Overview

In an increasingly interconnected global economy, many market participants are considering the question of whether it is possible or desirable to move toward a more uniform global “language” for financial reporting. The proponents of this idea argue that a uniform set of global accounting standards, supported by strong governance, independent standard-setting and a sound regulatory framework, could benefit investors and businesses alike. Others suggest that trying to establish a uniform set of global standards would run the risk of overlooking the unique economic, political, cultural, legal and regulatory realities that exist in different nations and regions.

Over the past decade, this global discussion has intensified. In 2001, the International Accounting Standards Board (IASB) adopted the first iteration of International Financial Reporting Standards (IFRS) to serve as a possible pathway for establishing uniform global accounting standards. Since then, IFRS has been adopted or become accepted in over 100 countries. Over this same period, the Financial Accounting Standards Board (FASB) and the IASB have begun an effort to converge IFRS and the Generally Accepted Accounting Principles in the United States (US GAAP), essentially working to make the two sets of accounting standards increasingly similar to each other. More recently, some market participants have raised the possibility of transitioning entirely from US GAAP to IFRS for public company financial reporting in the United States.

In the coming years, critical decisions will need to be made regarding the use of global accounting standards in the United States. Market participants will be called upon to determine whether achieving a uniform set of high-quality global accounting standards is feasible, what sort of investments would be required to achieve that outcome, and whether it is a desirable goal in the first place. This dialogue will be critical to the future of financial reporting and of fundamental importance to the long-term strength and stability of the global capital markets.

In that spirit, the Center for Audit Quality (CAQ) has developed this Guide to IFRS to provide interested parties with useful information and to help facilitate an informed public discussion among all those who have a stake in our capital markets system.

The Evolution of Accounting Standards

Accounting standards around the world have evolved over centuries of business and capital market development. In this process, accounting standards historically were designed to meet the needs of each nation’s capital markets. Those standards that were found to work well in the legal, cultural, political and economic context of each nation became the “generally accepted accounting principles,” or GAAP, for that particular jurisdiction. Naturally, different norms in each nation led to different GAAPs in each nation.

The growing dynamic of globalization presented a challenge to these “legacy systems.” Global protocols for the internet, electronic payments, software systems and cargo shipping demonstrated the potential value of uniform global systems. A discussion began among market participants over whether the global capital markets would similarly benefit by having a single set of high-quality accounting standards that could be applied around the world.

In order to create a uniform global system for financial reporting, the IASB was formed to serve as the global accounting standard-setting body. (See sidebar for more information on the IASB.) In 2001, the IASB promulgated the first iteration of IFRS, offering the possibility of a single set of high-quality accounting standards that could be used by all nations.
The Challenges and Opportunities of IFRS

Since 2001, IFRS has become accepted or been adopted for public reporting purposes in over 100 countries, including the 27 member-states of the European Union. Others scheduled to follow in the next few years include Argentina, Brazil, Canada, Chile, India, Korea, Singapore and Mexico. In addition, in June 2009, Japan approved a roadmap for the adoption of IFRS which includes an election for Japanese companies to begin voluntarily using IFRS immediately. (See sidebar for information on global market trends.) As more and more countries adopt IFRS, a robust conversation has begun about whether the United States should take this step or otherwise participate in a process that leads to the acceptance of more uniform global accounting standards for use in the U.S.

As part of that effort, since 2002, the IASB and the FASB, which sets accounting standards in the United States, have been engaged in a process aimed at “converging” IFRS and US GAAP. (See sidebar for more information on the FASB.) The goal is that over time the differences between IFRS and US GAAP could steadily be diminished and eventually the two sets of standards would be essentially, if not completely, identical. While progress has been made to reduce the differences between IFRS and US GAAP, the speed at which that progress has been made has been substantially slower than originally anticipated. In addition, there are some who believe that convergence is unlikely to get to the point where the two sets of standards are truly identical. This view has led some to call for the United States to adopt IFRS outright to replace US GAAP. In that vein, the U.S. Securities and Exchange Commission (SEC) in November 2008 proposed a “Roadmap for the Potential Use of Financial Statements Prepared in Accordance with IFRS by U.S. Issuers” (the Proposed Roadmap) and solicited public reaction. (See sidebar for more information on the Proposed Roadmap.)

Global Market Trends

Accounting Standards Used by Global Fortune 500 Companies:

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>US GAAP</td>
<td>42%</td>
<td></td>
</tr>
<tr>
<td>IFRS</td>
<td>32%</td>
<td></td>
</tr>
<tr>
<td>Japan*</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>Canada*</td>
<td>3%</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>14%</td>
<td></td>
</tr>
</tbody>
</table>

* Have committed to accepting IFRS


<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Korea</td>
<td>163%</td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>53%</td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>53%</td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>27%</td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>.01%</td>
<td></td>
</tr>
</tbody>
</table>

Percentage of Worldwide Market Capitalization on Exchanges:

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Korea</td>
<td>0.9%</td>
<td>1.4%</td>
</tr>
<tr>
<td>India</td>
<td>0.5%</td>
<td>1.8%</td>
</tr>
<tr>
<td>Singapore</td>
<td>0.4%</td>
<td>0.8%</td>
</tr>
<tr>
<td>China</td>
<td>4.1%</td>
<td>9.3%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>8.1%</td>
<td>5.5%</td>
</tr>
<tr>
<td>United States</td>
<td>48.2%</td>
<td>34.9%</td>
</tr>
</tbody>
</table>

1 As of 2007
2 Data derived from World Federation of Exchanges statistics reports

The Proposed Roadmap laid out a process and a set of milestones which, if met, could lead to certain larger public companies in the United States being required to begin issuing their financial reports in accordance with IFRS by the year 2014, with smaller public companies adopting IFRS in 2015 and 2016.

About the IASB

The IASB is based in London and is overseen by the International Accounting Standards Committee (IASC) Foundation, which is a private, not-for-profit corporation. The IASC Foundation is governed by 22 trustees from geographically diverse backgrounds.

The IASB is comprised of 15 members from different nations around the world. The current board consists of members from five EU member-states, China, Japan, Australia, South Africa, Brazil and five Americans. The IASB is funded through national levies as well as voluntary contributions from around the world, including large international companies, regulators, standard setters and international accounting firms.
Challenges

There are important considerations that need to be evaluated prior to the potential adoption of IFRS in the U.S. These include the following:

- **IASB’s Funding, Staffing and Governance**
  The success of IFRS as a high-quality set of global accounting standards depends upon the IASB functioning as a truly independent standard-setting body that enjoys the confidence of market participants around the world. To assure that confidence, the IASB needs to have a secure, stable funding mechanism, expert staffing and appropriate governance structure to ensure the standard-setting process is free from undue influence from various constituents. To address some of these concerns, in January 2009 the IASC established a monitoring board, made up of representatives from leading securities regulators (including the SEC) to enhance the public accountability of the IASC while at the same time maintaining the independence of the standard setting process.

- **Consistent Adoption, Application and Regulatory Review**
  While a significant number of nations have adopted or accepted IFRS, in order to achieve the true benefits of a uniform set of accounting standards, it is important that IFRS is adopted by nations in a manner consistent with those issued by the IASB. In addition, it is equally important that they are applied and enforced in a consistent manner. Therefore, there must also be a mechanism to ensure that auditing standards and the practices of auditors facilitate consistent application of IFRS. Similarly, over time there must be improved coordination of global regulatory review. Absent those changes, the adoption of IFRS may mean substantial investment, but without realization of all the benefits that could be achieved from a more uniform global reporting system.

- **Discontinuing US GAAP**
  Even among those market participants who acknowledge the importance of establishing uniform global accounting standards, there are some who are concerned with a transition away from US GAAP because they believe it is the true “gold standard” for financial reporting given its extensive development, understanding and use around the world.

**Cultural and Structural Changes in the U.S.**

In order for the United States to successfully transition to IFRS, it will require a significant effort and investment from virtually all market participants in the capital markets system. Some of the changes that would be required:

- Transition to IFRS would increase the need for training and education for investors, accountants, auditors and others involved in the preparation and use of financial statements. This would require, for example, the development of curricula on IFRS at the university level, adjustments to the CPA exam to reflect knowledge of IFRS and increased efforts by the accounting profession to expand the ranks of CPAs trained in IFRS;
- Businesses would need to integrate new software platforms and adjust their reporting processes to reflect the requirements of IFRS — this includes changes to internal control requirements and data gathering systems that currently are designed to meet US GAAP standards;
- Regulators would need to adjust oversight and disclosure requirements from the current system based on US GAAP to new standards based on IFRS and put a new emphasis on international cooperation and coordination;
- Investors (both individuals and institutions) and lenders would need to become familiar with financial reports prepared in accordance with IFRS. For example, lending agreements would need to be modified to allow for and consider reporting under IFRS; and
- Members of the United States legal system, including lawyers, judges and lawmakers, would need to work through a variety of tax issues and other applications of law.

In order to effectively navigate the considerations outlined above, there would need to be a clear national “blueprint” for achieving such a transition. The SEC’s Proposed Roadmap provides a meaningful basis to assist in the development of such a blueprint. Any plan though, should leverage the experiences of other countries that have previously undergone a transition to IFRS, would need to specify the actions that would be required of different capital markets participants, and ideally lay out target dates for the completion of those actions.
About the FASB

The FASB is the independent standard-setting body in the United States. The FASB was established in 1973 with the goal of ensuring greater objectivity and independence in the standard-setting process.

The FASB is organized as a non-profit, private sector organization. The FASB is overseen by the Financial Accounting Foundation (FAF), which selects the members of the FASB and funds its operations through assessments on public companies. The FASB is comprised of five board members who all serve on a full-time basis and are required to sever ties to other private sector firms in order to preserve independence.

Current board members include representatives from academia, the accounting profession and the investor community.

Opportunities

While the concerns outlined above warrant further consideration, there are a number of factors that support the idea of adoption or acceptance of IFRS in the United States:

• Facilitate More Efficient Capital Allocations
  A single set of high-quality global accounting standards would increase the ability of companies to raise capital in multiple jurisdictions around the world while at the same time allowing investors to more efficiently compare global investment opportunities.

• Align the United States with the Rest of the World
  Already, more than 100 nations have adopted or accepted IFRS, including most of the world’s developed economies. At this point, it is fair to say that IFRS is becoming the global norm. If the United States were to adopt IFRS, it would be joining much of the rest of the world, which would provide a powerful push toward worldwide acceptance of a single set of global accounting standards.

• Protect Long-term Competitiveness of U.S. Capital Markets
  Cross-border investment and the integration of capital markets may be easier among those nations that adopt IFRS. By choosing not to adopt IFRS, the United States may run the risk of seeing investors and businesses shift to financial centers in those nations that use IFRS, rather than accept the burden of having to operate in both IFRS and US GAAP.

• Promote Increased Transparency
  IFRS is a more “principles-based” set of accounting standards than US GAAP. As such, it may allow companies and auditors to focus less on strict adherence

About the SEC’s Roadmap

In November 2008, the SEC proposed a “Roadmap for Potential Use of Financial Statements Prepared in Accordance with IFRS by U.S. Issuers.”

This “roadmap” detailed a plan, with associated milestones and action items, by which public companies in the United States could transition from financial reporting based on US GAAP to IFRS beginning in 2014. Under the roadmap, the transition to IFRS would unfold in several stages, with certain large companies being granted the ability to make the transition before 2014. In the coming years, a number of milestones would need to be achieved in terms of preparing businesses, academic institutions, the accounting profession, and legal and regulatory systems for the transition.
to detailed requirements and “bright lines,” and instead concentrate on pro-
viding a clear statement of an entity’s assessment of the economic realities of
its business activities. Some studies have suggested that this principles-based
approach allows for, and in fact, incentivizes companies to provide financial
reports that offer a more transparent picture of the firm’s economic condition.

• **Reduce Complexity in Financial Reporting**

  Over the last several decades, the standards of US GAAP and associated guid-
ance have grown to many thousands of pages. By contrast, IFRS is substantially
shorter in length. The principles-based nature of IFRS standards may facilitate an
enhanced focus on the economic purpose of a company’s business activities
in its financial reports. This may make it possible for businesses to produce
financial reports that are less complex for investors and other users of financial
information. It is worth noting that while IFRS is less mature than US GAAP, it
does provide a level of interpretive guidance to assist companies in applying
the principles.

• **Increase Efficiency for Companies**

  Adoption of IFRS in the United States offers potential cost savings for compa-
ies operating in multiple countries around the world by making it less costly
to find local accountants, as the acceptance of IFRS worldwide may reduce the
number of accountants with knowledge of US GAAP. In addition, it may help
reduce the costs associated with maintaining multiple sets of books, as well as
reduce the chance of errors associated with translating financial information
from IFRS to US GAAP. Moreover, the transition to IFRS could lessen costs for
investors by eliminating many of the adjustments that analysts and other users
currently must make in order to compare financial results and financial conditions
in different countries.

**Conclusion**

The looming decisions about the future of accounting standards in the United
States involve complex and challenging questions. While there are significant
benefits for investors, businesses, and the entire economy of having all nations
move to a single, uniform set of high-quality accounting standards, there are a
number of considerations that need to be evaluated in making such a transition.

As this Guide demonstrates, IFRS is a dynamic — and fast evolving — issue.
To keep current with developments regarding global accounting standards, the
following websites include information about the development of IFRS, the
convergence efforts between the FASB and the IASB, and the acceptance of
IFRS around the world.

**Additional Resources**

- **CAQ**
  
  http://thecaq.org/publicpolicy/ifrs.htm

- **SEC**
  
  “Spotlight on: Global Accounting Standards”
  
  http://www.sec.gov/spotlight/ifrsroadmap.htm

- **FASB**
  
  http://www.fasb.org

- **IASB**
  
  http://www.iasb.org

**About the Center for Audit Quality (CAQ)**

The Center for Audit Quality is an autonomous member-based public policy organi-
zation serving investors, public company auditors and the capital markets. The CAQ
is dedicated to enhancing investor confidence and public trust in the global capital
markets by:

- Fostering high-quality performance by public company auditors;
- Convening and collaborating with other stakeholders to advance the discussion
  of critical issues requiring action and intervention; and
- Advocating policies and standards that promote public company auditors’
  objectivity, effectiveness and responsiveness to dynamic market conditions.

Public company auditors provide an essential perspective to the dialogue surround-
ing issues facing investors and the capital markets. By listening to those with the
most at stake in quality audits and credible financial reporting, the CAQ is working
to make public company audits even more reliable and relevant for investors, to
facilitate productive discussion and develop viable solutions regarding marketplace
challenges, and to modernize financial reporting to benefit all market participants.

Based in Washington, D.C., the CAQ is affiliated with the AICPA.

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