

ROUNDTABLE



INTERNATIONAL FINANCIAL REPORTING STANDARDS

Recent events in worldwide markets have shed light on accounting principles and the differences that exist in the way assets are valued and reported. In recent years, the globalisation of financial markets has intensified calls for a unified set of accounting principles. Not only will changes impact financial reporting, but there may also be implications for tax policies, M&A, financial planning and compensation structures.

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THE PANNELLISTS



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Can you outline the key arguments supporting the global convergence of accounting principles? In your opinion, is this goal achievable?

Venkateshwaran: The world is evolving into one large economy, with stakeholders spread across the globe. There is therefore a growing need to speak one financial reporting language. The ability to understand financial information irrespective of its geographical origin is a key requirement of the international stakeholder community – today, most large corporations have operations in multiple jurisdictions, and preparation of financial information in multiple accounting frameworks to comply with the local requirements can be a costly and inefficient process. Using a single financial reporting language brings about significant efficiency in internal and external reporting, leads to better comparability among peers and competitors, and provides better information to analysts and other users. Acceptance of IFRS in the US, the largest economy in the world, will be the next milestone in the global convergence of accounting principles, and appears to be back on track with commitment from both the US and international standard setters.

Peterka: The most common argument for supporting global convergence is the increase in cross-border capital transactions. Additionally, from an investor perspective, a global standard would offer consistency, clarity and transparency when evaluating global opportunities. The support for a global standard is also supported by multinational corporations, as it would ease their regulatory accounting compliance. With the current systems, many multinationals are keeping multiple sets of accounts for various regulatory reporting requirements. The two major accounting standard setting bodies, the FASB and the IASB, continue to support and work toward a global standard. Most professionals would support this goal. However, various barriers exist – the most obvious being political interference.

Gannon: In today's environment, having a global perspective on financial reporting is no longer a choice, but a necessity. The notion of a single set of global accounting and financial reporting standards has been debated for many years, and may now be becoming a reality. The leaders of the G20 countries recently noted that "key global accounting standards bodies should work intensively toward the objective of creating a single high-quality global standard". IFRS are now used for public reporting purposes in over 100 countries, with many others to follow over the next couple of years. Besides creating a level playing field for companies around the globe, having a single standard will eliminate accounting arbitrage between standards, and lessen the potential for political interference in the standard-setting process.

Henning: Global convergence of accounting standards is made necessary by the global nature of business itself. During the past decade, it was not uncommon for companies to prepare financial statements under IFRS, US GAAP and another domestic version of GAAP. The adoption of a single set of global standards provides companies with immediate cost efficiencies that will lead to greater comparability of financial reports over time. This goal of convergence is achievable, but it will take some time. Many countries around the world already require compliance

with IFRS or have set plans to do so. It appears to be a foregone conclusion that the US will also require adoption of IFRS, but the timing of such a requirement is still being discussed. This convergence will be forced by competition in global capital markets.

Lundelius: Accountants tend to look at global convergence as an end unto itself, but in the context of the flow of investment capital, convergence provides a helpful metric by which capital providers can compare performance and the risk of potential investments from around the world. Without convergence, capital providers must expend more time and expense analysing and reconciling different reporting standards, and that added time and expense slows or stops the flow of capital from one country to another. The goal is achievable, if politics do not interfere. Not all governments are in favour of the free flow of capital, and those governments may want their local businesses to appear financially stronger than they would under converged standards. Such governments would likely impose different accounting rules that favour local concerns, thus undoing convergence.

Epstein: The central argument is that international commerce and finance will be stimulated when buyers, sellers, investors and capital-seeking entities have a wider array of opportunities from which to choose. In the commercial sector, enterprises are often required to provide financial statements and other data before making decisions to sell goods on credit, buy goods and services, accept employment, grant business licenses and so forth. Being able to understand financial statements is a necessary condition, and when the parties are domiciled in jurisdictions with disparate financial reporting standards, the effort to learn a new financial reporting language can be daunting. The various parties may choose to walk away from such transactions, with obvious implications for growth. As to financing activities, from the viewpoint of the entity seeking to raise capital, if foreign investors, including lenders, are unwilling to tackle the issue of foreign reporting standards, economic theory suggests that the entity's cost of capital will be greater than it would have been had it been able to successfully offer its shares and debt obligations to potential investors in other markets. Higher cost of capital raises the cost of doing business, making economic opportunities less likely to be appealing, and reducing economic growth, with worldwide ramifications.

What are some of the benefits and drawbacks of making IFRS the worldwide standard? Is there a danger that it may not be applied in a uniform manner by all countries?

Lundelius: Chief among the drawbacks of IFRS is that its principles-based methodology may allow for divergence of application among companies, not just countries. For example, one software developer recognising revenue under rules similar to US GAAP may defer recognition while a peer developer may accelerate recognition; both could potentially be IFRS-compliant but produce radically different results.

Peterka: The biggest beneficiaries of a global standard would be listed entities with multinational operations and reporting requirements. Investors also would benefit as they would be able ►►

to evaluate investment opportunities with greater comparability. One of the drawbacks with adopting a global standard for listed entities is the real possibility that two standards will exist, one for listed companies and another for private entities. There is a very real danger that a global standard will not be applied in a consistent manner across different regulatory regimes. This is a reality that exists today with entities that are listed on more than one exchange.

Venkateshwaran: The benefits of moving to IFRS include increased comparability, reduced costs of compliance, and easier access to capital markets. Further, IFRS is currently accepted in over 110 countries, making it the largest accepted accounting framework in the world. Additional efforts that would be required to transition these 110 countries to another accounting framework would be the greatest argument for retaining IFRS as the worldwide standard in the future. However, moving to IFRS brings about its own set of challenges and drawbacks. In the initial years after transitioning to IFRS, financial reports in each jurisdiction are likely to retain a lot of regional favour as accounting practices are likely to be guided by practices in earlier home GAAP rather than by any international practice. Further, amongst the jurisdictions moving towards IFRS, the level of preparedness varies, resulting in inconsistencies in the application of standards. Principles based standards require significant use of management judgement and it could lead to inconsistencies in application if these principles are not understood correctly or applied in its true spirit. IFRS also requires significant use of fair values; the absence of knowledge of the guiding principles or the non-availability of skilled valuation specialists would lead to inconsistent and incomparable results.

Epstein: Any discussion of universal adoption of IFRS presumes that those claiming to apply the standards do so honestly and with competence. Having financial statements audited by qualified independent accountants who strictly enforce compliance would be one obvious requirement. For publicly traded companies, having strict enforcement of securities regulations, including those governing financial reporting and auditing, would also be a necessary condition. To the extent that an IFRS-compliant reporting entity is domiciled in a jurisdiction having known

weak auditing or regulatory oversight, it will still be less attractive as an investment opportunity than a similar entity operating from a jurisdiction known for strong enforcement. Indeed, academic research shows that European and Asian companies that listed shares in the US benefited from the perception that, if they voluntarily subjected themselves to strict US SEC oversight, those entities probably complied with high standards for quality financial reporting, transparency, and governance, and this was rewarded with reduced capital costs even by their domestic investors. There is a risk that enforcement of IFRS may vary under different regimes, but economic theory suggests that this will be recognised and punished or rewarded by investors, such that reporting entities will want to be perceived as strictly adhering to IFRS in order to reap the rewards of lower cost of capital.

Henning: With continued globalisation, it is easy to sell the merits of a uniform financial reporting paradigm. The benefits from complying with one, instead of multiple financial reporting systems, may result in significant cost savings for many companies. In addition, efforts can then focus on enhancements to one system with the goal of making that system more transparent and reflective of underlying business transactions. The difficulty with the global adoption of a single financial reporting system is that social, legal and other cross-cultural differences may inhibit uniform application of IFRS globally. In fact, we have witnessed with the adoption of IFRS in Europe that companies have different interpretations of what constitutes compliance with IFRS. However, these differences should fade over time as knowledge of the official English language version of IFRS matures.

Gannon: The potential benefits of a single global accounting standard are real and significant: greater transparency with more relevant information for financial statement users; greater emphasis on accounting for the 'economic' of transactions and events, resulting in less risk; and reduced costs in the long run for everyone. Critics of IFRS often associate more detailed guidance with increased rigour in financial reporting. A recent academic study found that financial statement preparers are less likely to report aggressively under a more principles-based standard than under a more precise or rules-based standard. They also found significantly less variability in application among preparers that used a less precise standard, suggesting that the application of more principles-based standards such as IFRS need not result in less comparability than the application of more precise standards such as US GAAP.

Having financial statements audited by qualified independent accountants who strictly enforce compliance would be one obvious requirement.

Could you explain the perceived problems with fair value or mark-to-market accounting? How does IFRS seek to overcome those problems?

Peterka: Mark-to-market accounting certainly has been one of the most discussed and politicised accounting topics. There has been a lot of negative information regarding fair value, with much of it coming from politicians whose comments showed a lack of understanding at times. It is inherently difficult to argue that fair value does not provide users of the financials with information that is beneficial, compared to that of a historical cost model. However, financial statements continue to be a mixed ►►

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attribute model, which can confuse users. It is not reasonable to believe that an accounting standard can overcome the challenges of adopting a fair value measurement standard given the changes that are inherent in adopting such a standard. The FASB should be commended on issuing a principle-based statement in SFAS 157 and not yielding to immense political pressure.

Lundelius: There are problems with the application and interpretation of fair value accounting. The main application problem is determining whether a financial instrument trades in a sufficiently active market in order to provide a valid quote or price. An inactive or inefficient market does not provide a price that incorporates all publicly available information. Therefore, such a price should not be used as a fair value input. The best approach to address this problem is not to try to meticulously define when a market is active, but rather to require disclosure of the reason why a market quote or price is not used as an input. Such a disclosure could state that the market was tested for efficiency during the relevant period and was found to be inefficient. There are accepted standards for market efficiency, such as tests for random walk, which would allow firms to assess whether a market is active. The interpretation problem is linked to cost of equity capital. Fair values fluctuate, impacting balance sheet values and comprehensive income.

Venkateshwaran: There are two sets of issues with fair value – one which is inherent in the use of fair value itself, and the other relating to the challenges in determining fair value. The issue inherent in the use of fair value is that it brings in a significant degree of volatility to reported earnings and financial position. However, that most often also reflects the changes to the values of the underlying assets and liabilities of the entity. The other issue is more important as it stems from various underlying issues such as lack of observable inputs or market data, particularly in an illiquid market. The challenges are also slightly different for a developing market such as India – in more developed economies there is more experience of market transactions, experience in using valuation in the face of uncertainty, ability to corroborate judgements, etc. In developing economies, due to lower levels of transactions, these become greater challenges. Further, in developing economies, there is a relative lack of access to valuation expertise both in terms of knowledge of and experience in the use of accepted valuation tools and techniques.

Epstein: During the recent financial crisis, fair value accounting was widely vilified as having caused or exacerbated the decline in lending activity in particular, and other economic woes in general. The argument was that when banks and other lenders were forced to write down loans and investments because of their respective declines in fair value, these unrealised losses impacted banks' regulatory capital, thereby shrinking the available supply of lendable funds. The impact was also deemed to be psychological, to the extent that by recognising losses that had not yet been realised, banks reported lower earnings and were discouraged from lending, even when funds were otherwise available to do so. IFRS' posture is not unlike that of US GAAP, UK GAAP or other national standards, insofar as the perceived value of mark-to-market accounting is concerned. Financial reporting should provide information about the reporting entities' respective fi-

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ancial positions and results of operations, and the more closely these accounting-based measures correspond to real economic measures, the better. IFRS and other reporting standards regimes have been moving, albeit slowly, towards greater congruence with economic measurement, and the expanded availability of computer-based and other information and methodologies is now making this more feasible to accomplish. There is thus little probability that there will be a reversal of the trend toward incorporating more fair value information into IFRS or GAAP financial statements.

Henning: The perceived problems with fair value accounting are that management has too much discretion in determining what constitutes fair value, and that fair value itself is too subjective. During the financial crisis of the past few years, we all heard the circular argument of how fair value accounting rules required the writedown of financial assets, leading to declines in the market value of a company's shares, leading to additional writedowns of financial assets, etc. The involvement of Congress led to further 'interpretations' of fair value rules by the FASB and the SEC in the US. While the inherent subjectivity of what constitutes fair value is of concern to many, IFRS seeks to alleviate these concerns by requiring comprehensive disclosures that enable readers to better understand how sensitive reported results are to critical assumptions used to arrive at fair value.

Gannon: Notwithstanding recent criticism, there is support for mark-to-market accounting. I believe the challenge for standard-setters is to agree on a common fair value definition and the appropriateness of fair value in certain circumstances – e.g., when markets for an asset or liability don't exist or are limited. Any fundamental change to fair value reporting does run the risk of reducing confidence among investors, which in turn may restrict the flow of capital. Despite its imperfections, fair value reporting does provide a level of transparency that the markets demand.

What are the implications of converting from a rules-based to a principles-based accounting system? Does this require a huge shift in thinking and application?

Gannon: With the movement to more of a principles-based set of standards, there must be a greater acceptance of judgment, ►►

which is something that is difficult for most people in the US. In practical terms, this means spending more time on transaction analysis, understanding the substance, and less time on researching accounting literature. Ultimately, there will be more pressure on the decision-making process – understanding the assumptions used, any alternatives, and those consulted and their level of expertise – and the disclosures in the financial statements. In many respects, we’re really talking about a fundamental shift in how we approach accounting and financial reporting.

Lundelius: The most significant challenge in moving to a principles-based system is maintaining comparability of application of the accounting principles within an industry peer group. A firm’s financial management will have to ask, “how are peer companies applying these principles and should we conform or adopt our own unique applications?” If the firm chooses the latter, its financial management and its auditors will have to assess the implications, which at a minimum would involve disclosure of how applications diverge. I foresee a significant role for accounting and financial consultants, who will assist firm financial management in assessing peer accounting practices and whether the firm should or should not conform to those practices.

Venkateshwaran: A shift from a rules-based to a principles-based standard represents a paradigm shift and will demand significant changes to the existing process. Typically, companies in a rules-based system will be comfortable with having detailed rules for most type of transactions that are prescriptive, akin to handholding. When transitioning to IFRS, companies will need to adjust to the reality that there will no longer be bright lines, and that they will need to make significant judgements supported by detailed disclosures. This is more of a mindset issue. For someone who has been used to applying rules, it would take time to get used to applying principles, especially in extremely judgemental situations. Transactions or transaction structures that were outside what is envisaged in the rules might have had more flexibility in the way they were accounted – however, under a principles based system, the same principles are likely to apply to most transactions irrespective of how they are structured. Indeed, this will require a process of unlearning and learning the newer standards.

Henning: A rules-based approach is easier to implement when business models are static. In a rules-based approach, specific facts and circumstances yield a specific result that most will be able to replicate. This narrow range of answers provides us with comfort that the results are “real.” In a principles-based system, it is more likely that similar facts and circumstances will yield greater variability in results. The challenge in a principles-based approach is to be able to decouple the changes in financial position and operating performance between those attributable to changes in the underlying economics and those attributable to the accounting method choices. We normally value the former and not the latter. This inherently requires more transparent disclosures and a greater understanding of the accompanying footnotes to the financial statements.

Peterka: The idea that US GAAP is a rules-based system and that IFRS is a pure principles-based system has become a cliché often used by critics of the convergence efforts. The FASB and the IASB have done a tremendous job in working toward convergence. While there are still major issues to be dealt with, this should not overshadow the progress that has been made. Regarding the ideal that a principles-based system would be a major change in the US, this view has little merit. The US has converged with the IASB on standards, such as stock compensation and others, and these converged standards have not caused major issues upon adoption in the US.

Epstein: This has been vastly overstated, in my opinion. IFRS are far less detailed than US GAAP, reflecting the fact that the process of developing these standards dates only from the early 1970s, whereas US GAAP is about 100 years old as a process, and UK GAAP even more venerable. Also, IASB and its predecessor, IASC, had fewer resources than, say, FASB, and simply couldn’t afford to develop as detailed a body of standards as US GAAP. Finally, the so-called ‘rules-based’ standards were largely responsive to demands from preparers and auditors in the US, who wanted less ambiguity to reduce litigation risk. US GAAP was once as principles-based as IFRS, but constituents demanded more guidance, and so it was provided to them. The rules-based vs. principles-based debate arose largely when Europeans, in particular, found it useful to observe that US financial reporting frauds such as Enron and WorldCom occurred in the context of rules-based standards, which were unfavourably contrasted to IAS/IFRS. Less often noted was the fact that Enron and WorldCom grossly departed from US GAAP, and correct application of GAAP brought these frauds to their conclusions. As IASB matures and as universal IFRS adoption nears reality, it is entirely predictable that IFRS will grow to contain more guidance and examples, and thus come to resemble US GAAP in terms of volume of materials produced.

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What are some of the macro level challenges faced by countries that are currently rolling out IFRS, such as managing changes to existing legal and regulatory requirements?

Epstein: Historically, many nations viewed accounting standards as an adjunct to the taxation system. Accounting was dictated by statute to facilitate tax collection. In some instances, particularly where there was a bias toward creditor protection, ►►

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certain practices were mandated, such as the provision of statutory reserves, which caused a departure from pure economic measurement. However, since the EU mandated IFRS reporting for group financial reporting by publicly held entities in the EU beginning in 2005, the importance of national GAAP in such code law nations as France has been diminished. Of course, there are still obstacles to universal adoption of IFRS and these will necessitate actions to reform legal or regulatory requirements at individual jurisdiction levels. In my view, the trend to IFRS adoption is inexorable and will require that these accommodations be made, which will add to the burden, but which cannot indefinitely postpone or derail the process.

Venkateshwaran: Countries that are transitioning to IFRS face various challenges that are linked to how closely the application of existing accounting framework compares to IFRS principles. Several countries that have or are in the process of moving to IFRS are those which have had accounting frameworks largely influenced by local regulations, tax requirements, etc. In these countries, replacing home GAAP with IFRS would involve significant changes to the local rules and regulations that pertain to financial reporting. For instance, one of the main challenges that India is experiencing at a macro level include resolution of inconsistencies between IFRS and existing laws and regulations – a precondition for smooth transition. In addition, availability of skilled accounting, teaching and valuation resources, clarity on tax impacts on adoption of IFRS, education among the auditors to ensure consistent application of the standards, etc are also challenges in India. Of all these challenges, those relating to timely and consistent amendment of all laws and regulations remains the biggest challenge, especially when there are multiple regulators or ministries involved.

Henning: There are certainly regulatory challenges related to the adoption of IFRS. My experience is that the regulatory process is slow to change upon adoption of IFRS. For example, in many jurisdictions in Europe, companies in regulated industries are largely still required to submit regulatory reports using home-country GAAP, even though conversion to IFRS took place six years ago. In contrast, changes to existing legal systems take place much more quickly. For example, in jurisdictions where financial reporting is also used for tax purposes, changes in levels of profitability using IFRS quickly led to changes in tax rates since governments still had the same social obligations to meet.

Peterka: For the countries that are currently adopting IFRS for listed entities, it is critical that the security regulators develop a thorough understanding of IFRS and understand how IFRS differs with the regulatory requirements of those jurisdictions. Many of the challenges that will be needed will not be apparent for registrants until the initial adoption. Regulators will need to work with registrants throughout this period and provide timely response and guidance during this period of transition so that registrants can meet their regulatory filing requirements.

Lundelius: In the US, there are some well-founded concerns that a principles-based system will allow firms to choose less-rigorous accounting applications and create a race to the bottom of accounting standards, that is, firms attempting to see how far

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they can go in pushing the boundaries of the principles to accelerate revenue recognition or defer expenses. Disclosure helps identify any firm engaged in such a race, but may not cure all problems. Regulators will need to reassess disclosure requirements and may need to increase compliance budgets to review financial filings more closely.

Gannon: The biggest IFRS implementation issue I see is one of culture. With the use of IFRS, preparers and auditors, as well as regulators and users, will need to adapt to an accounting and financial reporting framework that requires more judgment and less reliance on bright lines. I believe this will mean considering appropriate changes in the legal and regulatory environment to lessen the possibility that others may use hindsight to unnecessarily challenge and overturn reasonable professional judgments.

To what extent may the worldwide adoption of IFRS be held back by a lack of resources in terms of training, valuation expertise, and so on?

Henning: There continues to be concern globally about capability building at the macro level. There is an urgent need to continue training accounting faculty, retrain professional staff in accounting and other service firms, and develop introductory and advanced training programs. Changes to certification examinations will accelerate the development of those entering the profession with IFRS capabilities, but will not impact those already in the profession. In addition to the retraining of accountants, global adoption of IFRS requires assessment of impact on analysts, investors, companies, management, and ratings agencies. The costs of such efforts will be significant, and partially explains the SEC's indecision on the timing of convergence, especially in these economic times and on the heels of the costly Sarbanes-Oxley implementation by most public companies in the US.

Gannon: I would view education and expertise as more of an implementation issue, rather than an obstacle. As the need for IFRS increases, the education and expertise will be developed. In the US, general awareness of IFRS has increased significantly over the last year, and this will only continue. While there will be educational challenges, it's important to note that the learning ►►

curve is likely to be much less in the US relative to other countries as much of IFRS is either based on US GAAP or will be converged. So while differences between IFRS and US GAAP will still exist, there will be few areas where there is no convergence.

Venkateshwaran: Preparers and users of financial information will have to update their skill sets to meet the needs of IFRS. Convergence to IFRS is a paradigm shift. Countries like India that have very ambitious plans for the transition to IFRS need to be cognizant of the fact that this would require a very high level of preparation. Without adequate understanding of IFRS, the financial performance and position can be construed very differently. Lack of adequately skilled resources can impact timelines on IFRS adoption, and more importantly, also effect the quality of financial information prepared post adoption. A significant threat in India is the possibility of principles being misinterpreted and applied inconsistently which will derail the process of convergence. Similarly, without adequate valuation expertise, and without any baseline standards on valuations, and lack of consistency in the application of judgement and the familiarity with new valuations tools and techniques, there can be total lack of comparability in valuation reports used for financial reporting, defeating the very purpose of the transition to IFRS. Therefore, skilled accounting, training and valuation resources will be key determinants in ensure a smooth and successful convergence.

Peterka: While in certain countries the lack of knowledge and training in IFRS will be a deterrent, IFRS has been a notable development in most major economies which has led to the development of IFRS material for all major stakeholders to access. International firms should be complimented for their IFRS material which is widely available, independent associations have developed IFRS material, and there is a variety of training programs available for interested parties. The one item that is needed, which is not exclusive to the adoption of IFRS, is a better understanding amongst stakeholders regarding fair value. This is a skill that is not widely held amongst the stakeholder community.

Lundelius: Training among accounting practitioners and academics is a major issue. The accounting curriculum at most

US universities is still focused on US GAAP, and the examination for the US Certified Public Accountant designation will only begin to ask IFRS-related questions in 2011. Fortunately, convergence is limiting the differences between US GAAP and IFRS, and convergence may mitigate the general lack of specified IFRS knowledge in the US.

Epstein: Clearly there is a need to train both current students and mid-career professionals about IFRS. In the US, the organization of academic accountants, the American Accounting Association, has a task force drafting curricular recommendations to deal with this. Furthermore, both the Canadian (CICA) and the US (AICPA) organisations representing public accountants have added copious guidance to their respective web sites, and are developing continuing education programs, to address this. In my experience, this is eminently feasible – any accountant already well educated in a national GAAP can quickly be retooled as a competent practitioner of IFRS. Valuation expertise is not, per se, part of accountants' skill sets. In the US, there are valuation experts who are relied upon, for example, in assessing impairments of intangible and tangible long-lived assets, including goodwill, and this can continue under IFRS as well. For those accountants whose practices do include valuation work, valuations to be done in connection with IFRS reporting will not differ from those done for national GAAP. Training in IFRS is required but readily accomplished; training in valuation is optional and is not financial reporting standards-specific.

What kind of monitoring and reinforcement mechanisms will be used to ensure compliance with IFRS?

Peterka: Monitoring compliance with IFRS will be a critical part of achieving consistency in the application of the IFRS. Obviously, for listed entities, the securities regulators will be at the forefront of this task, but it would be a terrible mistake for regulators to be the only monitoring mechanism. Companies should ensure that they have acquired the appropriate knowledge to ensure they are applying IFRS consistency throughout their organisation. The investing community and other users should be active participants, as well as auditors who need to ensure that they are applying the standards in the spirit of principles-based systems.

Lundelius: For securities regulators, IFRS' principles-based system will require greater emphasis on disclosure to provide adequate specifics about how the principles are applied. However, to enforce disclosure requirements, regulators will likely need to increase compliance monitoring and perhaps the investigation and enforcement function as well.

Epstein: As already noted, reliable financial reporting is an issue under national GAAP as much as under IFRS. Investors and others rely on strict auditing and, where relevant, securities regulation. This will be no different if IFRS is adopted, although auditors and regulators will require education about IFRS, and to the extent there is a 'learning curve,' there may be more problems during the early years of the transition. My expectation is that there may be a spike in disputes, including litigation, during this transition phase, some of which will be purely opportunistic – for example, disputes among business partners who seek to ▶▶

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use the conversion to IFRS as a strategic lever, even if it played no real role.

Gannon: The enforcement of accounting and financial reporting standards still rests with national regulators, and the adoption of IFRS is unlikely to change that. So in the US, the SEC will continue to enforce the applicable accounting and financial reporting standard used, whether US GAAP or IFRS. I think what's important to note is that the movement toward IFRS has caused national regulators to re-think their approach to enforcement. The global regulatory environment has steadily evolved since 2005, when EU companies were required to adopt IFRS. Today the world's regulators are working much closer together than was the case just a few years ago. For example, the SEC has a work plan with the EU regulators to address differences in interpretation and application of IFRS. In addition, IOSCO has maintained a database of issues that its members have addressed in enforcing IFRS that all regulators can access.

Henning: In the US, the SEC has been writing comments for several years on IFRS-based financial statements filed by foreign private issuers. Similar to its current process, the SEC will be interested in establishing that companies are in fact complying with IFRS and that management has considered all of the variables that it should consider in developing its reporting of financial transactions. While the SEC does not audit the financial statements of the companies listed on US exchanges and relies extensively on management representations, its oversight role and ability to subpoena company records provides a powerful incentive for compliance. The development of similar enforcement mechanisms in other parts of the world will have a similarly powerful effect of enhancing compliance with IFRS.

Venkateshwaran: Consistent application of IFRS across all jurisdictions can only be achieved over a period of time. In the initial period there will always be a regional or country flavour to the IFRS financial statements. This will gradually reduce over a period of time with the increased comparison of financial information with competitors, peer groups and others at an international level. The other issue relates to inconsistent and incorrect application of IFRS itself. This issue can only be overcome by effective oversight at each country level. There are still several jurisdictions, including large economies like India, where there is no independent oversight or where the oversight function is not effective due to lack of resources, etc. The quality of IFRS reporting can only be improved through periodic reviews by the independent regulators in each jurisdiction, who are able to act as an important catalyst in promoting quality financial information that are consistent with IFRS. Further, if these independent regulators are able to reach a level where they are able to share information amongst themselves from a knowledge sharing perspective and learn from issues being faced in other jurisdictions, and promote methods to streamline them with necessary interpretations, focused training, etc., this can lead to more comparability and consistency in application.

How should companies prepare to manage the costs associated with the transition to IFRS compliance?

Venkateshwaran: Upfront planning is key to an efficient transi-

The movement toward IFRS has caused national regulators to re-think their approach to enforcement.

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tion to IFRS. Costs of transitioning to IFRS are impacted by various factors, and vary significantly between countries and within countries between different sectors and companies. Companies should ideally carry out the transition in phases to manage the processes over a period of time. Our experience shows that companies that have proactively taken steps to plan the transition get an 'early bird' advantage. Those in a position to identify varying approaches to convergence can benchmark against best practices, use internal resources effectively and thereby reduce external costs significantly without compromising quality. Companies should maximise benefit and minimise costs by training internal resources and using them for the transition project, rather than relying on an external adviser to provide a solution. IFRS reporting needs to be a sustainable process and therefore the company should have adequate resources that are trained and have hands on experience with the new requirements. It is also important to note that the more significant costs of convergence are related to IT systems.

Lundelius: US companies that are slated to transition to IFRS under the SEC Roadmap in 2014 will need to begin IFRS data capture in 2012 (or sooner) to fulfil US securities requirements for presentation of historical financial statements. That data capture essentially requires running an accounting system that parallels the existing, US GAAP system. The Roadmap contains certain milestones that must be met before the SEC approves transition to IFRS, but the milestones may not be evaluated in time to avoid the costs associated with running parallel systems.

Gannon: While there will be some incremental cost in the transition to IFRS, these costs can be managed and spread over several years. Right now, companies have time to understand the impact of IFRS and the related costs of adoption. My experience with companies that have adopted IFRS suggests that costs could have been managed better with greater upfront consultation and more time to implement. Other suggestions on how to reduce costs include starting sooner, having a better initial assessment of the impact that IFRS may have, having better project management and training, and more effective communication with subsidiaries.

Epstein: GAAP has evolved over time, and not one year goes by ►►

that doesn't require some training of accountants, auditors, and regulators, to deal with that year's new standards. Adoption of IFRS may require a greater effort, and somewhat greater cost, but this should be offset, over time, by IFRS' slower pace of change, making subsequent training less likely to be burdensome.

Henning: Effective planning is the key to managing the costs associated with the transition to IFRS. Effective planning means starting your transition three or more years before the required transition. It takes time to identify the differences between IFRS and home-country GAAP. Understanding these differences will enable management enough time to plan for systems changes that are required to capture the necessary data for the transition. Allowing enough time will enable management to consider and evaluate the accounting method choices it has when transitioning to IFRS. In addition, a plan that contemplates enough lead time will reduce a company's reliance on external consultants, minimizing the costs of transition.

Peterka: Cost could be one of the greatest barriers to the adoption of a global standard. There has been a lot of discussion of this topic in the US and the figures have been significant for large multinational registrants. Companies need to be proactive in understanding the developments with IFRS. They should understand the challenges and cost of other countries that have adopted IFRS. In addition, companies need to proceed with caution on what can be done in house and what will need consultants. One of the lessons learned from the Sarbanes-Oxley adoption in the US is that registrants need to own the adoption process to avoid unnecessary expense.

Do you believe adoption of a single accounting standard for all the world's companies would definitely help comparability? Is the international playing field really level?

Gannon: Having a single accounting standard will facilitate greater transparency in financial reporting, and as a result, greater comparability. Evidence from the recent adoption of IFRS in the EU corroborates that, and reinforces the importance of cross-border comparison. In addition, recent events have highlighted the importance of transparency in financial reporting. Today, users are increasingly focused on the transparency of financial statements. Many user groups have stressed the importance of transparency in financial statements and focus less on a single measure. What we've seen with the recent financial crisis is that sometimes there is a disconnect between the accounting outcome recognised in the financial statements, and the economic reality that underlies the transactions that are being accounted for. The focus of IFRS is on transparency and accounting that ultimately reflects reality.

Henning: The adoption of a single set of accounting standards globally will definitely help comparability. However, social, political, legal and other cross-cultural differences are likely to mean that differences in the application of IFRS will continue. Nonetheless, financial reports under IFRS will be more comparable than

they would be using different financial reporting systems. However, since financial reports are only one piece of the information puzzle, differences in required disclosures about a company's activities in different jurisdictions means that the international playing field will not be level. Since financial exchanges largely dictate what other information a public company must disclose, it seems that the exchanges requiring the highest quality of information will likely survive the consolidation of financial systems that we are sure to see during our careers.

Epstein: Comparability in financial reporting will enhance and encourage international flows of capital, which should serve to benefit producers and consumers in all nations. Comparability in financial reporting won't, per se, produce a level playing field, since that depends on legal climates, labour laws, and a whole slew of other, non-accounting considerations. However, it will clearly contribute to an eventual achievement of the level playing field, and that alone is an enormous prospective accomplishment.

Venkateshwaran: The financial crisis has clearly demonstrated that the world's capital markets are more closely linked than ever before. As the world's economies continue on their course of integration an investor's ability to compare and understand financial information produced in any part of the world using a single accounting framework will assist in expunging geographical boundaries. Having said that, it is also a fact that economies, cultures, etc., are different and it is not fair to assume that international playing fields are level. Different markets are at different levels of maturity – the needs of users and resources available in a developed market such as the UK or US are very different from those of the emerging economies such as India or China. Therefore, the application of these standards would always be influenced by the perspectives of the preparers, users, etc., in each of these markets. In the medium term it would help in bringing about comparability – but to get there, there has to be a starting point, and that's probably where we are today.

Peterka: The ideal of a single set of high quality standards is appealing. However, whether or not the different regulatory and political regimes truly allow for comparability in the adoption and interpretation of the standards will be a challenge. It is a good question to ask, if IFRS will really level the playing field for companies. Obviously the largest multinationals will benefit from greater comparability to their competitors. However, for middle market companies, the answer is not as clear.

Lundelius: Assuming the single accounting standard is principles-based, such as IFRS, whether the single standard helps comparability depends on how it is implemented. If financial statement preparers, particularly those within the same industry, manage to come to agreement on how the principles are implemented, then there will be true comparability. Capital providers, such as investment and commercial banks, and the analysts that assist the capital providers, may have enough clout to force some level of agreement among financial statement preparers, but there are no guarantees. ■