Russell Novak & Company LLP

U.S. GAAP vs. IFRS

International Financial Reporting Standards Overview

Dr. Barry Jay Epstein, CPA, an international accounting expert on U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), recently participated in an IFRS Roundtable published in the February 2011 issue of Financier Worldwide Magazine (www.financierworldwide.com). His answers on IFRS questions appear below.

FW: What regional trends have you seen over the last 12 months or so in the implementation of IFRS around the globe? Why are moves to a worldwide standard so important?

The biggest 'region' yet to adopt IFRS is the US. Thus, US firms lag in experiencing the benefits of producing internationally comparable financial statements. All major nations, including Canada, India, China, Japan, and the EU nations, have, or are committed to, adopting IFRS, at least for publicly-traded companies.

The acceptance and use of a global set of accounting standards is imperative to remove accounting risk, which is an impediment to international trade and investing. Removing accounting risk from the set of risks faced by investors facilitates international capital flows, which in turn lowers the cost of capital to be borne by businesses seeking to begin or expand operations. Removing obstacles can only improve economic performance and provide jobs for a growing world.

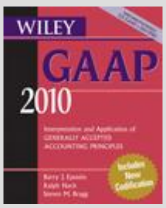
FW: In your opinion, will the global convergence of accounting principles truly establish comparability and level the playing field? Is the idea of uniform application actually attainable in practice?

If all major nations adopt IFRS without any local modifications, then indeed there will be true comparability insofar as financial reporting is concerned.

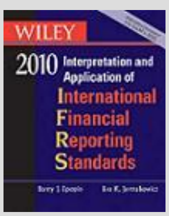
Another hurdle, outside of the risk of nations adopting IFRS only in part, or with amendments, is that all reporting entities must actually abide by the standards as written and, to the extent that interpretations must be made in the absence of clearly stated requirements – a consequence of IFRS being 'principles-based' and thus less explicitly comprehensive – that those interpretations be made in good faith.

Thus, a key to achieving comparability, as it is currently also the case if all entities were to use US GAAP, will lie with the skills and training of, and the strictness of enforcement by, the independent auditors.

Dr. Barry J. Epstein, CPA



Wiley GAAP 2010
Barry Jay Epstein
Ralph Nach
Steven M. Bragg



Wiley IFRS 2010
Barry Jay Epstein
Eva K. Jermakowicz

Dr. Epstein served as the lead author of 26 annual editions of Wiley GAAP (1985 through 2010) and 14 annual editions of Wiley IFRS (1997 through 2010), all published by John Wiley & Sons.

Dr. Barry Jay Epstein, CPA *312-464-3520* BJEpstein@RNCO.com

FW: What do you think the consequences would be if key countries, such as the US, decide not to move towards IFRS?

The failure of the US to adopt IFRS, or to at least permit its use by all 'issuers,' or registrants, would have serious consequences, due to the importance of US capital markets.

Outgoing IASB chair David Tweedie has been outspoken regarding the harm to be caused by further US SEC delay on making this commitment, probably overstating this threat to spur action.

No other major nation has the ability to derail near-universal adoption. In my view, the momentum is now unstoppable and the US will have to join in, albeit perhaps after a modest delay.

FW: What are some of the challenges faced by countries that are currently rolling out IFRS? For example, is it often the case that legal and regulatory frameworks are slow to change? How can such challenges be overcome?

The challenges include the need to modify certain contracts – for instance loan covenants based on existing GAAP measures, such as debt to equity – to incorporate IFRS-based criteria; the risk of misapplication of IFRS during the early 'learning curve' years, resulting in erroneous financial reporting; and the risk of litigation arising from confusion on the part of financial statement users – investors, for instance – as well as to innocent misreporting by issuers.

Care should be taken in early periods of IFRS adoption to educate users, even to the extent of expanding the 'significant accounting policies' notes to contrast IFRS to whatever GAAP was formerly employed.

FW: Will national regulators need to rethink their approach to monitoring and enforcing financial reporting under IFRS, particularly on a global scale?

National regulators, such as the US SEC, probably could not delegate any authority to IOSCO or any transnational agency under their respective legal mandates. However, if securities regulators act in a coordinated manner to recognize the risks and step up oversight of the respective national auditing professions during the transition period, monitoring and enforcement should be manageable.

FW: Broadly speaking, in what ways can a switch to IFRS affect tax, M&A, financial planning, executive compensation, and other corporate issues?

The impact of IFRS versus US GAAP or UK GAAP has probably been overstated; the differences are modest in number and can readily be identified and explained. Bonuses and other payments driven by reported earnings can either be adjusted by formula so that the new base can be substituted, or else 'frozen GAAP' can be applied until existing agreements run out, although this requires keeping 'two sets of books'.

Tax law is typically already not fully congruent with GAAP, so moving to IFRS doesn't add a new problem, with a few exceptions, the US 'LIFO conformity rule' being the most significant. Once universal application of IFRS is achieved, M&A and other transactional matters will be simplified.

FW: To what extent does the principles-based approach of IFRS put considerable pressure on subjective judgment and decision-making during the accounting process? Are more prescriptive rules likely to develop over time?

The principles-based vs. rules-based argument has been somewhat overstated for at least the past decade. Europeans pointed to the US GAAP's 'cookbook' accounting standards as the cause of Enron, WorldCom and other frauds, then had no way to explain Parmalat, Royal Ahold and other frauds by companies using IFRS.

In truth, all these involved gross departures from existing standards – GAAP or IFRS – which the auditors failed to identify or prevent. Having said that, it is true that IFRS is less prescriptive and, yes, over time users will demand guidance and more 'rules' are likely to be developed.

FW: What complications can arise under fair value accounting? What proposals have been put forward to address this issue?

Fair value has been endorsed not only by IFRS but by US GAAP and other national financial reporting standards, and this will be a fixture in future reporting. A good deal of guidance already exists.

FAS 157 in the US – now incorporated as part of Accounting Standards Codification Topic 820 – additional guidance promised from FASB in early 2011, and an international standard that will be a 'wrap-around' of FAS 157 expected from IASB in early 2011, offer copious assistance to those still learning about fair value measurements.

More guidance will probably evolve over time. Again, the key is to train the auditors and hold them responsible for seriously testing managements' methodologies and assumptions on a more comprehensive basis than has heretofore been commonly done.

FW: In your opinion, what should companies do now to prepare for IFRS conversion?

There are many seminars and books available to those who wish to get an early start, but realistically, most will wait until final requirements are established before seriously addressing IFRS. In my experience, qualified accountants who are GAAP-savvy can be educated on all the intricacies of IFRS in two to three days.

There may be minor systems conversion issues. More important are the afore-noted contractual implications, and it could be useful to anticipate those, by doing 'pro forma' IFRS statements now, to determine if loan covenants and other requirements need to be revised – if so, early communications with lenders and others would be advised.

FW: What advice would you give to companies on managing the costs associated with transitioning to IFRS?

Once the need for conversion seems a certainty, larger companies could opt for in-house training of finance and accounting personnel. There are many training and consulting firms already geared up to provide these, and local universities with commerce programs are sure to have one or more faculty members anxious for such opportunities.

Live instruction is strongly recommended, versus merely providing written materials, so that active learning can be made more likely to occur. There will be a cost, but it won't be a material expense, since some retraining of staff occurs annually in any event.

ABOUT THE AUTHOR

Barry Jay Epstein, Ph.D., CPA
Partner, Russell Novak & Company LLP
T: +1 (312) 464 3520
E: bepstein@RNCO.com
www.RNCO.com

Dr. Barry Jay Epstein is a partner in the Chicago firm Russell Novak & Company, LLP, where his practice is focused on technical consultation on accounting, auditing, financial reporting and financial analysis matters, and providing consulting and testifying assistance on commercial and white collar criminal litigation matters. Dr. Epstein is author or lead co-author of several current IFRS and U.S. GAAP reference works and of dozens of articles published in recent years in leading law and accounting journals.