

Abstract: In the midst of transitioning towards IFRS, accounting authorities must also decide on the best solution for private companies. IFRS for SMEs (Small and Medium-sized Entities), a standard issued by the International Accounting Standards Board for private companies, represents one of their options. However, the over simplified standard represents a major risk in the rules-based accounting culture of the United States and if the Panel recommends its implementation, consequences could include the division of the accounting talent and expertise pool, the limitation of financial statement comparability, and many unnecessary expenditures for conversion costs.

The International Accounting Standards Board (IASB) published an abridged version of its International Financial Reporting Standards (IFRS) entitled IFRS for Small and Medium-sized Entities (SMEs) on July 9, 2009 (IASB, IFRS for SMEs 2009). They were released in response to protests from private companies in regions with limited accounting resources and where public and private companies alike are required to file financial statements; neither of these situations applies in the U.S.

Currently, the American Institute of Certified Public Accountants (AICPA) officially recognizes the IASB as a standard setter, which means that private companies may use full IFRS or IFRS for SMEs to prepare their financial statements, provided that state law permits this (AICPA, Appendix A 2008). It has also joined the Financial Accounting Federation (FAF) and the National Association of State Board for Accountancy (NASBA) to put into place a Blue Ribbon Panel to discuss the possible adoption of a set of standards for private company accounting (FAF, Blue Ribbon Panel 2010). However, a separate set of standards is not the best long-term choice in view of forecasted accounting developments and the perspective of the end users of the financial statements.

In the context of the rules-based culture of the United States, it is important to recognize that U.S. GAAP is already a highly technical set of accounting standards to which most private companies adhere. According to a survey conducted by Deloitte, approximately 88 percent of the SMEs (defined as private companies earning less than one billion dollars in revenue) who responded currently prepare their statements using U.S. GAAP (Deloitte and Touche, IFRS Survey 2009). There are a few SME proponents who argue that full IFRS imposes too much of a burden on preparers and users; in fact, the end users of financial statements in the United States are accustomed to the precise requirements of U.S. GAAP and would be less prepared

to accept statements prepared on the basis of standards even more simplified than full IFRS. Since private companies would be able to choose between the two versions, this would create inconsistency and drastically reduce the comparability of their financial statements.

Allowing private companies to choose between two sets of standards would be detrimental to the transparency of the financial statements and end users' ability to compare them, especially if they have doubts regarding the relevant treatment for a transaction. For example, if two private companies had similar, complicated transactions not treated by IFRS for SMEs, which would be their sole explicitly permitted reference, they might account for the transaction differently and their financial statements would be less transparent and informative. While complicated transactions may not be commonplace amongst most private companies, those who engage in them should have to account for them just as a public company would, and may need the more specific guidance of full IFRS. In this case, separate standards only present an obstacle between the financial statement preparer and the proper accounting treatment for a given transaction, and could furthermore lead to discontinuity in the presentation of similar transactions among private entities.

Many of the setbacks of IFRS for SMEs stem from the standard's definition of eligible companies. According to §1.2 of the standard, companies who may apply it are not publicly traded and "publish general financial statements for external users." The problem is that this definition encompasses businesses with less than a handful of employees, as well as the private companies earning billions in yearly revenues. Under IFRS for SMEs, the latter would use different accounting treatment than similarly sized public companies for similar transactions simply because of their status as private entities. This is neither logical, nor in the

interest of the users of the financial statements. If full IFRS were universally adopted, however, companies could be more easily compared as needed.

The end users of financial statements ultimately drive this issue of comparability to the forefront. For example, a survey taken by Grant Thornton, the accounting and audit firm, of CFOs in the fall of 2009 found that, after current equity interest owners (26 percent), the primary users of financial statements were loan providers (31 percent), management (29 percent) and regulatory agencies (five percent) (Grant Thornton, Survey of Financial Executives 2009). These users are by no means inexperienced in understanding complex accounting terminology under U.S. GAAP and would thus be able to understand statements prepared under full IFRS. Therefore, it is important to note that a single set of standards would better permit efficiency in comparisons by loan providers, for example, or benchmarking among managers.

Beyond the difficulties posed towards the end users, the implementation of two sets of standards would also divide the talent pool of qualified accountants. According to the Bureau of Labor's most recent statistics, there are approximately 1.3 million accountants and auditors in the U.S., all of whom manifestly have extensive technical knowledge of U.S. GAAP. This figure should grow at a rate of 22 percent between 2008 and 2018 (Bureau of Labor Statistics, Accountants and Auditors 2010). This rapid growth would be complicated, and potentially impaired, if two sets of standards were put into place.

First, accounting students would need to choose early on to specialize in full IFRS or IFRS for SMEs. While the college experience is meant to be a time of discovery, students would need to complete coursework and internships in a single market segment, thereby limiting

their capacity to learn about their preferences. The restricted experience in college would inhibit students' entry-level job prospects to either public or private entities. In the United States, where a single set of accounting standards has existed for decades, there are several risks involved with teaching dual standards. To begin with, instruction in two sets of standards could lead to confusion among graduates in a field where accuracy and precision are of the utmost importance. Secondly, in splitting the curriculum, students lose the opportunity to deepen their understanding of full IFRS, and thus have a diluted comprehension of the standards. Future accounting professionals are not the only ones affected. As mentioned earlier, the primary users of financial statements include equity holders, loan providers, managers, regulators, and others. These users, as well, would need training in both full IFRS and IFRS for SMEs and could find comparisons difficult when examining companies that are similar in all aspects except their accounting treatment.

More experienced accountants would find it hard to make a career transition between a public and private company, or vice versa. Such transitions already present a challenge because of the accounting issues that differ between companies, but at least the accounting treatment for a given transaction remains constant under a single set of standards. For an accounting professional hoping to change jobs, personally financed training might be too expensive in terms of time and money, thereby causing him to ignore opportunities that could encourage professional growth. And while his 20 years of experience with IFRS for SMEs would probably result in an unproblematic hire at a private company, the immense employer-supported cost of training an employee might deter an equally sized, public company using full IFRS from hiring the same candidate. The reverse would apply to professionals employed in accounting firms, which represent a large source of talent in the accounting industry. Since all publicly traded companies are clients of these firms, their employees would likely be most

familiar with full IFRS. Consequently, a key segment of accountants with a wealth of full IFRS knowledge would be limited from applying their experience to the private sector. All other conditions (size, industry, clientele, etc) being equal, professionals who wished to change jobs between two companies could not do so as easily if one company was publicly traded and the other was not, since the accounting treatment for transactions would differ, and therefore necessitate additional, costly training.

Even the IASB would suffer from the division of the talent pool. In order to better develop new standards, it reaches out to accounting experts for their feedback. However, since, according to its own estimates, the majority of accountants work for private companies, it would most likely lose the valuable input of a large portion of its resources. These accountants could certainly continue to contribute to requests for feedback on IFRS for SMEs, but the majority of the IASB's complex projects would focus on full IFRS. One of the main hurdles preventing full IFRS adoption in the U.S. lies in concerns about its quality versus that of U.S. GAAP and the ability of the U.S. to provide its input regarding the standard setting process. Without as much contribution from professionals as possible, the IASB risks losing input from a large number of its users.

Training costs are not the only considerable expenses involved in the bi-standard approach; conversion costs from IFRS for SMEs to full IFRS for companies considering an IPO, M&A transaction, or facing requirements from a regulator or capital provider, would not only be substantial, but also redundant. Companies would most likely convert from U.S. GAAP to IFRS for SMEs to full IFRS. Their costs would include staff training, updates or an overhaul of information systems, restatement of past financial reports, as well as a change in internally published accounting policies, all of which would be incurred at both steps. There would also

be the issue of the business disruption and time cost caused by the conversions. Many smaller companies already have severely limited resources in comparison to larger competitors, and they could be put to better use than a second conversion. A private company's objective when presented with growth opportunities is always to maximize shareholder value, and an avoidable cost such as an accounting conversion does not amount to a smart business decision in this respect.

In the highly technical and rules-based atmosphere of U.S. accounting, both the accounting community and the primary users of private companies' financial statements are more than capable of adapting to full IFRS, which is already simpler than U.S. GAAP. The implementation of a double standard would inhibit comparability, divide the large and continually developing pool of expertise, and cause growing companies in need of as much liquidity as possible to incur unnecessary and redundant expenses. This is why it is important that with the rapidly approaching adoption of full IFRS, both public and private companies use the same set of standards and why it would be a mistake for the U.S. to adopt two levels of accounting standards.