

## Cooking with IFRS

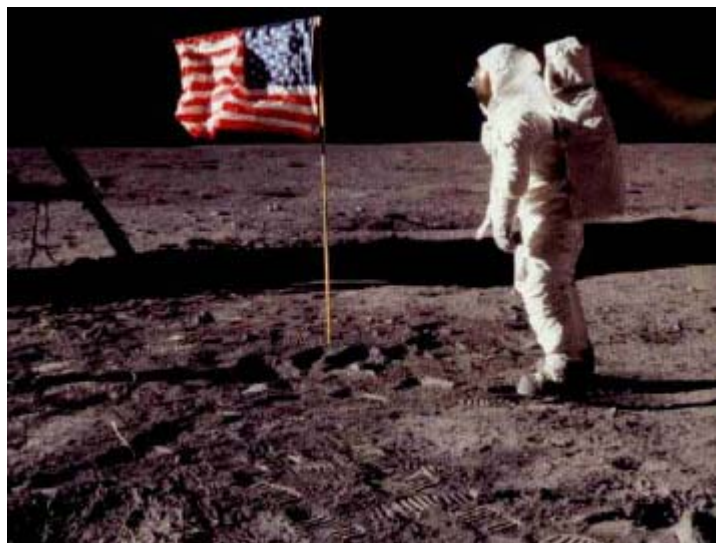
Canada is moving full steam ahead to implement new reporting standards, while the U.S. drags its heels. Why bother?

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When asked recently how long it will take before the U.S. adopts International Financial Reporting Standards, the head of the standards board there was clear: 10 to 15 years. Given that timetable, the U.S. could have a permanent human outpost on the moon before it concedes to using IFRS.

This might come as a shock to Canadian investors, because IFRS promoters have been implying that U.S. adoption of the new standards was all but a done deal, despite persuasive evidence to the contrary. More shocking, perhaps, is that Canada is still moving full steam ahead toward implementing the new rules in roughly 18 months.

Upon reading IFRS sentence by sentence, it becomes clear that the list of potential deficiencies is very long. So it is not surprising that even the U.S., with a strong enforcement presence in the SEC, sees this as a huge potential problem for investors.



In a nutshell, IFRS means more management leeway for executives to present the figures they want. In accounting, the more choice that is involved, the less comparability there will be. Nevertheless, greater comparability of financial reporting globally is held up by IFRS promoters as one of the alleged major benefits of the new standards.

Like the concept of increased management choice, marking-to-market (fair-valuing) assets is also supposed to be a so-called anchor of IFRS. But political tampering in different countries over the past year has not only decreased comparability in this area, it has completely cut the anchor loose.

IFRS is a clear step backward compared to what Canada currently has in place. IFRS deletes several needed prohibitions that exist in current Canadian accounting, which were created after previous corporate collapses. As well, IFRS is also silent on critical industry-specific issues that simply cannot be ignored.

In brief, many of the basic accounting concepts to which investors have become accustomed over decades have been left to rot under IFRS, including the matching of revenue and expenses, and the conservative use of historical cost figures.

More specifically, some of the most common issues that will pose problems for investors include: adjusting up and down the value of various assets at the time of adopting IFRS, with significant potential impact on future income; disguising executive greed by not quantifying and fair-valuing related-party transactions; building up hidden reserves for the purpose of manipulating future income; recording revenue years in advance of it actually being earned (if ever); hiding deteriorating cash flows through poor disclosure and netting together transactions; and adjusting the value of inventory up and down to meet short-term performance metrics.

With politicians and regulators asleep at the switch, investors have been left to fend for themselves against the pitfalls of investing in Canadian companies using IFRS.

The easiest approach for investors is to tackle one issue at a time, starting with related-party transactions. Canadian accounting requirements are already abysmal because they do not require the fair value of a related-party transaction to be quantified and disclosed for investors. However, under IFRS, fair-valuing assets and transactions is supposed to be a major pillar of advancement. Unfortunately, this concept is completely absent when it is needed most—to protect investors from executives who can easily mislead boards into approving unfairly priced deals.

It will take significant time, perhaps five years or more, for investors to grasp the impact of the shortcomings that currently exist with the new reporting standards. In addition to these, major changes will also be made to address broad areas of accounting that are weak and long-outdated, like those for leases and pension plans. Plus, despite claims by IFRS standard-setters, existing guidelines will need to be beefed up considerably to address extensive flaws and loopholes in the current rules. All in, it puts the difficulty of navigating IFRS roughly on par with that of, well, a successful moon shot.