

The Impact Of Switching To International Financial Reporting Standards On United States Businesses


Ashley B. Harper, MS, CPA; Kaplan University, USA
Linda Leatherbury, PhD; Kaplan University, USA
Ana Machuca, PhD; Kaplan University, USA
JoDee Phillips, MBA; Kaplan University, USA

ABSTRACT

There has been controversy brewing among accounting professionals regarding the impact of switching to International Financial Reporting Standards (IFRS) on United States corporations as deemed to converge in the near future (Deming, 2005). The viewpoint presented in this paper is that the United States should conform to the international standards primarily because a single set of standards creates uniformity and comparability for stakeholders regardless of their geographic location. This paper addresses the potential advantages and disadvantages of moving to a global set of standards as well as how the Financial Accounting Standards Board (FASB) will need to work with the International Accounting Standards Board (IASB) to align the current United States Generally Accepted Accounting Principles (GAAP) with the newly proposed international accounting standards. If adopted, a wide range of issues relating to the operations within a business will need consideration in the future. One of these issues include effects of taxes as businesses will need to become keenly aware of how a country's tax law and auditing practices affect their operations. The paper presents the repercussions United States corporations will face as a result of the convergence and how future accounting professionals, investors, financial institutions and students of accountancy. They will need to continue to stay abreast of changes in this area as these changes can ultimately change the way accounting standards are practiced, credentialed and taught over the next decade.

Keywords: International Financial Reporting Standards; Multinational Accounting Practices; Global Accounting Standards

INTRODUCTION

 ver the last several decades, progress has been made to harmonize financial accounting standards and practices into one set of single standards to be implemented by businesses domestically and internationally. Some of the organizations who have played a dominant role in this project include the European Union (EU), the International Organization of Securities Commissions (IOSCO), and the International Accounting Standards Committee (IASC) (James, 2009). On November 14, 2008, the SEC issued a proposal entitled, "Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers," which would force publicly traded corporations in the United States to begin implementing IFRS for years ending after December 15, 2014, 2015, or 2016. This would also be dependent on the entity's filing status. The SEC may also allow IFRS adoption early by corporations that qualify for fiscal years ending after December 15, 2009 (James, 2009). The common accounting principles are formally referred to as Generally Accepted Accounting Principles (GAAP) and they are in theory, unique to each country. The purpose of using a recognized international reporting standard is to provide a common and accepted standard for evaluating and comparing the financial status of any business worldwide.

STATEMENT OF THE PROBLEM: THE EFFECTS OF SWITCHING TO IFRS

Because of this major reporting change and implementation, those who write financial and accounting standards, accounting professors, Certified Public Accounting firms, international businesses investors and financial institutions, have started detailed training programs to assist professionals, to get prepared for the major changes that will take place with the implementation of the IFRS. Accounting educators have already seen an emphasis on international accounting taking precedence in many accounting courses as future accounting professionals will be addressing these new standards in upcoming years. The pervasiveness of the IFRS will be a great bearing on curriculum in higher education institutions as it impacts on all aspects of decision making with respect to the transparency and conduct of United States businesses operating both domestically and internationally and the role of the accounting professional.

RATIONALE: THE NEED FOR ONE INTERNATIONAL ACCOUNTING STANDARD

The authors of this paper believe that the United States should adopt a single set of high quality international accounting standards that are transparent, explicable and made compulsory; and if the United States FASB does not conform, businesses will fall behind in the financial and corporate competitive world. This project is a huge undertaking and currently progress and research is underway in this area. Countries that choose not to accept the international accounting standards will encounter comparison issues because the reporting standards will vary between countries making comparability nearly impossible with countries that do accept the standards. Investors will want to be assured they can accurately compare and interpret financial statements when investing in businesses that operate in foreign entities and the time and expense of applying different accounting standards will be greatly reduced with a single set of accounting standards.

LITERATURE REVIEW

As a single set of standards is introduced worldwide, like the IFRS, it becomes imperative to weigh the potential advantages and disadvantages regarding how corporations that operate multi-nationally will address each of the standards. Doupnik & Perera (2012) imply that multinational corporations benefit from one set of standards due to the following reasons: a reduction in costs of the preparation of consolidated financial statements with the use of one set of standards, the reduction of costs of applying for an increase in capital assets in international markets due to one set of standards, and one set of standards assists with the analytics and comparability of the various financial statements among competition and future mergers and acquisitions (p. 117). Disadvantages of having a single set of standards include the costs of training professionals and business owners, comparability to prior years, and phasing out any old information previously reported under the old system into a newly adopted set of standards.

There are considerations regarding problems caused by worldwide accounting diversity that companies must take into consideration, such as the inventory method LIFO being accepted under US GAAP but not under the proposed IFRS system. Also, according to Doupnik & Perera (2012), international accounting diversity creates an extensively more complex arena for international corporations when understanding how to prepare consolidated financial statements from the parent corporation's using applicable GAAP rules. One issue raised is that each international subsidiary would need to be responsible for recording transactions in two diverse sets of accounting books. One set of accounting books with the financial records recorded in the company's local GAAP rules and regulations and the other set of financial records would need to be prepared according to the parent corporation's country standards. Diversity in accounting also creates issues with international businesses trying to get permission for entry in foreign markets as many creditors and stakeholders require financial statements prepared in accordance with their local reporting standards (Tarca, 2005). These international businesses that require financial statements for future acquisitions that are prepared according to the GAAP with which the parent company's managers have familiarity with will need a similar basis for comparison for properly analyzing and evaluating the business's overall financial position and operating results.

Multinational corporations also must look at the potential benefits that could derive from the international convergence of accounting standards. Doupnik & Perera (2012) imply the biggest advantage that results from the harmonization of financial reporting standards is the comparability on an international level of those financial

practices and standards (p.112). They state that some of the examples of this benefit can include the following: a decrease in costs of financial reporting for international companies that are trying to put their potential stocks on international stock exchanges, a decrease in costs of consolidated financial statement preparation, and the ease in transferring accounting professionals to other subsidiaries with little or no training involved (Doupnik & Perera, 2012).

RECOGNIZED ADVANTAGES FROM INDUSTRY PROFESSIONALS

According to Tyson (2011), a study was conducted that analyzed accounting, financial and legal industry professionals comment letters to the SEC on the final decision regarding the convergence. Many different viewpoints were discussed in these comment letters that were submitted to the SEC from Congress pointing to the vastness of the impact of one set of global standards; international organizations, major corporations from multiple industries, multinational corporations, institutional investors, trade associations, accounting organizations, and academia had varying interpretations of the impact. According to Tyson's study, a large part of responders, many of whom were directly involved in international accounting or auditing discussed the advantages of having one set of standards worldwide. These advantages mentioned in their comment letters included the following results: increased competitiveness of U.S. issuers in capital markets; a lower cost of capital- especially for preparers and investors; process and cost efficiencies for multinational U.S. issuers and auditors; and improved ability for investors to assess investment options (Tyson, 2011, p. 26). The respondents who were in favor of the implementation of IFRS also stated that principles-based IFRS standards, as opposed to the more rules-based United States GAAP which, were designed to incorporate the better use of professional judgment and overall resulted in better clarity and transparency.

RECOGNIZED DISADVANTAGES FROM INDUSTRY PROFESSIONALS

Industry professionals who were opposed of IFRS argued that the advantages of a one single set of international standards did not outweigh the costs of the implementation and transition of the standards. Tyson (2011) recognized those arguing against conversion or adoption of IFRS identified a large number of disadvantages. These included: loss of control in the United States over standard setting, large transition costs to implement IFRS, including employee training and Internet technology systems, especially during a period of severe budget shortfalls and economic crisis (Tyson, 2011, p. 26). Moreover, other potential concerns involved the lack of any evidence supporting that the IFRS were in fact superior standards to the United States Generally Accepted Accounting Principles and another concern was the omission of clarity on the FASB roles and SEC roles after the convergence. Business concerns were related to the removal of LIFO under the IFRS and the confusion regarding some industry-specific rules under the IFRS.

SIGNIFICANCE OF THE CONVERGENCE

Although in an overall significance, IFRS and United States GAAP are far more similar than they are different. Part of eliminating the current differences in the IFRS and United States GAAP involves the FASB and IASB working together in the overall development of future standards. This cooperation has already begun and is evidenced when the FASB sets new standards; they included references to the current IASB standards and mentioned the relationship between those standards and United States GAAP. The continued cooperation among these two organizations will help to eliminate some of the major differences between the two sets of standards over time (James, 2009).

The influence of the United States GAAP and United States business practices is considerable. According to Lamoreaux (2011), the FASB would also aim to include the current IFRS into United States GAAP over the next several years. After the transition is completed, the FASB would be the official organization overseeing changes in the United States GAAP and eliminating any differences caused by the convergence. The Security and Exchange Committee (SEC) would also be involved in overseeing the coordination of this project. Tarca (2005) states, "this convergence project has been a long awaited goal of all the international standards setters in many markets" (p. 67). The United States is a valuable player in the convergence and the FASB is working diligently with the IASB to create harmonization among standards.

Despite the commonness of some of the standards, multinational companies have begun the process of hiring global accountants and lawyers to research tax law, auditing practices, and legal instruments tied to the finances of businesses in countries they are operating in. The impacts of the international standards must be evaluated by looking at the bottom lines of these businesses and especially the tax effects of operating in multiple countries (Tarca, 2005). One of the most expensive costs to businesses that operate internationally is the costs of taxes paid to each individual government in which they operate. Multinational corporations try to minimize their tax liability in multiple countries working within the confines of each country's applicable tax law. If tax costs are sizably more expensive for preparation of multiple financial reports due to different reporting standards or beyond comprehensible everyday business operations, a business may decide to forego the opportunity of a merger or acquisition in that particular country causing a loss of opportunity for both the business and the development of the country itself.

Three main tax issues are associated with opening a new operation in another country: the location, the legal form of the operation, and the financing of the foreign operation (Lasmin, 2011). The location decision depends on the basis of the after-tax profits that they could earn in that country. The legal form a business would either be a subsidiary or a branch of a company. The reason this decision would be important is that some foreign countries tax branches differently than subsidiaries and vice versa. The final decision is the method of financing used for foreign operations. Businesses can choose to either finance their operations through equity or debt financing. This decision ultimately impacts the after-tax cash flows depending upon each country's rules on how they tax financing dividends and payments (Doupnik & Perera, 2012).

Special care should also be taken to consider some of the international repercussions for United States businesses having its current system of financial statement reporting influenced by outside interests within a global system. Policymakers and committee members who work on the IASB will come from many different countries. While the United States will have representation, the United States goals will only be a part of the whole determining body. If companies switch to an international set of rules, then current ways of structuring transactions and financial statements along with current methods like LIFO and revenue recognition may not be allowed under the new system. These changes can have both positive and negative impacts on a business's overall reporting. Businesses can adjust and this growing area of specialized knowledge will create jobs for those in this field. Time-honored accountants will have to be trained extensively on IFRS along with other related professions working inside multinational corporations who will be needed to translate financial information to investment institutions.

CONCLUSION

The ongoing discussion regarding what standards will be adopted in the area of International Accounting will continue until a conclusion is reached on the convergence. The United States GAAP can no longer be assumed to be the governing standard for financial standards worldwide. The FASB has stated: "Investors would be better served if all United States public companies used accounting standards promulgated by a single global standard setter as the basis for preparing their financial reports. This would be best accomplished by moving United States public companies to an improved version of International Financial Reporting Standards" (Doupnik & Perera, 2012, p. 103). The ultimate move to IFRS in the United States will be extremely complex and will take several years to fully implement. Changes must be made to the United States financial reporting system, auditing standards, licensing requirements, and the current education of accountants. The SEC was tasked to make a decision in 2011 on whether and how to incorporate the IFRS in the United States but this immeasurable decision was delayed. Political pressures and lobbying from various groups will be triggered upon the convergence of these standards. Some accounting treatments may be favorable to some groups under IFRS and not to others. This controversy will arise as the implementation of one international standard draws closer.

This paper presented some of the major issues that professionals should be aware of in the beginning stages of the implementation of the IFRS. Harmonization remains the goal of the convergence of GAAP across all organizations worldwide. Accounting professionals from the United States will be instrumental for the initial implementation of the IFRSs once adopted. The arguments made in this paper point toward an advantage to United States businesses as well as multinational businesses in adopting unified financial international standards. The FASB has a lot of work to accomplish with the IASB in making this project successful. Researchers in

multinational companies have to work on understanding tax laws in many companies and the impacts that they will have on the financial statements. The United States will most likely be at the forefront of the conversion project with lobbyist and policy makers ensuring that domestic businesses do not suffer as a result from changes in accounting methods due to the convergence. Henceforth all areas of accounting including, tax law, auditing, financial, corporate, managerial, and accounting education will all be affected by the final outcome of the GAAP convergence project. Once the determination is made, precision will be required in linking financial statements with qualified accountants and the decisions dependent on the information contained in the financial statements.

AUTHORS' INFORMATION

Ashley Harper is an adjunct instructor in the School of Business and Management. She was formally the Associate Department Chair of the Accounting Program at Kaplan University. She has been involved in teaching both traditionally and online since 2002 and has developed and taught accounting courses in all areas of accounting at both the undergraduate and graduate levels. Ashley's credentials are a MS from Louisiana State University with an emphasis in taxation and she is also licensed Certified Public Accountant (CPA) in the state of Louisiana, which is currently active. Ashley has just completed her accounting coursework towards her PhD in Accounting from Northcentral University and is currently working on her research courses towards her dissertation. E-mail: ashleyharper@i-55.com (Corresponding author)

Linda Leatherbury is a full time faculty professor in the School of Business and Management where she teaches accounting and Taxation courses. Dr. Leatherbury has been teaching for more than 15 years. Dr. Leatherbury obtained her Bachelor of Science Degree from Drexel University and her Masters of Taxation from Widener University. Her earned Doctorate of Philosophy (PhD) in Accounting is from Union University. Dr. Leatherbury worked 15 years at a major investment firm before beginning her teaching career. She has taught both face-to-face and online classes.

Ana Machuca currently is a full time professor in the School of Business and Management. She has been teaching since 1997 online and face-to-face and has been involved in administration, curriculum, and development within Kaplan University. Dr. Machuca's credentials are a Bachelor's Degree in Accounting and Finance from Florida Southern College, a Masters of Accounting and Financial Management (MAFM) from Keller Graduate School, a Master's in Business Administration (MBA) with concentration in Management from Webster University and a Doctor of Philosophy (PhD) degree in Business Administration with a specialization in Financial Management from Northcentral University. She is a Certified Public Accountant (CPA) and a Certified Fraud Examiner (CFE), which she uses for clients who hire her to investigate fraud.

JoDee Phillips is an adjunct instructor in the School of Business and Management. She was formally the Assistant Dean of Curriculum and Academic Department Chair with Kaplan University. She has been involved teaching online and assessing and creating curriculum for five years. JoDee's credentials are an MBA from Marylhurst University and has passed her dissertation written comprehensive exam from Northcentral University working toward a PhD in Business. E-mail: JPhillips@kaplan.edu

REFERENCES

1. Deming, S. (2005). International financial importance. *Michigan Bar Journal*. doi: 14-18. 10.1108/01443571011039614
2. Douppnik, T.S., & Perera, M.H.B. (2012). *International Accounting*. New York, NY: McGraw-Hill.
3. Gornik-Tomaszewski, S., & Sellhorn, T. (2010). First-time adoption of international financial reporting standards by U.S. company. *Review of Business*, 31(1), 22. doi: 10.1080/09638180.2012.718487
4. James, M. L. (2009). Accounting for global entities and the effect of the convergence of U.S. generally accepted accounting principles to international financial reporting standards. *Journal of the International Academy for Case Studies*, 15(5). doi: 29 10.1111/j.1467-8683.2010.00798.
5. Lamoreaux, M. G. (2011). Beyond convergence: SEC staff floats compromise on transition to IFRS. *Journal of Accountancy*, 212(2), 46.

6. Lasmin, (2011). Empirical evidence on formal and material harmonization of national accounting standards. *Journal of International Business Research*, 10(2), 69. doi:10.2308/jibr-10212
7. Tarca, A. (2005). International convergence of accounting standards: an investigation of the use of IAS options not acceptable under U.S. G.A.A.P. *International Journal of Business Studies*, 13(1), 67. doi:10419/32779/1/62600926X
8. Tyson, T. (2011, June). The convergence of IFRA and U.S. G.A.A.P. *The CPA Journal*, 81, 26. doi: 10.2308/acch.2010.24.1.117. 2011

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.