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CFOs on IFRS: Forget about It

CFOs urge the SEC to drop a proposal mandating U.S. companies to use the international accounting rules.

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When the U.S. economy went into a tailspin last September after big financial institutions faltered and the credit markets seized up, many a project was put on the back burner. One was the Securities and Exchange Commission's proposal to move all publicly traded U.S. companies to international financial reporting standards by 2016.

The so-called roadmap — outlining the various deadlines for getting to the point where companies would no longer use U.S. generally accepted accounting principles — was first introduced by then–SEC chairman Christopher Cox last August before Lehman Brothers collapsed. But it wasn't formally released for public view until November.

Now, nearly eight months after Cox declared IFRS could become a "uniter of the world's capital markets and investors everywhere" and its adoption necessary to keep U.S. businesses competitive globally, CFOs are pressing his successor, Mary Schapiro, to table the IFRS project, focus on the financial crisis, and keep the convergence work between the United States and global standards-setters. "I don't get the impression that the new Administration has made IFRS a priority in the same way the last Administration did," concludes William Stocker, an audit and accounting partner with Marks Paneth & Shron, a regional firm.

Moreover, many of the nearly 40 finance executives who have commented on the SEC's proposal worry about the cost of switching accounting systems and doubt many companies will consider the change worth the trouble. "Conversion to IFRS could lead to confusion and reduced marketplace confidence in financial statements at a time when confidence in the U.S. financial markets is already low," wrote Patrick Mulva, controller for ExxonMobil.

Under the SEC's proposed time line, all publicly traded U.S. companies would be required to use IFRS within five years if the SEC votes in 2011 to push its plan forward. Large accelerated filers (those with a market capitalization of $700 million or more) would begin using IFRS in 2014, followed by accelerated filers (those with a market cap above $75 million) in 2015 and smaller companies in 2016. The proposal would also let about 110 companies use the international rules as early as this year, depending on their size and their industry.

However, since the SEC extended the public-comment period for the 165-page roadmap proposal to April 20 from its original February 19 deadline, it's unlikely the commission will stick to those original dates.

Schapiro has also indicated she may have changes in mind. At her Senate confirmation hearing earlier this year, she said, "I will not be bound by the existing roadmap that's out for public comment." She also expressed reservations about the independence of the overseas standards-setter that writes IFRS and the quality of the rules themselves.

Her qualms are matched by some finance executives. In their comments to the SEC, they cited concerns over whether the U.S. legal culture and auditors could handle a more principles-based accounting language, getting their staff up to speed on IFRS, the integrity of the International Accounting Standards Board, and whether the international rules are truly better than U.S. GAAP.

Most of all, these executives are worried about the cost of conversion. The SEC predicts that early adopters of IFRS would each incur about $32 million in additional costs in the 10-Ks they file in 2010. James Campbell, corporate controller at Intel, estimated an IFRS conversion would cost his company $50 million, prompting him to ask the SEC to study the issue more thoroughly before issuing a mandate in 2011.

Health-benefits company WellPoint, which had $61.1 billion in revenue in 2007, estimates it would cost $80 million for the first year of implementation, a number that would decrease to $2 million by the third year. Chief accounting officer and controller Martin Miller doubts investors will want their companies to make such a "significant" investment on IFRS. "Given the state of the current economy, many companies potentially do not have additional funds available to expend on an IFRS adoption project," he warned in his letter.

Indeed, many companies are taking a wait-and-see approach to the IFRS momentum, which seemed to be moving fast under Cox precrisis, but has now hit a standstill. More than two-thirds of financial professionals have not budgeted for converting to IFRS, according to a Deloitte & Touche survey in March of 150 CFOs and finance managers.

That report may come as little surprise to Barbara Scherer, CFO at headset manufacturer Plantronics, who notes the recession has forced her company to cut costs and head count and to focus on cash flow. An IFRS conversion would raise her accounting and legal fees, plus staffing costs to maintain two accounting systems during the transition and for training. "In the current business and economic environment, any resources and funds used on the IFRS implementation would not be the appropriate resources at this time and provide little return or benefit to our business or shareholders," she wrote.

Further, the downturn will likely crimp the SEC's original plan to give the largest U.S. companies the chance to adopt IFRS early. "Given the current economic environment, significant issues challenging most companies, and given the uncertainty regarding the final decision in 2011, it is contrary to sound fiscal management to expend resources on a long-term project that has not been fully vetted and where the final outcome is not readily apparent," wrote Douglas Shuma, chief accounting officer and corporate controller at Telephone and Data Systems.

Some observers argue that adoption of IFRS, rather than convergence, may be the better route. For one thing, adoption would eliminate "the arbitrage" between the two standards that has caused politicians to exert undue influence over what should be an independent standards-setting process, says DJ Gannon, a Deloitte & Touche partner specializing in international accounting and reporting. During the past year, U.S. lawmakers and European heads of state have pushed the Financial Accounting Standards Board and the International Accounting Standards Board, respectively, to change rules to eliminate any advantage American companies may have had over their international counterparts, or visa versa.

Further, Gannon told CFO.com that IFRS already has been blessed by the SEC as appropriate for use by foreign private issuers that list on U.S. exchanges. Still, "the SEC is sending a mixed message," says Gary Illiano, the national partner in charge of international and domestic accounting for Grant Thornton. He argues that the SEC contends that while IFRS "is good enough" for foreign private issuers and big companies that qualify for early adoption, it's not for the vast majority of public companies.

Accountants, like finance executives, cite some costly practical issues that will haunt their clients if the SEC decides to require IFRS. For example, if the SEC gives the green light to IFRS and sticks to its roadmap, companies would have to switch by year-end 2014 and include three years of comparative results. That timing would force companies to start reporting under IFRS beginning in 2012, which is impractical, claims Gannon. Again, the SEC took a more lenient stance with foreign private issues, waiving the three-year rule and requiring only a year's worth of comparative results for the first year those companies adopted IFRS.

Pragmatists also complain that besides data-gathering and systems changes, switching to IFRS would require companies to review items linked to U.S. GAAP, such as debt covenants, executive compensation, and investor-relations materials, says Illiano.

Meanwhile, the SEC must be mindful of how moving to IFRS will affect other regulators, including those that keep watch over banks, insurance companies, utilities, and pensions. Those rulemakers mandate their own brand of accounting, "but most start with U.S. GAAP," Stocker told CFO.com.

On the other side of the issue are companies that are well positioned to make the switch to IFRS, says Illiano. They include smaller U.S. companies that have been acquired by international companies that already use IFRS. Another group of possible IFRS rooters consists of non-American companies that move into the U.S. market through a reverse merger, added Stocker.

A popular way of raising capital is for a non-U.S. company to buy an American company that has shut down operations and exists only as a shell. The larger company goes through the merger, gives its stockholders 90% of the shell-company shares, and becomes an SEC registered company.

Real estate companies that are sired international holding companies probably wouldn't shy away from reporting results in IFRS, nor would existing American subsidiaries of non-U.S. companies.

Further, the American Institute of Certified Public Accountants, as well as some states, recently changed its rules to make IFRS acceptable for reporting the financial results of private companies. That means the affected accounting firms will be able to give a clean audit opinion to private-company clients that use IFRS without having to issue an audit report that explains the differences and exceptions related to U.S. GAAP.

The SEC is likely to take at least six months to mull over the comment letters. Gannon thinks an announcement will be made before the end of the year, likely around the same time the G20 leaders meet to announce what progress has been made on a variety of global projects, including the financial crisis. Gannon contends that the reason the SEC took several months before publishing its IFRS roadmap is that the regulator was waiting to see what the G20 had to say about accounting. In the end, "U.S. GAAP used to be the de facto [international] standard," but after 12 years, IFRS has now gained ground in terms of quality, asserts Gannon.