

IFRS - One world, one standard – almost a reality?

Over the last year or so there has been widespread debate about IFRS (International Financial Reporting Standards) replacing US GAAP (Generally Accepted Accounting Principles), but how close are we and what does it really mean? Are we really about to see a single worldwide accounting standard applied in every major market?

The chances are it will happen, but there are still issues to be resolved for regulators, businesses and for their professional advisers alike. Not only is the debate about US convergence and adoption of IFRS still ongoing but, assuming it does happen as expected, there will be major challenges for US businesses just as there were for European companies when IFRS came into force in 2005.

These issues include the transitional provisions contained in IFRS for converting to the new standards, elections available to first-time adopters and the general differences between IFRS and US GAAP financial statements, such as presentation and disclosure. US GAAP for example runs to some 25,000 pages whereas IFRS is more like 2,500.

The problem for the US is that it is used to more detailed rules. It is a more litigious society and these are less well-defined principles. The fear is that, at least in the short term, it could lead to more lawsuits.

Because the process and the implications of IFRS convergence can vary widely among companies based on a number of variables (such as level of experience, degree of centralisation of accounting processes and data collection, and the number of current accounting methods) IFRS conversion is much more than simply an accounting exercise – it is a vital business-wide exercise in change management.

Background to change

Let's look at the background to this seismic change in financial reporting.

The International Accounting Standards Board (IASB) was set up in 2001, as part of the International Accounting Standards Committee (IASC), with the task of bringing some sense of order to international financial reporting standards. The IASB is committed to developing, in the public interest, a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements. IFRSs are the means by which the IASB seeks to achieve this goal.

Almost immediately these ambitions were given a powerful kick-start when the European Commission decided in 2002 that all listed companies in Europe should follow IFRS from 2005 onwards. It was great credit to the IASB that it achieved this goal despite the tight deadlines and the political minefield that it found itself operating in. But in 2005 IFRS did indeed become effective in Europe.

Commitment to IFRS

Seeing the European corporate world driving down the IFRS route, the rest of the world followed suit and now well over 100 countries have committed to introduce IFRS. China, Japan, India and others have announced deadlines by which they will join in. And regulators in the US are now formally en route to acceptance of IFRS.

US acceptance of IFRS is a major step change for the accounting world. It makes it almost a certainty that a single set of accounting standards will be followed around the world. Late in 2007, the US Securities and Exchange Commission (SEC) decided to allow foreign companies to file in IFRS without reconciling their accounts to US GAAP – a tacit acceptance of the quality of IFRS. Now there is every likelihood that IFRS will be accepted for US-listed businesses as well.

The US should benefit from the European experience and that of the many other countries that are using or adopting IFRS. Europe and other first-wave adopters learnt from the problems of being early-users. New rules were being issued by standard-setters right up to the last minute, making it tough for everyone to prepare for the new regime. The US will miss this painful start and can go directly to proven workable standards. However, the issues for the US are now around training of accountants and auditors, and making companies and investors aware of the changes – and the real benefits these will offer.

Effects on mid-tier companies

But also of great relevance to UHY clients is the debate around how much IFRS should apply to smaller companies, an issue that is far from resolved. While superficially a simplified system should be universally accepted, proposals for an IFRS-related system for small and medium-size businesses have become a hotly debated issue. The debate is ongoing and fierce but the outcome is likely to be a new multi-tier system.

As John Wolfgang, UHY chairman, commented at the time of his appointment: “The accounting world is going through a time of great change. Convergence of accounting standards is not just an issue for huge multinationals. It is also a serious concern for dynamic mid-tier businesses – the natural client constituency for UHY member firms. It is an issue for UHY as we investigate a consistent audit methodology across our global association.”

Robert Bruce, the veteran accountancy commentator, writing in the *Financial Times*, said: “The end result is likely to be a three-tier system in most countries around the world.” He postulated that Listed Companies will produce figures under the full IFRS system. The remaining large companies will follow the SME standard, obtaining significant cost savings in the process. The smallest end of the business world will produce no accounts at all, or accounts under a further streamlining of the system, adequate to satisfy bankers, credit agencies and a small handful of investors.

Financial statements are prepared and presented for external users by many entities and, while these may appear to be similar in most countries, there are differences that have probably been caused by a variety of social, economic and legal circumstances. Different

countries have also had the needs of different users of financial statements in mind when setting national requirements.

These differing circumstances have led to a variety of definitions of elements of financial statements, including assets, liabilities, equity, income and expenses. They have also resulted in the use of differing criteria for recognising items in the financial statements and in a preference for different bases of measurement. The scope of the financial statements, and the disclosures made in them, has also been affected.

Benefits to users and companies

The IASB, through IFRS, seeks to narrow these differences by harmonising regulations, accounting standards, and procedures relating to the preparation of financial statements. In theory, this means that users of financial statements should be able to compare companies in similar industries but different countries, eg. a French retailer with a US retailer or a manufacturer in Europe with an Asian manufacturer. It hasn't reached that stage yet but the world is becoming smaller and more uniform, at least in accounting terms, and that ideal is now much closer.

So who are these users for whom this standardisation is being delivered around the world? Broadly speaking they are: present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies, and the public. They use the financial statements to satisfy their differing needs for information, but it is recognised that financial statements cannot satisfy the information needs of all these users. As investors are providers of risk capital to the business the provision of financial statements that meet their needs will also meet most of the needs of other users. And broad qualitative principles of understanding, relevance, reliability and comparability, that underpin the IFRS technical content, ensure that these wider needs are satisfied.

The challenge

The challenge for businesses and their advisers is now to meet the demands of these users for consistent, transparent, high quality and comparable reporting. IFRS is the means to deliver this across the world, but it will place additional demands on professional advisers to deliver the highest standards of advice for their clients.

UHY was recently named as one of the first full members of the Forum of Firms after reporting it had implemented a globally co-ordinated quality assurance programme, committed to the use of International Standards on Auditing (ISAs), and met other specific ethics requirements.

John Wolfgang said: "We have embraced the high quality assurance and ethics standards required of Forum members in order to serve the public interest and to help raise the standards of the international practice of auditing.

"More specifically, so many mid-tier companies now have interests in at least one country outside their home base – many have wider international operations. UHY's membership of

the Forum of Firms means these mid-market clients have access to the same quality of professional service from firms like ours. We not only have the global spread but now have the attested compliance infrastructure to deliver a transnational service that any client can count on.”

It is this consistent application of IFRS across the globe by professional advisers such as our UHY member firms that will ultimately deliver the quality of reporting that the IASB set as its goal in 2001 – the world really is moving towards a single voice on financial reporting and that can only be good for every user of financial statements.

UHY certainly intends to be at the forefront of this drive for quality, and our Forum of Firms membership is recognition that we have the capability and technical competence to deliver the levels of service that our clients expect.

About UHY International

Established in 1986 and based in London, UK, UHY International is an association of independent audit, accounting and consulting firms with offices in over 200 major business centres in 69 countries. Over 6300 staff generated an aggregate income of US\$614 million in 2007, ranking UHY International among the top 25 international audit, accounting and consultancy networks (by revenue). Each member of UHY International is a legally separate and independent firm.

UHY is a full member of the Forum of Firms, an association of international networks of accounting firms. For additional information on the Forum of Firms, visit www.ifac.org/Forum_of_Firms

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