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Prepping for International Accounting Rules Changes

 By [Randy Myers](#), October 12, 2010


IFRS FAQ

Here are additional resources for learning more about International Financial Reporting Standards for Small and Medium-Sized Entities, commonly referred to as IFRS for SMEs:

- [IFRS v. GAAP](#) – CFO.com guide to the accounting rules shift.
- [IFRS FAQs](#) – Questions and answers from the American Institute of Certified Public Accountants.
- [IFRS for SMEs: Pocket Guide 2009](#) – From Big Four accounting firm PricewaterhouseCoopers.
- [IFRS for Private Companies](#) – From accounting firm BDO Seidman LLP.
- [Private Company Financial Reporting](#) – A spring 2010 report from accounting firm Grant Thornton on a range of issues related to private company financial reporting.
- [KPMG IFRS Institute](#) – From Big Four accounting firm KPMG LLP.

The odds that private U.S. companies will be switching from U.S. to international accounting standards got a little longer in July when a blue ribbon panel failed to endorse the idea. That doesn't mean the issue is dead; private companies can switch to the international rules if they wish. But it does suggest that most should stick to their current accounting regime for now.

The question is, should yours?

The notion of adopting international accounting standards gained real momentum in the United States in 2008, when the [Securities & Exchange Commission](#) proposed that publicly traded companies begin making the switch in 2014. The SEC is expected to make a final decision next year. In the meantime, the [International Accounting Standards Board](#), the global standard-setting body, has drafted a slimmed down version of the international rules for privately held companies.

On their face, the [International Financial Reporting Standards for Small and Medium-Sized Entities](#), commonly referred to as IFRS for SMEs, have plenty of appeal. More than 60 countries already have adopted them or are in the process of doing so. By joining that crowd, U.S. companies operating in an increasingly global economy could find it easier to compete for capital and customers around the world.

IFRS for SMEs are refreshingly brief – approximately 230 pages compared with about 25,000 for U.S. generally accepted accounting principles. The global rules also eliminate some accounting headaches. For example, rather than require private companies to calculate impairment to goodwill annually, they allow goodwill to be amortized.

An Appealing Idea - With Major Caveats

Dive much deeper, though, and the value of switching becomes less obvious. For starters, some accountants believe the international standards, like U.S. GAAP, are overly focused on the needs of companies seeking to raise capital in the public equity markets, rather than companies that primarily borrow from banks or raise funds privately. In part, that's because the international rules are based on existing accounting standards used mostly by larger companies in more than 100 countries. The United States is not one of them, although many in the accounting industry expect SEC to come down in favor of IFRS next year and give U.S. public companies several years to change over.

What's more, the brevity of IFRS for SMEs is misleading, argues Andy Thrower, a consulting CFO and a member of a subcommittee on private company standards at [Financial Executives International](#), an industry trade group. Thrower says without extensive guidance from the Financial Accounting Standards Board that backstops U.S. GAAP, companies using the international rules could struggle to justify accounting decisions to auditors.

Janice Patrisso, executive director of the IFRS Institute at Big Four accounting firm [KPMG LLP](#), agrees. "While the standards are far less lengthy, there are likely to be a number of situations in practice where IFRS for SMEs have very limited guidance," she says.

Critics also argue that there is simply no demand for IFRS for SMEs in the United States from lenders, customers, vendors and other entities that review private companies' financial statements. Thrower, who has followed the debate closely as a past member of the [Financial Accounting Standards Advisory Council](#) and a FASB small business advisory committee, says he's not aware of any independent, privately held U.S. companies using them.

"There's not a lot of push to have it happen," seconds Gary Illiano, a national partner at accounting firm [Grant Thornton LLP](#). "When I've sat down with bankers and other capital providers, they have a lot of misunderstandings as to what this thing is, and it doesn't give them a warm, comfortable feeling. My personal view is that until you see (full) IFRS gain some traction in this country, it's unlikely to trickle down to the private company universe."

Don't Count IFRS Out Yet

The major U.S. accounting industry organizations aren't lining up in favor of IFRS for SMEs either, including the [American Institute of Certified Public Accountants](#), the [National Association of State Boards of Accountancy](#) and FASB's parent organization, the Financial Accounting Foundation. Last year, those organizations established a blue-ribbon panel to figure out how U.S. accounting standards could be tweaked to meet the needs of banks and other entities that use private-company financial statements. After evaluating multiple alternatives, the panel asked for further review of three U.S. GAAP-based options and ignored IFRS for SMEs. The panel's final recommendation will be taken under advisement by the FAF and FASB.

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None of this means international standards for small and medium-sized companies are dead. In 2008, the AICPA's governing council voted to recognize the International Accounting Standards Board in London, which created IFRS, as an accounting body. Since then, AICPA members have had the option of using the international principles as an alternative to U.S. GAAP.

KPMG's Patrisso says some companies are taking advantage of the opportunity, primarily businesses partly or wholly owned by foreign multinationals that use IFRS reports. She says KPMG also has seen companies owned by private equity firms beginning to report financial results under both IFRS and GAAP at their owners' request, or under IFRS only in anticipation of a sale or initial public offering outside the United States.

When to Consider IFRS for SMEs

Should your company move to IFRS for SMEs? Probably not, unless your business is more tightly woven into offshore markets than that of the typical U.S. company. But you might consider switching if:

- Current users of your financial statements are foreign investors or investors who might push for a sale in a foreign market
- You will be raising capital in foreign markets
- Most of your growth is expected to come from foreign markets
- You're subject to statutory reporting requirements in foreign markets using IFRS
- Your key peers have adopted IFRS for SMEs.

In all cases, experts suggest companies consult with the parties that use their financial statements before making a change.

Meanwhile, stayed tuned to the IFRS for SME debate, as well as the SEC's consideration of IFRS for public companies and ongoing efforts by FASB and the IASB to reconcile differences between their two accounting systems. The latter could lead to changes in U.S. GAAP regardless of what happens with IFRS for SMEs.

Long-term, it's hard to imagine the push to adopt international standards won't gain momentum. "There are forces driving the adoption of IFRS around the world," says Illiano, the Grant Thornton partner, "and we are not immune to those forces. At some point, I think, it will not be viable for us to be the outlier, largest economy or not."

George Beckwith, controller for privately held [National Gypsum Co.](#), a leading producer of wallboard in Charlotte, North Carolina, is sympathetic to that argument. He suspects that even if IFRS for SMEs is adopted in the United States, the rules would likely be modified for domestic companies, much the way they have been in other countries, including Canada. After all, Beckwith notes, the current practice of forcing small and mid-size companies to follow the same accounting rules as Fortune 500 enterprises doesn't make a lot of sense, either.

"It might be a utopian idea to think you can have a simple set of accounting rules that everybody can understand," says Beckwith, the incoming vice chair of a Financial Executives International committee on private company standards and a member of a FASB-AICPA committee on private company financial reporting. "But right now, the little guy with a flower shop, if he needs GAAP-audited financial statements, has to follow the same rules that General Motors and Bank of America have to follow. If (full) IFRS were more mature here, I think there would be a move to have a flavor of IFRS for SMEs, but not necessarily IFRS for SMEs as they're written right now."

For most companies, such change may be years in the offing. But it's a possibility worth watching, and if your company is already deeply enmeshed in international markets, it may be worth pursuing sooner rather than later.

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