Bumps in the Road to IFRS Adoption:
Is a U-turn Possible?

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Thanks very much, Pamela [Roush] for that kind introduction. It's an honor and a privilege to be speaking here today. I'll be addressing the question of adoption of International Financial Reporting Standards in the U.S.

Let's start with some background. Congress believed that inadequate accounting standards were at least partly responsible for the wave of frauds exemplified by Enron and Worldcom. Consequently, Section 108 of the Sarbanes-Oxley Act of 2002 directed the SEC to consider, when adopting accounting standards, whether "…international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors." The SEC, FASB and IASB have been working together towards adoption of IFRS since the passage of Sarbanes-Oxley.

One of the first formal actions was the so-called Norwalk Agreement, whereby the FASB and IASB entered into their initial Memorandum of Understanding to make their best efforts to converge U.S. GAAP and IFRS. After six years had gone by, little substantive progress had been made on convergence; yet, just as SEC Chair Christopher Cox was preparing to step down, the SEC published its proposed Roadmap[1] toward final rulemaking that, if finalized, would eventually require all SEC registrants to comply with IFRS. To be sure, the Roadmap has hit numerous snags, and timelines have been stretched. Nevertheless, a follow-on policy statement from the SEC should be coming by the end of the year.

The SEC staff provided a strong indication of what may come from the Commission in a May 2011 staff paper informally referred to as the "condorsement" proposal.[2] In that paper, the Staff has finally conceded that a complete abrogation of U.S. GAAP in favor of IFRS as set forth in the Commission's Roadmap Proposal would not be feasible, and now proposes a restructuring of the standard setting regime: the FASB would retain its status with the SEC as the standard setter for U.S. GAAP; but it would not add any new projects to its agenda, unless to endorse an existing IASB standard, or to work with the IASB on a project the IASB chooses to undertake.

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[1] SEC Release No. 33-8982, Proposed rule, *Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers,* November 14, 2008, available at: http://www.sec.gov/rules/proposed/2008/33-8982.pdf

[2] Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: Exploring a Possible Method of Incorporation, May 26, 2011, available at: http://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-052611.pdf

At this point in time, the FASB and IASB are focusing their efforts on achieving closure on just a couple of pivotal projects: revenue recognition and leases. These projects have, as one would predict, been extremely controversial, but some sort of final standard is clearly a prerequisite to a continuation of the SEC's efforts to adopt IFRS.

Ten Arguments for IFRS Adoption: and Why They are False

Time is of the essence on IFRS adoption; in large part because the IASB has made it clear it will not continue to wait for the U.S. to come up with a firm IFRS adoption policy for much longer. Its own final public relations push began this past October when Hans Hoogervorst and Harvey Goldschmid, IASB chair and CAQ board member, respectively, delivered keynote speeches at the IFRS Foundation/AICPA Conference in Boston.[3] While I understand that speeches in that kind of setting leave little time to deal with the details, I do believe that the devil of IFRS adoption is in those details.

So, with apologizes to David Letterman, I have made a "Top Ten" list of the claims made in support of IFRS, to which I will be adding as many details as time permits. Richard Breeden, a former SEC chairperson and now the head of a $2 billion international investment fund, stated that if the SEC were to adopt IFRS, "it would be the darkest day in the history of the SEC."[4] My goal today is to convince you that he was not exaggerating, and that the SEC should have long ago made a U-turn on its IFRS adoption proposals.

1. Some large U.S. corporations want to switch to IFRS.
2. A move to IFRS would restore the public trust in accounting standards.
3. U.S. GAAP is not superior to IFRS.
4. IFRS is already widely adopted.
5. Even though IFRS may not be consistently applied elsewhere, the SEC can enforce compliance with IFRS as it sees fit.
6. Costs of conversion to IFRS can be spread out over a long transition period.
7. The U.S. will not experience a loss of sovereignty over its ability to set accounting standards.
8. Bad things will happen to the rest of the world if the U.S. does not adopt IFRS.
9. Bad things will happen to the U.S., if the U.S. does not adopt IFRS.
10. All nations share the same goals for accounting standards.

1. There are some large U.S. corporations that want to switch to IFRS.

Indeed, there are, but there are many more that adamantly oppose a switch to IFRS. As summarized by Gaylen Hansen, Vice-Chair of NASBA, large public companies responding to the SEC's original

[3] The text of both speeches are available at:
http://www.ifrs.org/News/Announcements+and+Speeches/Hoogervorst+AICPA+speech+Oct+2011.htm
[4] As reported to me by Lynn E. Turner, former SEC Chief Accountant, who two years ago attended the semiannual meeting of the Council for Institutional Investors in Los Angeles where Mr. Breeden spoke and made this statement. Among other reasons, Mr. Breeden believes US GAAP provides him and his portfolio managers with better data.

Roadmap proposal opposed IFRS adoption by 47 to 28; and of the 47 that opposed IFRS adoption, 35 – about three-quarters of them– *strongly* opposed IFRS adoption.[5]

Those invested in IFRS adoption would like to dismiss *any* analysis of the comment letters on the grounds that only 240 letters were received in total. However, based on historic response rates to SEC requests for comments and widely accepted statistical norms, a sample size of 75 large companies is considerable, and I have not seen anyone try to claim that the sample was not representative of the population from which it came. If anything, the weight of the comments received would seem to be biased *for* IFRS adoption, because economic incentives to write a comment letter in support should be high; and there seems to be little incentive to be critical of IFRS adoption. For example, if a company's management actually perceived that IFRS adoption would be profitable, then it would seem that the marginal cost to write a comment letter in support of IFRS adoption would be low relative to being able to nudge the SEC in the direction it obviously wanted to go. The presence of economies of scale would further suggest that the cost-benefit tradeoff could be most attractive to the management of large public companies.

Setting aside the sample size issue, the results of the comment process were strongly negative, and that negativity has been confirmed by subsequent feedback. During the first panel of the July 2011 Roundtable convened by the SEC to discuss the Staff's condorsement proposal, the representatives from the credit rating agencies conceded that they do not rank either accounting framework, U.S. GAAP or IFRS, above the other in rating financial statements. Most tellingly, the smaller public companies panel unanimously and emphatically turned their thumbs down; all anyone saw in IFRS was a lot of incremental cost and zero benefit.

As to the few large companies that still support IFRS adoption, my own consultations with U.S.-based global companies makes me skeptical of the claim that adoption of IFRS would save money.

For example, foreign operations often have local statutory reporting obligations that may conflict with, or may even be completely independent of IFRS, and these statutory reporting requirements will remain even if U.S. GAAP is replaced with IFRS. Moreover, in the significant majority of the companies I have interacted with, the accountants physically located at the foreign operations are in charge of producing U.S. GAAP financial statements; and the managers at the foreign subsidiary are evaluated on their U.S. GAAP results as stated in the foreign currency. In these cases, whether IFRS is currently in the mix or not, everybody already speaks the same language; and that language is U.S. GAAP.

IFRS adoption would mean that *all* U.S. accountants would have to learn a new language, and so would many of the accountants at the foreign subsidiaries. As for accounting educators such as yourselves, there will come the day when you will have four bases of financial reporting to know and to teach – and your students will have four sets of rules to learn and to be tested on: U.S. GAAP, U.S.

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[5] Gaylen Hansen's PowerPoint slides are available at: http://www.nasba.org/files/2011/03/SECs_IFRS_Roadmap_Economy_Version_Presentation-2009.pdf

GAAP for non-public companies, IFRS, and IFRS for SMEs; and that doesn't include all of the tax rules that must be taught, learned and tested.

2. **A move to IFRS would restore the public trust in accounting standards.**

I'm going to present three examples – one from 2007 and two from 2011 – that directly challenge this claim.

The 2007 case is one of my pet peeves. It has to do with the revisions to IAS 23, *Borrowing Costs,* ostensibly to further convergence of US GAAP and IFRS. I say "ostensibly" because there are still significant differences between IFRS and its U.S. GAAP counterpart. The bottom line is that IFRS rules *still* give management more latitude to manage earnings than the corresponding U.S. guidance.

Be that as it may, I'm am very confident that this audience of academics will concur that separation of financing costs and operating costs is a principle derived from economics and finance. And, prior to the 2007 revisions to IAS 23, that was the IASB's principled position as well.

Under IAS 23, prior to the 2007 amendments, two accounting treatments were permitted for self-constructed assets: the treatment designated as the "benchmark" treatment was to expense borrowing costs; but the "allowed alternative" permitted rules-based capitalization: a senseless alternative, unless one values opportunities to manipulate earnings.

Incredibly, the IASB in 2007, the supposed principles-based system of accounting, blithely rejected the sound and long-ago-established principles it had embraced earlier, by requiring the capitalization of interest on self-constructed assets. In other words, it threw out the principles-based benchmark and now permits only the management-friendly erstwhile allowed alternative. There can be no basis, other than politics, for this change, but that did not seem to bother all but two of the IASB's members. This is what was stated in the basis for conclusions of the revised standard:

1. Eliminating a difference between IFRS and GAAP is always progress. (In other words, two wrongs can make a right.)
2. Allowing only one method will enhance comparability. (This is not true, because companies with different financing policies will generate non-comparable results from business operations. It is more accurate to state the irony that the IASB's rules-based standard actually defeats comparability since initial asset values and subsequent depreciation charges will depend on the timing and type of financing employed.)
3. It will improve financial reporting (for reasons unstated).
4. The fourth reason is so ludicrous and outrageous that I have to quote it verbatim:

> "The Board further noted that both IAS 23 and SFAS 34 *Capitalization of Interest Cost* were developed some years ago. ***Consequently***, neither set of specific provisions may be regarded as being of a clearly higher quality than the other. [Nonsensical] ***Therefore***, the Board concluded that it should not spend time and resources

> considering aspects of IAS 23 beyond the choice between capitalisation and immediate recognition as an expense." [bold italics supplied]

I chose this example because it demonstrates that the IASB cannot be trusted to adhere to its own due process policies, or to provide a legitimate basis for conclusions. Yes, both Boards are susceptible to pressures, but the way that the IASB went about it was *untrustworthy* and made a mockery of its own "due process" policies. There can be little question that big-issuer interests drove the revisions to IAS 23; both investors and smaller issuers were cast aside without so much as a nod to the real reasons for the adoption of a rules-based accounting standard. Any issuers that formerly elected the benchmark treatment were forced to change their accounting to a lower quality and costlier-to-implement alternative. *The unavoidable conclusion is that the IASB caused significant wealth destruction, and it continues today under the guise of convergence of accounting for borrowing costs, no less to a standard that has no hope of enhancing comparability.*

The second example is the IASB's revisions to its pension accounting standards, which incidentally were not undertaken as part of any convergence project – and I shudder to think that the FASB might actually be called upon to incorporate these changes into U.S. GAAP. I wrote a rather lengthy description of the revisions to IAS 19, *Employee Benefits,* in my blog this past October,[6] and the bottom line is the same as for the first example: the revisions foster more income smoothing and earnings management; they indicate that the IASB cannot be trusted to tell the truth or to put investors' priorities first. Again, and just a few months ago, to accommodate special interests, the IASB shows its willingness to promulgate accounting standards that surely result in shareholder value destruction.

My third example is the secret letter sent by Mr. Hoogervorst to the European Securities and Markets Authority this past August,[7] in which he expressed concern at the inappropriately high valuations produced by specific EU banks on their holdings of Greek sovereign bonds classified as 'available for sale.' Setting aside the accounting implications of that letter, and there are many, the subsequent revelation that the letter was kept secret – until the IASB was forced to make it public once news of its existence was leaked to the *Financial Times*[8] – raises trust issues that can be directly traced to the current head of the IASB.

Hans Hoogervorst, as a former regulator, surely knew that sunlight would have been the best disinfectant, yet he chose secrecy. The numbers in financial statements are cyphers, and pronouncements of accounting standards are the principal means by which they are de-encrypted. If one is not concerned that investors fully understand the basis under which the financial statements were prepared, then one might have no qualms about withholding part of the de-encryption key.

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[6] *The IASB's Revisions to Pension Accounting Rules are Based on a Preposterous Premise*, available at http://accountingonion.typepad.com/theaccountingonion/2011/10/the-iasbs-revisions-to-pension-accounting-rules-are-based-on-a-preposterous-premise.html.

[7] August 4, 2011, available at http://www.ifrs.org/NR/rdonlyres/949CAE0C-3E3B-4F64-9F1D-53B491458880/0/LettertoESMA4August2011.pdf.

[8] " IASB criticises Greek debt writedowns," August 30, 2011, available at http://www.ft.com/intl/cms/s/0/9582fb8c-cfe9-11e0-a1de-00144feabdc0.html#axzz1bZM1YWsc

Evidently, the IASB wanted to be certain that European regulators fully understood the financial statements, and for the regulators to have that knowledge without letting investors in on the secret. It leaves a strong impression, to say the least, that EU regulators are currently the IASB's primary constituency.

3. U.S. GAAP is not superior to IFRS

Mr. Hoogervorst stated that quality of the actual accounting standards should be the most important consideration for the SEC as it formulates its IFRS policies, but he is "not convinced by the arguments that one set of standards is clearly superior to the other."

Moreover, he stated that "academic studies have concluded that both IFRSs and US GAAP are high quality standards." A vaguely-worded footnote to that statement reads as follows:

> American Accounting Association Financial Accounting Standards Committee, 2008 - Karim Jamal

That footnote leads me to believe that Mr. Hoogervorst was referring to a paper published in *Accounting Horizons* by the AAA's Financial Accounting Standards Committee.[9]

Let's take a closer look at that paper. That committee did indeed cite evidence from academic research that IFRS and U.S. GAAP were substantially similar; but, crucially, it added that it had no basis to state that either set of standards were 'high quality.' Furthermore, that same committee stated in a subsequent comment letter to the SEC that high quality depends on a number of factors that are specific to each environment: legal systems, securities enforcement, taxation and incentives of preparers, for example.[10]

Taken as a whole, the paper from which Mr. Hoogervorst took one supportive nugget out of context clearly would not provide academic support for IFRS adoption in the U.S. Rather, I took the committee's remarks as an endorsement of a standard setting system that supported where standard setters were *in competition with each other*. And indeed, in the comment letter I mentioned, the Committee stated:

> [A]cademic research indicates that using a single set of uniform accounting standards will not lead to the production of comparable and consistent financial reports that are desirable to regulators [citation omitted]. ***The promise that adoption of IFRS will deliver comparability and consistency in accounting reports is false and misleading.***[11] [bolding and italics supplied]

[9] American Accounting Association's Financial Accounting Standards Committee, "A Perspective on the SEC's Proposal to Accept Financial Statements Prepared in Accordance with International Financial Reporting Standards (IFRS) without Reconciliation to U.S. GAAP ", *Accounting Horizons,* Vol. 22, No. 2, 2008, pp. 241- 248.
[10] Available at http://www.sec.gov/comments/s7-27-08/s72708-104.pdf.
[11] Ibid.

There are two more quick points I want to make about what academic research has to say about the relative merits of IFRS versus GAAP. In the same issue of *Accounting Horizons*, another AAA committee of academics, the Financial Accounting and Reporting Section of the Financial Reporting Policy Committee, took the opposite position on the relative attributes of the IFRS versus U.S. GAAP: empirical evidence suggested that analysts actually preferred working with GAAP financial statements instead of IFRS. Moreover, the elimination of the SEC requirement to provide reconciliations of differences between IFRS and U.S. GAAP was premature.[12]

But, whatever these papers stated at the time they were published, time has elapsed, and both IFRS and GAAP have changed. Has IFRS been improved?

I think that the SEC needs to acknowledge that IFRS has taken a number of steps in the wrong direction: to name just a few, there are the borrowing costs and pension accounting issues that I already mentioned; there is also the free choice in accounting for non-controlling interests, and most recently, there is the proposed hedge accounting revisions that would broaden and liberalize the application of hedge accounting. I wonder if a single investor has called for any of these changes that will permit preparers to further manipulate earnings.

4. IFRS is already widely adopted elsewhere

The IASB has been successful in achieving various degrees of acceptance of IFRS in many jurisdictions, and notwithstanding one significant carve-out, the EU should be regarded as the IASB's greatest success. But, if proponents of IFRS adoption are claiming that the U.S. should be following the EU to IFRS, the reasons why the EU adopted IFRS must be examined – for they are as different from legitimate regulatory goals for the U.S. as north is from south.

The impetus for IFRS adoption in the EU has its roots in events that were triggered by the NYSE listing of Daimler-Benz in 1993. At that time, German GAAP was known for the availability of so-called "hidden reserves," which permitted a high degree of non-transparent income smoothing. The SEC was under significant pressure to waive the reconciliation to GAAP requirement, but the SEC held firm; and the financial results reported by Daimler backed them up. For its latest reporting period disclosed in its initial registration statement, Daimler showed a small profit under German GAAP, but a significant loss under US GAAP. The difference was due to Daimler releasing reserves that were accrued in prior periods under German GAAP.

For similar reasons, the Daimler-Benz listing incited a debate in Germany about whether its own accounting standards were adequate. In 1998, German law was changed to allow listed companies a

[12] American Accounting Association's Financial Accounting and Reporting Section of the Financial Reporting Policy Committee, "Response to the SEC Release, 'Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP File No. S7–13–07'", *Accounting Horizons,* Vol. 22, No. 2, 2008, pp. 223-240.

choice between German GAAP, IFRS or US GAAP. The end result was that many companies switched away from German GAAP, and about half of those switchers picked US GAAP.

Just as today, where the EU fears that the US could end up with too much influence on the IASB, the US GAAP switchers seem to have caused great concern throughout Europe; both governments and large banks feared the loss of their power to establish accounting standards, and especially feared inflexible standards that were rigorously interpreted and zealously enforced by the SEC. Stated bluntly, there was great concern that US GAAP could take over Europe; so, in 2002, the European Commission acted swiftly and decisively to mandate IFRS for all listed companies in the EU.

My point is that the SEC is now being urged to give up its prerogative to set accounting standards for U.S. issuers – not for the greater good as is generally thought, but solely because members of the EU feared their own loss of sovereignty. ***Without adoption of IFRS by the EU, we wouldn't be discussing whether the US should be adopting IFRS in any manner, shape or form***; and anybody who doesn't think that the EU won't push back hard if it finds that the U.S. is limiting the EU's ability to influence, if not control, the IASB is kidding herself. If the shoe were on the other foot – in other words, if the U.S. were part of the IFRS coalition along with the rest of the world – would the EU be inclined to join the coalition if it couldn't control the outcomes? Of course not.

5. **Even though IFRS may not be consistently applied elsewhere, the SEC can enforce compliance with IFRS as it sees fit.**

It's hard to imagine that SEC enforcement of IFRS can take place without similar levels of enforcement in the EU at a minimum. More likely, one of two scenarios will come to pass: SEC enforcement will raise the quality of IFRS worldwide, or the SEC will be pressured to join in a race to the bottom. I fear, and would expect, the race to the bottom scenario.

Here's an example of how the race to the bottom could take place: a questionable interpretation of IFRS is the basis of a loan loss allowance methodology adopted by, say, a French bank; and that treatment is approved by its French auditors and regulators. The race to the bottom begins when SEC registrants facing similar facts and circumstances argue to the SEC that if they were forced to comply with the SEC's stricter interpretation of IFRS, then they would be placed at an economic disadvantage – it could create competitive pressures, or perhaps affect compliance with banking regulations.

Consequently, even though the SEC may find no merit in the registrant's position, it might have to yield to pressure from registrants and sacrifice investor protections. The pressure could also come from an outside source: Congress, lobbyists for special interest groups, other foreign governments, and maybe even the United Nations. Even if the SEC manages to keep the high ground, the scenario is not pleasant to contemplate, and arises from the fundamental problem of a single set of global accounting standards: the present and likely future reality is that one size doesn't fit all. The relatively low degree of detail in IFRS also creates opportunities for this type of race to the bottom scenario to occur, and the higher detail present in U.S. GAAP may explain why it rarely occurs in the U.S.

I think there is also a technical problem that has not yet been the subject of much discussion and could easily start that race to the bottom rolling. If the SEC were to implement the so-called 'condorsement' approach, U.S. GAAP would continue to survive with IFRS rules incorporated into it. Ignoring whether such an approach is actually practicable or even feasible, U.S. GAAP provides that when an authoritative source does not specify an accounting treatment, an issuer would eventually be allowed to adopt a "practice that is widely recognized and prevalent either generally or in the industry."[13] U.S. registrants could validly claim that they are permitted to adopt industry practices that developed globally among *any* critical mass of IFRS issuers, and not just in the U.S.

6. **Costs of conversion to IFRS can be spread out over a long transition period**

All I can do here is to point out the obvious: merely spreading out the costs doesn't lessen them, nor lessen opportunity costs. What cost spreading does, however, is unduly prolong the time until financial reporting will reach a stable environment. If proponents of IFRS adoption are still playing that misleading comparability card as a primary benefit of IFRS adoption, then they should also explain why prolonging the transition, and the resulting lack of comparability, benefits investors.

Especially in light of the feedback the SEC has already received and the current economic climate, what is the benefit for a small public company of incurring the transition costs to IFRS? These companies could care less about how they stack up against the financial statements of a foreign company, and neither could their banker or venture capitalist.

We know from the European and Canadian experiences that transition costs were not trivial – to say the least – and it put a lot of shareholders' money into the pockets of auditors. If any member of Congress that voted for the Jumpstart our Business Startups (JOBS) Act believes that companies with $1 billion in sales or less have been unduly burdened in their capital raising by SEC rules, then they should enact just as quickly to prohibit the SEC and FASB from changing accounting standards primarily for the sake of convergence with IFRS.

7. **The U.S. will not experience any loss of sovereignty over its ability to set accounting standards.**

There could be mechanisms to assure that the U.S. will always be heard, but the absolute very best the U.S. can expect is to have a significant influence over IASB decision making. That's a far cry from sovereignty; and frankly, any efforts to minimize this issue are disingenuous.

Added to the fact that the EU will continue to do its level best to control all aspects of the IASB, there are other formidable forces that may be working to mitigate the U.S. voice in IFRS. Let's take one case that has recently been in the news – India. From reading an interview with India's Chairman of

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[13] FASB ASC 105-10-05-3.

its National Advisory Committee on Accounting Standards,[14] the mindset of India's accounting establishment reminds me more of the reserve-oriented income statement smoothing approach developed by the Germans. The interview mentions four (of a total of 65) major carve-outs from IFRS; but one in particular, on deferral of gains and losses on foreign currency-denominated debt, best reflects the great divide that still exists after years of negotiations with the IASB. Indian issuers, who rely on foreign debt more heavily than their U.S. or European counterparts, are unwilling to tolerate the income statement volatility of FX gains and losses on that debt. Hence, an exception to IFRS in India permits an issuer to spread any foreign exchange gain or loss over the life of the loan.

This is just one of many examples of an irreconcilable difference in financial reporting mindsets. It is inconceivable that such differences can be bridged by a single set of global accounting standards. It's just not realistic to expect that the U.S. will be the winner in every case when there is a difference in mindset, regulatory, political or legal circumstance; or not even in the majority of cases.

Indeed, history suggests that the U.S. will lose most of these battles. The numerous failed convergence projects alone attest to how many battles the U.S. stands to lose if it incorporates IFRS into U.S. GAAP. None of these issues – R&D, inventories, pensions, borrowing costs, business combinations, impairment of long-lived assets, financial instruments, hedge accounting, to name the ones that quickly come to mind – are trivial. For, if any of these, or any of the other differences between U.S. GAAP and IFRS were small differences, surely they would have been converged by now.

It is not unreasonable to expect, even, that a country like India might form a coalition with other countries against the U.S. Here's just one scenario: India makes a deal with the EU, and together they push a new standard that permits the deferral of unhedged foreign exchange gains and losses on foreign currency denominated debt. How will condorsement work? Will we carve out that particular deferral option? If so, the goal of comparability would be irretrievably lost.

I should add that what we are seeing now in the United Nations is not all that different from my hypothetical. It seems that numerous smaller nations have learned to use the United Nations to advance agendas that are making citizens of wealthier nations question their own willingness to continue belonging to and funding these efforts. Thus far we do not have a similar problem arising with the uniting of smaller nations to dominate standard setting in the IASB. However, once the U.S., Japan, India, and China become committed to IFRS, smaller nations could begin to rise up in the IASB. Their incentives would come from the fact that international accounting standards are not necessarily neutral when it comes to global capital flows and economic development.

8. Bad things will happen to the rest of the world if the U.S. does not adopt IFRS

Mr. Goldschmid speculates that, without IFRS adoption, the so-called coalition of IFRS members would break apart. However, history strongly suggests otherwise.

[14] Available at http://www.moneycontrol.com/news/management/ifrs-carve-outs_515230.html.

As I mentioned before, much of IASB's growth was driven by the desire to insulate Europe and other jurisdictions with less developed standards, like China, from the influence of U.S. GAAP. So*, maybe the only thing that could possibly break up the IASB would be for the U.S. to join it.*

The IASB was created in 1973. It was reconstituted in 2001. In all those years, it has *not* been the sole creator of accounting standards. Yet it has grown and done well. Without the U.S. in the coalition, the IASB will continue to have the degrees of freedom events have shown that it needs to do what it takes to bring everyone currently in the coalition even closer together. That will mean giving the EU the financial instruments and hedge accounting standards it wants, giving India the foreign exchange standards it wants, and giving China the watered down related party disclosure standards that it wants – and so on and so forth, and all in the form of free choices that are in opposition to the goal of comparability and the mindset of U.S. GAAP. None of that would be possible if the U.S were to adopt IFRS.

I find it difficult to imagine that the U.S. could ultimately justify subsequent endorsement of the IASB's standards from the numerous failed convergence projects without significant modification – and what if the EU likes those standards just the way they are now? Just recently, for example, the *Financial Times* reported that there was a "real risk" that the European Commission would reject the IASB's new consolidation and joint venture accounting rules, developed jointly with the FASB, and which were due to become effective for 2013.[15] Indeed, it is entirely possible that, as the EU has threatened before, they could cut their support for the IASB, establish aggressive new carve-outs, or even promulgate its own standards.

9. Bad things will happen in the U.S. if the U.S. does not adopt IFRS

Mr. Goldschmid also predicts that if the coalition does not break apart, it will leave the U.S. to fend for itself when it comes to accounting standards. According to Mr. Goldschmid, this is would be the worst of all possible worlds.

Again, history would suggest otherwise; and moreover, if it did occur, many believe that it would be a good thing, not a bad thing. As the AAA's Financial Accounting Standards Committee concluded, standards competition is desirable, and monopolies can have dire consequences. I find it extremely ironic that individuals and organizations such as the AICPA that normally speak out for free markets for goods and services somehow think that granting a monopoly on accounting standards is preferable to accounting standards produced in a competitive environment. Even if, and this is certainly not true at present, IFRS could be regarded as higher quality at some point, granting IFRS a monopoly would risk stagnancy – and in place of innovation toward higher quality accounting standards, we could be racing to the bottom. It is a great understatement to say that there is still plenty of room for improvement in both IFRS and U.S. GAAP, and a monopoly would virtually assure that not enough of that improvement would happen.

[15] "Accountants at odds with Brussels," *Financial Times,* January 29, 2012, available at http://www.ft.com/intl/cms/s/0/59c69aae-4a78-11e1-8110-00144feabdc0.html#axzz1qOQczYvU.

And, perhaps the monopoly effect explains the many failures to progress on convergence in the past ten years. If one were to accept that execution of the convergence projects and the results of that work to-date are the most important factors for the SEC to consider when deciding the future status of IFRS in the U.S., one would have no choice but to conclude that continuation by whatever means – condorsement or anything else – will be a monumental waste of time. That should also make it apparent that the FASB's time would have been much better spent on efforts to improve the quality of U.S. GAAP, instead of on convergence with IFRS.

It's hard not to be amazed at how much time has been devoted since 2002 to debating accounting issues and to see how so little of the convergence objectives have actually been accomplished. Going back just two years to the time of the SEC's February 24, 2010 Statement on IFRS, the FASB and IASB had nearly a dozen joint projects planned for completion by both boards by mid-2011. The Commission was hopeful that at least some of those projects would be completed by now; but even IFRS adoption skeptics, like me, could not have imagined that we would actually be further from convergence today than we were back in February 2010. Progress has been made toward partial convergence of some trivial matters – like the way that the components of dirty surplus (so-called "other comprehensive income") are presented, and the IASB has finally agreed to adopt the FASB's fair value measurement standards for the few items that are measured at fair value. But, almost everything else seems to be heading in reverse.

Even, as Mr. Goldschmid warns, the US could lose its seat at the IFRS table, but this doesn't mean it will lose its voice. Even before convergence projects began, it was obvious that IFRS owed its form, and a great deal of its substance, to U.S. GAAP. It is very clear that IFRS wouldn't be what it is today without U.S. GAAP to serve at least as a point of reference, and whatever U.S. accounting standards will become in the future, they will always make the rest of the world at least stop and think – if not do.

10. All nations have the same goals for financial statements.

I suppose that one could take the position that although there may be differences in objectives for financial statements, they are not enough to abandon efforts to establish a single set of accounting standards suitable for use by companies worldwide. Yet, who could in all seriousness state that the financial reporting objectives of the SEC and Chinese regulators are anywhere near the same?

Even more significant at the present time, the history of the EU's efforts to monitor and steer the IASB clearly indicate its regulators believe that a legitimate role for accounting standards is to support the agendas of politicians and key industrial powers. It is undeniable that when it comes to bank accounting, EU regulators clearly see nothing wrong with investor protection taking a back seat. I know the Greek bond problem remains extremely serious, but I have to admit that it amused me last fall to see heads of state Angela Merkel and Nicolas Sarkozy arguing on television, for all to see, over an accounting issue: the size of the balance sheet haircut that banks should take on their Greek bonds. Surely, their constituencies must have been asking themselves, 'what are they talking about'?

If IFRS ***were*** high quality, as Messrs. Hoogervorst and Goldschmid claim, then politicians wouldn't have to get involved in accounting debates, and could instead turn their attention to the real problems. The EU could continue to muddle along using the same approach to financial problem solving long after the Greek bond crisis is behind it. But, that doesn't mean the SEC has to muddle along with them. By adopting IFRS, the SEC will essentially be telling U.S. investors that it is willing to tolerate insurmountable barriers – such as the EU's obdurateness – to high-quality, investor-purposed accounting standards.

Where We Stand

Allow me to close with some observations about the SEC staff's remaining IFRS adoption Work Plan announced in February 2010[16] and the current convergence projects.

Let's begin with the comment letter from the CFA Institute, representing over 100,000 investment professionals worldwide.[17] A year-and-a-half into the Work Plan, CFA Institute was compelled to point out that the Staff had a responsibility to delve into all of the potential costs and benefits of IFRS adoption, and that after a year and a half, significant questions remained unanswered. At that time, little had been done to:

- Define what "high quality standards" means, and whether IFRS standards measure up;
- Address whether the IASB's has made needed improvements to its infrastructure and governance;
- Specify an enforcement mechanism for IFRS; and
- Specify how endorsement of IFRSs would actually take place (and by implication lead to the ambitious goal of generating financial statements that simultaneously comply with US GAAP and IFRS).

Moreover, in a speech last December, SEC staff member Paul Beswick acknowledged practically in passing that constituents had expressed significant concerns that net benefits from condorsement would not materialize; yet, nothing in the Staff's planning documents provide any indication that such an analysis is in the works, or will ever be produced.

As we sit here today, more than two years after the announcement of that work plan, we are still in about the same place, even though the Staff did issue two progress reports a couple of months ago. A progress report produced in the Office of the Chief Accountant is a comparison of the differences between U.S. GAAP and IFRS. Although revenue recognition, leasing, and financial instruments were excluded, it's amazing how many significant differences still exist! First, there are all of those convergence projects that have been abandoned or indefinitely postponed; second, there are the significant differences that remain from projects that the staff is counting as converged; and third,

[16] SEC Release No. 33-9109, *Commission Statement in Support of Convergence and Global Accounting Standards,* Feb. 24, 2010, Appendix.
[17] August 30, 2011, available at: http://sec.gov/comments/4-600/4600-150.pdf.

there are the differences that are so fundamental that the Boards never bothered to put them on any convergence agenda. Two quick examples of these are asset impairments and inventories.

Yet, it appears that the staff has attempted to downplay the sheer impossibility of bridging these differences, mainly by providing a document that no Commissioner would find any reason to actually read, except perhaps as a natural and highly effective cure for insomnia. The bulk of the report is a turgid regurgitation of differences between IFRS and U.S. GAAP that could have easily been lifted from a pamphlet written by any one of the Big Four. The staff also made sure to leave out any summary, takeaways, or any indication whatsoever of the dim prospects for, and herculean efforts that convergence will continue to entail – even under the more moderate condorsement scenario now seen as most likely. If the staff in the Office of the Chief accountant intended to provide no new information or guidance, then they succeeded admirably.

The Staff Paper produced in the Division of Corporation Finance is an analysis of the use of IFRS in practice by the subset of Global Fortune 500 companies that claimed to comply with IFRS. This paper was actually well done. It notes a number of apparent departures from IFRS and the inconsistent ways that IFRS has been interpreted by the largest companies. By itself, it should explode the myth that worldwide adoption of IFRS will result in more comparable financial statements – whether this is due to lack of consistent enforcement, ineffective gatekeepers, or standards that provide too much opportunity for gaming. The unavoidable and unstated conclusion from this paper is that even if a single set of global accounting standards were possible, there is no reason to hope that comparable financial reporting could be the outcome. A single set of standards without a single, consistent and rigorous enforcement mechanism is enough by itself to know that convergence will fail to deliver on its promise of comparability.

As I mentioned earlier, we have come to the point where the SEC is placing all of its hopes for any indication of significant progress toward convergence on the revenue recognition and leasing projects. However, the best that can be said of these projects is that two watered-down standards could become finalized by the end of 2012. I do not consider this to be progress, as I believe that the FASB would have been capable of creating higher quality standards without having collaborated with the IASB. We do have our politics here in the U.S., but recent years have shown that it is nothing compared to the political pressures exerted on the IASB by its many "stakeholders."

The major project that seems most likely to be finalized in 2012 is revenue recognition. In the revised exposure draft issued earlier this year, the Boards have abandoned any semblance of a principled position on the asset/liability view – supposedly one of the prime reasons the project was begun fully 10 years ago. If finalized as currently proposed, all sorts of deferred costs will populate the balance sheet.

Overall, I think it is fair to say that this project has devolved into a desperate quest to somehow quell criticisms by preserving current practice while at the same time replacing the rules from 200 separate pronouncements and interpretations with one cohesive document. The unsurprising result is a draft standard that is so vague and lacking in robust illustrative examples, I wouldn't be surprised that we will soon have 200 new interpretations to deal with before an effective date finally comes to pass –

which I expect to be no earlier than January 2017 – that's 15 years after the project was added to the FASB's agenda.

The prospects for a high-quality lease accounting standard are even more dismal. The Boards are being pushed to whittle down recognition of lease obligations to some crudely calculated and arbitrary minimum amount that lessees might grudgingly accept, but is untraceable to economic reason. The boards may have actually arrived at an impasse on the issue of lessee expense patterns; and lessor accounting, after years of vacillation and improvisation, is still in flux.

So, here today we sit with the awareness that IFRS adoption is still laden with many problems and issues. There is seemingly overwhelming opposition to IFRS adoption, but many fear that the decision to proceed with some form of condorsement is soon at hand.

I would like to thank the people who have provided comments on earlier drafts of these remarks: former SEC Chief Accountants Walter Schuetze and Lynn Turner; Gaylen Hansen; my colleagues, Jim Noel and Ray Stephens; and Bob Jensen, retired professor and current lifeblood of the AECM listserv.

I am confident they all agree with me on this, but I can only speak for myself: for the sake of investor protection and the public interest, the SEC should have long ago made a U-turn on its Roadmap to IFRS adoption.

Thank you very much.