FINANCIAL POST

Critics speak out as IFRS looms

Charest latest to criticize vague new rules

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Yet another prominent Canadian executive has come out against the adoption of International Financial Reporting Standards (IFRS) in Canada. This time it was Yvon Charest, chief executive of Industrial Alliance Insurance and Financial Services Inc., who saw little advantage to be gained by switching to IFRS, and only indigestible and volatile financial statements as the main result.

There will no doubt be more voices of concern as Canada moves closer to adopting the rules, and criticisms will start to emerge from all sectors, not just financials and insurance. It's a fair assumption that executives at utilities and resource and real-estate companies have probably been too busy grappling with the forced adoption of alien IFRS rules to make much comment so far.

Canada's auditors are moving the country toward the adoption of IFRS, now slated for mandatory use in roughly 18 months.

Recently, the United States decided to put off adopting IFRS for another 10 to 15 years, citing numerous drawbacks and weaknesses in the vague standards, which will make it easier for companies to hide balance-sheet problems. This column regularly looks at specific IFRS pitfalls that can mislead investors, which continue to go unaddressed by the auditors and standard-setters of Canada.

Perhaps Canadian executives realize what a waste of time it would be to criticize IFRS, when they are doomed to be ignored by the financially conflicted Accounting Standards Board (the group controlled by the auditors of Canada that mandated the premature switch to IFRS).

Of course, that's a major problem with Canada's archaic approach to securities regulation. Instead of enacting a Canadian equivalent of the SEC, our politicians spend their time listening only to those who are the main cause of investor losses. Our auditors, in turn, continue to promote exceedingly weak IFRS rules, which the United States has clearly rejected due to their inferiority and other major drawbacks.

The Accounting Standards Board (AcSB) published a quick response on the heels of Mr. Charest's concerns. Several pages of unsupported generalities eventually culminate in the real reason that IFRS has been forced onto Canada, "Retaining a unique Canadian GAAP is no longer cost effective."

Not cost-effective for auditors, that is. Investors, on the other hand, can suffer.

As it stands now, the audit firms of Canada financially support the AcSB, whose sole job is to set accounting rules. Until recently, the AcSB was a cost centre for the auditors. So, they were kept deliberately hobbled with a skeleton budget, which had the dual benefit of stopping the board from setting rules that might require additional auditing and trigger added legal responsibilities.

By forcing a switch to IFRS, the AcSB has effectively been turned into a revenue centre, since the audit firms will reap hundreds of millions in fees by transitioning Canadian firms to the new rules. The only costs will be for rubber-stamping any IFRS amendments.

Some question why there has not been a larger debate on why IFRS is especially unsuited for Canada. It's not that financial talent is so lacking in Canada. Rather, all the talent that has had any motivation to gain expertise in IFRS thus far is concentrated in the audit firms, and tends to be strongly influenced by economic gains, and pressure from their partners in the same vein.

Nevertheless, executives are gaining experience quickly, and are recognizing the problems that IFRS will spawn. Complaints will soon be made concerning other major areas of accounting, such as revenue recognition and fair valuing non-financial assets.

What often makes IFRS so unreliable for investors is its reliance on vague and open-ended phasing. One example, regarding conditions for recording revenue is that it has to be "probable that the economic benefits associated with the transaction will flow to the entity." Not only are phrases such as "probable" and "economic benefits" hopelessly imprecise, but timing of receipt is not pinned down to any sense of reality.

Overstatements of revenue (including recognizing it too early) have produced an extensive number of litigation cases in Canada, Nortel being just one. Over the years, since before IFRS was even invented, Canadian accounting rules have been tightened to cut down on improper revenue recognition. But with IFRS, the rules for recognizing revenue border on the pathetic.

Canadian courts require investors who have suffered losses to prove that the company's accountants and auditors violated professional rules when they reported bloated, fictitious income. As forensic accountants, we encounter such court demands case after case. Accordingly, vague rules seriously disadvantage investors who seek to recover their losses caused by financial deception.

Simply stated, IFRS generally does not contain the prohibitions necessary to prevent shenanigans that have been used to mislead investors in the past. The one-sided wording of IFRS is staggering in its near-contempt for investor needs. We have re-examined several past cases, for which convictions for investor deception were rendered, and have concluded they would not likely have been successful if the company had been permitted to use IFRS.

Improper revenue recognition can affect any stock or bond, and by extension any mutual fund or pension plan. So, a major warning to investors exists when top executives claim that adopting IFRS distorts the economic reality of their companies. It seems a wiser choice to heed their concerns rather than listen to the auditors raking in fees and telling investors not to worry about the consequences of IFRS.

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