US ADOPTION OF IFRS MAY HELP TO JUMPSTART THE US ECONOMY

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ABSTRACT

The United States prompt adoption of International Financial Reporting Standards (IFRS) may help to jumpstart the US economy. Investors would be able to make comparisons and evaluate investment opportunities worldwide. US Multinational companies would be able to cut costs. In preparation of financial statements using IFRS the results presented usually portray higher figures. This would help to present more favorable valuations and help to promote growth with improved financial reporting. The result will be more job opportunities, a reduction in uncertainties, and may help to jumpstart the US economy. This paper examines existing differences in required reporting by the SEC as well as other factors affecting the adoption of IFRS in the US. We will review the effects of not adopting IFRS that may have contributed to the delay in the recovery of the US economy and the uncertainty that has been created.

JEL: M41, M48

KEYWORDS: IFRS, US economy, FIFO, LIFO

INTRODUCTION

The movement of business toward a global economy has accelerated the need to move toward global accounting standards. The United States prompt adoption of International Financial Reporting Standards (IFRS) may help to jumpstart the US economy. The US Securities and Exchange Commission, (SEC) decision in 2007 allowed foreign companies to eliminate the required reconciliation to United States Generally Accepted Accounting Principles, (US GAAP) and use IFRS for financial reporting on the US stock exchanges. This has been in contrast to (SEC) requirements to require United States multinational companies with foreign subsidiaries to continue financial reporting using (US GAAP). This requirement implies that the "same corporate performance would be materially different under the two sets of standards" (Henry, Lin, & Yang, 2009). Also, United States companies have not had direct access to foreign stock exchanges, except through American Depository Receipts, (ADRs'), to raise capital since they require IFRS. Thus in a three year period from 2008- 2010 the United States multinationals as well as other US companies have had a financial disadvantage creating uncertainty in financial reporting.

This paper will examine existing differences in required reporting by the SEC as well as other factors affecting the adoption of IFRS in the United States. We begin the paper by reviewing the literature findings from studies that support the positive effects of adopting IFRS on corporate financial statements and economic growth. Then we present evidence of the impact of global IFRS adoption by Germany, China, and India. Our primary focus in this paper is to examine some of the factors that may have impeded the recovery of the United States economy and the instability that has been created as a result of not adopting IFRS. We discuss the effect of IFRS on foreign firms reporting on the New York Stock Exchange, the impact of the Obama 2010 budget proposal to eliminate the use of LIFO for income tax reporting, and provide hypothetical examples of how elevated results of IFRS reporting could jumpstart the US economy.

LITERATURE REVIEW

The literature review indicates that there is overwhelming support for worldwide adoption of IFRS with indicated success (Buthe & Mattli; Daske, Hail, Luez & Verdit, 2008; Henry et al., 2009; Lee 2009, Stovall, 2010). In a report on "The International Standards Project", Buthe and Mattli (2008) stated that "there are several good reasons for this drive toward a single set of international standards, including that differences in financial reporting lead to differences in the kind and amount of information available to investors, which impedes the efficient allocation of investment capital" (Buthe & Mattli, 2008). Hail, Luez, and Wysocki (2009) showed that the decision to adopt IFRS mainly involves a cost benefit tradeoff between comparability benefits for investors, cost savings accruing to multinational companies and transitional costs borne by all firms and the US economy as a whole. Stovall (2010) stated "That with international reporting standards, IFRS is already being implemented in a wide range of companies in numerous countries, it is nearly inevitable that the United States will adopt global accounting standards in the near future. The transition to these new standards provides many benefits but involves many challenges relating to the accounting profession" (Stovall, 2010).

Prior research has examined the U.S. GAAP reconciliations of U.S. listed foreign firms (Harris & Miller, 1999; Vander Meulen, Gaeremynck, & Willekens, 2007). However, the firms studied were voluntary adopters (Harris &Muller, 1999) or did not address the areas that differed or converged between US GAAP and IFRS earnings (Van der Meulen et al., 2007). Daske et al. (2007) found that "capital market effects are most pronounced for firms that switch to IFRS, both in the year they switch and again later when IFRS becomes mandatory". Other studies detail positive effects of adopting IFRS on corporate financial statements and economic growth (AICPA, 2008; G20, 2009; IFAC, 2007; Henry et al., 2009) and are summarized in Table 1.

According to a 2004-2006 study of reconciliations of 75 EU countries by Henry et al. (2009) where firms were previously required to detail calculations of converting IFRS to US GAAP disclosed that more than 70% of the companies examined had a higher return on equity under IFRS compared to US GAAP (Henry et al., 2009). The authors state that "using IFRS allows most of the companies in our sample to report higher profitability than would be the case under US GAAP" (Henry et al., 2009).

Although in 2007 the SEC eliminated the IFRS to US GAAP reconciliation for non US companies. Furthermore, a study of 3,100 firms in 26 countries mandated to adopt IFRS revealed powerful benefits including increases in companies' stock market value and lower cost of capital (Daske et al., 2009). According to the authors "the capital-market benefits occur only in countries where firms have incentives to be transparent and where legal enforcement is strong, underscoring the central importance of firms' reporting incentives and countries enforcement regimes" (Daske et al., 2009).

Business leaders around the world think that IFRS adoption will be important for economic growth. In a global survey of business leaders on the importance of IFRS for economic growth, 55% felt it was very important (AICPA, 2008). A 2007 survey by the International Federation of Accountants, (IFAC) of 143 leaders from 91 countries, 90% reported that a single set of international financial reporting standards was very important for economic growth in their countries, (International Federation of Accountants, IFAC, 2007). The Group of Twenty, (G 20) leaders in 2009 called for the standard setters to redouble their efforts to complete convergence of global accounting standards by June 2011.

Table 1: Summary of Findings of Studies that Support the Positive Effects of IFRS

Source	Type of Study	Finding
Henry et al., 2009	Studies of reconciliations between 2004-2006 of 75 EU where firms were required to detail calculations of converting IFRS to US GAAP	More than 70% of the companies examined had a higher return on equity under IFRS compared to US GAAP
Daske et al., 2009	Examination of 3100 firms in 26 countries mandated to adopt IFRS	Increase in market value, increase in market liquidity, lower cost of capital supported by strong regulatory requirements
AICPA, 2008	Survey of Business Leaders around the world by AICPA	55% of business leaders worldwide believe use of IFRS will promote economic growth.
IFAC, 2007	Survey by the International Federation of Accountants, (IFAC) of 143 leaders from 91 countries	90% reported that a single set of international financial reporting standards was very important for economic growth in their countries
G20, 2009	The Group of Twenty (20) Country Leaders meeting in 2009	Outcome of meeting was that the G20 leaders called for the standard setters to redouble their efforts to complete convergence of global accounting standards by June 2011

Table 1 summarizes the findings of studies by Henry et al. (2009), Daske et al (2009), AICPA (2008), IFAC (2007), and the G20 meeting that support the positive effects of IFRS.

EVIDENCE ON GLOBAL IFRS ADOPTION

In a review of IFRS Adoption in other countries, Jeanjean and Solowy (2008) researched the effect on the management of earnings. They reviewed 1100 firms in three countries (Jeanjean & Soloway, 2008) including Australia, France, and United Kingdom. According to their research, Australian and United Kingdom firms earnings remained stable (Jeanjean & Solowy, 2008) . However, management of earnings in French firms increased (Jeanjean & Solowy, 2008) suggesting that the earnings quality was not improved by adopting IFRS. All three countries are IFRS first adopters. Early adoption of IFRS prior to 2005 was not possible for any of them France and United Kingdom are two European Union countries governed by mandatory adoption of IFRS. Australia opted for adoption of IFRS in 2004 close to the European timeline. Conversion to IFRS by these three countries in the case of France and United Kingdom were requirements and Australia opted to join the many countries adopting IFRS.

The expected benefits of adoption include financial reporting that is consistent, transparent and help to improve the global competiveness of the countries. Thus the world stage of business is accepting IFRS, International Reporting Standards reporting.

Reviewing Australian IFRS adoption, Chua and Taylor (2008) indicate that the demand for legitimate action in the face of tightly coupled and complex global markets is important in generating support for IFRS (Chua & Taylor, 2008). Recognition by powerful groups such as the World Bank, The International Monetary Fund, and The European Union offers an indication of acceptance of IFRS as a legitimate form of International Best Practice. Thus countries adopting IFRS will do so in order to secure legitimacy.

In reviewing current happenings of foreign firms listed on the New York Stock Exchange dramatic changes have occurred. Germany has delisted all but three German firms from the New York stock exchange. The listings have been moved to the Frankfurt Stock Exchange in Germany. The primary reason for delisting German companies from the New York stock exchange is expensive accounting fees such as Sarbanes Oxley requirements. Germany has been paying $10,000,000 to $15,000,000 in annual fees to the United States to maintain the listings (Kelsey, 2010). As a result of delisting the German companies from the New York stock exchange the American markets are no longer attractive to Germany.

On the other hand, the president of Germany, Angela Merkle, has created a firestorm bailing out of Portugal, Italy, Greece, and Spain, the (Pigs) in their financial failings. Or as one writer has written in "The Selling Out of Germany" it has become a battle of the politicians against the markets (Krieger, 2010). Ms. Merkle is willing to bailout the Pigs, but not willing to pay the Sarbanes Oxley fees to keep German companies listed on the New York Stock Exchange which perhaps may be a political move.

By contrast, Germany is contracting their US and Global involvement, whereas China and India are expanding. Already listed on the NYSE (using IFRS), China is expected to expand the use of IFRS financial reporting for all medium and large organizations by 2012. India is also expanding and will adopt IFRS standards in April 2011 (Wilson, 2010).

According to the SEC Progress Report released on October 29, 2010, China has indicated in its exposure draft issued in 2009 that it intended to make every effort to eliminate existing differences between Accounting Standards for Business Enterprises, (ASBE) and IFRS by 2011. The World Bank Report of 2009 has stated that the ASBE are "substantially converged" with IFRS (SEC, 2010).

The Ministry of Finance published a roadmap late last year stating that China will complete ASBE convergence to IFRS by 2011. All medium to large organizations will be required to use this revised set of standards by 2012. Many of the largest organizations in China have already adopted IFRS including 17 firms listed on the Hong Kong Stock Exchange and on the NYSE. One of the firms listed is Petro China Ltd (PTR) the largest oil company in China (Wilson, 2010).

India has announced a plan to adopt IFRS as the Indian Financial Reporting Standards effective April 2011 for all listed and "large private companies". Medium sized companies will follow in 2013 and smaller organizations in 2014 (Wilson, 2010).

EVIDENCE OF THE ROLE OF IFRS ON THE US ECONOMY

Some companies have found the American capital market to be more attractive than in the past. In the case of INBEV, a Belgium firm using IFRS has purchased Anheuser Busch, an American firm reporting under US GAAP. As a foreign firm listed on the New York Stock Exchange, INBEV has converted the Anheuser Busch financials to IFRS. The combined firm is called Anheuser Busch In Bev, (ABInBev), (ABInBev, 2009). The firm has done well. A current stock price has hit a 52 week high. The first quarter 2009 reporting results showed earnings of $783,000,000 compared to $398,000,000 in the first quarter of 2008. One year after the buyout, quarterly results have shown a 25% earnings growth (Tritto, 2008). The results from the world's largest brewer show an increase in value using IFRS reporting.

Table 2 lists of some foreign firms on NYSE showing increased profits from 2008 to 2009. American Capital Markets. These companies include Heineken, Diageo (owns Guinness and Pillsbury), and Novartis (Diageo, 2009; Heineken, 2009; Novartis, 2009). From the table below, foreign firms listed on the NYSE have shown increased profits and a benefit from American capital markets.

The Elimination of LIFO a Barrier to IFRS Adoption by the United States

In order for the US to adopt IFRS accounting standards, the elimination of Last In First Out Inventory (LIFO) valuation method would have to occur. IFRS does not recognize or allow the LIFO method of inventory valuation. IFRS recognizes First In First Out and Weighted Average Inventory valuation, but not LIFO.

Table 2: Foreign Firms Listed on the NYSE Showing Increased Profits from American Capital Markets

Company	Currency	2008 Profit (millions)	2009 Profit (million)
Heineken	Euro	347	1,142
Diageo (owns Guinness & Pillsbury)	United Kingdom	1,597	1,725
Novartis	Dollar	8,233	8,454

Table 2 lists four companies that are listed on the New York stock exchange that showed increased profits (in millions) from 2008 to 2009. The currency used for the company is listed in the second column. The profits for 2008 and 2009 are listed in the third and forth columns. The source of the data was the 2009 company annual reports.

The LIFO inventory valuation method is similar to the Base Stock Method of Inventory that originated in England in the middle of the nineteenth century and at times was referred to as the Normal Stock Method (Peloubet, 2000).

The Base Stock Method was developed from the idea that some businesses had to keep a constant level of inventory in order for the firm to operate normally. The Base Stock Method controlled sharp movements in inventory profits and losses. As items were sold, they were taken from the last items added to the inventory. The items were not removed from the Base Stock Inventory, which was left intact. During periods of rising prices profits were reduced and when a decline in prices occurred losses were also reduced. Thus profits were reduced under periods of rising prices as well losses being reduced when declines in prices occurred.

Originating over 70 years ago, Congress under Franklin Delano Roosevelt created the Revenue Act of 1939 incorporating LIFO Inventory. The LIFO Method is similar to the Base Stock Method. The cost removed when items are sold is the most recent addition. The cost of goods sold are recorded at current market prices and reduce profits accordingly (Cotter, 1935). LIFO has resulted in lower reportable net income and therefore lower income taxes providing huge benefits for many large companies. Tax laws in the US require companies using LIFO for tax purposes to also use LIFO for reporting their financial statements.

The Obama 2010 budget included a proposal to eliminate the use of LIFO for income tax purposes. Tax payers that currently use the LIFO method for taxes and financial reporting would be required to revalue their beginning LIFO inventory to its FIFO value in the first taxable year beginning after December 31, 2011 (Tax Policy Center- Urban Institute and Brookings Institution, 2010). This one time increase in gross income would be taken to account ratably over the first taxable year and the following seven taxable years. LIFO would be repealed and companies would pay tax on the accrued difference between LIFO and FIFO inventory valuations. It would impose a substantial one time tax and a smaller permanent tax as long as prices are increasing. In HR3970 Ways and Means Committee Chair Charles Rangel proposed to allow firms to spread income from the initial adjustment from LIFO to FIFO over eight years. (Tax Policy Center- Urban Institute and Brookings Institution, 2010). Already proposed is the elimination of the LIFO inventory valuation beginning 2012 by the Treasury Department The increase in taxes resulting from the elimination of LIFO should help to offset future proposals by Obama to raise taxes. Also, the exclusion of LIFO allows the US to remove a major hurdle in adopting IFRS.

The change in using FIFO instead of LIFO for inventory valuation with increasing prices will result in higher figures and provide an increase in the current ratio determined by dividing current assets by current liabilities. Table 3 gives an example comparing the ratio of current assets to current liabilities for a company using LIFO and FIFO that has current assets of $100,000 cash and $50,000 accounts receivable; and current liabilities of $100,000. The inventory using LIFO is $150,000 and the inventory using FIFO is $350,000. The current ratio is calculated as Current Assets/Current Liabilities. The current ratio is 3:1 using LIFO and 5:1 using FIFO.

Table 3: Comparison of Quick Ratio for a Hypothetical Company using LIFO and FIFO

Under LIFO		Under FIFO	
Current Assets		Current Assets	
Cash	$100,000	Cash	$100,000
Accounts Receivable	50,000	Accounts Receivable	50,000
Inventory LIFO	150,000	Inventory LIFO	$350,000
Total	$300,000	Total	$500,000
Current Liabilities	$100,000	Current Liabilities	$100,000
Current Ratio	3:1	Current Ratio	5:1

Table 3 compares the current ratio for a company using LIFO inventory valuation and FIFO inventory valuation. The example illustrates that the current ratio is higher using FIFO inventory valuation meaning that a company is better able to pay its bills using the FIFO inventory valuation.

The current ratio is a measure of the company's ability to pay its short-term liabilities with its short-term assets (cash, inventory, receivables). The higher the current ratio, the better able the company is to pay its bills. The company in this example has a current ratio of 3:1 using LIFO compared to 5:1 using FIFO. When the company uses the FIFO valuation method their current ratio increases. A current ratio of 5:1 means the company under FIFO would be able to pay their bills five times over compared to being able to pay their bills three times over using LIFO. The valuation of the company using FIFO would be higher allowing the investor to feel more secure in their investment.

To determine whether income taxes increase in practice, rather than in theory, data of the impact of a FIFO adoption by companies was reviewed from a Georgia Institute of Technology Study that was completed in 2008 (Mulford & Comiskey, 2008). The results of the study revealed in a sample of 30 companies that were using LIFO if they had been using FIFO taxes would have been 10% and 12% higher in 2006 and 2007 respectively. Furthermore, the study revealed the companies would have had more than $15,000,000 of cumulative federal income taxes due if they had switched from LIFO to FIFO. The companies with the highest taxes are the petroleum refining companies. This includes Exxon-Mobil, Marathon Oil Company, Valero Energy Corporation, and Sunoco (Mulford & Comiskey, 2008).

The FIFO pre-tax and LIFO pre-tax income for the petroleum refinery companies showed an average percent change of 48.7%. Sunoco had a 113.2% increase in pre-tax income when switching to FIFO (Mulford & Comiskey, 2008).

Effect of Switching to FIFO on Taxes, Net Income and Primary Earnings Per Share—A Hypothetical Example

Table 4 presents a hypothetical comparison of FIFO versus LIFO calculation of income tax, net income, primary earnings per share under increasing prices.

It is interesting to note that under FIFO income tax is higher than under LIFO. But it is also interesting to note that increased income taxes under FIFO is offset by increased Net Income and increased EPS. Investor interest should improve because of the higher earnings and EPS despite the increased income taxes under FIFO. Further evidence of adoption of IFRS will help to improve the US economy is demonstrated by a review of the financial statements. For example, handling of Research and Development Costs in general is done differently between IFRS and US GAAP. A hypothetical example is presented in Table 5.

The result of the above comparison is that under IFRS both the Balance Sheet and the Income Statement show higher figures. Whereas under US GAAP both the Balance Sheet and the Income Statement show lower figures decreasing investor interest.

Table 4: Hypothetical Comparison of FIFO versus LIFO Calculation of Income Tax, Net Income, Primary Earnings per Share under Increasing Prices

Purchase of Items **Cost**	**Item 1** **$10**	**Item 2** **$20**	**Item 3** **$40**	**Item 4** **$60**	**Item 5** **$70**
Sold 3 items @ 400 each					
Total Sales		$1,200			
Income Statement Using FIFO					
Sales Income		$1,200			
Total Purchases	$200				
Less FIFO Inventory	130				
Cost of Goods Sold		70			
Income Before Taxes		$1,130			
Income Tax 30%		339			
Net Income		$791			
Primary EPS on 100 shares		$7.91			
Income Statement Using LIFO					
Sold 3 items @ 400 each					
Total Sales		$1,200			
Purchases	$200				
Less LIFO Inventory	30				
Cost of Goods Sold		170			
Income Before Taxes		$1,030			
Income Tax 30%		309			
Net Income		$721			
Primary EPS on 100 shares		$7.21			

Table 5: IFRS and US GAAP- Handling of Research and Development Costs

Panel A: Balance Sheet and Income Statement with No R&D					
	BALANCE SHEET			**INCOME STATEMENT**	
Assets	$100,000	Liabilities	$20,000	Revenue	$200,000
		Equity	80,000	Expenses	$50,000
Total	$100,000	Total	$100,000	Net Income	$150,000
Panel B: IFRS generally records R&D on the Balance Sheet. If R&D incurred was $60,000 financials would result					
	BALANCE SHEET			**INCOME STATEMENT**	
Assets	$100,000	Liabilities	$80,000	Revenue	$200,000
R&D	60,000	Equity	$80,000	Expenses	$50,000
Total	$160,000	Total	$160,000	Net Income	$150,000
Panel C: US GAAP generally records R & D on the Income Statement. If R&D incurred was $60,000, financials could be effected					
	BALANCE SHEET			**INCOME STATEMENT**	
Assets	$100,000	Liabilities	$20,000	Revenue	$200,000
R&D		Equity	80,000	Expenses	$50,000
				R&D Expenses	60,000
Totals	$100,000	Total	$100,000	Total Expenses	110,0000
				Net Income	90,000

The result of the above comparison is that under IFRS both the Balance Sheet and the Income Statement show higher figures. Whereas under US GAAP both the Balance Sheet and the Income Statement show lower figures decreasing investor interest.

The hypothetical examples presented are a reflection of the effects the adoption of IFRS by the US and how the financial reporting of elevated results could help US companies. By dropping LIFO to meet IFRS requirements and using FIFO Inventory valuation much higher income taxes would be paid. However, the offset is noted that also higher Net Income and higher Earnings Per Share, (EPS) would result. Along with stronger Balance Sheets and Income Statements, US companies would generate more investor interest with improved financials. The US has to learn to operate on the world's stage even by adopting IFRS if it must forgo some of the gold standard US GAAP's.

In 2008 the AICPA reported that more than one-third of the companies surveyed used a combination of cost flow assumptions (AICPA, 2008). More than 65% used FIFO for a significant portion of their inventories. About 35% use LIFO. Less than 30% use weighted average or specific identification

The industries with the greatest percentage of firms using LIFO include firms in the chemical industry and firms that manufacture industrial and f arm equipment. Retailing firms use LIFO extensively. The industries with the smallest proportions of firms using LIFO include technology based firms which experience decreasing production costs such as computer and other electronic equipment (AICPA, 2008).

CONCLUDING COMMENTS

The goal of this paper is to show that adopting IFRS could help jumpstart the economy. We reviewed the literature and found evidence that there are positive effects when countries adopt IFRS on corporate financial statements and economic growth. Then we reviewed the IFRS conversion process of Germany, China, and India. Our findings were that despite the complex disruption of various countries, the global markets will continue to expand so that the adoption of global accounting standards such as IFRS will prevail. The current movement of China and India into IFRS adoption as well as Canada, Brazil, Mexico and Japan presents a strong advancement in this direction. The progressive interest in capital markets and global interest in a single set of strong accounting standards is now being confirmed.

We created hypothetical comparisons of FIFO versus LIFO current ratios, calculation of income tax, net income, primary earnings per share under increasing prices. This calculation showed that switching from LIFO to FIFO would result in increased income taxes under FIFO which would be offset by increased Net Income and increased EPS. We compared hypothetical balance sheets and income statements for handling Research and Development Costs which is in general done differently between IFRS and US GAAP. The results is that under IFRS both the Balance Sheet and the Income Statement show higher figures

Opening up worldwide opportunities for investment and for investors to compare will provide growth around the world. US Multinational companies will be able to cut costs and produce more favorable financial statements. By adopting IFRS the US may help to jumpstart the economy and provide much needed job opportunities. The United States has not adopted IFRS. This research is limited by the uncertainty of the adoption of IFRS by the US.

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