

KPMG's Audit Committee Institute Focus

What Does a New World Accounting Order Mean for Audit Committees?

August 2007

The Securities and Exchange Commission's recent moves to consider embracing International Financial Reporting Standards could eventually change U.S. financial reporting as audit committees know it.

The SEC made public a proposal that would allow foreign private issuers to file financial statements prepared according to IFRS without a reconciliation to U.S. GAAP, as is the case now. Comments on that proposal are due Sept. 24. The SEC then voted to publish a concept release allowing U.S. issuers to prepare their financial statements using IFRS as published by the International Accounting Standards Board (IASB). Comment is due 90 days after the release is published.

Former FASB Chair Dennis Beresford, who is audit committee chair for Kimberly-Clark Corp., Legg Mason and Fannie Mae, believes it's unlikely that many U.S. companies will begin using IFRS in the next few years, but this could change over time.

Beresford, who is also an accounting professor at the University of Georgia, spoke with Audit Committee Insights on the SEC concept release about the use of IFRS by U.S. companies.

Audit Committee Insights: What would U.S. public company audit committees need to know about the SEC's concept release that would allow domestic public companies to use IFRS?

Dennis Beresford: This is only a "trial balloon" at present and it will be very low on the priority list for audit committees. However, it could become a rule proposal if it gets a good response. If the SEC gets a negative response, then that could mean the end of it.

In general, U.S. companies want a level playing field with foreign filers when it comes to the requirements for their financial statements. So the SEC is



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considering addressing that by allowing domestic companies to use the international standards that foreign registrants may be allowed to follow without reconciliation to U.S. GAAP.

ACI: Why should audit committees care about the possibility of using IFRS for their financial statements?

Beresford: Anytime there are available options, the audit committee will want to know the pros and cons of the choices.

Would one approach result in what the company thinks would be a better reflection of "economic reality" for the company? Are other companies in the same industry mainly foreign-based and likely to be using international accounting standards? Would one approach be less expensive for the company to use? Would one approach be more likely to result in challenges to the company's accounting by regulators and other outsiders? These are just a few questions that come quickly to mind and I suspect audit committees would have many others.

ACI: What should audit committees do to prepare for such a potential change in their financial statements?

Beresford: It's pretty early to worry about this now, but staying somewhat informed about the status of the SEC project makes sense.

ACI: How many U.S. companies would the IFRS concept release potentially affect?

Beresford: Potentially, all domestic public companies could elect the international GAAP option. However, I suspect that only the largest, multi-national companies would seriously consider doing this. My guess is [that] with that option, most U.S. companies wouldn't switch from following U.S. GAAP because they are used to preparing their statements that way and there would be many implementation issues in making a change.

But many companies would at least go through the exercise of seeing what they would look like under international GAAP and then think about all of the issues in making a change.

ACI: How soon could a changeover in financial reporting standards take place?

Beresford: We're talking about at least a few years at this point. The SEC would have to propose a rule and it would be mid-2008 at the earliest before the SEC could adopt a final rule. Then there would probably be a couple of years for companies to seriously think through if they would do it.

ACI: Could this potentially mean the end of U.S. GAAP?

Beresford: It's possible that this could be the beginning of the end, but I think the chances are pretty slim at this point. I do think it's fairly likely that the SEC is going to allow U.S. companies to use IFRS after they complete this process that is now just beginning. At the same time, there is the FASB project to converge standards with the International Accounting Standards Board. Over time the differences between U.S. and international accounting are narrowing.

But there are still many differences. In particular, our standards deal with industry specifics and other details that are well beyond what the IASB has done. And even though the FASB and IASB are attempting to converge, that doesn't mean they will agree on all of the issues. So I expect the FASB to be around for the foreseeable future.

ACI: What issues would those involved in the U.S. financial reporting process have to deal with regarding international standards?

Beresford: Mainly, they would have to have a very detailed understanding of the international standards and how they differ from our GAAP. For example, one big difference is the accounting for R&D costs. Under international standards, companies expense research costs but treat development costs as assets. In the U.S., all R&D costs are treated as an expense.

They would also have to look for areas where accounting issues are not covered under existing international standards. Remember, there are probably three or four times the number of rules in U.S. standards versus international standards.

Some companies will continue to take comfort in the more detailed guidance that is available under U.S. accounting. But others might prefer the more general IASB standards that presumably allow for more judgment.

ACI: Will the use of IFRS create an undue burden on investors when it comes to reading the financial statements?

Beresford: Yes, because they would have to understand more than one version of accounting. But some investors have said they don't get much value under the current reconciliation to U.S. accounting by foreign filers, so they may feel that two versions can be accommodated.

ACI: Will they create an undue burden on audit committees?

Beresford: In the final analysis, the company will use only one set of accounting standards to prepare its financial statements. So, on an ongoing basis this won't

be a problem. But there will be a small burden at the time the company and the audit committee talk about whether they want to take advantage of the option or not.

ACI: Would such a rule change lead to the need for an international reporting standards expert on audit committees and the possible globalization of those committees?

Beresford: I don't think so. The basic financial statements will be the same and most of the accounting conventions will be the same or similar. While audit committees should understand the major differences between international standards and U.S. GAAP, they don't necessarily need to go out and get an expert. They should be able to rely on the finance group and the outside auditors for this education.