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Ready for global financial standards?

private sector commentary

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As the Obama administration dismantles the prior administration's financial policies, the nation's corporate finance and accounting communities are in limbo over a major, pressing question. At issue is whether to abandon a tried and true, but complex and globally unpopular financial reporting system and join the majority of the industrialized world in adopting international financial reporting standards (IFRS).

At a time when the financial health of U.S. and foreign companies are tightly intertwined – and when scandals and mismanagement have upended Wall Street and badly shaken investor confidence – the questions of corporate oversight, accountability and transparency have never been so important.

A shift to IFRS from generally accepted accounting principles (GAAP) would mean far more than just a change in paperwork. Rather, warns one Fortune 500 executive, it would impact virtually every aspect of a company's operations.

IFRS Benefits

As our economy languishes, some argue that having one set of international standards would benefit the global financial system. GAAP's complexities and the significant compliance cost (including Sarbanes Oxley) have driven many companies to foreign exchanges for initial public offerings.

GAAP grows increasingly complex each year, with tens of thousands of pages of rules and as many exceptions, while IFRS is a high-quality, principles-based framework far less cumbersome.

With more than 100 countries adopting IFRS, its use in the United States could result in more foreign firms listing securities, or establishing operations, here. This would be especially meaningful for Pittsburgh which is a center for foreign owned companies, and at a time when capital infusion is sorely needed.

The online journal CFO.com recently said: "The move is intended in part to make it easier and cheaper for foreign firms to list on U.S. exchanges, particularly in light of recent U.S. fears that foreign exchanges are growing more competitive."

In addition, we as a society have become "global investors." The SEC estimates that two-thirds of U.S. investors own securities in foreign companies that use IFRS. The previous SEC Chairman, Christopher Cox, said his purpose in pursuing adoption was the "increasing worldwide acceptance of financial reporting using IFRS, and U.S. investors' increasing ownership of securities issued by foreign companies."

And Ian Mackintosh, chair of the United Kingdom's Accounting Standards Board, said, "If the U.S. were also to decide to adopt IFRS, we would have true global standards."

IFRS downsides

IFRS adoption would negatively impact securities issuers in several ways. In planning the conversion, they would need to analyze whether to create a new parallel system or modify a current one. The adjustment could cause a company's financial position to change, potentially resulting in failure of loan covenants or other financial agreements.

The switch also would force companies to retrain accounting staffs and make significant adjustments to information technology processes, among other issues.

Corporate America is ill-prepared for the time and cost of what lies ahead. One major survey suggests that four in five corporate executives lack a grasp of IFRS details, and demographic data show an aging population of CPAs as well as business school faculty who are not adequately teaching IFRS to students.

Another argument against IFRS is the cost. Some companies may spend up to 1 percent of annual revenues on implementation, and one corporation reported it would spend up to four times the amount expended to implement Sarbanes Oxley.

A third view, espoused by new Securities and Exchange Commission Chair Mary Schapiro, is that international standards are too "loose" and might encourage more fraud or mismanagement.

Proposed road map

Last year, the SEC presented a "road map" for the transition to IFRS for publicly traded companies as early as 2013. The proposal was embraced by Wall Street analysts and investors as well as the American Institute of Certified Public Accountants and Financial Accounting Standards Board, the governing body of GAAP.

But the excitement was dampened in early 2009 by Ms. Schapiro, who said she would not "feel bound" by the road map and that American businesses should proceed with great caution. She admitted she had concerns with IFRS and the ability of the International Accounting Standards Board to set standards independently.

Her comments have raised concern that the Obama administration is pursuing a "protectionist" attitude, with some experts pointing out that U.S. protectionism after the 1929 stock market crash kept the world in a lingering depression for many years.

Despite the SEC's delay, the convergence process continues to move ahead, albeit at a slower pace, driven by the Financial Accounting Standards Board and International Accounting Standards Board, which continue to "converge" their respective accounting standards to become more closely aligned.

Both organizations estimate that the convergence should be completed by 2011. Once that's done, the doors should be open for the IFRS transition. The question is whether corporate America will be ready.

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