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The Road to IFRS Convergence in the U.S. : What it May Mean for the Hospitality Industry

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Introduction

In the U.S., generally accepted accounting principles, known as US GAAP are the accounting standards that must be utilized by any private, publicly traded companies and non-profit organizations. Generally accepted accounting principles (GAAP) have been developed by major organizations such as the Financial Accounting Standards Board (FASB), the Securities and Exchange Commission (SEC), and American Institute of Certified Public Accountants (AICPA). The US GAAP first established in 1936 by the American Institute of Accountants (AIA) (later American Institute of Certified Public Accountants, AICPA), and were continuously developed according to the changing conditions and demands from the business world.

While the U.S. companies use accounting standards developed by the related organizations as stated above, the International Accounting Standard Committee (IASC) based in London developed a different set of standards to be used internationally, emanating from the nature of business transactions. The IASC has released 41 international accounting standards between the years of 1973 and 2000. In April 2001, the IASC was restructured to create the International Accounting Standard Board (IASB) which would issue new standards as International Financial Reporting Standards (IFRS). IFRS was intended to introduce a single set of comparable, transparent, principle-based and global accounting standards (Reuben, 2009). Both IFRS and US GAAP share the same general principles and conceptual framework; however, US GAAP is more “rules based”, whereas IFRS is more “principles based” (Elena et al, 2009). Rules-based standards prescribe the proper treatment of accounting transactions according to detailed rules accompanied by specific guidance. On the other hand, principles-based accounting provides a conceptual framework to follow instead of a list of detailed rules and give less attention to specific application guidance. As a result, today, more than 100 countries have already adapted uniform international accounting standards released by the IASB. In Europe, the European Council of Ministers approved the regulation to require all EU region companies to report using IFRS for accounting periods beginning on or after January 1, 2005. In the same year, over 8,000 companies in the EU region adopted IFRS, a global set of standards for financial accounting and reporting. Several other countries are expected to adopt the standards in the next few years, including Brazil (2010), Canada, Japan, Singapore, South Korea, India (2011), and Mexico (2012).
Benefits and Costs of Adopting IFRS

A research conducted by Citigroup Inc, in 2007 found that IFRS has boosted income, investment returns and other financial measures for European-based companies. The study which analyzed the differences between IFRS and U.S. GAAP for 73 European companies that traded on the U.S. security and exchange markets report under both IFRS and US GAAP found that more than 80 percent of the companies had higher net income and returns on equity (ROE) under IFRS. Overall, the study found that 82 percent had higher net income under IFRS, while book value (BV) was lower for about 70 percent of the sample. The impact on some companies was startling. Chemical giant Bayer’s profits under IFRS were 525 percent higher than under U.S. GAAP. Lloyds TSB, the UK Bank posted IFRS profits 54 percent above the US GAAP equivalent (Malwitz and O’Rourke, 2009; Heffes, 2009; Baker, 2008).

The trend towards IFRS has evolved around a widespread agreement to synchronize accounting standards internationally. The ultimate goal is to reduce costs for multinational corporations, and to allow investors to make valid comparisons across the world (Anonymous, 2010). According to the PriceWaterhouseCoopers National Professional Service Groups, there are four important reasons to shift to IFRS: (1) Globalization, (2) Complexity of the current U.S. standards, (3) Convergence of US GAAP and IFRS is complicated and (4) IFRS will create cost efficiencies. In general, the benefits of IFRS can be summarized as follows:

- Improved transparency
- Decrease cost of capital
- Better resource allocation decisions
- Enhance worldwide comparability for investors
- Decrease the cost of preparing and interpreting financial statements
- Increase the movement of capital and more efficient capital allocation
- Many accounting functions can be centralized and financial employees could be easily transferred from one country to another without major educational challenges.

IFRS potentially offers companies transparency and consistency of financial information, streamlined, simplified and improved internal controls, greater access to capital simplified cross-border Merger and Acquisition (M&A) transactions, and opportunities to improve cash management and implement income tax strategies. Many of the challenges in adopting IFRS will be affected by specific, significant competitive realities of the industry (Deloitte, 2008).
While there are many benefits to adopting IFRS, there are also some costs of adoption. Professors Hail, Leuz and Wysocki (2010) argue that adopting IFRS would require various upfront costs for companies, investors, auditors and regulators. During a transition phase, companies would have to modify their accounting systems and processes as well as provide comparative financial information between their previous U.S. GAAP reports and new IFRS-compliant reports. In addition, companies would have to train their employees and outside stakeholders such as analysts and investors in preparing and using IFRS numbers. According to the IFRS.com (IFRS, 2010), adoption costs would be determined largely by the size and nature of the respective company. The initial cost to identify and quantify the differences between U.S. GAAP and IFRS, staff training and implementing IT support could be significant. According to a CFO Magazine article (Johnson, 2009), the SEC estimated that the largest U.S. registrants that adopt IFRS early would incur about $32 million per company in additional costs for their first IFRS-prepared annual reports, and that the average U.S. company would incur costs of between 0.125% to 0.13% of revenue.

Uniform Accounting Standards in the Hospitality Industry

Although the Financial Accounting Standards Board (FASB) and other organizations set the accounting rules in the U.S., the hospitality industry has developed its own specific rules and guidelines for the various segments of the hospitality industry for operators and accountants. The three most used and well-known systems in the industry are the Uniform System of Accounts for the Lodging Industry (USALI), the Uniform System of Accounts for Restaurants (USAR) and the Uniform System of Financial Reporting for Clubs (USFRC). The USALI was one of the earliest attempts in the United States to create uniform standards and guidelines for preparing financial reports for a specific industry. The USALI was first developed by the Hotel Association of New York City in 1926 for the needs of the member hotels. The USALI was designed for hotels to classify, organize, and present their financial information in a uniform manner. The objective was to provide uniform (standardized) accounting and financial reporting practices which reflected the specific terminology and unique activities of that industry (Kwansa and Schmidgall, 1999). Although there is no requirement that a lodging operator uses the USALI, the degree of compliance with this time-tested, turnkey system is substantial (Popowich, et al, 1997). Over the years, the USALI has been important in bringing about a convergence of accounting practices in hotels, due to both the expansion and influence of U.S. hotel groups internationally, and also its adoption by many non-U.S. large hotel companies (Harris and Brown, 1998). The primary reason for widespread adoption of the USALI has been comparability. It was felt that comparability would be enhanced and the resulting output would be suitable for the needs of users such as investors.
and industry associations. Lodging operators tend to use financial statement data generated by competitors as a benchmark against which to measure their own operations (Popowich, et al, 1997). The USALI states that all financial statements should be developed to meet an owner’s financial statement needs, while remaining consistent with GAAP. The uniform standards, layout and presentation of operational data made it possible to compare and measure the financial performances of different hotel properties across the U.S., and across the world. The USALI allows lodging properties to analyze activities of a hotel property according to the pre-determined standards. The users of financial reports set based on USALI principles can see the financial performance of each revenue generating department in hotels, evaluate overall performance, and accordingly make proper operational and management decisions.

The Uniform System Accounts for Restaurants (USAR) first published in 1927. It provides sample statements, analysis blueprints, classification of accounts, and an expense dictionary. Uniform System of Financial Reporting for Clubs (USFRC) was published in 1954 and is an accounting resource for club managers, officers, and controllers.

**IFRS Adoption in the U.S. and Tourism Hospitality and Leisure Industry**

Since the year 2002, the U.S. SEC has encouraged the development of IFRS as a uniform accounting standards. The FASB has been working with the IASB to harmonize US GAAP and IFRS with the goal of producing a single, high-quality set of accounting standards. In August 2008, the SEC has permitted foreign corporations to use IFRS in preparing their financial statements, instead of US GAAP. In the same year, the SEC issued a roadmap for the potential use of financial statements prepared in accordance with IFRS by U.S. issuers (Kamman et al, 2009). The road map calls that the SEC will decide by the year 2011 if U.S. companies will be required to use IFRS beginning in 2014. Under the roadmap, the SEC envisions requiring large public companies that file financial reports on an accelerated basis with the SEC to use IFRS in 2014, requiring medium-sized accelerated fillers to do so in 2015, and small, non-accelerated fillers in 2016 (Anonymus, 2008). The SEC road map would not apply privately held companies or to non-profit organizations. However, it would be naïve to think that two accounting standards would be an acceptable method of doing business in the U.S. While private firms will not be mandated by SEC fillings to conform to a new standard, the pervasive thought would be that they would eventually be moving toward embracing IFRS (Ramirez, 2009).

As full acceptance of the IFRS in the U.S. nears, developing a plan around IFRS implementation is becoming increasingly important for all publicly-traded
companies, as well as publicly traded hospitality companies to effectively position themselves for the future. More hospitality executives may be asking how will IFRS impact their companies and industry? What triggering events would compel them to move more quickly to adopt IFRS? What obstacles might stand in their way? What events would influence their companies pace of IFRS adoption? (Deloitte, 2008).

In an effort to answer these questions and help hospitality executives, Deloitte has announced the release of a white paper, titled "IFRS in Tourism, Hospitality and Leisure: More Than Just Accounting." This paper provides information to chief financial and information technology officers, senior finance leaders, and other corporate executives regarding the adoption of international financial reporting standards for the tourism, hospitality and leisure industries. This report provides practical industry insights on IFRS and includes useful sections on:

- Challenges and opportunities facing hospitality companies
- The potential implications of IFRS relating to human resources, regulatory, tax, treasury, contract management, accounting and technology issues
- Evaluating approaches to IFRS conversion
- Planning for IFRS adoption

Tourism Hospitality and Leisure companies often have operations and assets that span countries and continents, and tap increasingly global capital markets. Therefore;

- These companies face variety of rules and regulations, tax jurisdictions, building and occupancy codes, lease and tenant issues, finance and accounting concerns, and much more.
- In a challenging economy and highly competitive market, the tourism, hospitality, and leisure companies are continually looking for ways to stay ahead of their rivals, in addition to finding ways to secure funding from investors to continue to fund their expansions.

In the same vein, the research institute of Hospitality Financial and Technology Professionals (HFTP) has published a white paper discussing the impact of the convergence of the IFRS on the hospitality industry. The paper explains that international implications need to be added to the USALI and that HFTP needs to be the guiding force behind any major industry decisions pertaining to the IFRS. It recommends that financial executives begin to educate themselves on IFRS. At this time, they may not be impacted by the new
standards, but at some point in their career they will likely have to deal with IFRS in one capacity or another (Hotelnewsresource, 2009).

**Some differences between IFRS and US GAAP for Tourism Hospitality and Leisure Companies**

Citigroup reports that there are as many as 426 total differences between IFRS and US GAAP, but in many areas there is little divergence (Jetuah, 2007). Some areas of specific differences that exist for hospitality industry include reporting of fixed assets, goodwill and intangible assets and inventory valuation methods. Under IFRS there is a fair value option but under US GAAP, fixed assets must be reported using historical cost. In valuing inventory under IFRS, LIFO is prohibited, but permitted under US GAAP. The gain on sale and leaseback (operating lease) which occurs when an owner sells a hotel to obtain cash but still controls it is reported immediately under IFRS but is deferred over the lease term under the US GAAP. Interest costs on a hotel loan must be capitalized under the US GAAP, but can be expensed under IFRS. A hotel holding company is required to consolidate entities based on majority voting right in US GAAP, but under IFRS the standard is control which leads to differences in reported profit. Other differences include impairment of assets such as when a hotel or restaurant is no longer meeting cash flow projections and its carrying value must be reduced through a charge to income, stock option accounting, and business combinations (hotel acquisitions) (Vago, 2009).

In terms of financial statement presentations, IFRS and US GAAP do not set the format for financial statements. Instead, they prescribe what information they have to provide. Depending on the specific features and significance of an enterprise and on the special requirements of particular standard, the enterprise can decide how they will be disclosed within the financial statement and in the notes. Based on the US GAAP, the USALI required that presentation of assets and claims to its assets will be according to its liquidity preference. The expected balance sheet form satisfies the IFRS requirements too, because it allows liquidity preference if it increases the statements “true and fair view” (Pajrok, 2009).

Several key accounting differences that may have a significant impact on Tourism Hospitality and Leisure companies may be summarized as (1) accounting for property, plant and equipment, (2) accounting for impairment of long-lived and indefinite-lived assets (3) accounting for customer loyalty programs, and (4) accounting for leases (Deloitte, 2008). The following table shows major differences between the US GAAP and IFRS for the Tourism, Hospitality and Leisure companies.
**Table: Major Differences between IFRS and USGAAP for the Tourism, Hospitality and Leisure Companies.**

<table>
<thead>
<tr>
<th>Areas</th>
<th>US GAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue Recognition</strong></td>
<td>Provides many specific rules and industry guidance and how revenue should be measured.</td>
<td>Provides limited guidance. Occurs when risks and rewards of control have been transferred.</td>
</tr>
<tr>
<td><strong>Comprehensive Income</strong></td>
<td>Unrealized gains/losses on investment and foreign currency translation disclosed as a separate component of equity.</td>
<td>Option to present a statement that shows all changes or only those changes in equity that did not arise from capital transactions with owners or distributions to owners.</td>
</tr>
<tr>
<td><strong>Fixed Assets Valuation</strong></td>
<td>Revaluation is not permitted. PP&amp;E is valued at historical cost less depreciation.</td>
<td>Revaluation is permitted. Allows to revalue PP&amp;E to fair value when an active market exists.</td>
</tr>
<tr>
<td><strong>Impairment of Assets</strong></td>
<td>The asset should be written down using undiscounted cash flows. Reversal of losses is not allowed.</td>
<td>Impairment loss be calculated if impairment indicators exists. Prohibited for goodwill.</td>
</tr>
<tr>
<td><strong>Revaluation of Intangible Assets</strong></td>
<td>Generally prohibited.</td>
<td>Permitted only if the intangible asset trades in an active market.</td>
</tr>
<tr>
<td><strong>Inventory Valuation</strong></td>
<td>LIFO is permitted. Inventory carried at lower of cost or market rule.</td>
<td>LIFO is prohibited. Inventory is carried at lower of cost or net realizable value.</td>
</tr>
<tr>
<td><strong>Reversal of Inventory Write-Downs</strong></td>
<td>If written down, any reversal is prohibited.</td>
<td>If written down can be reversed if specific criteria are met.</td>
</tr>
<tr>
<td><strong>Valuation of Goodwill</strong></td>
<td>Goodwill is not amortized, but goodwill is to be tested for impairment annually.</td>
<td>Goodwill is amortized to expense over its useful life with a maximum of 20 years.</td>
</tr>
<tr>
<td><strong>Borrowing Costs</strong></td>
<td>Capitalization of interest costs is required while a qualifying asset is being prepared for its intended use.</td>
<td>Capitalized, as part of the cost of the asset, if costs incurred to finance acquisition, construction or production of qualifying asset.</td>
</tr>
<tr>
<td><strong>Development Costs</strong></td>
<td>Expensed as incurred unless addressed by a separate standard.</td>
<td>Mandate capitalization; subject to certain criteria.</td>
</tr>
<tr>
<td><strong>Customer Loyalty Programs</strong></td>
<td>Recognize award credit based on Vendor-Specific Objective Evidence.</td>
<td>Considered a multiple element arrangement. Defer fair value of award credit until recognition of all.</td>
</tr>
</tbody>
</table>
Will IFRS Lead Some Changes in Hospitality Financial Reporting?

There is no doubt that the transition from US GAAP to IFRS will certainly cause some challenges for publicly traded organizations, including publicly traded hospitality tourism and leisure companies. The question is whether individual lodging properties which mainly use the USALI as a guide for financial transactions will be affected from this transition. When IFRS is adopted by publicly traded companies it is expected that international hotel companies will adopt IFRS standards in order to improve comparability of different hotel operations across countries. A principles-based accounting approach is more appropriate for multinational hotel companies, since majority of countries around the world - including U.S. based overseas operations - have already adopted the IFRS. It seems that changes in standards will see the most affect at the corporate or management company level. These changes will vary depending on ownership structure, asset structure and make-up each individual company. From an industry level, it does not appear that the hospitality industry will see as significant changes as perhaps other industries, but there will be changes nonetheless. A survey conducted by Venegas (2009, 2009a) among HFTP members demonstrates that many HFTP members noted that USALI should start incorporating IFRS into future guidelines. A change from US GAAP to IFRS is not only a financial reporting one, but in many cases a change in management as key performance indicators, employee and executive compensation, investor relations and legal issues will potentially be affected by the change (Ramirez, 2009). Differences between accounting practices under IFRS could be numerous in many industries. Individual companies or organizations must determine an IFRS conversion strategy and synchronize that with other projects in the organization.

Summary and Conclusion

This paper highlights the importance of the IFRS convergence and possible affected areas from the hospitality and leisure industry perspective. It was intended to bring together certain fragments of information related to IFRS adoption and its possible affects in the hospitality industry, and is to bring some additional understanding to hospitality educators, academicians, and professionals. The question whether the USALI will be affected from this transition has already being replied in the article. It is likely that the IFRS will impact the USALI applications in the future, as US GAAP did in the past. This impact will be more significant for publicly traded and international hospitality companies at the first phase in order to comply with the government requirements and improve the comparability of hotel operations across countries. At the same time, the impact of convergence will also be different for (a) company-owned properties, (b) management companies, and (c) franchised properties, due to their ownership and
liability structures. In the long term, other privately held companies may also adopt IFRS rules, if (1) they can see some benefits of adopting IFRS (it is said that the IFRS will create cost efficiencies), (2) if IFRS principles better reflect the nature of operational transactions than US GAAP, and of course (3) if there is no contradiction between US GAAP and IFRS principles. Possibly, a new form of USALI will be developed in the long term to be used globally by all lodging properties around the world and may be called “Global USALI”.

References


