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IFRS: What private companies should know*

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With the release of IFRS for Small and Medium-sized Entities (SMEs) in July, the topic of IFRS is back in the news, and private companies should take note.

IFRS first piqued the interest of most private US companies and other stakeholders in 2007, when the US Securities and Exchange Commission (SEC) took its first tentative step toward moving US public companies to IFRS by issuing a Concept Release asking for feedback on the idea. The SEC maintained that momentum in 2008 by issuing a proposed road map that discussed the benefits, challenges, and a proposed timeline for a path forward that would require IFRS adoption by all public companies. But then, as a new administration took office, the credit crisis intensified, and the ailing economy redirected the focus from bringing IFRS to the US and created uncertainty around the timing of adoption. Now, however, the release of IFRS for SMEs, a somewhat simplified version of the standards, has reinvigorated the discussion, and it presents private companies with a new opportunity to carefully consider whether adopting one of these standards makes sense for them.

The ongoing impact of IFRS

Over the past several years, IFRS has quickly become the most widely used financial reporting language globally; more than 100 countries allow IFRS for certain types of reporting. Nevertheless, many private companies have little knowledge of the standards or of what the standards may mean for their businesses: 63% of respondents to PricewaterhouseCoopers' Private Company Trendsetter Barometer said they are not very knowledgeable about IFRS; nearly half were uncertain about what kinds of changes IFRS might mean for their businesses.

Nevertheless, US companies, whether public or private, are already—or will soon be—affected by IFRS. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have been working diligently to improve both sets of standards while reducing the differences between US generally accepted accounting standards (GAAP) and IFRS. The boards have an aggressive project agenda that includes rewrites of major accounting standards, such as revenue recognition, leasing, and financial instruments. These joint standard-setting efforts will have widespread and immediate impacts on US companies. In many instances, the new standards will look more like IFRS than like US GAAP. In fact, they may impact almost every significant line item on the balance sheet, as well as both the top and bottom lines of the income statement.

Ongoing global adoption of IFRS for statutory reporting impacts private companies that have non-US subsidiaries. In addition, IFRS may already impact private companies through interactions with vendors, customers, and other parties that already have adopted IFRS. Finally, private companies considering an acquisition of or by a company already reporting under IFRS would benefit from a clearer understanding of IFRS.

In other words, change is coming—whether through modifications to US GAAP driven by convergence with IFRS, the impact of the global adoption of IFRS, a voluntary decision to convert to IFRS, or a mandate to convert to IFRS from company stakeholders or potential stakeholders. Leadership will want to understand the potential impact of these possible changes on their financial statements as well as on their broader business strategy. "Management must be informed about this new accounting framework so that they can make educated decisions about whether they should adopt IFRS or continue to report under US GAAP," said Timothy O'Hara, partner with PricewaterhouseCoopers' Private Company Services practice in Philadelphia.

IFRS for SMEs

To ease the burden of IFRS reporting on smaller, nonpublic companies, the IASB released IFRS for SMEs in July 2009. Though IFRS for SMEs has its roots in many of the same principles as IFRS, it was specifically designed to address the needs of companies that do not have public accountability.

IFRS for SMEs offers private companies the opportunity to simplify their accounting and disclosures as compared with both IFRS and US GAAP. For example, it allows for broader use of the cost method (for instruments that may require fair value accounting under IFRS or US GAAP), and it allows goodwill amortization rather than requiring an annual impairment test (although an impairment test would still be required at times).

As with a move to IFRS, companies considering a move to IFRS for SMEs will need to consider the local statutory regulations in the countries in which they operate and will need to remember that regulations do not apply equally to IFRS and IFRS for SMEs. Because IFRS for SMEs was just recently issued, the rules around its acceptance for statutory purposes are still evolving.

Opportunities and challenges of converting to IFRS and IFRS for SMEs

Opportunities

- Simpler accounting standards; IFRS has fewer details and exceptions than US GAAP
- Broader reliance on professional judgment allows better reflection of the economics of transactions
- Increased global comparability of a company's results
- Eased access to non-US capital markets and potential to make cross-border acquisition activity more efficient
- Streamlined reporting processes; reduced costs for companies operating multinationally
- Eased international expansion for domestic companies

Challenges

- IFRS does not currently allow access to the US capital market
- IFRS for SMEs will not provide access to any global capital market
- Cost and complexity of conversion process; time and availability of dedicated resources to manage and execute the conversion
- Application of judgment required by principles-based standards may result in fewer black-and-white answers when setting accounting policies in certain areas
- Modification of contracts, partnerships, and other arrangements to incorporate IFRS considerations
- Conversion of reporting systems capability and data requirements
- Impact on budgets, plans, forecasts, and other indicators, as well as on overall control environment and risk management strategies
- Potential tax implications

Who might adopt

"IFRS offers one more option for private companies to consider when evaluating the best accounting framework to most accurately reflect their operations," said O'Hara. And while all private companies would benefit from understanding the implications of IFRS, two groups in particular may want to consider transitioning sooner rather than later:

US-based multinationals with significant foreign operations. These companies tend to have higher compliance costs because their international subsidiaries maintain two sets of accounting records: one on US GAAP for consolidation purposes and one on local GAAP for statutory reporting purposes. The trend is clear: As IFRS or IFRS for SMEs becomes more widely accepted for statutory reporting purposes, companies with many foreign businesses could realize significant cost savings by converting the entire company to IFRS or IFRS for SMEs and accomplish additional cost savings by establishing shared service centers to do the bookkeeping. "Just the time to complete closings, not to mention the internal resources and external costs involved in managing and reporting, will be improved when the entire organization is reporting uniformly rather than under multiple standards," said O'Hara. Getting all locations onto the same accounting platform also offers opportunities for enhanced consistency of accounting and financial reporting across all subsidiaries and the parent company. "When the same standards are consistently applied globally, information will be more transparent and management may achieve improved decision making," he said. Private companies that decide against converting the entire company to IFRS or IFRS for SMEs should still retain corporate oversight of their subsidiaries' adoption to ensure the standards are being applied uniformly.

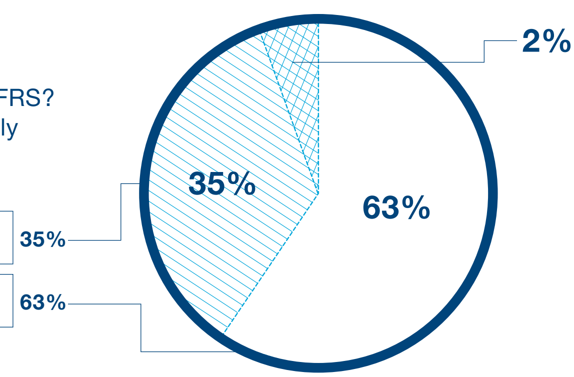
Companies that have relatively straightforward accounting transactions. Companies whose operations necessitate fairly complex accounting—such as multielement revenue arrangements, complex special-purpose-entity structuring and heavy use of derivatives—may find IFRS or IFRS for SMEs just as challenging to apply as US GAAP. However, companies where such accounting is unnecessary, as well as companies whose users would be comfortable with (or perhaps even welcome) a more streamlined accounting and disclosure framework than US GAAP currently requires, could be good candidates for considering whether IFRS is a better option for them.

Additional considerations for private companies: For all companies, converting to IFRS or IFRS for SMEs is a commitment—of management focus, of resources, and of funding. The transition may have considerable implications to processes, systems, and people and may be costly, complex, and time-consuming. Management teams will want to conduct a well-constructed cost-benefit analysis when deciding whether a conversion is the best strategic decision overall for the company. Private companies in particular will want to evaluate certain key concerns in addition to the time and cost considerations:

- Private companies considering exit strategies involving the US capital markets (for example, initial public offerings [IPOs] or strategic sales to public companies) will want to ensure that any IFRS conversion decisions are aligned with the SEC's proposed timeline for moving public companies to IFRS. While we believe that IFRS will ultimately be adopted in the US for public companies, there is uncertainty around the timing.
- The SEC will not accept IFRS for SMEs for financial reporting purposes. Companies adopting IFRS for SMEs now should consider that moving to IFRS for SMEs increases the differences with US GAAP, and those

How knowledgeable are you about IFRS? In our survey, only 6% were extremely knowledgeable.†

Extremely knowledgeable	6%
Somewhat knowledgeable	29%
Not particularly knowledgeable	27%
Not at all knowledgeable	36%
Don't know/Not reported	2%



†Source: PricewaterhouseCoopers, 2009. Private Company Trendsetter Barometer, May 2009

differences will need to be resolved should they consider an IPO before IFRS is adopted for public companies. In addition, after IFRS is adopted for public companies, private companies contemplating a public exit strategy would still need to convert from IFRS for SMEs to full IFRS.

- Although IFRS is widely accepted globally for public companies, a number of countries still have restrictions on the use of IFRS for statutory reporting purposes by private companies (or private subsidiaries of public companies). And since it was just recently issued, statutory acceptance of IFRS for SMEs is still evolving. Private companies contemplating a move to IFRS or IFRS for SMEs should understand the specific rules of each country where they have statutory reporting requirements to ensure that all of the benefits of moving to a single set of standards are achieved.
- IFRS encourages, even requires, more professional judgment than US GAAP does, which could be burdensome for private companies that may not have sophisticated accounting resources on staff. To a lesser extent, this also applies to the somewhat simplified, IFRS for SMEs.
- Companies that currently apply last in, first out (LIFO) for inventory valuation should carefully consider the tax implications of an IFRS adoption. Neither IFRS nor IFRS for SMEs allows LIFO, and as a result of book/tax conformity rules in the US, companies could face considerable cash tax liabilities when adopting either set of standards.
- Adoption of IFRS or IFRS for SMEs may have additional tax implications, both domestically and internationally. Companies should carefully consider the tax expense and cash tax impact of IFRS or IFRS for SMEs adoption in each of their tax jurisdictions.

Accounting for change

After considering all the options and evaluating the business as a whole, some private company leadership may decide that US GAAP is still their best option. Regardless of the ultimate decision, it's important for private companies to make this assessment at some point. "While there is uncertainty around the adoption date for US public companies," said O'Hara, "those private com-panies that carefully consider the issues and implications of the transition now will be best able to manage costs, avoid surprises, and position themselves advantageously for the coming change."

Want to know more about how IFRS could impact your company? We will be releasing publications that examine the technical accounting differences and related business implications between IFRS and IFRS for SMEs, as well as the differences between IFRS for SMEs and US GAAP. Please contact:

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