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BY JACK SWEENEY

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IT HAS BEEN ONLY 5 MONTHS since the Federal Reserve announced that the wealth of American families plunged nearly 18 percent in 2008 — a loss that was equal to the combined annual output of Germany, Japan, and the U.K., the *Wall Street Journal* reported.

It's no secret that more than half of U.S. households invest their savings in the market. In fact, no other country comes close to the number of households participating. It's just this sort of local wealth disaster that invites public scrutiny of subjects that ordinarily may not have appeared ripe for public consumption.

IFRS is just such a topic. Its very acronymic identity could tame even the heartiest of appetites among business news addicts. However, when $11 trillion of American wealth suddenly vanishes, something as seemingly arcane as International Financial Reporting Standards becomes a viable menu option. And, as luck would have it, the inclusion of IFRS on the public menu could not be better timed. It appears that America's wealth debacle has occurred just as the U.S. prepares to outsource the very guts of its regulatory operating system. Or to put it another way, if America's regulatory system were an IBM computer, IFRS would be on the verge of becoming the next MSDOS.

And while to this day business school students still debate how IBM management could have somehow been blinded to the strategic consequences of not owning the system within, America seems to be orbiting in a similar state of impairment — one fueled by a simple assumption: that the adoption of IFRS by the United States will reduce the cost of capital by achieving comparability of financial reporting through a common global accounting language. It's a rational assumption, even an intuitive one. But it's a distraction. Whatever fruits the adoption of global standards may bear, the forfeiture of America's sovereignty over accounting standard-setting may be at a price too high — at least when you consider the political and opportunity costs that America will incur if and when it opts to outsource its system of standard-setting.

"The larger cost of IFRS is what we will be giving up in terms of the technology of standard-setting and having a set of standards that, frankly, work with our regulatory system — by that, I mean standards that work with how the SEC sees financial reporting, how investors see financial reporting," explains Karthik Ramanna, a Harvard Business School professor who has recently published a number of studies examining the convergence of accounting standards globally. Among the more noteworthy conclusions is the notion that multiple standard-setting bodies, rather than one international body, would result in better standards globally.

"One advantage of competing standard-setters is that these alternate accounting systems can coexist, and companies rather than regulators will have a choice of selecting into a particular accounting system — this allows innovation in performance measurement and innovation in control to happen," says Ramanna, who believes that the financial crisis was in part caused by the failure of accounting systems to keep up with the level of innovation taking place within financial securities. "The innovation of accounting systems has been kept at the regulatory level as opposed to the firm level, and regulators don't have the types of incentives to innovate that firms do," explains

Ramanna, who is today one of a growing number of top accounting academics who is speaking out against the movement to adopt a single set of accounting standards globally.

GAAP: AMERICA'S OPERATING SYSTEM

Far from perfect, the accounting system commonly known as generally accepted accounting principles (GAAP) has played a central role over the years in keeping U.S. capital markets healthy — a fact not unrelated to the large percentage of Americans who participate in U.S. capital markets. Again, none of the more than 100 countries that require or allow use of IFRS can boast the level of U.S. participation. Moreover, the U.S. accounting standard-setting process (warts and all), historians tell us, has achieved a hard-fought level of independence that has contributed to a lack of bias in the standards being issued.

Seventy-five years ago, when Congress created the Securities and Exchange Commission, it mandated that publicly traded companies submit annual financial statements that follow GAAP. Since that time, the SEC has depended on the private sector to arrive at a consensus on reasonable accounting standards — a move intended in part to remove politics from the process of standard-setting. The Financial Accounting Standards Board (FASB), based in Norwalk, Connecticut, is the third and most enduring standard-setting body to serve in this role — a feat that many agree can be attributed to FASB's willingness at times to entertain politics.

"We live in a society that's a political one. We have to be responsive to that," said FASB chairman Robert Herz during a panel discussion last May at Baruch College in New York City. "But while you're being responsive, also be responsible," he quickly added.

Back in March, Herz participated in a congressional hearing intended to prod FASB into more speedily releasing new "mark to market" accounting rules. For their part, lawmakers have pleaded for emergency accounting relief for banks that were forced to write down trillions of dollars in securities due to faltering subprime mortgages.

"Don't make us tell you what to do," was one of the more memorable sound bites issued at the hearing by Rep. Randy Neugebaurer (R-Tex.), whose verbal strong-arming was trumped only by even blunter Rep. Gary L. Ackerman (D-N.Y.), who put things this way: "If you don't act, we will."

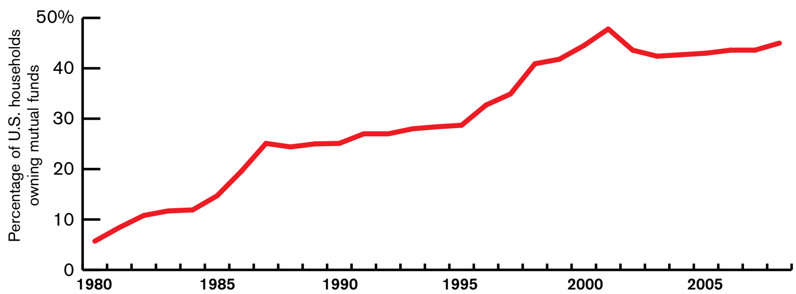
Herz agreed then and there to release new FASB guidelines related to mark to market within 3 weeks. Whether real or perceived, the image of FASB so publicly responding

GARY FLETCHER

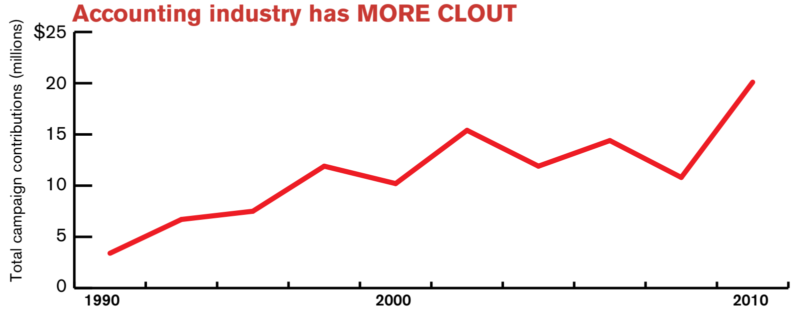
STANDARD-SETTING POLITICS:
What's Changed?

The last time the United States changed the standard-setting body for U.S. GAAP was during the Nixon administration.

American households have MORE AT RISK



Accounting industry has MORE CLOUT



SOURCE: INVESTMENT COMPANY INSTITUTE (ABOVE); THE CENTER FOR RESPONSIVE POLITICS (BELOW)

STANDARD-SETTING & INDEPENDENCE: An Ever Present Challenge

1939 to 1959
Committee on Accounting Procedure

"The Committee on Accounting Procedure of the American Institute of Accountants is supposed to be the watchdog in establishing and improving accounting principles. Recently, that committee had an important accounting principle under consideration. One of the leading industries heard about it. That industry didn't like the effect of this principle on reported profits, and some of its members began applying pressure on the committee to discontinue their discussion of the proper accounting.

— Leonard Spacek, Arthur Andersen & Company, speaking before the Milwaukee Controllers Institute of America, February 12, 1957

1959 to 1973
Accounting Principles Board

"I would like to refer back to the Accounting Principles Board's last effort to adopt the deferral method of accounting for the investment tax credit. As you all recall, the Principles board exposed an opinion recommending the deferral approach. Subsequently, several key members of the Executive Department and Congress caused the board to withdraw its recommendation."

— David F. Hawkins, professor of Business Administration, Harvard University, November 12, 1973

1973 to Present
Financial Accounting Standards Board

"The real scandal here is not the decision by the FASB. ... Rather, it is how the independence of regulators and standard-setters is being threatened. ... Chairman Herz acquiesced, it appears, in order to keep Congress from invading FASB turf. Yet in seeking to protect its independence, the board has surrendered some of it in the bargain."

— Arthur Levitt, former SEC chairman, March 26, 2009 to legislative threats led former SEC chairman and arch investors advocate Arthur Levitt to author an editorial in *The Washington Post.*

"The real scandal here is not the decision by the FASB. … Rather, it is how the independence of regulators and standard-setters is being threatened. … Chairman Herz acquiesced, it appears, in order to keep Congress from invading FASB turf. Yet in seeking to protect its independence, the board has surrendered some of it in the bargain," wrote Levitt in the March 26, 2009, editorial.

IT'S THE ECONOMY, STUPID!

Levitt's sentiments, along with the March hearing's more strident comments, would not be unfamiliar to earlier accounting standard-setters who alternately found themselves at odds with both politicians and champions of independence. In fact, one of the more insightful lessons history offers future standard-setting bodies is that a standard-setter's survival relies as much on its ability to stay in tune with national economic goals as it does on its ability to wage the battle for independence. And here's where the adoption of IFRS by the U.S. could become very costly.

"Having one standard-setter globally sounds very persuasive, but then you realize that the U.S. would be giving up a lot of influence over standard-setting. We need to think a bit more about this because there's no question that accounting standards influence behavior. If the U.S. government doesn't like certain behaviors being induced by accounting standards, it currently has a lot of power to deal with it, but once these other national governments realize that they have the same power, the whole approach changes," says Harvard professor David Hawkins, who back in 1973 — on the eve of the creation of FASB — delivered a speech in which he implored the new standards board to set accounting standards that are technically and "behaviorally sound" and that are "not at variance with the national economic goals and the government's programs to achieve these goals." Hawkins's speech was in part intended to underscore the failure of the FASB's predecessors (the Committee on Accounting Procedure from 1939 to 1959 and the Accounting Principles Board from 1959 to 1973) to stay in tune with national economic goals.

"In terms of politics, the APB was tone deaf," writes accounting historian Thomas A. King in his book *More Than a Numbers Game: A Brief History of Accounting* (John Wiley & Sons, 2006). According to King's text, the FASB quickly proved itself more politically adept than its predecessors.

"Academics and some practitioners had criticized the CAP and APB for promulgating standards without guiding principles. The absence of a theory can leave accounting rules up to politicians, where answers favor those in power. … Yet the FASB learned early on that it serves at the pleasure of the SEC, a federal administrative agency created by Congress. Politicians serve constituents, not theories," writes King, who details a string of FASB decisions where politics came in to play.

Certainly the U.S. Representatives who recently sought to let FASB's chairman know that they mean business can be added to the list of lawmakers who have acted at the behest of powerful business interests. And it shouldn't be any surprise that many members of the subcommittee that held the hearing receive campaign contributions from banks and other financial institutions.

Again, Hawkins's 1973 speech — which undoubtedly displeased champions of independence — appears to have foreseen a growing awareness of the economic impact of accounting standards.

"Those in Congress and the executive branch of the federal government who are charged with managing the nation's economy are becoming more and more aware of the behavioral aspects of corporate reporting and its macroeconomic implications. Increasingly, I believe, these policy-makers will demand — particularly in times of economic turmoil — that the decisions of those charged with determining what constitutes approved corporate reporting standards result in economic behavior that is consistent with the nation's macroeconomic objectives," reads Hawkins's text.

If, as Hawkins suggests and history demonstrates, effective standard-setting requires policy-makers to demand accounting standards that result in behaviors in line with national economic goals, the foremost question becomes: What are the channels through which the SEC and Congress will communicate to IASB standard-setters the best interests of U.S. capital markets?

WHY ONE IS SUCH A LONELY NUMBER

First established in 2001, the International Accounting Standards Board (IASB), based in London, boasts a trail of successful accomplishments, the most fruitful probably being its continued collaboration with the U.S. Securities & Exchange Commission that last year culminated in the publishing of the SEC's road map for U.S. IFRS adoption. Not unlike its American peer the FASB, the IASB aspires to create high-quality accounting standards, while not bending to the wishes of powerful companies and politicians. However, unlike the FASB, the IASB is not independently funded, and it currently collects funds for its operations from the companies it audits and their auditors — a nagging shortcoming for any entity engaging in a daily battle for independence.

"If the IASB wants its standards to be considered for use in the United States, it should present a plan for independent funding for the SEC to consider … and then we need to go beyond funding and focus on adopting and sticking to national policies of protecting the standard-setter, whether it's the FASB or the IASB, from influences unrelated to the quality of its standards," said Charles Niemeier, a board member of the Public Company Accounting Oversight Board, in a speech delivered to the New York State Society of CPAs last September. The speech — viewed by many as a stinging assault on the proposed U.S. adoption of IFRS

2001 to Present
International Accounting Standards Board

"While I think Rick [Enron's chief accounting officer] is inclined to do this given Enron's desire to increase their exposure and influence in rule-making broadly, he is interested in knowing whether these types of commitments will add any formal or informal access to this process (i.e., would these types of commitments present opportunities to meet with the trustees of these groups or other benefits)."

— an email uncovered in a 2002 congressional inquiry of Enron. The author, David Duncan, partner, Arthur Andersen, explained how Enron chief audit officer Rick Causey had inquired about how much influence a $500,000 donation to the International Accounting Standards Board would have bought

— helped to amplify growing concerns that the SEC, under chairman Christopher Cox, was seeking to make IFRS adoption by the U.S. a fait accompli before the next presidential administration took office.

Among the pieces of information that the Neimeier speech mentions in passing is a remarkable email written by David Duncan, the Arthur Andersen partner who oversaw Enron's audit. Apparently, Duncan was seeking information on behalf of Enron Corp.'s chief audit officer, Rick Causey, who had been inquiring about how much influence a $500,000 donation to the International Accounting Standards Board could buy.

Duncan's email reads: "While I think that Rick is inclined to do this given Enron's desire to increase their exposure and influence in rule-making broadly, he is interested in knowing whether these types of commitments will add any formal or informal access to this process (i.e., would these types of commitments present opportunities to meet with the trustees of these groups or other benefits)."

The email is noteworthy because it exposes not only the eagerness of an American company to begin influencing international standards but also the willingness of an audit firm to help extend its client's global reach. To date, the accounting industry — keyed up by the Big Four accounting houses — can be counted among the biggest backers of the U.S. adoption of IFRS.

One wonders how the same U.S. Representatives who *had a go* at FASB's Herz back in March will engage the IASB if and when the U.S. adopts IFRS. Without an independently funded IASB, it would seem that corporations and their audit firms would be perfectly within their rights to seek out *meet-and-greets* with IASB trustees after the board cashes their checks.

Still, IFRS supporters point out that FASB's funding operation was similar to IASB's up until 2002, when Congress ordered public companies to pay fees to support FASB as part of the Sarbanes-Oxley Act. Until then, FASB had been funded by the private sector, mostly from public accounting firms. For its part, IASB likes to characterize its funding efforts today as broad-based and open-ended — meaning not contingent on any action.

Earlier this year, the trustees of the IASB's oversight body announced the formation of a new monitoring board designed to better establish a means of accountability to government authorities. The new monitoring body is intended in part to assist trustees in choosing board members and to review procedures within the standard-setting process.

"You can imagine that this could be a very smooth process and that the IASB will turn out to be a very savvy and independent standard-setter, but on the flipside we could end up with accounting standards that look more like UN resolutions — that really don't mean anything," concludes Harvard professor Ramanna.

While it's true that the American public may have yet to conjure up an appetite for the technical applications of accounting standards, it remains to be seen whether America will willingly forfeit its standard-setting influence without more of a dustup in the press. Certainly, $11 trillion in lost wealth may give more Americans pause. Whether regarding NAFTA, the Panama Canal, or similar issues, public debate has revealed that Americans have a strong sense of their historical contribution to the world — and a great reluctance to forfeit influence quietly. BF