

THE IFRS CODE: TOWARD THE HOLY GRAIL OF CONVERGENCE: AN INTRODUCTION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

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If you thought that *The Da Vinci Code* was the best selling book of recent years, think again. Thanks to arguably the largest-ever change in financial reporting standards around the globe, topping the best seller list this year and for years to come will be a heavy tome dedicated to the new accounting religion about to become law throughout Europe and beyond.

From January 1, 2005, almost all companies listed on exchanges within the European Union (EU) will be required to follow International Financial Reporting Standards (IFRS) when preparing their public financial statements. This article will provide the background to these standards and their development, outline some of the major differences with US Generally Accepted Accounting Principles (GAAP), and identify how their implementation will affect all hospitality entities in the United States – either directly through overseas affiliations or indirectly through convergence of US standards to IFRS.

What are IFRS and where did they come from?

The predecessor of the International Accounting Standards Board (IASB), the International Accounting Standards Committee (IASC), was set up in 1973 with the initial involvement of nine countries, and the first standard, International Accounting Standard 1 (IAS 1), was issued in January 1974. Despite early hurdles that led to many alternative treatments in early standards, the fledgling group grew and gained influence thanks to a number of factors: the rise of multinational corporations; the growth of global capital markets; increased international economic interdependence; more foreign direct investment; the growth of multinational political organizations, specifically the EU; and, perhaps the most powerful factor of all, the ensuing reduced costs of cross border financial transparency for owners, creditors, preparers, analysts and the general public.

Today the IASB has 14 members from a variety of major global standard setting countries, including the US, and is funded, indirectly, by major accounting firms; private financial institutions, industrial companies; and central and development banks. Its funding sources does leave it open to lobbying and influence and certainly as the IASB worked toward what it refers to as a “stable platform” of standards, the efforts of the lobbyists intensified, particularly on the topics of financial instruments and derivatives. As of March 31, 2004, IASB had published 46 standards – 41 IASs and 5 IFRSs – the new name for the more recent standards.

Trying to meet the demands of so many different national influences was the most difficult problem faced in developing the standards. This dilemma manifests itself in the alternative treatments allowed in some of the early standards: most of the standards had a “benchmark” or preferred treatment but still allowed other approaches. For example, it was possible to report the correction of an error as a prior period adjustment or as a current year adjustment. Clearly, these “pick the option that suits you” standards struggled to gain credibility in the global financial marketplace. To that extent, the IASB launched an improvements project to enhance the older standards by removing many of the alternative treatments. This project was completed in December 2003. A number of other, new, standards were issued early in 2004. So by March 31, 2004, the IASB was able to proclaim it had achieved a “stable platform” of standards. This was essential given the 7,000 companies in Europe that were anxiously trying to deal with the mandatory transition to IFRS as of January 1, 2005.

How will US entities be affected?

The new international standards will affect companies in the US in one of three ways.

- i. The US company is a subsidiary of a company headquartered in the European Union.
- ii. The US company is the parent of a subsidiary or has operations located in the European Union.
- iii. The FASB’s ongoing convergence project will move US accounting standards progressively toward IFRS, ultimately affecting all US entities.

Either of the first two situations is a distinct possibility for some segments of the hospitality industry, given the number of international hotel and restaurant chains. In addition, a significant number of companies in the US are tightly linked with Europe: the SEC reported in 2003 that more than 300 SEC-listed companies are headquartered in the European Union and thus are required to use IFRS beginning in 2005. Controllers should not think that they are off the hook if they do not deal with EU operations; many other jurisdictions have signaled their intent to either adopt IFRS or conform their national GAAP to the international standards. Such countries include Australia, Japan, and, perhaps most significantly given the size and rate of expansion of its economy, China.

Eventually, all entities – hotels, clubs and restaurants included – will be affected by the third situation. The FASB already has issued a handful of exposure drafts specifically to bring US GAAP directly into convergence with IFRS and now expressly considers the convergence position when issuing new standards.

How will the differences affect financial statements?

In 2002, Ernst & Young released a study of the reconciliations from IFRS to US GAAP provided by 38 foreign registrants in their Form F-20 filings with the SEC. While many of the differences will have decreased since the time of the study due to the ongoing efforts for convergence both by the IASB and the FASB, there still are differences in a number of areas today. Table I displays the overall financial statement impact of the differences among the study population.



Table 1: US GAAP equity and income compared with IFRS

	<i>Equity</i>	<i>Income</i>
Higher under US GAAP	16	15
Equal	4	2
Lower under US GAAP	18	21

Though discussion of detailed differences is outside the scope of this article, key areas still open for reconciliation are listed in Table 2.

Financial Statement Items	Nature of Difference
Deferred Tax	Calculation methodology and disclosure differences.
Property and Equipment Costs, including investment property	IFRS permits upward revaluation.
Stock Options	IFRS requires expensing of options; US GAAP currently permits but does not mandate option expensing. FASB has issued an exposure draft to converge to the IFRS position. This draft, however, has come under much criticism and has been the subject of a bill in the US Congress to prevent its adoption by the SEC.
Revenue Recognition	There is one general international standard. US GAAP has a plethora of very detailed rule-based standards that often can lead to different results from the IFRS position. Revenue recognition is high on the convergence agenda of both the FASB and the IASB.
Defined Benefit Pension Plans	IFRS has no requirement to record an additional liability for accumulated benefit obligations in excess of plan assets.
Asset Impairment	Differences in the level at which to test for impairment and also in the mechanics of the impairment calculation
Changes in Accounting Policy	IFRS requires retroactive restatement. FASB has issued an exposure draft to converge to the IASB position.
Working Capital Definitions	IFRS requires current liabilities to be classified based on condition at the balance sheet date, regardless of the conditions at the date of issuance of the financial statements. FASB has agreed to converge toward the IFRS position.



This is by no means an all-encompassing list, and controllers who find themselves dealing with IFRS on a regular basis need to review each international standard in detail and determine how it affects their situation. Table 3 provides some resources to assist controllers in this regard. Perhaps the best way to gain an overview is the IASB publication, *IFRS – A Briefing for Chief Executives, Audit Committees and Boards of Directors*. These concise and easy-to-use briefing notes provide summaries of all current standards issued at March 31, 2004, and are available through the IASB website.

Controllers, though, are not alone in their need to be aware of the new standards. The standards in some cases will require new disclosures of information that perhaps was not being captured before. This will lead to systems modifications and technology changes, none of which will come cheap. In the United Kingdom alone, it is estimated that first time adoption of IFRS will cost Britain's public companies at least \$900 million.

Given the far-reaching and rapid changes in US GAAP in the past number of years, IFRS consideration might not be something that hospitality financial professionals want to deal with in the short term; but deal with it they must. IFRS is not only coming, it is here and, as with other changes in financial reporting, it is up to us to lead the way in terms of informing and communicating with our management teams, boards and owners as to the impact of the new regime on managing our businesses and reporting our performance. It may not be as high profile a task as cracking the Da Vinci Code, but there is no doubt it will be more demanding.

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Table 3: Influential Parties and resources

The European Union is an economic and political alliance of European nations with 25 members.

The Financial Accounting Standards Board (FASB) is the primary accounting standard setter in the United States. It has therefore been the primary US representative in the effort to converge IFRS and US GAAP. www.fasb.org

The International Accounting Standards Board (IASB) is an independent, privately funded accounting standard setter committed to developing in the public interest a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements. www.iasb.org

The Big Four Accounting firms all have sections of their web sites and significant resources devoted IFRS. For example, see www.iasplus.com.

For training, see www.cpa2biz.com for a range of self-study options.

A number of training companies are focusing on IFRS. See www.iaseminars.com

