

THE EFFECTS OF IFRS ON VARIOUS STAKEHOLDERS

The primary driver toward the adoption of a single set of high-quality, globally accepted set of accounting standards is the globalization of the capital markets, including enhanced comparability. International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) have the momentum of worldwide adoption and would enhance financial statement comparability by using a single set of standards.

The SEC issued its Proposed Roadmap for the adoption of IFRS by U.S. registrants, but has yet to fully commit to IFRS. As a result, many reporting entities have chosen to ignore, at least for the present time, the differences between IFRS and accounting principles generally accepted in the United States (GAAP).

However, every major non-U.S. capital market is either using IFRS or moving in that direction. Currently, there are over 120 countries that have adopted or are in the process of adopting IFRS. Since U.S. domiciled businesses are not functioning in a vacuum, IFRS demands our attention right *now*.

IFRS can be relevant to U.S. domiciled businesses seeking capital or targeting foreign acquisitions, or those that are targets for acquisition by foreign domiciled businesses. IFRS can be relevant to U.S. subsidiaries of foreign domiciled parents and U.S. domiciled entities with foreign subsidiaries and/or foreign trading. The differences that exist between the two accounting platforms, including, but not limited to, revenue recognition, fair value accounting, accounting for leases, and share-based compensation, can significantly impact business practices. These differences

Per the U.S. Council Foundation in their April 2009 report, titled "How U.S. Multinational Companies Strengthen the U.S. Economy," there are over 2,200 U.S. multinational parents that own a majority (more than 50 percent) interest in a foreign entity. These 2,200-plus companies account for almost 25 percent, or more than \$2.5 trillion, of all private sector output, in GDP terms. These companies have a 50 percent or greater interest in approximately 24,000 foreign affiliates, which have to report in their home country GAAP and/or IFRS (with an anticipated move exclusively to IFRS reporting standards), with implications at the parent level. Further, there are approximately 11,000 U.S. entities that own more than 10 percent, but less than 50 percent of one or more foreign entities. Also relevant are the more than 9,000 foreign entities, which own close to 12,000 U.S. entities. Again, all of the foreign entities have to report in their home country GAAP and/or IFRS and this can have a significant impact at the U.S. entity level. With respect to listed entities there are over 800 foreign companies listed on U.S. exchanges and over 200 U.S. entities listed on foreign exchanges.

may arise in dealing with customers, vendors, employees, or sources of financing, but eventually the challenges created by these differences will become evident and require attention.

Stakeholders should develop a general understanding of IFRS early and obtain insight into how the differences between IFRS and their current accounting platform can impact their business practices. This may include, among other things, a formalized education program.

Among the issues that various stakeholders should consider:

- **Owners, boards of directors, and audit committees** should be aware that although cash flow likely would not be impacted by employing a different accounting platform, reporting under IFRS could have an impact on business valuations. It is important to understand what basis of accounting is used in the

financial statements underlying a business valuation. Significant differences in reported revenues, net income, net assets, and net worth can arise, which could impact a valuation.

Audit committees need to be aware that an orderly transition to IFRS will require modifications to accounting policies, information technology systems, business processes, and internal controls. For these reasons, audit committee representatives should currently communicate with their CEOs and CFOs regarding the implementation plans for adopting IFRS if and when required.

This group, along with attorneys that advise this group, should also remain cognizant of any local statutory IFRS financial reporting requirements of foreign subsidiaries. Such requirements can warrant significant conversion efforts and related costs.

- **CEOs and strategic management teams** may need to rethink key performance indicators, such as those which may affect loan covenants or employee compensation if a different basis of accounting is contemplated for use. Further, these stakeholders may need to consider certain commercially sensitive disclosures that may be required by IFRS.

- **CFOs and finance teams** will shoulder the largest burden in determining how IFRS might impact the following:

- Financial accounting and reporting systems
- Debt covenants
- Budgeting
- Acquisitions and contingent consideration (i.e., earn-outs)
- Leases
- Tax planning (i.e., LIFO and transfer pricing)

When negotiating agreements that give consideration to future financial results (e.g., debt covenants, contingent rentals, contingent consideration in an acquisition, and employee incentive compensation), it is important to

specify the basis of accounting that will be employed. Also, management needs to be aware that existing agreements may require renegotiation. This consideration may require the attention of attorneys that advise the entity.

- **Sales management**, in coordination with finance teams, may need to consider that standard revenue arrangements created to allow for revenue recognition under U.S. GAAP may need to be reevaluated when operating using the IFRS accounting platform. This factor could significantly impact the way an entity goes to market.
- **Investor relations** may need to consider the education of users of financial information.
- **Human Resources (HR) professionals** may need to rethink and/or renegotiate compensation arrangements, both cash incentive compensation and share-based compensation arrangements. HR likely would also be involved in coordination of necessary training for finance and accounting staff.

- **IT management** may be tasked to acquire or develop new systems or reconfigure existing systems to capture the necessary financial accounting and information for reporting under IFRS.

IFRS is here to stay and is in play in every major non-U.S. capital market. In today's global business environment, this different accounting platform and its impact on business practices certainly demands the attention of stakeholders in U.S.-based entities with an international presence. ■

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