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THE CASE FOR THE "GOLD STANDARD":

WHY THE US MUST ADOPT INTERNATIONAL FINANCIAL REPORTING STANDARDS

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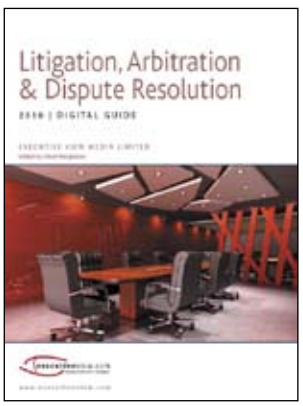

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Can you envision a world in which the U.S. is no longer the world's premier marketplace for capital? We can. In fact, unless U.S. companies and exchanges act, we believe that the world may be well on its way to a new financial order, one in which the U.S. no longer leads.

At issue is the adoption of International Financial Reporting Standards ("IFRS"), a set of reporting requirements promulgated by the International Accounting Standards Board ("IASB") that establishes "principles based" standards for financial reporting. By contrast, the U.S. system, rooted in GAAP (Generally Accepted Accounting Principles), is (in spite of the use of "principles" in the name) more rules-based and thus more restrictive.

IFRS is Gaining Momentum

The push for IFRS is gathering momentum around the globe. According to the American Institute of Certified Public Accountants ("AICPA"), more than 12,000 companies in approximately 113 nations have adopted IFRS. The numbers include listed companies in the European Union. AICPA reports that other countries, including Canada and India, are expected to transition to IFRS by 2011. Mexico plans to adopt IFRS for all listed companies starting in 2012. By some estimates, the number of countries requiring or accepting IFRS could grow to 150 in the next few years. Japan has introduced a roadmap for adoption that it will decide on in 2012 (with adoption planned for 2016). Still other countries have plans to converge their national standards with IFRS – with IFRS likely to dominate.

But Many in the U.S. Resist IFRS – This is a Serious Mistake

But the pattern of adoption is not uniform. While in the U.S. there are signs of movement toward IFRS adoption (the Obama administration and the SEC have both indicated support for uniform global standards), many U.S. companies and the major exchanges have indicated resistance toward IFRS. There has even been talk of an IFRS "resistance movement."

Rejection of IFRS would be a serious mistake. And convergence, suggested as a less burdensome alternative, would be an unsatisfactory half-measure. The reason is that full-scale adoption of IFRS represents more than just a shift toward an alternative accounting system. It represents a clear commitment to the highest standard of financial reporting – a commitment that confers competitive advantage.

Conversion to IFRS Will Challenge Businesses – Large and Small, Public and Private

Conversion to IFRS presents a series of challenges to business organisations of all sizes, challenges that go far beyond financial reporting requirements. For example:

- Companies must establish internal controls that comply with IFRS and not U.S. GAAP. During the transition, companies will need to develop controls that bridge the old and the new environments.
- Audit committees' expertise will need to be refreshed. This will require specific, detailed training for each committee's designated financial expert.
- Sarbanes-Oxley 404 compliance procedures and systems will need to be revised to allow for operation under IFRS.
- Extensive staff training will be required, as will significant revisions to information systems.
- Contractual arrangements (e.g., debt covenants and bonus plans) will require changes to conform to IFRS standards.
- Tax reporting will require reconciliation of IFRS to GAAP income.
- Transaction structures will have to be built with IFRS in mind.
- Investor and stakeholder communications programs will be required to educate all parties about the company's financial health and its go-forward strategies in IFRS terms.
- Financial reporting must be in place long before the conversion to IFRS is complete. Companies will need an opening balance sheet that meets IFRS standards two years prior to adoption, as well as at least one year of financial statements in both IFRS and U.S. GAAP.

These challenges fall not only on public companies, but on private companies that anticipate going public, or that need access to bank financing – banks are likely to demand IFRS financials as a condition for lending.

The question therefore comes to mind: Is IFRS conversion worth the effort? We believe the answer is a resounding "yes."

IFRS is an Information "Gold Standard" that Investors will Favour

Across the globe, IFRS is increasingly regarded as the "gold standard" – the highest quality of information available to investors, regulators and other stakeholders. Markets always favour the best information, and they will favour the companies and exchanges that provide it. Companies and exchanges that do not provide that information will suffer. Companies will find it harder to attract capital, and exchanges will find it harder to attract listings.

In addition, there is a global trend toward uniformity. Uniform standards mean predictability, and divergence from uniform standards represents risk. Investors will reward uniform standards and punish divergence.

Capital will Seek Out Exchanges and Companies that Adopt IFRS

At a time of global consolidation of financial exchanges, such shifts in investor preference can mean life or death for the exchanges, the companies that list on them, and the financial services industry that, in each nation, supports the capital formation process.

Actelion, a Swiss pharmaceutical firm, serves to illustrate what's at stake. Actelion initially wanted to list in the U.S., but did not because of the unfavourable accounting treatment under U.S. GAAP relative to IFRS that would have affected its reporting. Had Actelion applied U.S. GAAP, the result would have been the deferral of significant revenue, causing the company to report a large deficit in shareholders' equity. This prospect led management and its advisors to decide against a U.S. listing. NASDAQ lost the listing opportunity, and U.S. financial services firms lost the chance to support the listing.

Project this experience out on a macro scale – involving thousands of companies and all seven global exchanges – and the risks of rejecting IFRS become clear. In a truly globalised financial environment, where capital flows freely, there is no requirement that all seven exchanges survive, and no guarantee that they will. Capital will flow to the exchanges – and their listed companies – that seem to offer the highest level of predictability and the best quality of information.

Resistance to IFRS Will Damage Companies, Exchanges and the U.S. Economy

In other words, U.S. resistance to IFRS will damage U.S. companies, U.S. exchanges, the U.S. financial services industry and U.S. economic competitiveness in the long run. The effects will be far-reaching. For example, it is not just exchanges, companies and investment banks that will suffer. The U.S. trial bar – and its clients – will pay a penalty as well. If companies avoid U.S. listings, the bar's ability to prosecute cases will be greatly limited since U.S. law no longer predominates.

The case for IFRS is clear. It represents a higher standard and will emerge as the global standard. U.S. regulators and exchanges need to hasten its adoption. U.S. companies need to hasten to support it. And the U.S. financial services industry, as well as other professional constituencies that serve public companies, need to speak forcefully in favour of IFRS. The shift to IFRS will be challenging, but the alternative is to fall behind, and never recover. And that is not an alternative that any responsible participant in the U.S. financial system can reasonably contemplate.

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