IFRS*: The New Esperanto ?©

Subtitled:

The Next Great Financial Disaster©

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* International Financial Reporting Standards

In this paper the author reviews International Financial Reporting Standards ("IFRS") and the "Roadmap" for their forced adoption by domestic US companies. He examines a number of the most serious concerns of a number of the prominent, 'objectors' to this SEC-muscled initiative. Starting with its history as a "noble cause" to build a universal set of international standards by the British-based International Accounting Standards Committee [the "IASC"], he explains how he had learned that the IASC had been taken under contract by IOSCO, the International Organisation of Securities Commissions, supported by the New York Stock Exchange, to build a high-level set of standards equivalent to GAAP, without the political baggage of GAAP -- a far-sighted marketing program. With this financial support, the IASC was able to hire a professional staff, including the prominent British accounting standard enforcer, Sir David Tweedie.

The now re-named International Accounting Standards Board's [the "IASC/B] newly re-constituted IFRS, far from a functional, complete set of standards, was adopted with modification [otherwise known as a carve-out] by the European Union [the "EU"] in 2002 for use starting with the 2005 fiscal year. As the dominant economic bloc utilising the IFRS, the European Commission [the "EC"], the EU executive, made it clear that it would modify "its" IFRS standards when it saw fit. It would, in subsequent exercise of this prerogative, announce in October of 2008 that unless IFRS were modified, that it [the EU] would modify the EU version. The trustees of the IASC Foundation responded to this dictate by abrogating their formal procedures and made the appropriate change to "official" IFRS at the end of that same October. Thus was struck the ultimate blow to the credibility of the renamed International Accounting Standards Board under Sir David Tweedie. The terminal event eliminating any illusion of the independence required of an accounting standard maker and of Sir David's endeavour occurred in January 2009, was the EC's announcing its intention to take over the funding of the IASC Foundation, the parent body of the Board, thereby "taking it in-house."

The work further deals with the marketing image of IFRS as a "principles" based system, which is shown to be a euphemism for an incomplete, unrefined system of standards. Next it examines a number of flaws with IFRS as currently structured which make it wholly incompatible with the US legal system. First among these attributes is the connate contradiction between one of the "4 pillars" of IFRS creation and the law of the land, the Securities Acts of 1933 & 1934. The "legal marketing hyperbole" of Sir David's promotion is exposed in the context of the US legal paradigm. The current state of case law and how it has, in fact, re-enforced the principles of GAAP is discussed.

Finally a number of acute operational weaknesses of current IFRS as a "working" set of standards, contrary to their marketed image, are reviewed.

INTRODUCTION

On the summer of 2005 Chris Cox, a lawyer and then-Chairman of the SEC announced his support of an earlier staff promulgation of a "road map" for the acceptance and use of International Financial Reporting Standards ("IFRS"), as they were yet being created by the IASC/B[1], for financial reporting purposes in the U.S. Additionally, he approved the use of these incomplete standards by foreign situs corporations listed on U.S. securities exchanges. His new position was predicated upon the results of a Study[2] mandated by Public Company Accounting Reform and Investor Protection Act of 2002[3], §108(d), which bade the SEC to conduct a review of the extant basis of U.S. public accounting, and to assess a determination as to the feasibility of replacing it with an entirely new system approach. Such a study was not an unreasonable mandate by a Congress disturbed by a serious perversion of current accounting rules by the Enron Corporation and its accountants and lawyers, and reeling from the Worldcom debacle and the prior Dotcom Bubble[4] pop. This legislation was widely viewed as the acknowledgement of the hope and belief in ' a better way' in regards to the GAAP[5] accounting paradigm, a complex and rule-bound archetype which had allowed not only this egregious fraud by a [self-proclaimed] pillar of the financial establishment, but which, somehow, had been the underlying responsible for the DotCom Bubble[6] as well. Or, so it was claimed by the clamor of the financial press and numerous pundits.

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[1] The International Accounting Standards Board, a metamorphosis of the IASC, the International Accounting Standards Committee, a private accounting organisation whose mission was to create and promulgate an accounting system to support the highest financial reporting standards in the world, to at least match, if not exceed, U.S. Generally Accepted Accounting Principles ["GAAP"] in the sphere of accounting standard promulgation.

[2] §108(d)(1) Study

(A) In general The Commission shall conduct a study on the adoption by the United States financial reporting system of a principles-based accounting system.

(B) Study topics

The study required by subparagraph (A) shall include an examination of -

(i) the extent to which principles-based accounting and financial reporting exists in the United States;

(ii) the length of time required for change from a rules-based to a principles-based financial reporting system;

(iii) the feasibility of and proposed methods by which a principles-based system may be implemented; and

(iv) a thorough economic analysis of the implementation of a principles-based system.

[3] *aka* Sarbanes-Oxley, or, simply, by the acronym "SOX"

[4] A global speculative rise in share prices between c. 1997 and 2000 driven by the alleged opportunities for profit presented by the Internet . Access to the Internet, and especially to the Worldwide Web, became widespread in the mid-1990s, and many new companies were established that promised to utilize it in various ways. (These companies were generally based around websites with names ending in ".com", whence the term "dotcom".) Because the Internet was a new medium, neither the opportunities nor the limitations of doing business on it were properly understood and new business models that ignored the "old" economic rules were accepted uncritically. Most Internet start-up companies did not expect to make money in the short term, but rather emphasized the scope for major long-term growth. Financed by stock-exchange flotations or venture...

. . . . Oxford Dictionary of World History. Ed. Edmund Wright. Oxford University Press, 2006. eNotes.com. 2006. 18 Feb, 2009 <http://www.enotes.com/wh-encyclopedia/dotcom-bubble>

[5] Generally Accepted Accounting *PRINCIPLES* [emphasis added]

[6] Oxford Dictionary of World History. Ed. Edmund Wright. Oxford University Press, 2006. eNotes.com. 2006. 18 Feb, 2009 <http://www.enotes.com/wh-encyclopedia/dotcom-bubble>

courtesy Deloitte

Which looks like the real accounting system to you ?

Principles are best - the non-Debate

This "better way" somehow in the collective psyche of the nation became an idealized [and idolized] "Principles-based" system, one where all participants would, for the purest [and obscurest] of reasons, drop their secular interests [and greed] and act "professionally"[7] in the best interests of the greater good. And Congress wanted a feasibility study on the implementing one of these. The "Rules" had failed and "Principles" were now the Grail, with the SEC as the new headquarters of the Roundtable. GAAP, the current principles had become corrupted by becoming "rule-bound" and could do with replacing, subject to the feasibility of doing so. This section of the law [SOX] was not without irony, as a large responsibility for the rule-making of the existing system was that of the Congress and of the SEC, who possessed, since 1933 in the case of the SEC, the ultimate authority for their creation and promulgation. Both institutions, on occasion, took a sometimes contentious hand in "balkanising" the existing principles [GAAP] into rules and

[7] " . . .objectives-oriented standards explicitly charge management with the responsibility for capturing within the company's financial reports the economic substance of transactions and events-not abstractly, but as defined specifically and framed by the substantive objectives built into each pertinent standard. In turn, auditors would be held responsible for reporting whether management has fulfilled that responsibility. Accordingly, objectives-oriented standards place greater emphasis on the responsibility of both management and auditors to ensure that the financial reporting captures the objectives of the standard than do either rules-based standards or principles-only standards. *Ibid* [Emphasis theirs]

"bright lines," with the threat of issuing their own regulations [laws and rules] on specific accounting policies. Further, the SEC had, since SOX, closely monitored and actively participated in[8], this accounting creation process and had -- and still does -- not only approve, but encourage the further rule-making and bright-line drawing.[9] It is important to note that most, if not substantially all, of the rule making and line brightening was done at the request of the preparer group of users, most often in a pro-active, litigation-preventive mode. In fact, the amount of "guidance" from the FASB and SEC, that is, the drawing of new bright lines and rule-making, requested from preparers of financial statements, has increased significantly in recent years, post-SOX. This can be attributed to the real-world effect of §302[10] of said law which requires the CEO and CFO to sign off on the annual statements. Clearly, these two individuals, who are now truly making the 'ultimate warranty' as to the accuracy of the financial statements that they only pretended to make in pre-SOX times, are now looking for as much authority on all their accounting positions as they can forgather. Given the environment in which they and their company do business, this is to be expected. The FASB and the SEC cannot, given the political environment of the US in the post-SOX era, deny this further guidance. What this means, of course, is that an exclusively Principles-based system cannot long exist in the US business paradigm.

The aforementioned SEC study[11] quickly debunked the "Rules vs. Principles" contrast as semantic nonsense.[12] What it proposed was the idea, the concept, that there was a noble system of accounting, as yet undeveloped in this world, that would be the solution to the current corrupted principles of rules-infested GAAP, with its pesky and dazzling "bright lines." This new, ideal paradigm, awaiting conception and creation, was "Objectives-Oriented"[13] accounting. However, as the study noted, such a paradigm did not

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8 The chief accountant of the Securities and Exchange Commission attends EITF meetings regularly as an observer with the privilege of the floor. EITF is the Emerging Issues Task Force whose function timely identification, discussion, and resolution of new, contemporary] financial accounting issues that can be analyzed within existing GAAP, to minimize to the extent possible FASB pronouncements.

9 The FASB receives many requests for action on various financial accounting and reporting topics from all segments of its diverse constituency, ***including the SEC***. The auditing profession is sensitive to emerging trends in practice and, consequently, is a frequent source of requests.. . . emphasis added . . .from "Facts about FASB" , Financial Accounting Standards Board, March 2009 at http://www.fasb.org/facts/

10 Titled "Corporate Responsibility for Financial Reports", it calls on the CEO and CFO to certify that "the fin

11 Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System SEC 7/25/2003 http://www.sec.gov/news/studies/principlesbasedstand.htm

12 "One may say that 'principle' is a concept without any paradigmatic use." *from* Rules, Principles, and the Problem of the Limits of Legal Reasoning, Mátyás Bódig, University of Aberdeen, College of Arts & Social Sciences

". . . .we must first define principles-based. There are a wide variety of views on the meaning of that term. . . . . .
In our view, the optimal principles-based accounting standard involves a concise statement of substantive accounting principle where the accounting objective has been incorporated as an integral part of the standard and where few, if any, exceptions or internal inconsistencies are included in the standard. . . . . . To distinguish our vision of a principles-based approach to standard setting from those proposed by others, we refer to it as objectives-oriented standard setting. Standards established in such a fashion are objectives-oriented in a number of senses. "

13 " We believe that neither U.S. GAAP nor international accounting standards, as currently comprised, are representative of the optimum type of principles-based standards. Defining what we believe to be the optimal paradigm provides a necessary framework for this study.

exist, especially in then-current 'international'[14] standards[15].

The situation at the end of July 2003, as encapsulated by the SEC's postulates, was that the U.S. had the best and most comprehensive set of accounting standards the world had ever seen.[16] Nonetheless, these standards, which were developed in an evolutionary process since 1936,[17] albeit with an accelerated intensity since 1973[18] were simply not good enough. These standards, the SEC staff concluded, needed not modification nor a refocus, but replacement. The absolute best paradigm to replace them was an "Objectives-based" one, though one such system did not exist in the known world. And, in regard to IFRS, the SEC's evaluation of the existing condition of IFRS was that they were a sham-principles system[19], the touting of the IASC/B and the EU, who had just adopted them, notwithstanding. While a time-table exhibit for the creation of this new Objectives system was included in the feasibility report, no plans were made to "invent" this system, as the priority rule-making objective was the convergence project then being undertaken by the FASB and IASC/B[20] for GAAP and IFRS.

In our minds, *an optimal standard involves a concise statement of substantive accounting principle where the accounting* ***objective*** *has been included at an appropriate level of specificity* as an integral part of the standard and where few, if any, exceptions or conceptual inconsistencies are included in the standard. " *ibid. [emphasis added]*

14 Nowhere in the literature or media is "international Standards" defined. In 2003 there were no such standards that had the universality to be "international", Outside of GAAP, only a handful of Commonwealth countries had 'adequate' standards [the author defining "adequate" as sufficient to meet NYSE listing requirements with but few adjustments]. The reference always appeared to be to those underway in development [IFRS] by the IASC/B, but not yet ready. Certainly, the IASC/B had a contractual obligation to IOSCO to produce a universal standard, but not necessarily an adequate one, though that was desirable.

However, at this point in time, all EU countries must now, by law, use IFRS, and over 100 countries in total have adopted it -- or their cultural version of it.

15 "As they currently stand, the IFRSs do not embody the objectives-oriented approach to principles-based accounting standard setting. Indeed, a careful examination of the IFRSs shows that many of those standards are more properly described as rules-based ***Other IFRSs could fairly be characterized as principles-only because they are overly general.*** Accordingly, we reject the notion that IFRSs constitute a model for principles-based accounting standards." *Ibid. [Emphasis added]*

16 " In the staff's view, U.S. generally accepted accounting principles ("GAAP"), *despite being the historical product of a mixture of standard setting approaches* , constitutes the most complete and well developed set of accounting standards in the world. " *Ibid.* Emphasis added for understanding, i.e. that the staff failed to comprehend or acknowledge, was that this "mixture is standard setting approaches" is unlikely to change.

17 As a result of the Acts of '33 & '34, under the new SEC's authority, the Committee on Accounting Procedure of the American Institute of Certified Public Accountants was set up in 1936. In 1959 it was succeeded by the Accounting Principles Board, also a part of the AICPA .

18 In 1973, the Accounting Principles Board was superceded by the Financial Accounting Standards Board, an independent body.

19 12 Ibid.

20 Known as the "*The Norwalk Agreement*" of September 2002, a Memorandum of Understanding between the FASB and the IASC/B on a joint undertaking to eliminate the substantive differences between GAAP and IFRS, achieving compatibility of standards, of a "Convergence". As much of IFRS had not yet been created to truly make it a complete set of working standards, much of its creation was, per Sir David Tweedie, a "cut & paste" of existing GAAP standards. As Sir David has been quoted on many occasions, the undertaking to meet the readiness deadline of 2005 for the EU adoption of IFRS was a difficult task.

Of curious historical interest in this tableau is the IASC/B itself. It's background is that of a voluntary study group formed by the Institute of Chartered Accountants of England & Wales [ICAEW] in 1966-67[21] which published papers on the need for international accounting standards. This effort led to the establishment in 1973 of the original International Accounting Standards Committee [the "IASC"], whose mission was to create international accounting standards which would be capable of rapid, worldwide acceptance, the new Esperanto of Accounting. From then until 2000, it released a series of 'standards.' However, as things went with Babel, so did they with the IASC. Because it was a multinational volunteer organisation composed of representatives with portfolios (i.e. chauvinistic baggage) and a shortage of funding for professional staffers, it accomplished little, and nothing of worth, in it's quaesitum of developing "the" universal and comprehensive accounting system. However, its nature and prospects changed in 2000. IOSCO, the International Organisation of Securities Commissions, contracted to fund the IASC's efforts. This funding permitted the acquisition professional research director and staff, a reorganisation, and a name change necessary to frame the IFRS of today.

While perhaps of only incidental interest and import, but of curious note to some,[22] is/was the essentia of IOSCO. Today it is an organisation which of some 180 member "regulators" around the world, organised into a number of specific technical and "reform" committees, with headquarters in Madrid, far from its roots as an Inter-American convention-convening body of Montreal. In that pre-9/11 era, in approximately the spring of 2000 in the plush but dignified confines of the Institute of the Chartered Accountants of England & Wales off Swan Alley in London, there was a colloquium sponsored by the guest organisation the UK Society of CPA's on the topic of IOSCO and IFRS. The speaker was an Executive Vice-President (the "XVP") of the New York Stock Exchange, a 'lieutenant' of its famous CEO, Dick Grasso. In the post-presentation cocktail confabulation, the Author catechized the XVP on the precise nature of IOSCO. The pithy response was "it's a Secretary and a desk and a chair in Montreal that answers to me." This individual further explained that he oversaw the funding for IOSCO to support the IASC/B's development contract. In other words, the NYSE was funding, through IOSCO, the development of IFRS.[23]

To those who have never lived and worked in the overseas environment, especially in the "mother" Commonwealth countries, it is difficult to convey the attitude of resentment, even disrespect, that business professionals have toward the litigiousness of the U.S. business model. When it comes to the GAAP paradigm, this attitude approaches one of scorn, often a very outspoken one. GAAP is viewed as a creature of litigation, an overly-complex burden [and cost] whose development has been distorted, is continuously

21 *"Knowledge Guide to International accounting standards"* Institute of Chartered Accountants of England & Wales. *available at* www.icaew.com/index.cfm/route/156901/icaew_ga/en/Technical_and_Business_Topics/Guides_and_publications/Knowledge_guides/Knowledge_Guide_to_IAS_IFRS

22 To the Author, at the very least

23 The besmirching of his reputation by NY Attorney General Elliot Spitzer notwithstanding, Dick Grasso was one of the more prescient heads of the New York Stock Exchange, and was, of reputation, far-sighted enough, and financially sound enough, to support this type of business development activity.

distorted and confounded the by its rules and bright lines which are seen as but a response to a parasitic legal system. Taking into account the intellectual nature of developing accounting paradigms, coupled with the typical chauvinistic perspective [i.e. "we are just as smart, if not a whole lot smarter than they, the US, are"], it is not difficult to see the near-insurmountable challenge of 'selling GAAP' to business and finance professionals in rest of the world, despite its indisputable validity.

So, to subsume the perspective of a profit-seeking US-based organisation which requires extremely high accounting standards of its clients but wants to expand its business among peoples who would never, on several levels, accept GAAP, then it would certainly be in that organisation's best interest to come up with a parallel equivalent to GAAP, but one without the taint of its having been developed by anyone who is 'contaminated' by GAAP. And, if one were concerned about the growing competition from a growing number of offshore finance centres, then such an 'independent' and convenient set of quality standards would be a convenient marketing tool. And, from the perspective of a major foreign corporation with strong local responsibilities and sensibilities, but yet desirous of the funding advantages of listing on a big board, an accounting paradigm of 'independent' [from GAAP] character, though just as disciplined, would be a very advantageous thing. In this light, the concept of IFRS as a Trojan Horse for the NYSE makes more than sense. However, that was then and this is now.

It's the EU's IFRS

The EU, aware of the growth and benefits to the UK economy of London's "City" as a financial centre, recognised the importance of a high-level accounting standards for the growth of other regional EU financial centres and the facilitation of raising of capital for EU companies. IFRS was a convenient non-US paradigm and was adopted,[24] in modified form with a major carve-out,[25] for financial reporting for publicly traded EU-situs companies in 1992[26] for use beginning in FY 1995. Moreover, it was a simple, barebones structure, easily "harmonised",[27] that is, adapted to local cultural gaap's of the members of the EU. Since it was represented as a Principles-based system, and since there is no accounting regulator akin to the SEC in Europe, there was no overseeing authority which would review the national, indeed, the individual company

24 Regulation (EC) No 1606/2002

25 David Simonds, *"Speaking in Tongues"*. The Economist. May 17th 2007

26 The "Regulation on International Accounting Standards" was adopted in June 2002, subject to the availability of the various EU language translations, which were officially endorsed the following year for implementation by publicly held EU companies for fiscal years starting 1995.

27 "Harmonisation" of all national and local laws to the laws passed by the European Parliament is fundamental to the creation of an effective union. This is particularly so for commercial laws. Simply put, when the Parliament, passes a law, or when EU court system ruled on one, each member country must review its existing laws in the field and either adopt the EU law or ruling,or, more commonly, bring their own law into congruity with the EU standard.

In this process there is no check upon the member countries actions unless the particular law is challenged in the court system. Given the various language barriers and local judicial procedures, this can be a difficult and expensive process, even where the violation is egregious.

adaption and usage, of IFRS. And, if there were a regulatory reviewer, such efforts would be of questionable effect, as "guidance" is an anathema to a principles-based system, IFRS in particular.[28] Indeed, there is no way of knowing whether the European penchant for hidden reserves, which meant at least three sets of books, has been altered by the adoption of IFRS.

However, subsequent events, in 2008 and 2009 have led first, to the compromising the integrity and independence of the IASB, then to eliminating its independence as a rule-making body thereby disqualifying it from any accounting credibility under US law, due to 'capture' of IFRS by the EC[29].

EU Says 'Jump'

The first event was the capitulation of the IASB to EU pressure in regard to the events of the current global financial crisis. The financial institutions of the EU [in particular, the French banks] became convinced that their IFRS financial statements were being more severely denigrated by the their IFRS reporting standards than the statements of their competitors reporting under GAAP. Specifically, in regard to the qualification of certain "assets" [esp. bad loans and questionable derivatives contracts], GAAP, they claimed, allowed more of these assets to be classified as "hold-to-maturity" type than did IFRS, which, they claimed, required more 'marked to market' [i.e. to zero in so many cases where a market did not exist] treatment for these assets than GAAP did. Initially, the IASC/B showed little sympathy for the institutions facing this accounting dilemma, as the risks of these assets were well known for a long time.

The EC became aroused over the issue, buying into the argument that this 'stronger standard' resulted in the erosion of the capital base of EU banks to a greater extent than the US and other GAAP reporting banks, making the EU crowd less competitive than their counterparts. The EC then demanded that the IASC/B rectify the situation by loosening up on its 'mark-to-market' rule and, unless this was done, promised to pass legislation to pre-empt IFRS and rectify the matter, to insure a 'level playing field.'[30]

The EC insisted that this rectification be immediate[31], though IASC/B constitutional procedures mandated a minimum three-month long process, and any EC regulation would have required six months for effect. Nonetheless, the trustees of the IASC/B's oversight Foundation dutifully waived it's procedures in a special trustees' meeting[32] and passed the revisions demanded by an aroused EC. These 'emergency' revisions gave

28 see Tweedy, *"THE 2007 KEN SPENCER MEMORIAL LECTURE".* The Financial Reporting Council of Australia. and many other speeches and interviews

29 The European Commission, the working body,commissariat of the European Union, subject to the laws of the Parliament, but relatively independent in implementing them.

30 *" We will ensure that European financial institutions are not disadvantaged vis-à-vis their international competitors in terms of accounting rules and of their interpretation. "* from International financial situation – European G8 members' summit – Joint statement©ˆ Paris, 4 October 2008

31 "This issue must be resolved by the end of the month." Ibid

IFRS users far more latitude in asset reclassification by allowing their changes to predate the cutoff dates required of GAAP users, thereby requiring less "mark to market" writedowns, resulting in less capital losses, and, in the event, surpassing the 'level playing field' demands of the European banks.

Hostile Takeover or White Night

The next event, the ultimate capture of IFRS and the IASC/B and the undoing of it's independence [and disqualification as a US accounting standard setting body] occurred in January of 2009. In a press release,[33] the EC announced it's intention to take over the funding of the IASC/B to protect it's interest in IFRS. The proposed legislation[34] contains numerous representations about the need and benefits of high quality accounting standards for the member countries and of the need for independence of the IASC/B. In fact, this latter reason is cited as the motivation for the financial support. Then it adds that the funding is necessary to protect its own interests, as

"*At the same time, a level playing field has to be ensured for companies around the world when subjecting them to financial reporting obligations,*"

and, therefore, it [the EU]

"*has a direct interest in ensuring that the process through which these standards are developed and approved delivers standards that are consistent with . . . . the Community's legal framework and with the European business reality.*"[35]

Despite its apparently contradictory ultimatum of October 2008, the EC is clearly implementing a control prerogative by "*. . . also pursuing a number of governance reforms aimed at enhancing the IASCF's*[36] *accountability, independence, as well as enhancements of the IASC/B's due process.*"

And, finally, the legislation sets in place a monitoring function[37] [by the EC] to "*monitor and analyse*" and "*evaluate*" the planning and activities of the IASC/B, and to "*ensure they operate efficiently and in the public interest of the EU.*" That the IFRS become an international standard is clearly a desire of the EC, but

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32 See IASB press release of 9 October 2008 " Trustees support IASB's accelerated steps on the credit crisis"

33 26th January 2009, IP/09/125 *Financial markets: Commission adopts measures to strengthen supervisory committees and standard-setting bodies for accounting and auditing*

34 Proposal for a DECISION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of […] **establishing a Community programme to support specific activities in the field of financial services, financial reporting and auditing** {SEC(2009) 54} COM(2009) 14 final 2009/0001 (COD)

35 § 1.2 Ibid

36 The International Accounting Standards Committee Foundation [the "IASF"], the body responsible for the funding and control of the IASC/B, also referred to as "the Foundation".

37 § 6.1 Ibid.

it is also clear that the IFRS is a serving European standard above all else.

SEC to the Rescue ?

In subsequential event in late January of 2009, which some might call a mitigant to the above EC action, and which was apparently cleverly[38] planned as such to keep the "roadmap" on track, was the announcement[39] that the SEC would take a permanent seat as one of five members on a new IASCF Monitoring Board[40], the oversight body of the IASCF (the "Foundation"). The IASCF trustees are the executive body of the IASC/B. This is being touted in some views as the necessary oversight necessary to protect US capital [primarily] and business in the accounting/reporting field.

This arrangement, clearly, is barely more than window-dressing, a public-relations patch on a now EC-owned institution. In fact, the very existence of the Monitoring Board is of an "at will" nature, subject to dissolution, without cause, by any of the participants,[41] the Trustees or the Monitors. In light of this and the strictly limited involvement of the Panel in the appointment of the trustees -- the selection of new Trustees being the exclusive prerogative of the *existing* Trustees[42] -- the SEC's vote, as only one of five, on a remote platform above the fray, is of de minimus impact. The result is that the rule-making for the world's largest economy and the world's largest capital market are beyond the effective influence of the SEC. It is, in fact, a highly political position as entangled in foreign relations as can be imagined, and neither politics nor foreign relations are skills with which the SEC is been known to have been endowed. This is in severe contrast to the hands-on, day-to-day involvement of the SEC in GAAP-making. The effort to qualify this arrangement as a position of "oversight," when, in fact it is simply that of a 'tame' observer' is not credible. And, in that accounting standard setter context, given the currently programmed adoption of IFRS and the IASC/B, the nomination of the IASC/B as a standard setting body would be in violation of Sarbanes-Oxley, which puts the choate authority of standard setting in the SEC's purview.

More Principles

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38 International Accounting Standards Board Chairman Sir David Tweedie CFO Magazine : September 2008 Issue : "*The overseer of a coming accounting revolution opines on U.S. companies' inevitable, eventual shift to IFRS.*" ; Tim Reason, CFO MagazinE, September 1, 2008 Full Quote: "The monitoring group is [also] quite cleverly constructed. I think it is pretty well scattered to make sure there is no region going to dominate."

39 IASC Foundation Press Release 29 January 2009 " *Trustees enhance public accountability through new Monitoring Board, complete first part of Constitution Review* "

40 The remaining members are • The European Commission; The Emerging Markets Committee and the Technical Committee of IOSCO, and The Financial Services Agency of Japan, a total of 5 members.

41 But a 60-day notice signed by either a monitor or a trustee suffices to dissolve the Monitoring Committee.

42 IASC Foundation® .Press Release 29 January 2009 London. "*Trustees enhance public accountability through new Monitoring Board, complete first part of Constitution Review*"

To summarize, IFRS, the SEC-programmed newly-designated as "principles-based" accounting paradigm is still on track to displace GAAP for financial reporting purposes. It can be seen that the IFRS paradigm is deeply flawed from its beginnings as a utopian project, to its evolution as a marketing/business development tool by the NYSE and to its ultimate evolution as the "house" standard-setter, owned and operated by the EU. Moreover, it is soon to be a "get-in-free" pass to the world's largest, cheapest capital source. Notwithstanding these, it has somehow, in the view of the Cox SEC, transitioned from the 2003 rules-based, broad & vague principles system into a "pure" and comprehensive principles-based system which is to pre-empt GAAP and 'save' the US financial reporting system. Certainly there has been some significant work done on the system, most notably a major "patch job"[43] by the staff of the IASB/C to get the system into a functional form in time for its legally mandated adoption by the EU countries in 2005. Possibly of higher quality was the concerted effort was undertaken by both sides to harmonise both standards, to bring them into functional "convergence." If the "roadmapped" changeover date of 2011 is maintained, the IFRS will still be a barebones standard, lacking all the necessary "bells & whistles"[44] of a complete system characteristic of highly industrialized countries with sophisticated capital markets.

The joint convergence effort was continuously supported[45] by then-Chairman Cox until shortly after his meeting with EU Commissioner McCreevy,[46] the result of which was the effective recognition of IFRS as the equivalent of GAAP by the Cox' granting foreign situs firms listed on the NYSE the right to use IFRS, with appropriate reconciliation to GAAP. Subsequently,[47] and despite the performance results of the IFRS companies in their SEC filings, the requirement of reconciliation was eliminated by the Cox committee, allowing foreign firms the full use of their 'national flavour' IFRS for raising capital in the US. This is a significant dereliction of the SEC's accounting standard remit, because it retains no authority whatsoever over the composition and individual company implementation of IFRS. Indeed, it appears that the SEC has granted privileged status to these foreign filers, with its announced "hands off" approach to their financials:

> *Recognizing that IFRS are principles-based standards, regulators should give full consideration to the positions of their international counterparts regarding application and enforcement of IFRS, and seriously endeavor to avoid conflicting conclusions.*

as quoted in the joint Cox-McCreevy announcement.[48]

43 Tweedie Ibid.

44 Tweedie Ibid.

45 The Norwalk Agreement was officially updated with a specific convergence "roadmap" issued in February of 2006.

46 SEC Press Release 2006-17. *"Accounting Standards: SEC Chairman Cox and EU Commissioner McCreevy Affirm Commitment to Elimination of the Need for Reconciliation Requirements".* February 2006

47 "Accounting Standards: SEC Chairman Cox and EU Commissioner McCreevy Affirm Commitment to Elimination of the Need for Reconciliation Requirements" SEC Press Release 2006-17, 8th Feb 06, available at http://www.sec.gov/news/press/2006-17.htm

48 Ibid.

This is appears to give carte blanche to foreign companies in regard to their filings: there are no uniform "applications" for IFRS; they are all local interpretations; and, there are no effective enforcing regulators other than the SEC, who it appears has agreed to waive its powers here. The case may be made that this action by the SEC is in violation of the law, as the SEC is required to be pro-active, not reactive in its investor protection role, an important part of which responsibility is accounting standard setting. An idealistic negligence on the part of the SEC this may be, it remains negligence.

Results Of The IFRS Filings With The SEC

Comparatively little has been reported about the results of the reviews of IFRS filings of foreign firms made with the SEC. But a single public report[49] was made by the staff of the SEC in July 2007 of 2006 filings, nothing subsequently. However, that one was enlightening. The staff report contained no statistics, but of the over 100 FY2006 filings, the ***"vast majority"*** were prepared with a ***"jurisdictional"*** version of IFRS. In other words, a localised version of the "universal standard." Again with no hard numbers provided, the staff reported that *"most also asserted that these (same financials) were in compliance with IFRS as published by the IASB."* Their auditors, apparently, were not quite convinced of the veridicality of this claim on their clients' financial statements, as staff noted that the ***"vast majority"*** [of outside auditors] again, ***"would only opine that the localised versions were in effect."***

In regard to the presentation of the statements of this relatively small number of companies, the staff duly noted that ***" companies based in the same jurisdiction and companies in the same industries sometimes used different income statement formats."*** [emphasis added]. So much for comparability, one of the prime functions an accounting paradigm provides its users. No further analysis of this observation was done by the SEC staff, and no follow-up noted. A number of other issues were noted, along with the staff's note that further clarification was requested in these cases, though no information on follow-up results were listed. Of these 'issues,' the most significant was the staff's discovery of a "range of accounting treatments" for common control mergers, recapitalisations, reorganisations, acquisitions of minority interests, and similar transactions.

No further details or follow-up reports were pursued, nor were any to be expected, as the SEC had telegraphed these results in a speech in June, in the SEC's "*Open Meeting: IFRS / U.S. GAAP Reconciliation,"* in which then-Commissioner Campos noted, that among the "issues that must be resolved" was the one where of meeting the SEC's expectation that these financial reports be published in the IASC/B's version of IFRS, not the multitude of localized jurisdictional versions that they were receiving. He then expressed the hope that the SEC's long-term objective of replacing GAAP with a "single, global" standard not a "multitude of them" was also that of his audience. But, he felt, it was "an issue" to be worked out between the SEC and the

[49] Staff Observations in the Review of IFRS Financial Statements July 2, 2007 available at http://www.sec.gov/divisions/corpfin/ifrs_staffobservations.htm

companies and their auditors, noting then, that:

> **"IFRS as promulgated by the IASB seems to allow for some jurisdictional variants *and still be consistent with IFRS as published by the IASB.* "** *[emphasis added]*

In other words, the "single, global" standard was no such thing. Instead of "local gaap", the reports were presented in "jurisdictional variants" of IFRS. Semantics.

In the September following, at the "World Standard-Setters Conference" in London, the Deputy Chief Accountant[50] of the SEC complained to the attendees of the myriad of specific forms of IFRS reporting that the SEC was encountering and implored them to tighten up their standard-setting to at least create a semblance of the "single, global" standard that the SEC was so committed to pursuing, and for which it was taking so much political risk.

The subsequent elimination of the 'reconciliation to GAAP' requirement of these foreign IFRS users, in light of the shocking results of but single year's experience with IFRS, raises serious questions about the behaviour, both legal and moral, of the Cox SEC. Here was the factual situation of an overwhelming contradiction of the SEC-claimed benefits of a "Principles based IFRS." Yet, the SEC acted as if its own research into the behaviour did not exist. No followup study was done, or, if done, it was kept secret by the SEC. This lack of followup alone is tantamount to gross negligence by the SEC. One of the most basic, fundamental requirements of accounting and auditing principles requires/legally mandates a followup study in a situation like this. If a public accounting firm acted in this manner, current case law would have it criminally prosecuted, punished by the SEC and pursued in the civil courts ad infinitum. Yet the SEC blessed its own negligence by going on to waive the reconciliation [to GAAP] requirement. Clearly, the Cox SEC was not going to admit that it's "dream" set of standards, the one it had put its entire credibility into, was a shambles.

The Case of Australia

One of the small handful of industrialised countries with a strong accounting paradigm, inherited from its Commonwealth roots and nurtured by a strong business education culture, Australia adopted IFRS and the IAS. According to Sir David, the new standards were named Australian International Financial Reporting Standards, ["AIFRS"] even though they were, he claimed, true IFRS, and that he had then persuaded them to eliminate this reference to Australian culturalisation.[51] Accordingly, per Sir David, the AIFRS would be known simply as IFRS.

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50 SEC spch092407jae, Julie A. Erhardt, Deputy Chief Accountant, Office of the Chief Accountant, "Implementation and Enforcement of IFRSs" at the World Standard-Setters Conference London, England, September 24, 2007 available at http://www.sec.gov/news/speech/2007/spch092407jae.htm

51 *"Simplifying global accounting: IASB chair discusses the future of IFRS, U.S. GAAP and the global . . ."* Pickard, Geoffrey. Journal of Accountancy. July 1 2007. available at http://www.allbusiness.com/professional-scientific/accounting-tax/4501531-1.html

A review of the various websites, however, reveal no such effectuation. On the contrary, the official government accounting website claims that rather than adopting IASC/B standards, the Australians "harmonized"[52] them. In fact, it is the case that

Australian Accounting Standards incorporate International Financial Reporting Standards (IFRS's), including Interpretations, issued by the International Accounting Standards Board (IASB), *with the addition of paragraphs on the applicability of each Standard in the Australian environment.*

Australian Accounting Standards also include requirements that are specific to Australian entities. These requirements may be located in Australian Accounting Standards that incorporate IFRS's or in other Australian Accounting Standards. [53]

The Australian Society of CPA's publishes a workup on these differences between AAS and IFRS.[54] Again contrary to Sir David's pronouncement, there is no mention of "AIFRS" in these documents. It fair to say that as Australian Accounting Standards might have been known as "Australian GAAP," that they might now be re-named and known as "Australian IFRS," but that is just the name. They are a version of IFRS unique to that nation, the same high quality standards that existed before "harmonisation," created, revised and interpreted in the same fashion as before.

On Harmonisation

While anecdotal, it is instructive to relay the experience of the author in a European Union Banking Law course at university in London: the large class had approximately 15 German members, all fully qualified, experienced practicing attorneys now pursuing a doctorate in law. The particular class discussion centered on a conflict, real or supposed, between UK and EU banking law and had become heated for a time. The topic of the 'debate' picked up at the coffee break among a mixed group of classmates; one of the German attorneys remarked somewhat disgustedly, "these Brits! They're the only ones that take this "harmonisation stuff" so seriously. In Germany, we refer these EU directives to the proper committee which studies them for an appropriate amount of time and then stamps them 'Found consistent with existing German Law.' End of story." There was no dissent to this comment from the other German lawyers.

Everybody's Doing It

One of the persistent marketing themes expounded by Sir David is that IFRS is an international accounting tsunami, that over 112 nations have already adopted it, soon to be 150. In fact, the SEC experience with

[52] '*Australian standards are harmonised with those of the International Accounting Standards Committee (IASC), in response to the development of the global economy.*" found at http://www.library.qut.edu.au/learn/type/accountingstandards.jsp

[53] *Excerpt from* **Preface**, page 4 of AASB Interpretation Interpretation 18. " *Transfers of Assets from Customers*" March 2009

[54] http://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECA-A269EB76/cpa/hs.xsl/872_19415_ENA_HTML.htm

the filings of just the largest companies from "the rest of the world" shows that there is little use of "IASC/B IFRS" and a lot of use of national-IFRS. The experience of one of the half-dozen sophisticated and transparent accounting paradigms - Australia - supports this. Regarding the other 100+ of these countries, almost all of whom are not sophisticated nor even, in many cases, opaque, much less transparent in their accounting paradigms, to expect that the "harmonisation to IFRS" was much more than a goodwill name change might be an insupportably optimistic conclusion. In fact, the first adoption of IFRS of any significance, started with a "multi-national" version with a 'carve-out': the EU Parliament simply eliminated the paragraphs it didn't like and adopted the rest.

There is another view to be canvassed in evaluating Sir David's success level in selling IFRS to so many countries: certainly the opportunity to get in on the "gravy train" of cheap US capital markets without the discipline of rigid financial reporting would be a slight motivation for most sensible companies. Any third-world country with the acronym IFRS in its accounting paradigm would make the demand that it be treated 'equally' in this regard, and demand that allowances be made for their less-developed status. This scenario is a familiar one in several international institutions.

Why IFRS Won't Work[55]

In this his tome, Albrecht begins with the observation that IFRS "cannot" be successfully adopted in the US because of a lack of infrastructure. He makes the following points on international infrastructure weaknesses:[56]

- The judgement allowed management under IFRS is excessive and cannot be justified in terms of effective regulatory regimes as they now exist in the international context;

- Investors' comparability is illusory because of the jurisdictional variants, which he sees as a growing problem, but which this author sees as but an intransigent one;

- The lack of internationally-integrated accounting firms with a single global accounting perspective, exacerbates the comparability problem;

- The lack of jurisdictional regulators, such as the SEC and the FSA, with the resources and mandate to enforce real compliance.

55 Albrecht, David, PhD, CPA, Accounting Department, Bowling Green University, 26th Sept 2008.

56 In addition to a cost benefit analysis which

Regulators: Only One SEC

In respect to the Albrecht's point, it is clear that the dominance of New York as the world's center of capital is, to a very large degree, a result of the regulatory regime instituted by the Securities Acts of 1933 & '34 (though some credit in this role has recently been earned by the State of New York). There is no such legal regime in Europe [or in the third world], though the relatively new Financial Services Authority ["FSA"] of the UK does have some considerable powers in regard to financial markets regulation. However, in regard to Corporate Governance -- a long-standing but long-ignored set of concepts until codified by Sarbanes-Oxley -- the "Combined Code," the Corporate Governance "law" in the UK, is completely voluntary company code of conduct set by a quango,[57] though supposedly enforced by the London Stock Exchange ["LSE"]. In fact, it is poorly, if at all, "enforced."[58] This fact did not deter the SEC, in its support of its IFRS roadmap, from declaring the Combined Code the functional equivalent of SOX. And, as the UK "regulator," the Financial Reporting Council [the "FRC"] is a toothless one, with no powers other than that of "naming and shaming," a power which, unlike that of the traditional British schoolmarm's, is used sparingly. And, by a significant margin, this FRC is the most formidable regulator of the EU.

In its rushed, forced quest to find other strong national regulators for support of IFRS, the SEC designated the FRC a functional equivalent of itself and executed a memorandum of understanding[59] with it for the sharing of information/consultation on companies "UK-listed/SEC-registered" who utilize IFRS. The document, while excellent international public relations, is quite useless to the SEC, as the FRC deals only with publicly filed documents and has no power to obtain any information, financial or otherwise, from said companies other than by the persuasion of a polite letter requesting same. In fact, the document may, in particular instances, be hugely empowering to the FRC, as it puts the full force of the powers of the United States behind its SEC-covered inquiries.

Outside of the UK, and possibly a handful of other Commonwealth countries, with its very pro-active accounting profession, the situation is even more dire. There are no empowered regulators. The EU situation can be summed up by the EC's actions in regard to the mark-to-market controversy described above. Its prime focus, and only strong focus, is on creating a system which has a competitive advantage over that of the U.S. Affirming this point is the recent case of Société Générale and the 6.4Bil euro loss generated by its 'rogue trader' in January 2008. (The same trader had generated a discreet profit of 1.5bil

[57] A quasi-autonomous non-governmental organization. Any of a number of bureaux set up in Britain with government funds. They are responsible for regulating or monitoring various aspects of industrial, political, financial and social welfare. They are not directly elected, but issue reports periodically on their operational findings. There is much public debate about these bodies, resulting from their expense and lack of accountability. . . . © World Encyclopedia 2005, originally published by Oxford University Press 2005, *available at* www.encyclopedia.com/doc/1O142-quango.html

[58] In the accounting firm Grant Thorton's 2006 review of Corporate Governance compliance in the FTSE 350 [the 350 largest publicly-held firms in the UK], only 31% ***claimed*** compliance with the Combined Code, with only 5% providing the 'required' explanation of same. By 2008, the number had risen to 44%, with 11% providing the details.
. . . *emphasis added* Such compliance claims are not affirmed by the auditors of the companies.

[59] April 25, 2007 Protocol between the Financial Services Authority, UK, the Financial Reporting Council, UK, and the SEC, USA, to facilitate implementation of the CESR -SEC Work Plan.

euros in 2007, with all contracts closed out.) Despite this huge loss occurring in the first quarter of 2008 the bank booked it against 2007 yearly results.

In doing this Société Générale invoked what is known as the "true and fair" provision of international accounting standards, which provides that "in the extremely rare circumstances in which management concludes that compliance" with the rules " would be so misleading that it would conflict with the objective of financial statements," a company can depart from the rules. [i.e. the EU version of IAS & IFRS][60] As Norris points out, two IAS standards, #10 & #39, appear to apply, but the bank availed itself of a specific EU 'carve-out' to those standards, which standards, the bank posited, would have been inconsistent with a fair presentation of its 2008 results. [The 'affair' started in 2007, where it made legitimate gains; therefore, goes the palliation, the loss is best booked against that year.] No regulator or authority, at the national or EU level, has made any objection to this matter. Indeed, it has been reviewed and approved by the French national offices of two of the Big-4 accounting firms.

And, as Turner[61] noted in his testimony before the Senate Banking Subcommittee,
" today no single regulator or law enforcement agency has responsibility for enforcement of standards issued by the IASB."
True now as when spoken in 2007.

Domestic Infrastructure Conflicts

- **Illegal as Built**

The problem is not so much the 'lack' of infrastructure in the U.S. but one that is hostile to IFRS, indeed, to a principles-based version of any regulatory regime, accounting or otherwise. In respect to IFRS as designed by the Tweedie regime, the design template for the standards is inherently contradictory to the US accounting environment, which was set by the original '33 &'34 Acts. IFRS as re-cast and developed since Sir David took over the IASC/B in 2001 has followed a four-part rule set:[62]

i. Is the standard written in plain English?

ii. Can the standard be explained simply in a matter of a minute or so? If not, why does it take longer?

iii. Does it make intuitive sense?

iv. Does management believe it helps them to understand and describe the underlying economic activity?

60 From FLOYD NORRIS. "*Loophole Lets Bank Rewrite the* Calendar" March 7, 2008 available at www.norris.blogs.nytimes.com

61 Lynn Turner, Former Securities and Exchange Commission chief accountant, in testimony before the Senate Banking Subcommittee in October 2007.

62 Sir David Tweedie. Testimony to the House Subcommittee on Banking & Finance. Washington, DC. 24 October 2007.

While all are, to a large degree, common sense guides to making comprehensive practical standards, the fourth sets a specific test and point of view for the IFRS' overall standard hatching. Clearly, it casts the overall purpose of standards as a management communication tool of management's choice. This is in direct contradiction of the spirit and letter of the '33 & '34 Acts, which directs that financial statements and accounting be oriented to provide users useful information in forms that they can utilise. There is nothing in these acts or the amendments to them which mention the 'usefulness of financial reporting to management' as any sort of a criterion. The entire raison de existence of the SEC is investor protection and its authority over accounting standards flows from that, accounting standards being one tool of investor protection.

The latest revision to the relevant parts of the Acts, in Sarbanes Oxley, specifically affirms that an accounting standard setter in the US must operate its standard-setting function so as to insure that its accounting standards are **"in the public interest and for the protection of investors."**[63] (It is also worthy of note that the concept of "in the public interest" does not exist in U.K. law, and IFRS, as re-developed in the UK by a UK-trained accountant, is not influenced by this concept.) This basic evolutionary principle of IFRS is clearly in violates the fundamental premise of almost 80 years of US securities law.

- **Incompatible with US Legal System ?**

There is no other jurisdiction in the world which has the degree of litigiousness of the US. This is in marked contrast to the U.K. and other countries of the EU where securities litigation is structurally inhibited and very expensive, particularly where the plaintiff does not prevail. Rules and bright lines, especially those blessed by the SEC, are an essential part of the accounting paradigm because they constitute an essential part of the legal paradigm. Public accounting in the U.S. is not an independent profession; it is a profession where litigation is the daily norm and where the practice of same must take a pro-active, calculated legal defense to accounting and auditing judgements and decisions. It is not inaccurate to say that legal representations are the fundamental cornerstone of audits by US public accountants. The US accounting paradigm is a derivative of the legal paradigm. As the legal paradigm is full of bright lines and rules, so it forms public accounting into its own image.

This "problem" of law being the dominant U.S. paradigm is dealt with facile antiphon by Sir David in his public promotions of IFRS as a GAAP replacement. IFRS will, in fact, be a tonic to this unfair litigation scene, he claims. For US-based audiences, he offers IFRS, as practiced in the UK within the company-biased, consumer-stockholder hostile UK court system as an ideal:

> Will it cause more litigation, particularly in the U.S., because of people second-guessing others? Tweedie says it doesn't happen that way in the U.K., and ***he doesn't believe it would happen in the U.S., either***.[64]

[63] Ibid, §108 (b)(1)(A)(v)

[64] *"With convergence closer, IASB chair reflects on progress ."* David Tweedie interview by Heffes, Ellen M. Article Financial Executive. Apr 1, 2006

> The IFRS procedure of a little conscientious research, a little professional [not legal] consultation and professional judgement is all that is needed, he says.
>
> In the U.K., he says, that process will get you off any negligence--because you've tried. "Okay, say you made the wrong call, in hindsight. But anyone can do that. That's professional judgment."[65]
>
> ***Sound like a Utopia?*** Tweedie reiterates: ***that's the way it is in the U.K.*** *. . . emphasis added*

This 'utopian' response, as divorced from the US reality as it is, is mere whiffling when compared to his expressed views to audiences in other parts of the world. For example, to a financial executives conference in Europe:

> Many preparers and auditors argue that making a professional judgment call is difficult for American accountants because the U.S. legal system is so litigious, and judgments that turn out to be wrong could also wind up being grounds for a negligence lawsuit. Yet other observers disagree. ***Cases that charge negligence when a sound judgment based on evidence is presented won't stand up in court, ultimately causing those types of suits to die out***, said David Tweedie, chairman of the International Accounting Standards Board, who gave the keynote address at the conference.
>
> ***Preparers will be called on "to make a call, and sometimes that will be wrong, <u>but it won't be negligence</u>," mused Tweedie.***[66] . . . *emphasis added*

Clearly, these are, at best, unsupportable claims. Evocative of a puff on the old carbolic smoke ball.[67]

- **Simon Says**

Niemeier[68], among others, makes the point that the US legal environment has been greatly determined by U.S. v. Simon[69]. This precedent, upheld in all challenges and parallel cases, has resulted in the great volume of requests/demands for "clarification" of accounting rules, both from the FASB and the SEC. In other

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65 Ibid

66 *"IFRS Requires a Soft Touch"* reported by Marie Leone, CFO.com. **November 17, 2008**

67 CARLILL v. CARBOLIC SMOKE BALL CO. Court of Appeal, 1893 1 Q.B. 256.

68 Niemeier, Charles D." Board Member, Public Company Accounting Oversight Board in Keynote Address on Recent International Initiatives presented at "2008 Sarbanes-Oxley, SEC and PCOAB Conference", New York State Society of CPAs, September 10, 2008.

69 425 F.2d 796, C.A.N.Y. 1969. Otherwise known as the "Continental Vending" case.

words, more rules and bright lines -- not because of an accounting need, but because of the legal one. The fact that Simon was a criminal case notwithstanding, the trial judge's instruction to the jury has become an ultimate standard: if the financial statements are not "fair" [i.e. honest, in that they represent the true condition of the company], then the application of all the highest professional accounting standards in the world and all their experts' opinions are of no avail.

The "clarification" effect of Simon notwithstanding, others[70] make the case that Simon has emphatically put principles back into the forefront of GAAP. Their argument that the lessons of Continental Vending are the ultimate set of principles which cannot be contravened without legal retribution is a strong one. If all the rules and bright lines and accounting practices and logic, as well as expert testimony, support the financial statement, but, yet, the financial statement fails to "present fairly" the true condition of the company and to disclose all the material facts, the principle and the law have been violated. Retribution follows.

The case of Enron and its special purpose entities [SPE's] is the ultimate example, where the management, with the complicity of its auditors, followed a set of generally accepted rules but violated the principles and paid the price for their transgressions. This is the way the system is supposed to work. Some herald IFRS as a preventative to the Enron case. A specious argument; rather than a preventative, they would likely have allowed far more deception given the "players" involved. Posits Cunningham:

> "*What the Enron-type debacles showed was not so much the dangers of rules but manifest violation of a different set of principles addressed by business and professional ethics.*[71]

If Simon is instructive of anything, it is that in GAAP, principles not only override GAAP, but they are the law.

- **And, It's even More Illegal**

As Cunningham[72] clearly demonstrates in his comprehensive work, IFRS [the 'official' IASC/B version] is not legal in the US for a number of reasons. His analysis finds IFRS or the IASC/B itself, as the standard-setter, in contravention of Section 108 of Sarbanes-Oxley. Indeed, one of the fundamental rules governing the structure and function of the IASC/B has been set to contravene a provision of US law specifically amended in Sarbanes. Regarding the timeliness of the issuance of new accounting standards for new and emerging business conditions, Congress' perception was that the history of new-standard issuance was far too slow. Therefore it specifically dictated[73] that a standard-setter utilise a majority vote principle/rule. The

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70 Ronald M. Mano, Matthew Mouritsen, and Ryan Pace. "Principles-Based Accounting It's Not New, It's Not the Rule, It's the Law." CPA Journal Online, N.Y.State Society of CPA's. February 2006

71 Lawrence A. Cunningham. "A Prescription to Retire the Rhetoric of "Principles-Based Systems" in Corporate Law, Securities Regulation and Accounting". Boston College Law School Faculty Papers. Year 2007 Paper 195

72 Lawrence A. Cunningham. THE SEC'S GLOBAL ACCOUNTING VISION: A REALISTIC APPRAISAL OF A QUIXOTIC QUEST. North Carolina Law Review Vol. 87 (2008)

IASC/B, requires a super-majority consensus. It is set up, as Sir David explains, so that no part of the world, the industrialised or not, can force issuance of new standards. What this has done to IFRS is to put standard-setting at the mercy of international politics, hardly a wise position to hold the US economy and capital markets to. Indeed, it presents the scenario that while the SEC may force the adoption of IFRS, it may not, by law, recognise the IASC/B as a standard-setter. In any event, Congress' instruction that this type of action be accelerated is countermanded by the operational structure of the IASC/B.

A second violation of US law is the funding arrangement required of a standard-setting body.[74] The SOX amendments call for the funding of the US standard-setting body to be raised from assessments on publicly listed companies. The IASC/B funding arrangement has historically been through donations from the accounting profession and industry, but will now be from the EU, not only a foreign government body, but one with the stated intent and history of using accounting for commercial competition with the US. This situation hardly approximates the requirement of independence which a standard-setting body must have.

Cunningham also considers that the mandate of "prompt consideration" of changes needed to cope with "emerging accounting issues and changing business practices" is not a part of the IASC/B structure. In fact, its structure is designed to support Sir David's premise that any consideration or consultation or clarification is an anathema to IFRS, that such is rule-making, which is not a proper part of IFRS. It is clear that while there is nothing in the IASC/B rule book to prevent such 'modifications', the organisation is set up to resist such changes at its discretion and has and will do so.

The last point[75] superimposed by SOX-amended law is the requirement that the US' accounting-setting body have "at a minimum" the capability of improving financial reporting and the protection of investors by assisting the SEC. The interpretation of this requirement is left to the discretion of the SEC itself, a most unsound provision in light of the SEC's performance in its blind pursuit of IFRS adoption, even when ignoring its performance in the current financial crisis. The framework of the IASC/B is such that meeting this responsibility is difficult to see. Certainly such support is at the discretion of the IFRS and not the demand of the SEC. And, as Cunningham notes, it is not within the mission of the international body.

Accounting & Business: the Granny Factor

Or, the "Aunt Tilly Factor," depending on Sir David's audience. 'Good standards,' he hammers at all, 'are simple enough that you can explain them in a minute or less' and they can be understood by your Granny and/or Aunt Tilly. Not being rocket science, good accounting should not rely on experts and their expertise for high quality practice, he further discourses repeatedly.

[73] § 108(b) (1) (A) (iv) of Sarbanes-Oxley

[74] §109 *Ibid.*

[75] § 108(b) (1) (B) *Ibid*

This sounds, of course, like good common sense. Unfortunately, it's not the case in the real world, because business, especially the controversial finance end, is complex, and getting more so. "*We have complexity in financial reporting today because of the complexity of transactions and instruments that are used by business today.*"[76] Tweedie concedes this, as he follows the 'Granny' bit in his standard pep talks with more accurate stuff, when he mentions the consequent statements that these simple standards will produce:

> *Greater user sophistication is necessary. Investors will need to rely on the variety of information that corporations are giving to explain financial results and be able to recognise the different sources of performance and volatility.*[77]

So there it is, Granny and Aunt Tilly may be able to understand the new accounting standard, but unless they're serious students of the corporate economy, not the report that it produces.

Further on the perspicuousness and comprehensibility of accounting standards, there appears to be something in the nature of human beings that makes accounting fundamentally arcane, in much the same manner that the study of mathematics does. While accounting is, as Sir David frequently notes, far from "rocket science," it is and always has been a field that many find more confusing than not. This was true even in the UK in Sir David's apprenticeship, before accounting standards existed there. In the comparison of the perceived complexity of the two subjects, while math is, indeed, a part of 'rocket science,' there is not a more abstruse, anagogic terminology than the fundamental two of accounting: debits and credits. In a contemporary business world where the explanations of business transactions themselves, especially those on Wall Street, are difficult for participants, the explanations that Granny and Aunt Tilly could effectively cope with would be insufficient to meet any standard of prudence. Accounting standards must at least fulfill that fundamental need.

"Tell me where it says I can't do what I want."/ Excessive Judgement

Another claim made repeatedly by Sir David and the 'IFRS-is-principles' crowd is that taking away the rules and bright lines will do away with the tendency of a self-interested management to manipulate earnings to their advantage by hiding behind these rules and across the bright lines. Confronted by a principle, these self-same people will, according to Sir David and his acolytes, put their self-interest behind them and approach the situation in an honest and accurate way that reflects the 'true economics' of the matter. Both managerial accountants and their auditors would get to mutually exercise "judgement," to the satisfaction of all.

This judgement will center on "a process used to reach a well-reasoned conclusion that is based on the

[76] Edward Trot, a Financial Accounting Standards Board member from 1999 to 2007, in an interview " On Accounting's Future" July 31, 2007.

[77] Ibid.

relevant facts and circumstances available at the time of the conclusion."[78] This process involves a three-step approach:

First, a Transaction Analysis where the economic substance is identified and analysed.

Second, Accounting Research, focusing not only on the relevant technical literature, but also any alternative views.

And, finally the Decision-making, a review process including all key individuals, include non-accounting professionals.

The first flaw in this judgmental process is the first step. Accountants are not economists. They, as a group, have little or, more often, no economic training. The case can be made that this lack of expertise has not perceptibly inhibited them in the performance of their public accounting responsibilities, nor should it.[79] If this is a serious requirement of IFRS, then the present generation of public accountants are not competent to use IFRS, and there will be years more of university study needed to produce competent practitioners.

A more important weakness of the argument is the use of the process itself as some sort of vaccine or phylactery, or even a form of mandatory arbitration that will somehow deter management from pursuing its own selfish interests. To the contrary, it will make such pursuits far easier to achieve. Instead of employing the rules experts to "engineer around" the rules, as Sir David says, they will simply employ economists and logicians to make their case with mountains of research. From a practical standpoint, it will make the contrary position of an independent auditor much more difficult, both in terms of the issue itself and the enormity of the process with a determined client.

Further weaknesses are the regulatory and legal assumptions behind this 'judegement' process. Will the SEC, a body of lawyers who don't understand accounting, but are trained in argumentative processes, really going to stand back 'hands off' when presented with these deliberations ? Will they really allow 'mistakes' in logic and research as they may see them to go unjudged as 'professional' practice ? In the usual course of human nature, this assumption of Tweedie's is highly unlikely. In the case of the courts themselves, it is worthless. Courts see themselves as arbiters of such matters, and, as is more often the case, such 'documented' processes can be held up as evidence to unsophisticated but well-meaning juries of negligence and/or lack of competence/due diligence.

More realistic previews of the results of this process are expressed by others:

> ". . . heavy reliance on executive professional judgment would make it easy for corporate executives to manage their reported earnings, something that they've shown an aptitude at for decades. U.S.

[78] Barry Salzberg of Deloitte [a Big-4 accounting firm, the US arm of Deloitte Touche Tohmatsu, strong proponents of the US adoption of IFRS] **"Tomorrow's judgments" a speech at** University of Illinois at Urbana-Champaign College of Business, Department of Accountancy. February 12, 2009

[79] The author, who trained as an economist and practiced in a Big-4 accounting firm rarely saw any economic expertise in the peer group, none whatsoever in the management group, yet all functioned highly competently in their field.

executives will manipulate financial statements to a much greater extent under IFRS. Corporate executives would have a field day."[80]

" . . . U.S. executives will manipulate financial statements to a much greater extent under IFRS. "[81]

". . . '*professional judgment*' is an euphemism for "client choice" and "client choice" is motivated by self-interest and not by some desire to provide quality and transparent financial reports.[82]

It is the author's view, based on three decades of observation, some of it participatory, that principles without implementing rules are the easiest barriers for a clever management to maneuver around and within. Given the nature of today's corporate executive modus operandi, building compelling arguments is just a matter of judicious spending on outside experts. Given the insider makeup[83] of all public boards and the near absolute control of the executives over them, coupled with the competitive nature of quarterly earnings, complemented by the unbreakable golden-handshake and -parachute agreements, the cumulative effect of management "professional judgement" on the economy and capital markets after a half-dozen or so years will be catastrophic.

Further on IFRS, the 'Accounting Paradigm'

One of the more compelling arguments against the adoption of IFRS as currently structured that further debunks its "principles" hype, is simply that it is a brand new system that has not been 'in the field' sufficiently long. As Niemeier has repeatedly emphasized, the view that IFRS is an accounting panacea which will fix all the problems in the current U.S. financial reporting system caused by the shortcomings of GAAP is but a "myth."[84]

"IFRS is not more principles-based, it's just younger," he says. "The biggest difference between GAAP and IFRS is that GAAP is older and has been tried."

The complexities of the contemporary international business scene, especially the finance end of it, make a bare structure like IFRS inadequate to the ordinary demands of an accounting paradigm. Guidance, i.e. "rules" and "bright lines" are required. That such are missing in IFRS only indicates its infancy.

80 Professor David Albrecht –IFRS Critic. Bowling Green University The Summa November 10, 2008 available at http://profalbrecht.wordpress.com/

81 Professor Itzhak Sharav, Professor of Accounting, Columbia Business School, New York

82 David Mosso, CPA. former Chairman, Federal Accounting Standards Advisory Board, former Vice-Chairman of the Financial Accounting Standards Board.

83 "Four Handshakes of Separation: The Small World of the American Corporate Elite, 1982-2001" Davis et al. Strategic Organization.2003; 1: 301-326

84 Neimeier ibid,

Not yet ready for Prime Time

The clear and obvious conclusion from the review of the issues outlined above is that IFRS is not yet a suitable set of standards for any large sophisticated, capitalistic economy, much less that of the U.S. Not the least of the structural impediments to its fitness is the author and ‘authority’ of IFRS, the IASC/B itself, now that it is effectively an ‘in-house’ organ of the EU. The marketing ‘hype’ of IFRS as a ‘principles-based system’ vs. the ‘rules-based’ system of GAAP is clearly outlined. Its design & operations format is as a management [i.e. ‘issuers’] tool vs. that of an investors’ protection communication mechanism, as mandated in the Securities Acts of 1933 & ‘34. The risks to the economy and capital markets from its central pivot of “judgement” are only too inevitable. It is, after all, a new, partially complete system that is insufficient for both the demands of the U.S. legal system and the daedal structure of modern international business.

“Competitive Re-Headquartering”

As for the ‘next great financial debacle,’ this stage has already been set by the utopian Cox SEC in its approval of an IFRS reporting regime in the US that not only is not reconciled to GAAP, but is not even reconciled to a “standard” version of IFRS, the one promoted by Sir David Tweedie. Lacking the discipline of an internationally-centralised public auditing firm, and wanting an empowered regulator like the SEC, there is no basis of reliability in the financial statements filed with the SEC, other than one can induce oneself to believe might exist in this condition. The example of the rise of the great contract services provider, Satyam Computer Services Ltd., is instructive. In the current SEC’s IFRS environment, with its loose controls, there can be no doubt that several such foreign companies will be able to find their way to the US capital market. And, if IFRS is approved for US corporate reporting, the ingenuity of the US’ self-serving corporate managements will ensure a number of “domestic Satyam's” operating in the capital markets as well.

Manifestly, the financial reporting ‘freedom’ of these foreign issuers will not escape the notice of domestic corporate managements. Moving headquarters of a large, sophisticated conglomerate, as Haliburton did, to a foreign situs, is becoming easier as communications technologies advance and “developing nations” develop. Selecting an offshore headquarters location with a ‘tame’ or unsuited regulator, and then ‘capturing’ a local partner of a big name audit firm to certify reports in the local version of IFRS [or even Sir David’s version] is not difficult. Once the first such “re-headquartering” takes place, simply the competitive edge of the first company over its competitors will serve to drive others to follow suit. Even if the prime motive of the company managements is not to “competitively enrich” themselves, just the ability to produce better reported results will lead to a competition which will degrade the financial reporting system -- and beget another financial crisis when the substance of such financial reporting comes out. While the magnitude of such an event may not match the ‘derivatives debacle’ of the current crises, the ease and simplicity of accomplishing this type of “competitive re-headquartering” insures its betiding.

What is clear from this now-planned ”roadmap” is that the world’s largest capital markets, at least that of the US, will be fair game to any and all comers, and that the price of admission, far from disclosure, transparency or any meaningful oversight or regulation, is simply the adoption of IFRS, in form or substance, in a national regime with a diminutive regulator. The actual capital of this market, largely the savings of US citizens, is subject to another round of untold plundering -- unless one believes the canard that the obscenely-overpaid executives of the NYSE companies and the Wall Street investment banks are some sort of guardians, rather than what they have consistently proven themselves to be.

In his many speeches, Chris Cox expressed the hope that IFRS would become the ‘Esperanto of accounting.’ He should made at least a cursory examination of Esperanto before so speaking. He would have found that though it might be a sound linguistic paradigm, that in terms of its utility to humanity, it was an utter failure. It was the an ill-conceived scheme of dreamers, the platform of the New World Order crowd, an errand of fools.

About the Author

Terry Saigh is a CPA with experience as a national bank auditor and as an investment banker with national bank joint venture partners and clients. He received the first PhD in Corporate Governance Law in the U.K., likely in the U.S. as well, just as Sarbanes-Oxley was being passed, after completing an LLM in international Banking Law in London, and upon retirement as an international investment banker.