergence process, and the international rules will have an impact on daily operations as businesses become more global, notes Kaplan.

The convergence effort alone will change the way U.S. companies account for revenue, leases, mergers, pensions, and financial instruments. What's more, any financial metrics (such as assets or income) that have to be adjusted as a result of the accounting changes will affect debt and legal covenants, as well as compensation arrangements based on those metrics, says Kaplan.

Converged accounting rules will also force companies to update shareholder communication and education efforts, as they may have to explain temporary volatility in financial results that could result from the new rules. In-house accountants and investor relations professionals may also want a working knowledge of IFRS so they can explain any reporting differences that emerge when doing comparisons with international peers.

U.S.-based multinationals will be forced to deal with the international standards if their offshore subsidiaries are required to adopt IFRS for statutory reporting purposes, says Kaplan. He points out that regulators in the United Kingdom are considering forcing subsidiaries of U.S. companies based in that country to switch from U.S. GAAP to IFRS. Furthermore, in the long run, IFRS could become the preferred rules for the global capital markets. Should that happen, any company still clinging to its local GAAP could be at a disadvantage with respect to access to global capital, suggests Kaplan.

Myth no. 6: Since the IASB is a foreign organization, U.S. concerns are not well represented on the board.
While the IASB is a global organization, it has several close ties to the United States, which is a founding member. Many of the standards used to launch IFRS were taken directly from U.S. GAAP, says Pounder. The current parent of the IASB is a Delaware-based nonprofit corporation, and 4 of the IASB's current 15 members are based in the United States, the highest number of representatives from any one country on the board.

Myth no. 7: Convergence will be completed by 2011.
It's no secret that the convergence-project agenda is aggressive. Even FASB acknowledged earlier this year that in trying to meet a self-imposed June 2011 deadline, it was churning out more exposure drafts than constituents could digest and comment on. So this past June, the board reworked its project timeline and promised to release only a maximum of four draft rules for public comment at a time.