International | ANNUAL CONFERENCE TOPIC

IFRS for All

In this exclusive interview for *Strategic Finance*, Sir David Tweedie, chairman of the International Accounting Standards Board (IASB), offers a view on the issues affecting the adoption of International Financial Reporting Standards (IFRS) in the United States.

BY RAMONA DZINKOWSKI

RD: In your view, what are the benefits of allowing American companies to file under IFRS?

SD: The recent SEC [Securities & Exchange Commission] concept release proposes that U.S. registrants should be able to choose either U.S. GAAP [Generally Accepted Accounting Principles] or IFRS. I suspect that U.S. companies would choose which set of standards to use on the basis of who their market competitors are. If they're entirely domestic, they are likely to think that they should be compared with their competitors using U.S. GAAP. If they're an international company, however, they are likely to consider that their competitors are international companies currently filing using IFRS. Under those circumstances they may be much more willing to choose to file using IFRS in America. At the same time, if American companies have many overseas subsidiaries using IFRS, they are also more likely to choose to file under IFRS.

RD: What are some of the critical issues regarding the U.S. eventually adopting or allowing domestic firms to file using IFRS?

SD: The important question for the U.S. to decide is how it would get to the end. For example, is it better to set a date and say, "Get ready, fellas—that's going to happen," or do you allow the market to decide and wait for more and more companies to start using IFRS? In four years' time anyway, the answers under U.S. GAAP and IFRS are likely to be so similar that the U.S. might well say, "If the answers are going to be broadly the same, why have two sets of standards? Let's go now." I think that's how the debate will go. It's just a matter of tactics. In the meantime, the rest of the world is already moving to IFRS, and there's only one major economy sitting out.

RD: If the Financial Accounting Standards Board (FASB) is in support of saying pick a date, what's the dilemma?

SD: The FASB is the standard setter for the U.S. capital markets, and if the U.S. capital markets say we're not ready yet, the FASB has to continue. But I believe the FASB's own view is that the U.S. should pick a date for adopting IFRS. Their argument would be that if IFRS are a worldwide standard, why don't we just take that standard and have done with it? When the IASB adopted certain standards from the FASB, however, we faced quite a bit of pressure. You can imagine the FASB having the same pressure. We were accused of importing U.S. standards into Europe without appropriate consideration. People complained that this was a sign of all U.S. GAAP pouring into Europe. It wasn't. It was the result of the IASB concluding that a particular U.S. standard was better than ours, and that's why we just took it. Otherwise,

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we could have spent four or five years playing with it, which we didn't think would be the quickest or best way of improving accounting. That's been our technique, and that's really what the FASB is proposing when it comes to something that isn't on our major joint project line.

RD: Given the strength of the lobby groups in Washington, do you see this boiling into a serious political issue?

SD: Possibly. I remember when we discussed stock options. Though the U.S. had a standard that did not mandate expensing stock options, we knew we had to do something quickly, so we took the U.S. standard but required the options to be expensed. I remember a meeting in Washington when industrialists said they had spent $70 million to lobby against expensing stock options and that they'd willingly spend another $70 million to kill it with us.

That's the advantage of an international board—it's not subject to a domestic situation because ultimately we say, "That's what we think the right answer is." We voted 14 to nil to treat stock options as expense. The U.S. followed suit in the following year. Internationally, if you have a board whose mission is to provide the right answer, you have less political pressure. Even though an international board is the target for many more people with a political agenda, we're not writing standards for just one country or one continent—we're writing them for everybody.

RD: We've talked about stock-based compensation. What's the next biggest politically charged issue with respect to IFRS?

SD: The IFRS that people really dislike is IAS 39, "Financial Instruments: Recognition and Measurement." It's based on the U.S. standards (SFAS 133, primarily). [The reference is to Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities."] It is very unpopular, and it's very complicated. I've often said, "If you think you understand it, you can't have read it properly." In the first quarter of 2008, the IASB will be publishing a document that suggests some ways to simplify IAS 39 and the U.S. financial instruments standards—the FASB will also publish it. It will have some fairly tough things to say. The complexity in IAS 39 is caused by people wanting rules to protect certain outcomes. If we wipe all those out, the standard is going to be much more brutal, but it will be much easier to operate. It will show a lot of things that some people might not like. I think the FASB will get the same pushback. People might not like IAS 39, but they have systems set up to deal with it and are not going to be happy changing them to deal with a new standard.

RD: Do you see any particularly contentious areas that could derail the whole IFRS conversion/adoption in the U.S.?

SD: Well, what you can expect from the IASB would be the same as what you can expect from the FASB. That's the purpose of our memorandum of understanding. We're working together on a joint program over the next four years. The program is packed with really big issues, such as financial statement presentation (for example, how you lay out the income statement); leases (about US$600 billion annually worldwide, most of it off balance sheet); pensions (there was a change in pensions accounting, but there are still some major aspects of the pensions standard that we think should be changed). These are big numbers we're talking about. Other topics include revenue recognition, securitization, conduits, consolidations. These are all issues that we're looking at together with the FASB.

RD: My concern is that there's not a significant level of awareness among corporate executives in America with regard to what this is all going to mean for them. Do you have any comments or recommendations for them?

SD: I think the interest level in the United States has vastly increased in the past year. But, generally speaking, you're right. We noticed a year or two ago that some of the major industrial organizations had started to monitor the IASB because they saw that what we're doing is starting to influence the FASB. Overseas registrants can now come in using IFRS, and we've had the SEC concept release…and suddenly the antennae are up. IFRS are no longer just something that Europeans, Australians, and the Chinese do. They could come to the U.S.

RD: Any recommendations for American financial executives who are trying to get their heads around this now?

SD: What the IASB will be doing in the future is also what the FASB will be doing. So my advice is to watch what the FASB does. By all means, send your comments to us, but send them to the FASB, too. The idea that we're trying to get across is that in four years' time IFRS and U.S. GAAP will be very, very similar. So you won't have that much of a fright. You will have different words and shorter standards, too, because U.S. GAAP is a huge collection of standards, interpretations, and other pronouncements. The main thing is to get involved with your industrial group and make sure they're aware of what you're thinking.

RD: In terms of providing support and education, perhaps you could identify some of the strengths and weaknesses that you see in the American market at the moment. How fast can companies roll out the education process in America?

SD: Well, that can be rolled out quite quickly. The spelling will be different of course! They are interpreting or seeing how to apply international standards. It's not the European version, by the way—it's international standards. We know that quite a lot of companies have set up task forces to see what the impact of the switch will be. I was amazed by how well Europe made the transition to IFRS. I suspect that the first year was a bit rough, but last year was a lot better, and it will just keep improving. It can be done.

RD: How happy are the audit firms in America about this?

SD: I think there's trepidation. On the other hand, the international firms are ready because they've had to do it. Half the world is now using IFRS, so the firms have had to audit IFRS accounts. They have the manuals, they have the expertise, often based in London. The IFRS desks are there. There's a lot of expertise in the firms. What they have to do is train those [who] will be training the auditors in the U.S. The answers won't be a lot different.

The big difference will be that we're not willing to provide all the guidance that is given in the U.S. We firmly believe that we should set out broad guidelines and that industry and auditors should then interpret those. If there's something that's outrageous, we'll step in. But, broadly speaking, I don't care if we find that you get an answer of 92, for example, and I get 95. If you get 61, then there's something wrong with the standard, and we've got to step in and in a big way. But we have to accept that we're not all going to get the exact same result. I think if you did that you'd be forcing artificial comparability and have a very long standard. What we're trying to do is say, "This is what you've got to do. Think about it, and at the end say that it is a fair presentation of what really happened. If it isn't, then you have to go back and think again." We're trying to get people to look at the principle.

RD: We know the impact of Congress on the audit community via the SEC and Public Company Accounting Oversight Board (PCAOB). What is the potential for that process to influence not only how companies in the U.S.

might implement IFRS but the ways in which the auditors audit IFRS?

SD: I think Sarbanes-Oxley was a product of its time. If you speak to Senator Sarbanes, he was distraught about what happened. Section 404 had two principles in it: One, you should have good internal controls, and, two, your auditors should comment. Nobody disagrees with that. What happened was in the implementation. You have the audit regulator saying "this is what you're going to do," and then turning to the firms and saying "make sure you get the same answer worldwide." The firms froze. So you go from about 400 words to let's say 10,000. And then 100,000 in the auditing firms. That's what caused the problem. It was going right down into the detail.

RD: Will the situation be different with respect to IFRS? Has the regulatory environment changed in America in your view? What can we learn from Europe going forward?

SD: Sarbanes-Oxley (and the related U.S. auditing standard) has been a good lesson in what not to do. In a way, the philosophy was wrong. I chaired the U.K. Accounting Standards Board for 10 years. We didn't write in detail like that. If you've got a fraud, you've got a fraud. That's people just breaking the rules. We didn't have those major accounting scandals in the sense that the standard was so defective that somebody fooled everybody. People stuck broadly within the rules. We used to hammer anyone that didn't. You have to have good enforcement procedures and allow companies and auditors to try to present the financial situation as it is. I don't believe in being a nanny, telling them what to do. I can tell you that in 2007 we had three interpretations. How many did the U.S. have last year coming out of the EITF [Emerging Issues Task Force]? And we're doing it globally.

We often say to people, "If you really want principle-based standards, why are you asking this question?" When we started, I remember that some of our North American members were saying that we must set up a Q&A team for every standard. I said, "What's that?" "Well," they said, "we're going to write all the normal questions, and we'll put up the answers." I said, "I'm not doing that." We're just not going to do it. We have never done that in the U.K., ever. And we inherited 200-odd questions on IAS 39. If you look at them, I think 50% of the answers are blindingly obvious. Why are we even being asked the question? The other half I would call micro accounting. Who cares what the answer is? I don't care. You've got standards now that have resulted in cottage industries. I feel very strongly that an audit partner and a CFO should be able to produce a set of accounts without rushing off to some expert to tell them what to do. If accounting goes back to these guys, we've failed. We've got to return accounting to the profession.

RD: Fundamentally, we are trying to restore reporting to describing the operations of the firm instead of letting the auditors and standards run the firm. The actual operations of the firm seem to have been lost in translation.

SD: Absolutely. If you speak to a lot of people in America, they will say that U.S. GAAP is crumbling under its own weight. There's too much. You've got staff bulletins, interpretations, standards, the AICPA [American Institute of Certified Public Accountants] getting involved, the SEC issuing regulations—a massive amount of material. How do you slim down U.S. GAAP? In a way, it's easier to have a different paradigm—to start again. I think that's also one of the reasons IFRS are catching on. Yet even in IFRS I think accounting for stock options is too complicated, financial instruments is too complicated, tax is too complicated. It's time for a change—we have to simplify these standards.

RD: What is the future of the IASB?

SD: Compared with six years ago, I am astounded to think that we're now in a situation where all the major capital markets are going to use our standards. Some 109 countries already use them, and in four years' time that figure will be about 150. If you're one of the countries that isn't using them, and if the U.S. and ourselves get the same answer, and Australia, Canada, China, Japan, Korea all get the same answer…why are you different? I think that question is going to be very important for the outside markets. Once there's a sniff that a country isn't using IFRS properly, Wall Street will stay well away. That is the strength of the system. Using IFRS removes one of the major accounting risks from the equation. If I want to invest in Korea in 2011, then I know the standards will be the same as the ones used in Europe and hopefully in Washington as well. So that's the big advantage of IFRS. It was North America that set the objective of one single set of high-quality standards. It was set partly by the FASB, partly by the SEC. So here we are. ■

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IFRS is a topic at IMA's Annual Conference, June 14-18, 2008, in Tampa, Fla. For information, visit www.imaconference.org.