

"IFRS Adoption? in US, Canada and World"

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| Date | Thursday, February 3, 2011 |
| Time | 13:30 - 17:30 |
| Venue | Room No. 505, Building No. 11, Waseda Campus, Waseda University |
| Organized by | Waseda Accounting Research Center |
| Co-organized by | Global COE Waseda Institute for Corporation Law and Society |

Agenda

- 13 : 30 *MC Opening Remarks*
Prof. Masaki Yoneyama (Graduate School of Accountancy, Waseda University)
- 13 : 35 *Moderator Opening Remarks*
Prof. Eiko Tsujiyama (Graduate School of Commerce, Waseda University)
- 13 : 40 *Keynote Lecture (1): "Is IFRS Monopoly a Wise Choice for Financial Reporting?"*
Prof. Shyam Sunder (Yale University, U.S.)
- 14 : 40 *Keynote Lecture (2): "A Perspective on IFRS adoption in Canada and Current Standard Setting"*
Prof. Karim Jamal (The University of Alberta, Canada)
- 15 : 35 *Welcome Remarks*
Prof. Tatsuo Uemura (Graduate School of Law, Waseda University)
Break (15 : 40~16 : 00)
- 16 : 00 *Panel Discussion*
Moderator :Prof. Eiko Tsujiyama
Panelists :Prof. Shyam Sunder and Prof. Karim Jamal
- 17 : 30 *End of Session*

This document contains the complete proceedings of the International Symposium entitled "The Present IFRS: Contemporary Issues Surrounding IFRS" which is a collaboration between Global COE Waseda Institute for Corporation Law and Society and Waseda Accounting Research Center.

MC Opening Remarks

Prof. Masaki Yoneyama

Graduate School of Accountancy, Waseda University

Ladies and gentlemen, thank you very much for waiting. We would like to start the international symposium, "IFRS Adoption? In US, Canada and World." I will serve as the

moderator of this symposium. I am Yoneyama from the Graduate School of Accountancy.



First of all, I would like to let you know some housekeeping information. First, it is about the handout. In the handout, there are six slides on a page, which is done to save paper, but it might be a bit difficult to see. A larger version in colors, however, is available from the website until the 7th of February, where you will be able to download, which has two slides on a page. Furthermore, in this hall, there can be 300 persons, which is the capacity of this hall. Therefore, please cooperate with each other so that all the participants will be able to find a seat.

The second part of the program will be the panel discussion, for which your opinions and questions are welcome. There will be a paper for you to write down your questions and during the break, please write them down and handover to the staff members, or put that paper into the collection box. We welcome your proactive questions.

This symposium is supported by the grant by the Ministry of Education, Culture, Sports, Science, and Technology (MEXT) and organized by the Waseda Accounting Research Centre (W-ARC) of Waseda University, also with the partnership and collaboration of the Global COE: Waseda Institute for Corporation Law and Society the Institute of Industrial Management.

That was the housekeeping information, and now, may I invite Prof. Eiko Tsujiyama, Head of the Waseda Accounting Research Centre (W-ARC) of Waseda University to welcome all of you.

Moderator Opening Remarks

Prof. Eiko Tsujiyama

Graduate School of Commerce, Waseda University

Thank you for the introduction. I am Tsujiyama. First of all, thank you for coming for this symposium despite your busy schedules. We are delighted to see this large attendance and this packed hall. Since, I would like to allocate maximum time for keynote speeches, I will be very brief in telling you why we have organized this symposium.

As you know as of June 2009, the so-called Interim Report was published by the Business Accounting Council, which was titled "Opinion on the Application of IFRS in Japan." According to this Interim Report, regarding the IFRS adoption in Japan, a judgment will be made by 2012. Before waiting for the decision by 2012, however, by July of 2009, IFRS Council was established in the private sector. Regarding the prospect of IFRS adoption, affirmative activities have been spreading in different sectors of the community, and there are different efforts and endeavors to prepare for potential adoption. Major audit firms are organizing a large number of related seminars and conferences.

Today's symposium, however, would be quite different from the practical seminars that are held for the preparation of potential adoption. We have top-level leading academics from the United States and Canada, and would share their thoughts from purely an academic perspective. The speeches would be independent of any other stakeholders.

Related to the international convergence of the accounting standards, our speakers will share with us their thoughts. Our two guest speakers are highly renowned for their experimental economics activities. From 2006 to 2007, Prof. Sunder had been the president of the American Accounting Association, and Prof. Jamal is the Chair of the Financial Accounting Standards Committee (FASC) of the American Accounting Association (AAA). So the two guest speakers are highly renowned accounting experts of the world. The two guest speakers are frequently invited to make many speeches across the world, which means they are also familiar with different accounting standard systems of different countries. I am sure that we would be able to hear extremely interesting insights about the economic outcomes of adopting IFRS. I hope you will enjoy the program until the end. There will be a panel discussion after the speeches, and we would like to welcome your proactive inputs. Once again thank you for coming.

Prof. Masaki Yoneyama

Thank you Prof. Tsujiyama. So, we shall go into the two speeches. The first speech is by Prof. Shyam Sunder, and the speech titled: "Is IFRS Monopoly a Wise Choice for Financial Reporting?" Let me introduce Prof. Sunder.

Prof. Sunder is a professor of accounting, economics and finance at the Yale School of Management, professor in the Department of Economics, and professor adjunct at the Yale Law School. He is a world renowned accounting theorist and experimental economist. His research contributions include financial reporting, dissemination of information in security markets, statistical theory of valuation and design of electronic markets. He is a pioneer in the field of experimental finance and experimental macroeconomics. Dr. Sunder has won many awards for his research that includes six books and more than 175 articles in the leading journals of

accounting, economics and finance, as well as in popular media. Dr Sunder's current research includes the problem of structuring US and the international accounting and auditing institutions to obtain a judicious and efficient balance between regulatory oversight and market competition. He is a past President of the American Accounting Association (AAA) from 2006 to 2007, an honorary research director of Great Lakes Institute of Management, and Distinguished Fellow of Centre for Study of Science and Technology Policy. Prof. Sunder, the floor is yours.

Keynote Lecture (1)

Is IFRS Monopoly a Wise Choice for Financial Reporting?

Prof. Shyam Sunder

Yale University, U.S.

Three levels of betterment

We can ask questions about the impact of IFRS at several different levels: social, market or accounting, each with different implications. In this session, I focus on the markets and economy levels. I assume from the outset that *greater prosperity of society* is the goal that we seek through choice of accounting standards and methods.

Monopoly vs. Competition

Will an accounting monopoly help us achieve this goal? There are two modes of using IFRS. The first is IFRS as a single standard for the whole world. The second is IFRS as one option among several competing sets of standards, in the manner the electronic equipment or car manufacturers compete with one another. From systems of government to standards of education in universities, we compete in many domains of our lives, and we can assess the consequences of competition in the domain of accounting standards.

IFRS through national regulators

We do not often hear about IFRS as a competing option alongside other sets of accounting standards. Instead, the focus of the supporters of IFRS has been on persuading national governments and regulatory authorities in various countries to require that all organizations within their jurisdiction adopt IFRS. During this session, I shall analyze the consequences of this monopoly proposal.

Popularity, imagination and creativity

Among learned professions, accounting has a special place. Accountants do not seek popularity, and indeed are not popular. As professionals, accountants have to stand firm in their independent judgment, often against strong resistance from people around them, especially the powerful, because the beneficiaries of their firmness and judgment are distant and dispersed. They are not to worry about adverse opinion and their popularity. Not surprisingly, imagination tends to have a negative connotation when used in accounting contexts. Society prefers accountants who are boring, not creative.

Crusade for fiscal responsibility

Accountants are expected to be firm against the winds of opinion, stand guard to protect the interests of society as a whole, and watch out for their own weaknesses and vulnerabilities.

David Walker, the former Controller General of the United States, resigned his high office to start a crusade for fiscal responsibility in the United States. He thought that the management of the economy and its accounting has gone wrong, and we have to pay attention to the future. Here is an accountant working for the larger good of society, without consideration of his self-interest. We should assess the consequences of IFRS monopoly for the larger good of society.

The slogan of comparability

The campaign to adopt IFRS across the world has been characterized by the repeated assertion that “a single set of high-quality principles-based standards used by all will achieve comparability across the world, and across the markets.” Many have repeated that mantra, without carefully thinking about whether comparability can be achieved by application of a single set of standards.

Unintended consequences

Why is the idea of betterment through IFRS monopoly a fundamentally flawed proposition? To the extent that IFRS is implemented, it is likely to bring more harm than good as a monopoly, including the unintended consequences for the markets and for the economy and prosperity of society. Despite some claims of empirical support for IFRS in a few research studies, the evidence is mixed at best, and is often irrelevant. I shall return to this problem in my remarks.

IFRS by Analogies



a. The flawed analogy of “weights and measures”

This piece of hematite stone, polished into a sleeping beauty of a duck, is an Assyrian weight. The state had standardized the weights and measures, so distrust and moral hazard will not stand in the way of people buying and selling things without hassle. We know the weights and measures to be one of the earliest functions of the state, and the idea of using standardized weights and measures to facilitate trade and exchange has contributed a great deal to the prosperity of human societies. To the present day the use the metric system

of grams, meters, and liters in most parts of the world makes our life much easier.

Proponents of IFRS have compared accounting standards to weights and measures, and solicited support for IFRS arguing that enforcement of IFRS as a uniform set of accounting standards in the whole world will also help us improve our prosperity. This analogy, however, is misleading. Gold, grain and milk do not react with the measurement system as investors, managers, accountants, and regulators do; the latter actively engage with the accounting system. The behavior of agents with respect to weights and measures is stationary; behavior of agents with respect to accounting standards is not stationary and is subject to continual adjustments.

b. The appropriate analogy of uniform “currency”

Instead of the metric system of weights and measures, uniform currency is a better analogy for IFRS. In 1999, after a long debate, some countries of Europe decided to adopt euro as their common currency. The argument for a common currency is more complicated than the mere convenience of not having to buy foreign exchange at airports. Currency is used not only for exchange, but also for managing many aspects of the macro economy, including credit, income,

unemployment, growth, and inflation, etc. We cannot simply assume that it is desirable to replace national currencies by a single currency. A dozen years after adoption of the euro, the debate on whether it was a good idea, and if it should be retained, and who should continue to participate in it, continues without a clear and obvious answer. If single currency is a good thing, the whole world should adopt it, and we have not even had such an argument yet. Greece, Portugal and Spain face very different circumstances, and it is not clear that a single currency is helpful to them. That question has to be decided through detailed analysis rather than a simple assertion that single standard will be good for everyone.

Similarly, we cannot simply assert that the use of a single method, or a single set of accounting standards is a good idea *because* it is a single method. Whether advantages of a single accounting method or standard outweigh the disadvantages of losing local customization and control of policy, cannot be addressed by simply repeating the standard mantra to promote IFRS. One size does not fit all.

a. *The flawed analogy of “language”*

Besides weights and measures, language is a second analogy used to promote IFRS monopoly. It has been claimed that accounting is a language of business, and I agree. But, it has also been claimed that, therefore, a single set of standards issued by the IASB will improve our prosperity, economic growth and welfare of society. That does not follow. The idea that a single language will improve the world and our society has been around for some time, and has failed. In the 1870s, L.L. Zamenhof theorized that most conflicts and wars in the world occurred because of misunderstanding and miscommunication among people speaking different languages. If everybody in the world spoke the same language, the argument went, there would be peace in the world. He proposed Esperanto as a single language for the whole world. Esperanto, however, has almost disappeared; after 125 years, very few people know about it. Why? It was based on a misunderstanding of how language works. Language does not work by ensuring precision in the meaning of its words. Certain ambiguity of meaning is essential for language to serve as a means of communication. For an example, how does one define a jacket, so it can always be decided which piece of clothing is or is not a jacket, without the necessity of having a separate word for every jacket? What is a jacket or a car is ultimately a matter of judgment and words cannot be defined precisely and yet retain their meaning. The reason we can use in language the word jacket is that it is subject to judgment; it cannot be precisely defined.

Yet that is exactly what accounting standards attempt to do. The more precisely we try to define accounting terms, the more trouble the accountants get into.

Economic rationalizations for standardization and costs

a. *Quality and co-ordination standards*

There are two basic economic reasons for standards.

- i. *Quality through standards*: One rationalization is to improve quality. Tokyo has standards for restaurants to ensure that the quality of foods served meets some minimum standard. Such standards for food and hygiene in restaurants ensure that we safely eat the food.
- ii. *Co-ordination through standards*: The second reason for standards is coordination. The reason that an electric bulb can be easily replaced by another one from any shop is that the electric current and sizes of electric bulb have been standardized, making it so much easier to buy and install replacements. I could bring my PowerPoint presentation file and

use it for this talk because of some standardization. Driving on the left in Japan, or on the right in the United States, is another example, without which traffic will be slower and there will be many more accidents. In a given country, usage of a single gauge for rails on which trains run makes coordination possible; standardization enables Shinkansen trains to run all the way across Japan.

b. Costs of standardization

Just because standards can yield quality and co-ordination benefits, it does not imply that we should standardize everything. Standardizing involves costs. It discourages innovation. Suppose we were to agree that iPhone is the best of all cell phones, and we could save costs and make everyone better off by standardizing it for universal use. Then, iPhone would be the only phone that can be made and used. Are we going to be better off by standardizing something that we are sure is the best choice today? What would happen to cell phones in five or ten years? Suppose we agreed that Toyota Lexus is the best car in the world, is that reason enough for us to standardize and demand that everybody drive only Toyota Lexus car? What will that do to the quality and price of cars in five or ten years? In absence of competition and innovation, the advancement of technology will slow down, prices will go up, and the costs of monopoly will overtake any temporary benefits of standardization.

Improvement in the quality and innovation takes place because of competition. Unless we are quite sure that the technology we have today is the best that we could have, and that it cannot be improved further, we could not justify standardization. By closing the door to alternatives, we also close the possibility that we could develop something even better in the future. We need strong evidence that what we have is the best possible thing we could have.

How many of us are convinced that the IFRS are the best possible accounting standards we could possibly have, especially, after seeing the role of IFRS in the global financial crisis. If we are not so sure about its superiority, do we still want to close the door to alternatives and allow monopoly to something that is far from perfect? Once permitted, we shall have no alternatives, and it would not be easy to get rid of the monopoly.

Standardization of financial reporting

Standardization of financial reporting can be thought of at multiple levels of disclosure, format and measurement.

a. Disclosure

Disclosure standards are essentially seen as quality standards as Prof. Jamal and I have argued in one of our papers.

b. Format

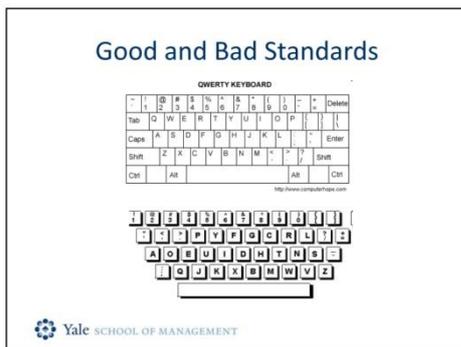
Format standards in the day of computers are probably not as important because formats can easily be translated from one to another by computers.

c. Measurement

The most difficult part of standardization is the measurement, because measurement standards include elements of both quality and coordination in varying degrees.

Good and bad standards

It is not clear that IFRS will confer any advantage over national standards in Japan, Europe, the United States or in any other parts of world. History is full of bad standards, with significant unanticipated consequences.



The QWERTY keyboard was standardized in the 19th century. In those mechanical typewriters, the keys got jammed if the typist typed too fast, and they arranged the keys to reduce the chance of jamming. Today electronic keys have replaced the mechanical keys, and in absence of the risk of jamming, we could type much faster if we use more efficient alternative keyboard layouts such as DVORAK. In fact, anyone can convert the computer keyboard from QWERTY to DVORAK by pressing few keystrokes. Yet few people

use this more efficient system because our fingers and brains are used to the QWERTY system through practice, and it is too much work to switch now. Once we get locked into a system it is difficult to get out of it even if something better comes along. Before we commit ourselves to IFRS, we should be quite sure that this is the best system possible that cannot be improved. Otherwise, we run the risk of getting locked into the monopoly of a poor standard for a long time.

Bases of deciding on standards

There are many ways of deciding on a better accounting system: prosperity of society, inclusion of information from all sources, stability over time, adaptability to changes in environment, robustness against manipulation and resistance against capture.

a. Prosperity of society

As I mentioned at the outset, prosperity of society is probably the best criterion to decide on standards. Everybody prefers prosperity.

b. Inclusion of information from all stakeholders

It is better to consider ideas and opinions of all relevant parties in making the choice. When a board decides on accounting standards, it may consider the opinions of some corporations, larger accounting firms, and regulators. Most investors actually do not bother to participate in the process, and only a few others, mostly academics, contribute their ideas to the process.

c. Stability over time

We have to think whether the consequences of changes in standards are stable, unstable or neutral. This is because some standards and changes can lead to instability.

Some 30 years ago, I published an article in the editorial page of the Wall Street Journal titled "Why is the FASB making so many accounting rules?" I argued that they are making so many accounting rules because they have to. If you give seven people, a staff of fifty or hundred people and a budget of \$25 or \$50 million dollars, what can they do except to write more rules? As professors, we have pressures to "publish or perish," but the same is also applicable to accounting standard setters. They have to publish new standards to keep the organization and their positions intact. Shall we keep them employed if they do not publish new standards? Accumulation of standards over time is a property of our current setup which ensures that the rulebook will get thicker over time.

d. Adaptability to changes in environment

We would like new standards to adapt not only to the changing circumstances but also to differences across different societies, business communities and countries. Different countries

have different systems and we cannot simply assume that the same accounting system is the best system for all economies.

e. Robustness against manipulation and resistance against capture

There is always the danger of people capturing standard setting bodies and manipulating them to serve their own interests.

Not-so-good bases for deciding on standards

Some arguments about deciding on IFRS are based on (1) the presence of statistical covariation between accounting and stock market data, (2) promotion of by interested parties, and (3) that “hundred and twenty countries have adopted it, all cannot be wrong, so you better adopt fast.” Let us address them in turn.

a. Statistical covariance between accounting and stock market data

Vishnani and Shah (2008) write:

“This paper aims at determining the value of relevance of financial reporting. The study aims at explaining likely impact of financial reporting by listed companies on market prices of their shares. Our study reveals that value relevance of published financial statements per se, is negligible. The results of our investigation depict negligible value being reported by cash flow reporting.”

This study reports on finding a statistical correlation between stock prices and accounting data, which is being interpreted with the word like “value relevance,” as if it is a causal relationship. We know that we cannot simply interpret statistical correlation as if it is a causal relationship. This is a major problem with the studies of this kind. There are two issues with the argument of these studies. First, the stock market cannot be considered the sole arbiter of choosing the accounting system, because accounting systems have consequences not only for the stock markets, but also for other segments of society, including governments, public, customers, suppliers, employees, creditors, etc. We cannot simply say that choosing accounting systems on the basis of stock price consequences is better for society. Even if we could choose accounting methods on the basis of stock price alone, statistical covariation cannot be used as a basis for choosing accounting policy. The time available does not permit me to go into the details given in the PowerPoint presentation distributed to you.

In summary, if statistical proximity of accounting and stock market data were sought to be maximized, then it is trivially simple to achieve the financial reporting Nirvana of being in the best of all possible worlds: we can close down the accounting system, let the staff go, and report the change in market capitalization as income of the firm to get perfect covariation between the stock price and accounting numbers. Will such an accounting system help create an efficient market? The answer is obviously negative because in such a world, the market will have little information. The argument about covariation being the basis for selecting accounting methods is fundamentally flawed.

b. Promotion by interested parties

Many organizations have taken it upon themselves to strongly promote IFRS over the recent years with much money and time. Why do they promote IFRS? Is it because they are convinced of its superiority in promoting economic welfare of society, or because it serves their own interests? In the former case, the arguments they put forth in support of IFRS need to be examined for their validity; in the latter case they should be ignored.

c. *120 Countries cannot be wrong*

Finally, there is this argument in support of IFRS monopoly: most other countries have adopted IFRS, and if you do not do so, you would be left behind. I hear that argument in the US, India, China, and most other countries. Threat that the train is about to leave the station, get on board or you will be left behind on the platform is a very old trick to create a bandwagon effect. Instead of being herded into a “follow the crowd” action, the wise would first ask where the train is going, and whether the destination of the train is also their own destination. Is it a good idea to get on to this train just because a hundred and twenty others have climbed aboard? It is not even clear how many people are, in fact, on board.

How do we learn what is better?

There are many ways of learning and deciding on what to do. We may choose on the basis of a priori beliefs, derivation from known first principles, controlled experimentation, or analysis of data gathered from the field. Variation is critical to learning. If Japan wants to find out if it needs to change its method of accounting for consolidation or some other aspect of accounting, what would it do? One possibility is to compare Japan with other countries. But in a world, say five years from now, with an IFRS monopoly, a comparative study would not be possible. There would be no economy to compare with. That is the high cost of monopoly. Monopolies cut information by eliminating variation, and without variation, we cannot learn, improve, innovate, and find better ways of doing what we do.

Rules and social norms

To consider the role and importance of social norms, look at these two photographs, one of a bride from India and the other from the US. Which bride is wearing the right costume? If the American bride were in an Indian village, her dress would not be approved and her wedding may have to be cancelled. The same may happen to the Indian bride in the US. Each conforms to the norms of its own society, but cannot with the norms of the other.

All aspects of our lives, personal and business, are driven by social norms. This conference is driven by social norms. You sit in silence while I speak here. Prof. Tsujiyama did not have to tell you the rules of this conference because we are following the social norms we all understand. Written rules do not govern many large and important aspects of our lives.

Until some eighty years ago, before federal securities regulation in the United States, Generally Accepted Accounting Principles (GAAP) was a social norm. Today, not much remains of the social norm. The norms and the personal responsibility it implied have been replaced by written rules and standards.

It would be better to find a balance between written rules and social norms. We cannot improve financial reporting by trying to replace more of the norms by more detailed written rules. There is little evidence that in these eighty years the United States accounting has improved. Perhaps you can tell me if financial reporting has improved in Japan.

Language and translation

We have mentioned language, but we should also consider the problem of translation. There are thousands of languages in the world. IFRS is written in English. Is it possible to translate the standards originally written in English precisely into Chinese, Japanese, Turkish or Swahili? How do you say “possible but not probable” in Japanese? How do you say “true and fair” in Turkish? Translation is required, yet natural languages do not have exact equivalents, and without exact equivalents we cannot find exact comparability even if the societies themselves were identical.

And they are not identical.

The creation of accounting systems

Top-down design

IFRS is based on a top-down design perspective. In this Cartesian (after Descartes, the French philosopher) perspective, we have the knowledge and ability to design social systems from top-down to achieve our desired ends.

Fatal conceit

Frederick Hayek, Nobel laureate economist, argued that modern civilization naturally evolved and was not planned, where its customs and traditions naturally lead to the current order and are needed for its continuance; and any fundamental change to the system that tries to control it is doomed to fail, since it will be impossible or unsustainable in a modern civilization.

Biological evolution

Darwin's concept of biological evolution suggests that the biological species evolved through replication, mutation and selection. Spencer expanded that idea to evolution of the social systems, which is what accounting is.

Fit in the legal, economic and business systems

Through that evolution, our accounting systems had to fit the legal, economic and business patterns of each society. We cannot argue that Japanese, Chinese, German or American societies are the same, and their accounting systems should be the same. Some individuals at IASB have claimed that China is going to adopt IFRS. What proportion of Chinese major corporations are majority-owned by the state? Maybe 90%, or may be more, in value. What is the consolidation criterion under IFRS? It is majority ownership. If IFRS is applied to the Chinese corporations, how many balance sheets would they get? One! Is China applying IFRS? Can they apply IFRS? How about related party transactions?

Criteria for choice of standards

Which standards are better? Cost of capital has been argued as a major criterion for this, but again it is not clear that cost of capital is an appropriate criterion. We could return to that issue in the panel discussion.

Fortunately, we do not need to select a criterion in bottom-up evolution. We could compare institutions across national boundaries and adopt, imitate, and adapt to better performing systems.

Dependence and judgment

At the time of birth, a child is completely dependent on the mother. When learning to ride a bicycle, it helps if the bicycle is fitted with training wheels. What if the mother keeps feeding the baby as he grows? What if she does not take off the bicycle training wheels? The child becomes dependent and may never learn to bicycle or to eat himself.

Written standards are like training wheels and mother's help to a baby. To stand on your own professional judgment, initially you may need help from the crutches of written standards. Attaining adulthood requires for a child to grow up out of such dependence. The same can be said of an accounting student and trainee developing into a mature professional accountant with

independent judgment of his own.

Financial reporting and financial engineering

Financial reporting and financial engineering interact with each other. Accountants are not the only players in the world of financial reporting; we share it with an elephant called financial engineers. It may take accountants five years to write a new accounting rule, and it may take a mere five minutes for a financial engineer to design a way around it. They can devise new instruments or structure transactions to get around the rules, and accounting boards have shown little evidence that they can deal effectively with financial engineering.

Proponents of IFRS have claimed that their “principles-based” standards require more judgment and are therefore more robust to financial engineering. Since these standards have accumulated to over 2,700 pages of written “principles” within a period of few years, this argument cannot be taken seriously. No learned profession has thousands of pages of principles. The fact is that the IASB’s processes are quite similar to the processes used by the U.S. FASB, and will yield similar results. The IASB started a few decades later, and the number of pages and detail of their standards will take a bit long to catch up with the FASB’s.

Financial reporting as eye-in-the-sky or camera-model

We can think of financial reporting in two different ways. Financial reporting could be seen as a camera, fixed to a satellite circling the globe taking candid pictures of the world underneath, unaware and unaffected by the satellite. Or we can think about financial reporting as the relationship between the cameraman and a model. The satellite picture takes a photograph of the earth the way it is, but there is active interaction between cameraman and the model. When the photographer picks up the camera, the model smiles; when the camera is put down, the model relaxes. Can the photographer record the model without posing for the camera? Accounting is closer to the later and yields smiling pictures of the model, no matter how much we wish to have the candid pictures taken from the satellite.

IASB and the story of the pied-piper

In the 1990s, Washington consensus was a popular idea. In managing the finances of the world, there was a consensus among the World Bank, the International Monetary Fund and major financial powers of the world that the world should be run by this particular set of financial policies. After 1997, that consensus began to fall apart, and within 10 years after that it is difficult to find anyone who is willing to support that received wisdom.

During the past five years there has been a concerted campaign to promote IFRS across the world, without a serious debate about its content and the consequences of a world monopoly. We should be careful, because granting a single organization monopoly rights over financial reporting systems of the whole world will have massive consequences. It will become virtually impossible to get out of it, no matter how bad the decision turns out to be. The IASB has acted like a pied piper—a children’s story in which somebody with sweet music leads unthinking children to their doom. By the time they find out that they are doomed, it is too late.

Accounting should be careful before deciding to abandon competition and comparison. Little harm would be done if IFRS were permitted in Japan, the US, or in other parts of the world. But there is no reason not to have Japanese and perhaps some other accounting standards available to corporations as options to choose from. Those who want to use IFRS may be allowed to do so, and those who want to use Japanese or American or some other system permitted by the regulators, could also do so. Under supervised competition, the market will help

sort it out with the help of investors, auditors, and managers. Yes, there will be some additional cost of financial analysis, but that cost would be worthwhile to improve and find better financial reporting systems over time. I hope you will analyze this problem and reach your own conclusions.

I am grateful to you, for your attention. Thank you.

Prof. Masaki Yoneyama

Prof. Sunder, thank you very much. Now, we will go into the second lecture of Prof. Karim Jamal from Canada. He will talk about the standard-setting in Canada. Let me introduce the speaker.

Dr Jamal is currently the president of the American Accounting Association's Financial Accounting Standards Committee, which provides scholarly opinion and discussion to the Financial Accounting Standards Board in the US, the International Accounting Standards Board, and the Securities and Exchange Commission. Dr Jamal's primary research focus is on; 1., understanding the effect of regulation on production, operating decisions of managers, earnings management and fraud, 2., e-commerce privacy, ethics and control, and 3., persuasion, justification and interpersonal perception in auditing. Dr Jamal has numerous publications in research and professional journals in accounting, psychology and economics published in Canada, the US and UK and Taiwan. In 2009, the Alberta Institute of Chartered Accountants made Dr Jamal distinguished contribution to accounting thought from Canadian Academic Accounting Association; and was appointed as Centennial Ambassador for the Institute of Chartered Accountants of Alberta. Professor, the floor is yours.

Keynote Lecture (2)

A Perspective on IFRS adoption in Canada and Current Standard Setting

Prof. Karim Jamal

The University of Alberta, Canada

As of January 1, 2011 Canadian GAAP is IFRS (London)

I am sure you all know as of January 1st 2001, the Canadian GAAP is officially the IFRS as set in London. I am going to break my remarks today into two parts, where in the first part I am going to propose that the more accurate description is that Canada is actually a multiple GAAP jurisdiction, and in the second part I am going to comment a little bit about current accounting standard-setting both by IASB and the FASB; and in particular, I am going to comment on the neglect of verifiability or auditing, in current standard-setting discussions.

Part 1: Choice of IFRS is a surprise for Canada

So let me start with part one, which is the choice of IFRS. The choice of IFRSs is actually a very big surprise in Canada, where historically, Canada has been harmonizing with US GAAP. Over time, however, there was a widespread revulsion with US GAAP and lots of complaints were received on too much rules, too many interpretations, and too much complexity. Therefore, the regulators actually officially cited all of these as reasons to rethink the harmonization process with the US.

CICA strategy consultations 1995-2005

For the period from 1995 to 2005, the Canadian Institute of Chartered Accountants (CICA), had a set of strategy consultations, may be similar to the kind of discussions you are having here in Japan right now. The questions that people started to ask are, should we go it alone? Should Canada have its own standards? Should we harmonize with US GAAP, because that had been the tradition in Canada? Or should we adopt IFRS?

Outcome of the consultations

The outcome of those consultations—which was a surprise to most people—was to actually do something very similar to what Prof. Sunder just argued for, which was to adopt multiple GAAP. A new slogan was created, which basically says “One Size Does Not Fit All.” So the Canadian model, in fact, recognized on one hand the need to connect to the world and to have something in common with other countries, and yet on the other hand, had a sense there is a wide diversity of organizations in the society, and one set of rules cannot apply even within the same country.

Four types of organizations for standard setting purposes

Canadian view now is that we would think about standard-setting for accounting in terms of four types of organizations. The first type is what we will call publicly accountable enterprises, where these are mostly publicly traded companies. The second type is non-publicly accountable enterprises, which are largely private companies. The third type is public sector organizations, and the fourth one is not for profit organizations. So, even in the same country, we would see these organizations as having significantly different accounting needs and accounting rules. We would not try to enforce even the same rules all over these kinds at the same time.

a. Publicly Accountable Enterprises

For publicly accountable enterprises, they would get a choice either to use IFRS as set in London, or they can use US GAAP if they are SEC registrants. Most of the large Canadian companies, banks, insurance companies, mining companies, and railroads are cross listed in the US, and all of them, if they wish, can simply use US GAAP. That is being the case since 2004, and that is being the policy of the Canadian regulators, and as Canada started officially transitioning to IFRS, that policy was reaffirmed. Accordingly, in October of 2010, the regulators officially reaffirmed that even after the shift to IFRS, any company that was listed in a US stock exchange could choose to use US GAAP. So, all the companies that were already on US GAAP would face no change at all, where they could stay on US GAAP.

b. Private Enterprises

For private enterprises, they are also allowed to use IFRS as set in London if they like. There is an IFRS coming for small and medium scale enterprises, so even IFRS is not proposing one set of rules for all companies, where in that case is more driven by size. Then, the Canadian Board created a new standard, and the acronym for that is ASPE, which stands for Accounting Standards for Private Enterprises. The view was that we needed a different set of rules for private companies, where a different set of cost benefit trade-offs would be made on the notion that the users of those financial statements needed different type of information, they did not need as much detail, and in many cases they had access privately to get information; and therefore, the published financial statements would have much less disclosure, and would even have a relaxation on various measurement methods as well.

At the present time, as you can see in the dates in the slide, the ASPE came out officially very late in about in December of 2010, and all private companies can choose if they like to use them. Officially, everybody is encouraged to use IFRS as set in London, but they can choose that if they want.

c. Public Sector Organizations

For public sector organizations, there is a separate Public Sector Accounting Standards Board (PSAB). Again, public sector organizations are encouraged to use IFRS as set in London, and the standard-setters have been trying to promote that. If they wished, however, they can use these standards set by the PASB. What I am told, however, is that there is very strong opposition in the public sector to using any kind of fair value accounting, because unexpected changes—volatility—in government numbers cause great difficulty for the politicians and for the senior civil servants. They are, however, encouraged at the current time to either switch to IFRS or stay on their own.

d. Not-For-Profit Organizations

The fourth type is nonprofit organizations, and they are thought to be different from the public sector organizations. These types of organizations are also encouraged to follow IFRS if they would like or if they can. At present time, however, it seems fairly an open option, where they can use IFRS for SMEs, public sector rules if they have more of a government type of operation, or they could use the private sector standards if they like. At the current time, the standard-setting board has not had time to really look at the non-profit organizations in detail yet, and basically being told that they will come and look at these entities very soon. There is, however, the sense that they have very different reporting needs.

Effect on standards board

The IFRS is set in London, and not in Canada. The Canadian standard-setting board, however, is still running at full capacity. So, the board members are still there, the staff is still there, the budget is still there, and they are still in business. The most recent thing that they have done is to issue this new set of standards for private enterprises, and the next is to start looking at public sector, and after that they will look at the nonprofit sector, which are their businesses for a while.

Effect on companies

How about companies? Well, companies are transitioning. Canada went through a three-year transition period, partly to get people to adopt IFRS gradually, to transfer expertise, and partly also to create comparative numbers. So, everybody has been very busy transitioning depending on how much change they face based on their industry. The big four accounting firms have been bringing in a lot of personnel from the UK, Australia, and other jurisdictions who have IFRS experience, and finding all of a sudden they have a lot of work, a lot of clients waiting for them. So, it has been a very good project for the Big four accounting firms, where lots of money made the conversion.

Effect on education

How about education? Well, the universities are now transitioning, and all the major universities—accounting departments—now teach IFRS in their standard accounting curricula and are also teaching the new Accounting Standards for Private Enterprise (ASPE). In the

economy, there are publicly traded companies who are prominent in our discussions, but there are a very large number of private companies. Therefore, both accounting firms and accountants will be spending a lot of time in the private company realm, and all the universities are starting to teach both of those accounting standards. In Canada, traditionally, the universities have never taught US GAAP. Although, many companies use US GAAP, it had to be learnt later as part of executive education, or under some other consulting companies and various educational institutions.

Hopefully, we hope that the promotion of multiple sets of GAAP will actually improve accounting education, since it will force both the students and the instructors to understand conceptually why all these different types of GAAP are required, who are the users of this GAAP, what are they going to do with these numbers, and why would you not just have a the same GAAP? We cannot be in the same world we used to be, where people would simply try and memorize the rules, and say “well, these are the rules, so you need to know them, and you need to apply them.” Now, increasingly they need to understand why did different set of rules were authorized for private companies, who will use those rules, who will use those outputs, and why does such stuff matter? We are hopeful that such multiplicity may actually increase the conceptual understanding of accounting, improve the teaching of accounting, and make accounting much more thoughtful rather than just saying, “here are the rules, apply them.”

Will IFRS improve accounting reports?

Well, the next question is will IFRS improve accounting reports? Will the quality of accounting actually improve? There is a lot of hope for that, but, we do not know. We rarely study this aspect.

I and my co-author Hun-Tong Tan use the transition to IFRS as a way to test on how Chief Financial Officers of companies would apply these rules. So, we got 90 CFOs of companies to take part in a study, matched them with an audit partner from a Big four accounting firm, and it turned out that the IFRS adoption led to better accounting only if the auditor also became principles-based. If the auditors stayed the same as the auditor had been before, you got no benefit from IFRS, and the situation actually gets worse. Thus, the shift in accounting requires also a shift in auditing, and I will talk some more about that because we do not talk enough about that aspect. We always want to talk about changing accounting without asking how it will change everybody else who deals with accounting, and if you do not change the auditor as well, you will get no benefit from IFRS.

Additional risk of IFRS

a. Fair value may make fraud easier

There are additional risks of IFRS that we have been worrying about, where one big concern is that the extensive use of fair value accounting in the IFRS makes fraud easier. Not harder but easier to perpetrate, and so the threat is that we will actually get more fraud, and not less fraud.

b. Opportunistic use of accounting standards

The second concern is the opportunistic use of accounting standards that we saw in the financial debacle, where when the market was going up, all the managers are happy to use fair value accounting and to book the gains, and take a bonus. On the other hand, when the market goes down, nobody wants to use fair value accounting and book a loss. Everybody wants to fight with the auditor to delay the loss; and everybody wants to fight with the regulator to suspend the

rule. That is not how it supposed to work in theory, and if that is how it works in practice, then you get the worst of both worlds.

So those are two huge problems about the way in which IFRS might actually be implemented; and whether the actual implementation might create all of these problems. Now, we do not have very clear evidence on this, and I do get a lot of reporters from newspapers asking me what will happen to fraud after IFRS—will all fraud go away?—is the usual question they ask me. The first answer to that is, of course, no! As long as there are human beings, there will be fraud. But, the second answer is that most likely there will be more fraud, and not less fraud.

Part 2: Comments on current FASB/IASB standard setting

Implementation problems in accounting standard setting

Let me comment on this aspect since I am in charge of an American Accounting Association Committee that sends a lot of comment letters to regulators in the US. I see standard-setting in accounting is having two implementation problems.

a. Transaction structuring

One is what I will call transaction structuring. The problem we have in real life is that real life does not work like a classroom. In the classroom, we start with a transaction that is already done, and then we map the transaction into the related accounting rules to say this is the correct accounting for this transaction. On the other hand, the problem in real life is that the managers already know the accounting rules, but the transaction has not been done yet, and thus can decide what the structure of the transaction will be, after they have seen the accounting rule. This is a huge problem for accounting. So, we need to think about how do we set accounting standards in a world in which the management already knows what are the accounting rules and can decide what will go into the transaction.

b. Auditor-client negotiation

The second problem is auditor-client negotiation. Very nice and precise conditions can be set out in the accounting standards on how certain things could be done, and then the problem occurs when the client and the auditor start to negotiate what will the actual meaning of those terms be, where the auditors might quickly find themselves in trouble. Again, as Prof. Sunder mentioned, sometimes if the standards are too precise, that actually is very bad for the auditor; because, the management get lot of time to develop its argument to fit that standard, and makes it very difficult for the auditor to say “no.”

How can we protect against implementation failures?

As we start talking about preventing what are called implementation failures, auditors become a very important player in the functioning of the standards, and yet they had ignored auditors in all the discussions. We have all kinds of discussions about how should we change accounting, but we say almost nothing about how will we change auditors, or what will the auditor do after we change all these accounting rules. If the auditor does not change, all other change in accounting will make no difference, or may actually make things worse.

I think this is one of the big problems we have, where we can keep talking about how do we deal with problems of off-balance sheet debt, how do we deal with problems of transaction structuring, but we keep talking only about accounting, and therefore we cannot solve the

problem.

Dealing with transaction structuring

Looking at transaction structuring, as we have said earlier, we have tried making the rules more precise. The most extreme example of that is leasing, where we have tried to write very precise rules, but actually that makes it easy to structure the transaction, and we end up with huge amount of leases being off-balance sheet, where the auditor cannot do anything. Auditors' hands are tied due to the rules being very precise, and therefore, when management structure the transaction based on those rules, auditor cannot say "no."

The official position of the FASB and the IASB is they are going to seek global consistency, and I will comment on that in a little bit of detail to show you how hard that is to achieve in practice. It is very easy to say that we shall write a standard that will be consistent, but to actually write the standard—even one standard—is extremely difficult, and to get the consistency across all standards is even more difficult. They cannot even do one standard, and I will show you an example, which I will explain a bit later. The FASB and the IASB cannot be internally consistent even in one standard, let alone across all standards.

Prof. Sunder talked a little bit about social norms, again I will not say very much about that, but if you were to rely on social norms, you would also need to change the auditor. Enforcement through social norms relies critically on judgment, and it is going to require very different kind of auditor than the kind of auditor we have now.

Let's look at leasing – widespread off B/S financing

Let us look at leasing as an example. Because of the widespread presence of off-balance sheet financing, leasing has troubled standard-setters in accounting for a long time. If you had to look for one accounting rule that was abused the most, it would be leasing, where the actual practice of accounting would be the most inconsistent with the desired practice of the standard-setters.

The standard-setters have been struggling with leasing for many years. Before the IASB got formed and started writing its standards, we had what are called the G4+1 countries who started to issue special reports on leasing, and two special reports on leasing were issued, one in 1996, and the other in 1999. Again, this is one interesting problem of standard-setting, where accounting standard-setting is actually too slow. Even after everybody knows of a problem, to generate the solution, it had taken a very long time for the leasing standard, but is a very bad standard being abused extensively, and there is no new standard for 14 years. Finally, we got a joint IASB and FASB Exposure Draft in August 17th of 2010, and the commenting period just ended on December, 15th of 2010, but there is still no new standard on leasing, although we are getting closer. If the financial engineers were moving in five minutes, the problem is that the accounting standards board is not moving for 14 years.

Example from Jamal & Tan (2010): Accounting Review

So, what we did is we again ran the experiment with the Canadian Chief Financial Officers (CFOs) of the Canadian companies both with IFRS and Canadian GAAP, where half of them playing under IFRS, and other half under Canadian GAAP. For this purpose, we took a company that needed a lot of electricity in their production process, where literally needed a power plant dedicated. The company—the players—wanted to keep it off-balance sheet as a lot of debt was required to have some additional plant expansion. So, we asked the CFOs that there is this real business need, but how they would structure the transaction, and then convince the auditor that

their accounting was proper, who was also present in the experiment.

The CFOs were very good at coming up with all kinds of ways to take the transaction off-balance sheet. They knew how to play with leases, they knew how to play with renewal terms, bargain purchase options (BPOs), to set up contracts with penalties instead of bargains—if bargain option could not be used to use a penalty instead, which but was not in the standard, sales and lease backs, they came up with the ways to buy the power from a utility, where they could buy all the power from the power plant on their land—but now that would not be a debt, and that would just be a normal commercial contract. They started looking for scope exceptions, and they started reading the scope paragraph of the standard to see if there was something in the scope paragraph that they could use to say this does not apply to this transaction. They tried to setup options to buy electricity, so that it would not be a lease any more. They talked about setting up special purpose entities, where a series of companies would get together and create a new company and the new company would buy the power. They were actually very clever, and they were able to come up with a lot of different ways that this transaction could be set up that would take it off-balance sheet. The only thing they would tell me is if I gave them more time or if there was really more money involved here, they could get more ways to take this transaction off the balance sheet.

How do you account for all these options the same way (comparable)?

One test for the new Exposure Draft is that could it create comparability in this setting? Could it take all these different ways in which this transaction could put together, and force the accounting to come out the same?

a. New Exposure Draft (ED) on proposed joint IASB/FASB lease standard

One of the key motivations of the new Exposure Draft is to stop this game going, where it suggest to use fair value and to get rid of the distinction between operating leases and financing leases, and therefore to basically require all leases to be on the balance sheet without any tests, conditions, and bright-lines. So, that seems fine.

b. Loopholes

We could check the loopholes. In the first place, all the CFOs started looking was in the scope, and checked would there be scope exemptions in the new standard. The answer is “yes.” There would be exemptions for intangibles, biological assets, leases to explore or use minerals, oil and natural gas, regenerative assets—their power plant could be considered a regenerative asset, where all of a sudden, they could argue that the standard does not apply to their transaction—as well as investment properties.

c. More inconsistencies

You start looking in the standard, and you start finding more inconsistencies. The standard proposes to treat leases, which are for less than 12 months differently from leases that are more than 12 months. This is actually trying to get at that issue of having a contract to purchase services, and normally when you purchase services—even if you have a contract to purchase services over several months—you would not record a liability, and therefore the short-term leases are being treated as normal purchases, and thus, they go off-balance sheet. Therefore, in the proposed standard of IASB and FASB, short-term leases will be treated differently than long-term leases. Again, you can see that a fool who likes playing games with the renewal terms would have fun creating renewal terms where each of those terms would become less than 12

months, and take all of them off-balance sheet.

The FASB and IASB also decided to try and close the loophole on renewal terms. Accordingly, renewal options would be counted, and they put a test in there, where if the term is more likely than not to be extended. Again, the interesting question comes here that how will the company and the auditor decide in case if there are several possible terms, and out of them which are more likely than not to be exercised. And there is actually a paper in *The Accounting Review*, where Kadous et al. (2003) had tried a similar kind of experiment with auditors, and they find that the auditors would generally find it very difficult to argue against the way management had defined which terms were more likely than not. Therefore, to a large extent, management could get away with interpreting that term in whatever way it wanted to.

There is a provision for revaluing at future dates, and if so that could decouple the asset value from the liability. So, you started at the beginning where the assets and the liabilities match, but at other points in time if you start revaluing they may not match even for the same transaction.

More on proposed lease standard

a. Special purpose entities (SPEs)

The standard does not deal with special purpose entities. Therefore, if you want to create special purpose entities, you can continue to do so and nothing in the new standard will prevent you in doing so that had been newly introduced in comparison to the old standard.

b. Different models

Another interesting thing that happens in the standard is that the lessor gets treated differently than the lessee, where while the lessee is fixed into one model, the lessor is given two models. So, the lessor and the lessee would not have to record even the same transaction in the same way. Now, this is from the IASB who believes in consistency! This is the standard they wrote after 14 years of study.

After 14+ years of study and drafting of Exposure Draft (ED)

So, after 14 years of study and drafting by the body who believes in consistency, their own standard is not consistent. Also, they cannot stop the games that are already being played, and I do not need the investment banker to be clever to create new games.

What do we conclude from this? If IASB knows which games the CFOs are playing, and they are determined to stop them, they had to spend 14 years trying to figure out a new standard. They believe fervently in consistency and they cannot write one standard, and then, it is just very hard for them to write the standard despite their best efforts and expertise. I believe that they really want to be consistent, but it is not.

Seeking global consistency/comparability

So, consistency and compatibility are nice slogans. They sound good in theory, but *they* cannot do it in practice, and forget about I cannot do it in practice. Now, we have only looked into one standard. We did not even look across standards to get consistency, and we did not even look at what is the new game the CFO might come up with. This standard is already not going to work. If this standard gets adopted, the manager will be able to get just as much stuff off-balance sheet as could be done before and does not even have to learn anything new.

So, let's focus on the auditor

I think we really need to start asking some questions about the auditor, because we can start writing these standards anyway we want, but it is not going to work. We need the auditor to come in and change the way these standards are being applied, and otherwise, I cannot see how it works.

So, now we can ask the question, what kind of auditor do we need, or how do we need to change the auditor to get the standard to reflect what is actually going on in the company? This is because this company is really buying power, and it is really assuming a debt obligation, and accordingly, how will the accounting show this reality given the management is very clever, and knows all kinds of ways to play with the rules?

Jamal & Tan (2010)

What we have found in our study is that we need really a principles-based auditor, where the auditor should not to say, "I'm checking to see that you follow the letter of the standard." Instead, what we need really is for an auditor to say, "I'm checking the substance of this transaction to see whether the true substance of this transaction is really being reflected in the accounting." Now, how do we get an auditor to do that?

a. Bring back true and fair override

We used to have a true and fair override in the standards, and in Canada we had that until very recently, where the auditor was expressly authorized to override any standard in case if they felt that it did not reflect the true substance of the transaction. Then, it was taken out as a part of the GAAP hierarchy, where we were so concerned about writing rules, and telling people which set of rules were the most important rules, and overriding the rule became almost impossible. No auditor could override the rule and simply say, "even though you comply with the rule, this does not reflect what is really going on here." So the regulators and the standard-setters effectively took away the power of the auditor, and the auditor simply cannot tell that.

b. Bring in Safe harbor

The second issue being discussed in the auditing literature in the US is of having a safe harbor for the auditor, in which the auditor could not be sued or disciplined by the professional regulators in a certain range of cases, where the auditor had exercised professional judgment. This could be considered another way to encourage the auditors to exercise judgment, and not just to follow the letter of the rules.

c. Auditing the auditors

A third argument that being starting to be proposed is that the Public Company Accounting Oversight Board (PCAOB), which is the main public company accountability board in the US that regulates the auditors, should start to audit the auditors by checking their professional judgments, and not whether they ticked-off a whole bunch of boxes in an audit program. Again, it means that the regulators and the rules of auditing would have to change drastically that changes dramatically the behavior of the auditors, and the power of the auditors to interpret the rules.

Auditor-Client Negotiation

a. Auditor appointment

Another issue which is much more contentious is to change the appointment process of the auditor. The auditor is appointed by the company, and therefore it becomes very difficult for the auditor to really take a stand against the management when very contentious issues come in. We have some studies looking at this aspect. At present, in some countries, I believe in Korea, the stock exchange is starting to appoint the auditors, and not have the individual companies appoint the auditors.

b. Auditor to enforce substance of rules

So, my main point here is it is good to have debates about accounting, the structure of accounting rules and the substance of accounting rules, but we also need to have is a parallel debate about the nature of the auditors. If the gains that we want from changing accounting rules are to be realized, we will have to change the auditors as well. If we do not change the auditors, you will get no benefit from changing the accounting rules. You can change IFRS, and you can incur all the cost of IFRS, but if the auditor applies the rules the way they apply the current rules, you will get no benefit from IFRS.

Conclusion

Have accounting & auditing standards set by same board

One possibility that maybe we need to think about is to have accounting and auditing standards set by the same body. One of the problems that I think we have right now is that the accounting standards board sets accounting standards, and does not worry about how the auditing will be done, which is left to the auditing standards board. For example, if some kind of fair value measurement gets put in, or some kind of judgment gets put in, like “this more likely than not,” then, that does not trouble the accounting standard-setters, and instead troubles the auditing standard-setters. Maybe, however, if the accounting standard-setter had to worry not only about how the accounting standard looks, but also how will the auditor actually be able to apply this rule, then we would get better implementation of the rule. This because that you would not end up with standards, where after they are written down and they look very nice, the auditor goes to apply them and then finds they cannot apply those rules, except to give management huge amount of discretion, in which case the auditors are in trouble, because then management can use the discretion the way they want.

Interesting to see effect of competing GAAP in Canada (and worldwide?)

I think we will have an interesting opportunity to learn, where as countries like Canada allow companies to choose their accounting, I think in the next few years it is going to be a very fascinating opportunity to see which companies continue to stay on US GAAP, which companies adopt IFRS, which companies chose those private standards, and what evolves over time, and how will each of these standards evolve over time; and we will get a very fascinating opportunity to see how that works across boards.

Additional remark

I will make one last comment, which is not in my remarks. I have had the opportunity to deal with US regulators as a foreigner. One impression that I always get when I deal with US regulators is that they think their opinion is the one and only right one. I cannot believe that the

US will ever get to a point, where they will let a foreign body to set the rules—as IFRS—for all US companies. I have never met an American government regulator who had any interest in the opinion of foreigners, and that they would actually follow the opinions of foreigners, I find almost impossible to believe. So, my prediction is that the US will never go to IFRS, and at the end of the day that will never happen. Thank you.

Prof. Masaki Yoneyama

Thank you Prof. Jamal. Before we have a break, we will receive a comment. As I mentioned this symposium is part of the Global COE program of the University, and therefore, Prof. Tatsuo Uemura will welcome all of you. Prof. Uemura, he's the Chief of the Global COE program.

Welcome Remarks

Prof. Tatsuo Uemura

Graduate School of Law, Waseda University

Thank you for the introduction. I am at the wrong timing, I admit that, excuse me for this. It so happens that this theme and time, at the Ibuka hall of our campus, regarding the financial ADR, there is another symposium. So I have to go to different meeting rooms here and there; I'm running around. Excuse me for this funny timing. But the Ibuka hall is empty, I must admit. May be this event, Tsujiyama-san, I am sorry you should have used the larger Ibuka hall, the other way around.

Prof. Zeff also visited Waseda University, and Prof. Tsujiyama has been the organizer when Prof. Zeff came here, and again you have organized this excellent meeting, thank you Eiko-san. At the G-COE, we have the Graduate School of Law and the Graduate School of Commerce. Both of the institutes are behind this Global COE. We enjoy research and exchanges together with our accountancy experts.

Prof. Jamal just mentioned that the American people would not be interested in learning non-American laws; that is also our impression. In particular the comparatively law, they do not have the concept of comparison; because they are the only correct persons. Your very last message Prof. Jamal, I fully agree with you. I strongly appeal that it is the same.

If I may, this is my observation, Prof. Zeff came to Waseda University just last week, and what impressed me was many of the developing economies have adopted IFRS. However, the World Bank loan includes the condition that they move towards IFRS. That was what Prof. Zeff told us when he came to speak. Now I ask about that question, whether that was an appropriate thought. But, of course, each and every country should develop their own good quality standard, probably it was only good intent by the World Bank. But, the developing economies had no freedom to say “no”, to what the World Bank told them, and therefore even if it might have been good intent by the World Bank.

In the 15th century and 16th century, Christianity was brought into Japan when Japan was closed by the Edo government. But, that is one big factor behind the reason why that more than 100 or in fact 120 countries have decided to adopt. Now, if there are 120 countries, they could not be wrong. That might be one argument. But out of this 120 or so, developing economies account for the large proportion and if they say they have adopted, there are multiple reasons,

maybe that there are non-accounting reasons as well. That is my first comment.

Number two, when it comes to this kind of issue, the global market is a presumption. The assumption is that as long as you are globally active, comparability might be required. That argument is understandable. So in that regard, as a rule of the financial capital market and the comparability and unification, is it a legal issue or is it a general accounting issue? When it comes to a general discipline of accounting, it could be different.

In Japan between these two disciplines, sufficient exchanges have not taken place. As I listen to Prof. Zeff at the other time, SEC and FASB, between these two organizations, it might not be public, but there are rule-making exchanges as part of the rule-making accounting setting is made jointly between SEC and FASB, even if it is not apparent at first sight. So the methodology and the relationship with the idea of legal context and the accounting method, the two professors, are you over thinking about this relationship or is this relationship only natural, which was the area that interested me. This is related to what I mentioned at the outset.

After all, just like it was in Japan after the Second World War, there was no market, so to say, the market had collapsed after the war. Now, the concept of regulation it was like policing the industry. We had to protect the investors from wrongdoers in the market. So it was not about unifying the market, there was no concept for consistency, but in the 1930s towards the 1940s, and protecting the investors and cultivating the investors became the next phase of a concept in the regulatory framework.

But in the last 10 or 15 or 20 years, finally we have started to focus our attention on a market. A market-based regulation making, it only started in the last 10 or 15 or 20 years. However, Japan does not have a mature rule that fits this level of society; that is my opinion. In many developing countries, where they don't have a market in the first place, then could they adopt IFRS just because of the pressure of the World Bank?; they were forced to start to use IFRS without having a mature market.

I have a big question, at the end of the 1940s or the 1950s in Japan, if we were forced and asked to use IFRS, there was no competence to start using IFRS had Japan been forced to adopt IFRS right after the war. But the reality, the circumstances of the market are the IFRS commensurate with the maturity or lack of maturity of the markets today in the developing economies; I personally have a big question. I am not able to stay to ask the questions during the panels, so I have unilaterally mentioned my observations. Thank you for this little time. Thank you.

Prof. Masaki Yoneyama

Thank you Prof. Uemura. We will have a break. We will break for 20 minutes until four o'clock. We will break until 4 PM.

One important matter before the break, about the paper to write your question; we welcome your questions, so please find the paper to write your question. So, we have some time to wait for you, we invite you to write the question on the paper. Please hand it to the staff.

Panel Discussion

Moderator
Panelists

Prof. Eiko Tsujiyama
Prof. Shyam Sunder
Prof. Karim Jamal

Prof. Masaki Yoneyama

Thank you for coming back. Ladies and gentlemen, we will start the second part, which is the panel discussion. And it will last until half past five. But there are 17 questions that we have received, and therefore we would like to use these as the basis of our questions and answers. During the panel, we will have our two lecturers as our panelists. Prof. Tsujiyama will moderate, and I will hand over the microphone to Prof. Tsujiyama.

Prof. Eiko Tsujiyama

Thank you very much for staying with us during this panel discussion. In the first part, there were two interesting and excellent speeches.



Sometimes, in other conferences, the chairperson is in a difficult situation by not receiving any questions, but I have received 17 questions, which is a large number. It might be, however, a bit too much for us to cover within a limited time. First of all, let me apologize beforehand that if we do not manage to respond to all possible questions, but, thank you very much for handing in your questions. As was mentioned in the two speeches, regarding the issue of IFRS adoption, I think we should divide this issue into two for this discussion. Number one is purely an institutional issue, and the second issue is on the substance of the standards. Of course, the system itself and the substance are interrelated, where they cannot be entirely disconnected. For the purpose of organizing the panel discussion, however, I would like to divide the discussion based on these

two dimensions. Among others, the questions received also include questions on the status of the future of adoption, and the scope of applying IFRS if it is adopted in Japan.

Question 1: Attitude towards IFRS in Brazil, Russia, India and China (BRICS)

Prof. Eiko Tsujiyama

As was mentioned at the beginning, our two speakers are very deeply versed and familiar with circumstances of other countries. From the Japan Corporate Auditors Association, Mr. Arai has submitted a question, and we shall commence with it. The question is that if you have information, what are the attitudes towards IFRS in Brazil, Russia, India and China—BRICS—countries?

Prof. Shyam Sunder

I know a bit about China and India, but not about Brazil and Russia. China may permit IFRS for some corporations, but I do not know the details. I also do not know the details of the form of IFRS China will adopt, and they may have a Chinese version of IFRS. If, for example, the IFRS were to be applied in China in a manner similar to Europe, most state-owned Chinese corporations will have to report as a single entity upon consolidation. I do not know what it means to apply the IFRS in China, but I have learned that China will allow the IFRS, and some claims that IFRS is being applied in some Chinese companies.

Translation is another issue. How many people in London can read financial statements in Chinese, or in other languages of the world? What do they know about the validity of the claims that the IFRS has been adopted in more than a hundred countries?

Until recently, the word was that India will adopt the IFRS—the Indian version of IFRS. So much for comparability! Now it appears likely that India may not permit an IFRS monopoly. I do not know about Brazil or Russia.

Prof. Karim Jamal

The only comment I can add about China is that in my understanding, China is determined to continue a domestic standard-setting capability both in terms of accounting and in auditing. China is also very keen to have Chinese auditing firms as the major players in the auditing market, and not to allow the Big four firms to dominate the market in China as they do in audit markets elsewhere.

Question 2: The possibility of adopting IFRS in US

Prof. Eiko Tsujiyama

Thank you. This is related to the earlier question. In Japan, IFRS adoption is discussed, and between 2008 to the autumn of 2009, there had been a great increase in discussion on potential adoption, where at that time we believed that the US would also go for adoption. The US reaction was a big factor. Mr. Arai in the earlier question also referred to the movement in US, and wants to know the observation of our two speakers and your opinion on the US action on adoption. Mr. Kumojima from Orix Corporation and some other members from the audience have raised similar questions. What do you think about the possibility of the US towards adoption, which you did refer to briefly in your speech, but if you could elaborate more, please?

Prof. Shyam Sunder

About 10 years ago, Prof. Ronald Dye of Northwestern University and I wrote an article in

The Accounting Horizons titled “Why Not Allow FASB and IASB Standards to Compete in the U.S.?” The reaction of the FASB to our article was negative, but the reaction of IASB was very positive; possibly because the IFRS was not allowed in the US at the time. Two years later, I wrote another article arguing why it is a good idea for all countries in the world to allow multiple GAAPs and promote supervised competition in their respective jurisdictions. This time, IASB reacted very negatively to the idea of competition. Perhaps it was not surprising because we all prefer competition for others and monopoly for ourselves.

Regarding your question on the US, I think the Securities and Exchange Commission under the leadership of Chairman Cox, and under President Bush, seemed to be committed to move towards letting the US companies use the IFRS. I do not know if they would have allowed an IFRS monopoly in the US. However, under the leadership of Ms. Schapiro in the Obama administration, that commitment to the IFRS and the IASB has waned. In my assessment, the US Congress is not likely to give up its authority over financial reporting standards in the US, which means that the IFRS will not be allowed to have a monopoly for the US companies.

The US does currently permit foreign corporations to report using IFRS, and they may permit US companies the option to use IFRS. However, as Prof. Jamal pointed out in Canada, a competitive regime seems more likely.

Prof. Karim Jamal

I have told you my view of the US regulators, and as the Chair of the Financial Accounting Standards Committee (FASC) of the American Accounting Association (AAA) that provides advice and opinions to the US regulators, any time we provide a recommendation to allow IFRS—even for foreign companies—we get a lot of resistance from the US professors. So actually, a lot of US professors of accounting are absolutely opposed to anything other than the US GAAP. Even within our own committees, even with people like Prof. Sunder and myself, we have enormous difficulty in convincing the American accounting professors that something other than American GAAP should be allowed in America. So, we face tremendous resistance, even from and within the academic community.

From outside, when the Securities and Exchange Commission (SEC) was deliberating on allowing foreign companies to use IFRS, and when we wrote a letter in support of that and said to consider allowing foreign companies to use IFRS without reconciliation, first we got attacked by a lot of people in the US by saying that they should not have to reconcile the IFRS to the US GAAP. Then, a lot of lawyers started writing letters to me saying that if the US SEC ever allowed IFRS to come in, they were all prepared to start filing lawsuits, and that the US government would be tied up for years in court, because they viewed that it as a violation of the Constitution, and that the government and a regulatory body of the government did not have the right to give up the ability to write US laws and US regulations to a foreign body.

In Canada, we just learnt a lesson never to make a harmonization decision because the US is going to make a decision. In 1970s, Canada had been on Imperial weights and measures, and during the Reagan administration, the US started talking about moving to the metric system. So in Canada we said, if the US moves to metric system, we need also need to move to that system, as the US is the largest trading partner of Canada. So, Canada switch to the metric system, and the US never did. Even today, the US is not on the metric system. We ended up incurring a lot of cost to switch to metric, and now we report everything in both measures. So at some point, we just realized that if we are going to make a switch because the US is going to make the switch, then to make sure they make the switch, unless otherwise we will be stuck.

So again, I just cannot imagine that the US will allow its laws or its accounting rules to be set

by a foreign body, which is not under their control. I think the reason why the head of the FASB resigned is that he had actually staked a lot of his reputation on convergence, and I think it became clear to him that that it would never happen, and he left quietly.

Question 3: Competing standards, one size does not fit all, and impact on innovation

Prof. Eiko Tsujiyama

Thank you. You summarized the institutional trend and global institutional trend and thank you. In your speeches today both of you mentioned that “one size does not fit all,” to mean that existence of a single set of accounting standards alone may not necessarily be good, and needless to say, there are both pros and cons of it.

There are some supporters—maybe the majority—who agree of the idea that there should be one single standard in the Japan, because otherwise, it would lead to the lack of comparability for the investors. We heard, however, from the speakers that standards should compete with each other, so that the better standard can survive the natural selection. Messrs Yasuda and Minami from audit firms, and Mr. Murakami of Waseda University, have similar concerns.

So, if one single standard-setter monopolized the standard-setting, then, would it really stop or block innovation? Is that true? Some do not agree with this idea and claim that having one single set would not necessarily impede competition, because for example, in Sumo wrestling, the Sumo wrestlers can compete on the same playing field. So they opine that having a single set of standards may not necessarily block innovation, and having multiple standards might not necessarily be the best. I have bundled up the questions, and the idea is that there are mixed views among the audience, and we would like to seek your observations on these views.

Prof. Shyam Sunder

I think these are important questions. Behind them is the weights and measures analogy. But it is not a good analogy. Why does the IASB proposes different standards for small and large firms? It is like arguing that the kilogram used by small vegetable vendors should be different than the kilogram or liter used by department stores? Standard-setters in the US, Europe and elsewhere have considered variations in standards based on firm size and industry, based on the argument that the same accounting rule does not create a level playing field for all. If that argument is true across size of firms and across industries, within the same economy, why would it not apply across countries, where legal systems, commercial codes, economic environment, and political environment differ substantially? In my remarks I mentioned the example of applying the IFRS for consolidation in China, and the latter claims it will not yield comparable results. Application of the same rule in different economic, social and legal environments does not yield comparable results.

Second, consider a Japanese example. I believe that in early 1990s, Japan adopted a consolidation standard fashioned after the American standard. The latter was based on equity ownership. Applying the American standard in Japan, the results were not comparable. In Japan, inter-corporate relationships depend less on equity ownership and more on operational, vendor-customer, or shared management relationships. Therefore, application of the same rule produced very different results.

Third, it has been claimed repeatedly that granting discretion to management to choose from alternative methods of accounting makes financial reports less informative to investors and other outside users. But when you give people opportunity to make choices, they reveal information

about themselves. For example, when a person applies for fire insurance, the insurance company would like to find out whether that person smokes. If the insurance company asked, the person would say “no”. How does the insurance company find out whether the policyholder smokes? The insurance company offers a choice between two carefully designed insurance policies. One insurance policy has a high deductible and low premium, while the second policy has low deductible and high premium. The design ensures that its better for smokers to choose the low-deductible high cost policy and for non-smokers to choose the cheaper high-deductible policy. By giving them a choice, the insurance company finds out the truth. The same is also true in accounting. If one company chooses accelerated depreciation, and the other chooses straight-line depreciation, and other things being the same, a smart reader of the financial statements will place more trust in the company using accelerated depreciation, because the management of that company is confident enough about the future of the firm to use this method of accounting. Choice of method of accounting is an important signal about what they management know about the future of the firm, and it is not easy to falsify. Giving them discretion allows people to give more information about themselves to the outside parties. Elimination of discretion eliminates channels of information from the firm to the outside parties.

Prof. Karim Jamal

I think in the current environment, the question that comes with innovation is that how do we get the standard-setters to think about what they are doing and prevent them getting into a group think of some kind, where they all think the same way and come up with just one kind of response. Let me give you one example by using again consolidation. For a long time, the US allowed pooling of interests accounting either because they thought that was a better accounting or the companies that were engaged in lot of mergers and acquisitions wanted that kind of accounting as it made the numbers look good. In Canada, however, the standard-setting board always considered that to be bad accounting, and disallowed pooling of interests accounting. Despite that Canada was in general trying to harmonize with US GAAP, this was one area where there was a very sharp difference in the accounting rules. Why was the Canadian standard-setting board adopting a type of accounting that was different than the American standard-setting board? But, eventually that question also got asked to the American standard-setting board. Thus, despite the huge power imbalance and the US economy being much bigger than the Canadian economy, where usually the pressure is on the Canadian standard-setter to converge to the US standard-setter, after a little while, it became clear that the Canadian standard was actually better, and eventually the US changed and prohibited the pooling of interest method. This is one very clear example where having more than one standard-setter, and having the standard-setters choose different treatments that can be very useful, and force all the standard-setters to think very carefully on why do they have the standard they have, and how can they be sure that their standard is actually is the better one.

But, as a broader kind of response to that question, I think that there is always this concern about competition, where competition will lead to what I will call a “race to the bottom,” and somehow if there are multiple sets of the standards, that people will find the worst one, and that the worst one will dominate and kill the better one. We have started to do some studies on that, and in a way looking at Canada versus US is kind of instructive because Canada tends to be much more regulated society compared to the US. Thus, what you tend to find in Canada is much less variation. If we looked at Canadian universities for example, what you would find is that there would be a range within which the universities would vary, but that range would not be very large. In the US, where competition prevails, you would get much more variation. You would

get a Harvard, and you would get a Yale, and you would also get some really bad universities. The competition actually generates a much wider range and the level of excellence occurs because of such competition, and not that such competition will make Harvard to become a bad university. In fact, Harvard becomes a better university all the time. In the case of accounting, because it will still be regulated—it would not be a totally unregulated market—I think we would have less risk of going to completely low quality standards, and we would have a chance to get really good standards. On the other hand, however, we cannot say definitively that there would never be bad standards as well. Furthermore, if you looked at software companies in India, a lot of them adopt the US GAAP even with no legal requirement to do so, because they want to access global markets, and they perceive the US GAAP to be a good GAAP and a better GAAP than the Indian GAAP. In Germany, a similar situation could be observed where certain companies who have the necessity and a choice, tend switch to IFRS from the US GAAP to access global pools of capital. Even in Canada, during the transition period, certain companies were very quick to transition, and certain companies had to be dragged by their feet and did not want to move. The Canadian companies that needed the most capital, were the ones who wanted to list in the US, because they could access a much larger pool of capital in the US, and they wanted the US GAAP, even with the requirement of the adherence to the Sarbanes Oxley Act and US auditing standards, which cost higher in Canada because it would be a smaller pool of auditors who would be familiar with US GAAP. But they voluntarily choose. So it is not clear that you would necessarily get a race to the bottom, although that is a valid concern. The presence of regulators would create a floor, so that you do not go all the way to the bottom, and you do not want anybody to go to the bottom.

Question 4: Preparation of individual and consolidated financial statements using IFRS

Prof. Eiko Tsujiyama

Thank you. Before shifting from the first part, there is one final question. Mr. Miyauchi from Asahi Life Insurance has submitted a question.

There is a serious attention and debate about potential adoption of IFRS in Japan. Even if you say IFRS adoption, it could be different in substance. Across the world, the first country to adopt is Canada, but still the US GAAP is permitted, and thus, there is a variation even if you say a country had adopted IFRS. In Japan, what is being discussed is whether to divide the consolidated financial statements and the individual financial statements in the application of IFRS.

Now, let me move into the question by Mr. Miyauchi. He notes that in Japan, adoption of IFRS in the context of the consolidated financial statements is the direction, and nothing is decided on the individual financial statements. He further states that it is known in Japan that in Europe, IFRS seems to be adopted in the context of the consolidated financial statements, but such adoption varies for the individual financial statements among the EU members. So, he asks what it is like in Canada?

Prof. Karim Jamal

In Canada, there is no notion of having different rules for consolidated versus non-consolidated financial statements. But, when you get into banking and insurance, those are highly regulated activities, and therefore, sometimes the regulators simply write the rules that they want, and the banks and the insurance companies sometimes get into trouble, because the bank regulator has written a rule, which is different than the GAAP. Let me give you one very

simple example, which is the calculation of bad debt expense. The bank regulator requires banks to take a general provision, which means as soon as the loan is made, the bank has to estimate how many of those loans will go bad, and set up a provision for them, even though there is no evidence of anything going bad. Then later, when you do have the history, you can make some additional provisions, but you cannot adjust the provision you made initially. So now what happens if the bank regulator starts to make accounting rules, which are not necessarily synchronized with what the GAAP body is doing? With the mounting criticism and political pressure, standard setters commenced saying that banks, insurance companies and other regulated entities should not have to be made to follow GAAP. So effectively, IASB suggests that banks and insurance companies can have their own GAAP, even in countries that are adopting IFRS. This was to avoid getting blamed for the bank failures and not reporting losses. So, effectively the insurance companies officially have no special rule under GAAP, but that authority is now being given to the regulator. So, companies could use IFRS, US GAAP—if cross listed—and there is actually a third option, where banks and insurance companies effectively can have their own GAAP.

Prof. Shyam Sunder

From what we just said, it seems clear that even in a world where IFRS is universally accepted, we are not going to achieve comparability. It is a false hope.

Question 5: Global adoption of IFRS and the impact on national auditing profession

Prof. Eiko Tsujiyama

Thank you. I forgot to mention this before. Prof. Jamal from Canada said that there is no Harvard or Yale in Canada, and the variation is small. But, I think he is very humble, where Alberta University is an outstanding top-level university. Let me add that comment, which I forgot to say right after he spoke about it.

There are other questions from the floor, and one question is on the scope of applying IFRS in Japan. In fact, during the lunch the professors asked me what would be the scope in Japan? The answer is that we do not know. As I explained at the beginning of symposium today, apart from a personal estimation, we are looking at the reality and circumstances.

Now, because our two speakers have a lot of information to share with us, and therefore, once you ask a question they continue to respond for long, what you do in a classroom is that you bundle some of the questions together, so that we can cover more questions.

So the next question is about auditing. Prof. Jamal, in your speech, you said that not only the accounting standards, auditors will also have to change. Probably, the person who wrote this question believes that it is okay if audit standards become more principles-based, Prof. Jamal what do you think? Furthermore, about auditing, I have my personal impression, suppose in Sri Lanka more than 10,000 CPAs are present, and if they adopt IFRS in Sri Lanka, and if the auditing standards become uniform globally, then what happens to CPAs in Japan and Canada? So would they be replaced by Sri Lankan CPAs? Will the Japanese auditors lose their jobs? Will there be so much abundance in the CPA market, and cheaper CPAs will be hired from Sri Lanka? PwC-Arata Mr. Yasui Hajime. I mean whichever audit firm you choose, if the outcome is going to be the same, there will be a bargaining for lower audit fees, and they will bring in non-Japanese auditors in this market. What do you think?

Prof. Karim Jamal

Well, the easy question to answer is about the bringing in the non-Japanese auditors. What we are seeing in Canada is increasingly audit work is being outsourced. There are a lot of accountants in India who are very knowledgeable about the US GAAP and the US tax. They know more about the US tax than they know about the Indian tax. I think almost all the big four accounting firms in Canada have an informal quota, where at least about 20% of the audit work has to be outsourced. You do not have to bring the Sri Lankan CPA to Japan, and just to send the work to Sri Lanka. So increasingly, audit work is amenable to being automated, and testing can be done by computer, and at least some of the work can be outsourced, and it will be. Especially with global audit firms, it is very easy for PricewaterhouseCoopers in Canada to send some of the work to PricewaterhouseCoopers in India, or in Sri Lanka, where they do not need to bring the accountant from Sri Lanka to Japan, and instead they would just send the work to their office in Sri Lanka. So, some of that is going to happen regardless of accounting standards, as under any set of standards, technology is going to change.

With regard to auditors, the question is that what would make auditors different than they are now. In the US particularly—maybe to large extent in Canada—the auditors tend to follow the rules very literally. So, what they mean when they express in their opinion that the financial statements present fairly is that the financial statements comply with the GAAP. If there is some rule in the GAAP that allows the management to do something, then the auditor feels that he cannot say “no.” So, if the management structures a lease to meet the exact lease accounting rules and comply with the tests, which maybe just to satisfy such requirements, but the auditor feels he cannot say “no.” Therefore, to have an auditor who can say “no”, first we would need a slightly different kind of accounting. Instead, the accounting should not be so precise or stated in such a way that the management could set up the transaction easily.

But the other problem for the auditor, particularly in the US and to some extent also in Canada, is that the auditor is subjected to being second-guessed by the regulators. In the US, you have the Public Company Accounting Oversight Board (PCAOB), which audits the auditors, and in Canada they have a similar board. Accordingly, if you are an auditor of a company in the US or in Canada, and after you have done the audit, a government regulator comes in to check your audit. Now, the question is what will that regulator do? If the regulator acts in a very mechanical way, in a sense that takes the rulebook and checks-off very precisely whether the auditor has followed the rules, then the auditor becomes very rule oriented, which is because the auditor can claim that each of the boxes of an audit program is ticked-off and thereby had followed the rules and therefore all is fine. Otherwise, the auditor knows that the government regulator is going to penalize for not doing so. So, the whole structure of regulation of the audit profession would have to change, and the whole incentive of the auditor would have to change. Furthermore, that is why it is important to resurrect the true and fair override. At least in the old standards, if the auditor felt that narrowly following all the rules created a presentation that was not reflecting the underlying substance, they could override them, and say “no.” But, by taking out those kinds of rules, officially the auditor has no right to say that. Therefore, I think we would need to change both the structure of the accounting rules and the auditing rules, and give the auditor the power of oversight, and also change the way the regulator deals with the auditor.

Prof. Shyam Sunder

I have argued for the advantages of competition among standards. Is promotion of competition for audit services a good idea? My answer is “no.” Such competition has caused huge problems, and these problems have arisen during the last 30 years, largely because of

changes in public policy in favor of promoting competition in markets for professional services in the US, as well as in many other jurisdictions. It may work for some professional services, such as medicine, law, and dentistry, but not in auditing.

Unfortunately, auditing services provide an extreme case of what economic theory has labeled “market for lemons,” after George Akerlof’s famous article in 1970, for which he received the Nobel Prize. Akerlof pointed out that when the quality of a good or service is not observable by its customers, promotion of competition in the market for that good or service destroys the market by lowering its quality as well as its price. Audit service is an extreme case of unobservable quality. The quality of medical services is at least partially unobservable because most patients learn if they get well after being treated. Similarly, most clients can judge the quality of legal services after they find out if they are behind the bars. In case of audit, the customer—especially the small shareholder—knows little about the quality of the audit service provided, either before or after the fact. It is a well-established result in economic theory that promoting competition in such markets results in decline in service, quality and price. Beginning 1979, United States pushed for increased competition in all professional services, not making an exception for auditing, and that change in policy has led to a decline in the price of audit services, and ultimately in the quality of audit. In this case, ignoring economic theory, or misinterpreting it, has led to severe problems in the audit industry.

Question 6: Regulators role and principle-based auditors

Prof. Eiko Tsujiyama

Thank you. There is a similar question that I had forgotten to ask before, which is from Mr. Ochi, Sumitomo Corporation. The opinion of Prof. Jamal that auditing and being principles-based are very closely related is very interesting, and in that case what role should the regulator play? In an international framework as Basel, where financial regulations are discussed, what kind of a role should regulators play in this regard? Could you please elaborate more on this?

Prof. Karim Jamal

If we will think that the regulator encourages the auditor to be principles-based, well, first the accounting standards would have to be principles-based, then the auditing standards would have to be principles-based, which means that the auditing standards would not be so prescriptive, and they would not be written in so much detail. An auditor who is completely routinized is a less effective auditor. But the bigger issue, at least as I understand in Canada and the US is this post audit done by the regulator, where the regulator checks whether the auditor had ticked-off various check-boxes, and then the auditor becomes very literal and becomes very rule-oriented. The auditor will not make any judgments.

So the kind of response to the comment—as Prof. Sunder also made—is that I think the regulator need to check the audit quality. But the way to check the audit quality would be like doing a tax audit. The regulator would actually have to go to the company, and look at what is the underlying transaction, and then see how that transaction got reflected in the financial statements, and did the auditor make sure that what is reported in the financial statements actually match the underlying transaction.

But what is happening right now in Canada and in the US is that the regulator does not actually go and look at the actual transactions. What the regulator does is the regulator looks only at the working papers of the auditor. But the audit of the working papers of the auditor cannot tell whether the auditor made a good judgment or not. The only thing that the audit of the

working paper of the auditor can tell is that the auditor filled out a working paper, ticked-off the relevant box, put the name and initials where it needed to be put in, and if some description of what had been done had to be put in had been written down. But, if such inspection is done, the auditor will not use the judgment. So, I think the interaction between the regulator and the auditor is crucial. But, the regulator would have to change the thinking about audit quality.

Question 7: Selecting between qualitative characteristics

Prof. Eiko Tsujiyama

Thank you. Concerning Mr. Ochi's question, there was one more point that he had asked. This is about the substance of accounting standards, and I was going to mention it later. Accordingly, in the first part of this question, it had been pointed out that the conceptual framework revision resulted in faithful representation by dropping reliability and verifiability. So, in the pursuit of being principles-based, IFRS essentially has taken up that kind of a characteristic. That is his opinion. But, I would like to ask our two professors' comment on this aspect, which relates to the substance of the accounting standards. So, could you provide us your views?

Prof. Shyam Sunder

In his presentation, Prof. Jamal pointed out that the IASB has moved in the direction of the so-called fair values, increasing subjectivity, and away from verifiability. It has become more difficult for auditors to verify such financial statements. In relatively liquid markets, such as those for US and Japanese treasury bills, that is not a problem. But most assets, even most financial assets, are not traded in such liquid markets. As financial reporting moves in the direction of market-based accounting, it requires estimates which have larger errors of measurement and greater subjectivity, rendering them less verifiable. Warren Buffett has called this mark-to-myth accounting.

The IASB has defended its standards by using the faithful representation criterion, and has put reliability on the back burner. These characteristics of financial reports call for difficult judgments, in making trade-offs between them in specific circumstances. It is not possible for an expert or a wise person to make definitive and right judgment about trade-offs among faithfulness, reliability and verifiability, in general. I think the proposal for competitive standards will allow different standard-setters to make different judgments to be evaluated by the investors and other parties who use financial statements, and the latter will ultimately decide which standards are better. We cannot settle the arguments about alternative conceptual frameworks and alternative weights on reliability, representative faithfulness and verifiability by ex-ante arguments by discussion on a table. Nor can such decisions be entrusted to boards such as the IASB. It is simply not a dependable approach to getting financial accounting done right.

Question 8: Better accounting, market and society

Prof. Eiko Tsujiyama

Well, here is a big topic, which is rather complex. But, let me read this question. Prof. Shiba from Kansai University raised this question. In the first slide of Prof. Sunder, there were three circles, which depicted better accounting, better markets, and better society. What is the best way to understand the relationship between these three levels? Regarding the IFRS monopoly, is that something that should be discussed at the accounting level, the market level or at the

societal level? So what is your picture trying to show?

There is a matrix here that consists of four cells or four combinations (good accounting, bad accounting, good society and bad society). So, for example, could accounting create good market, but creates bad society? Is that possible? Or bad accounting makes a bad market, but can lead to good society? Is that a possibility? So these kinds of combinations—a puzzle—how do we resolve this kind of puzzle? I will draw the matrix on the whiteboard. Prof. Sunder, can you start responding to the question while I draw it, please?

Prof. Shyam Sunder

I drew the three concentric circles to illustrate that we could have a good accounting system, but a good accounting system can only be a part of a good market. The definition of a market and its functioning depends not only on accounting, but also on many other factors, and accounting choices interact with those other factors. Even if we could agree on a definition of better accounting, which is not easy to do, it does not necessarily mean that under all possible and varied conditions, we will have the best possible markets. The reason I put better markets inside better society is that a society has many aspects in addition to markets. We can have a society, in which markets function well, but it is not otherwise a prosperous or efficient, and various factors of society will interact with the markets and with accounting. I drew the concentric circles because there are a large number of variables to consider in deciding what accounting methods we should use. The question of accounting cannot be separated completely—may be partially, but not completely—from the question of better markets, and question of better markets cannot be separated completely from better society. Today's discussion, of course is focused on better accounting, but even if we agreed on a better accounting system, it does not necessarily mean that we will have better markets and better society. Because there are too many other factors that go into the creation of better markets, and even more other factors that go into creation of a better society.

Question 9: Capitalization of development costs

Prof. Eiko Tsujiyama

Thank you. Concerning substance of accounting standards, there are some practical questions from Mr. Murakami from Omron, which rather are practical questions and he apologizes for that. He says that he does accounting in that manufacturing company—Omron—and they are preparing to transition to IFRS. He asks that concerning the developmental cost, looking at how that should be accounted for as an asset for the company and for the investors, what kind of an impact or benefit would this new rule have? He says that he not clear about that. So what do you think about the capitalization of development cost, what are the benefits, and what are the impacts of this?

Prof. Shyam Sunder

I had the chance to visit Omron Corporation a few years ago, and it was a pleasure to see your products. Like other accounting choices, the capitalization of development costs will have different consequences for different parties involved in Omron. It may have some consequences for employees, some consequences for management, and some other consequences for shareholders and customers. It will also depend on how the capitalization of costs affects the real decisions of the company, such as the level of its development activities, choice of development activities and pricing of the products of Omron Corporation. At this level of generality, I cannot

know the effect of capitalization of R&D costs in Omron because the answer will depend on so many details.

Prof. Karim Jamal

Let me just comment very briefly. Recently our committee—the Financial Accounting Standards Committee of the American Accounting Association—sent a letter to the FASB about revenue recognition. And this kind of issue is becoming important, because increasingly the standard-setters want to say that if you incur costs upfront—say to get a customer, or to do something of that sort—they want you to write that off right away as an expense. So, for companies who incur a lot of upfront costs to get a customer, potentially this kind of accounting could have very severe consequences, because that expenditure is not considered an asset, but an expense, and will end up showing a lot of losses, even though they actually acquired a customer. Either those companies will have to change how they pay commissions to their salespeople, because they cannot officially book any revenue until the revenue streams come in later, or they will end up showing losses, when they are actually creating assets.

I think these kind of discussions that are coming from IASB, where they are trying to write a definition of an asset, or a definition of a liability, and then they are trying to apply that to everybody, creates huge distortions in certain parts of the economy, where it does not reflect at all the economic substance in that transaction. So, I think in that side of the economy there is potential for lot of harm to come if rules get applied in this kind of mechanical way.

Prof. Shyam Sunder

If I may add, FAS 2 was adopted on research and development costs in the US around 1975. It required all companies to expense research and development costs. This led to many research studies on this subject in the late 70s and early 80s. On the whole, they found that after the implementation of FAS 2, companies started to cut their R&D outlays because they did not want the R&D expense to cut their income. Many in academia and business argued that the FAS 2 hurt the US economy by discouraging research and development. A similar, more intense, debate took place in 1970s on accounting for oil and gas exploration. Successful-efforts accounting method is like the FAS 2, and full cost accounting method is more like capitalization. When the FASB tried to mandate successful efforts accounting in the oil and gas industry in the US, the industry lobbied heavily and the FASB had to retreat. The industry had argued that successful efforts accounting will lead to a substantial decrease in exploration for new oil and gas deposits.

Question 10: The role of academia in improving the accounting standards

Prof. Eiko Tsujiyama

Thank you. Later on, I hope I will have the opportunity to offer my observations, but I think I will take up the last question from Asst. Prof. Garcia from Gakshuin University, who is from France. She notes that Prof. Saito of Japan and Prof. Colasse from France—I am sorry about my French pronunciation—have the same idea as Prof. Sunder in particular about competition between standards. She further explains that these two professors have experience as standard-setters, but their opinion in promoting competition between standards has never become the majority opinion. She notes that even being from such renowned professors, their opinion could not become the majority opinion. She asks that what normal researchers in accounting could do in order to contribute to the improvement of accounting regulation.

Prof. Shyam Sunder

I am honored to share some thoughts with Prof. Colasse, and Prof. Saito. Your question about the role of academics is very important. Society gives us time and resources to generate ideas, to analyze them and to share our analyses with the world. People in business, government and policy-making, standard-setting, our students, and the public look at the ideas, and reject most of them, as they should. Most new ideas turn out to be not good, even though they are generated with good intent. A scientist in a chemistry lab may generate millions of new molecules, of which only a few may turn out to be useful drugs? Most product designs, say of cell phones, never come out of the firms, because most of them turn out not to be so good. The same is true of new ideas we may generate. Our job is to generate ideas, and they get filtered through discussion, discourse, publication, criticism. A few may survive the filter of discussion and criticism to be adopted by others occasionally. This process may take a long time. We should not expect our ideas to be accepted when we propose them. There is a high chance that new ideas are bad, and they should never be accepted. Society should, and does protect itself from unfiltered ideas as well as unfiltered water.

Prof. Karim Jamal

As a Chair of an American Accounting Association committee—Financial Accounting Standards Committee—that provides input to the standard-setters and to the regulators, we have been discussing this issue. What is the best way that professors can contribute to the standard-setting process?

Well, historically in the United States, the way in which professors have sought to influence policy is by responding to exposure drafts from regulators, and sometimes, by working for the regulator and helping to actually draft the exposure draft. That was part of the mandate of our committee, where we were required to respond to the regulators when they asked for comments. Sometimes, some of our members had actually spent a year working for the regulator in formulating those proposals.

When I became the Chair of this committee, I believed that it was not enough. Responding to the exposure drafts is what I call the “acting in a firefighting mode.” The regulators got to decide the issues and define the terms, and then they sought comments from us, and we were coming in too late into the process. As part of our charter, we would do it, but in addition to that we decided to take an independent stand on thought leadership. And so I took my committee and divided it into subgroups, and assigned a topic to each subgroup. So one subgroup was told, suppose you could think about a conceptual framework from the ground up, if we had a chance to rethink the conceptual framework completely, what would you come up with, and explain why, and how you would justify what the standard-setter should do, even though the standard-setter have not asked us any questions about this, and they are not necessarily doing this right now. We took another group and we asked them to look at revenue recognition again from the scratch, before the regulators come and asked us specific questions. And then we did the same thing for disclosure. So, before the standard-setter puts it on the agenda, can we just have some pure academic thinking of what do we understand about this problem, and how could you think about this problem. Then, we encouraged the rest of the committee to critique these, and if needed even to write a dissent, so that the opinion of the committee would not be a forced consensus.

Now a third thing we have started to do or we have been talking about doing is to try and engage the whole membership of the American Accounting Association, and so for conceptual framework, for example, we decided that first the committee members would sit down and ask the question: when we are trying to teach accounting, what are the concepts of accounting that

we have the most difficulty in teaching? What is that about accounting standards that is not intuitive, which is not easy to explain that students cannot understand? And then, just kind of creating a list of such issues. Then, what we thought we would do is that we would engage the entire body of accounting professors—now the membership of the American Accounting Association is actually global, where about 300 Japanese professors are also members. So, we thought we would poll our entire membership and asked them of the above questions. We thought that might be very useful feedback to give back to the standard-setters, and say to them, look here, in this particular standards there are places where nobody seems to understand how to apply, and creates enormous amount of difficulty.

Thus, we are now trying this three parts strategy, 1., to respond to exposure drafts directly or being in the regulator, 2., to promote pure thought leadership projects, and 3., to engage the whole professoriate and maybe eventually engage financial executives, and see what are the problems that they have, and bring those back to the regulators, so the regulators can understand what part of what they are doing that most people do not get.

Question 11: Why Canada decided not to use their own standards for the listed firms?

Prof. Eiko Tsujiyama

That is the end of questions from the audience. Finally, let me obtain your opinion on certain issues. It is often said that the Japanese accounting professors might be isolated, and that the American professional accountants agree with fair value. Therefore, is it that only the Japanese accounting professors who are against fair value? As was mentioned by Prof. Jamal, there are 10 members on the Financial Accounting Standards Committee of the American Accounting Association, and I am one member of that committee. In fact, I do not feel that I am isolated. After listening to today's discussion, I think there is a shared understanding about IFRS adoption between the Japanese academia and the American academia, which is not only held by the two guest speakers. I have been able to reconfirm my own understanding, the feeling that the US probably would not go for adoption. That was already my gut feeling and I was encouraged that many people here share this feeling.

Earlier Prof. Uemura made a comment, and so let me repeat that again. According to what we heard earlier, if you look at the non-EU adopted countries, most of them are emerging economies, and because they had to borrow from the World Bank they adopted IFRS as a condition. But, Canada is an exception, which is an advanced economy and it is a unique country. Although, the US GAAP is permitted, Canada has decided not to use the Canadian standard for the listed companies. Prof. Uemura said that in case of Japan, assuming that it is still right after the Second World War and there was no mature market, it is possible that Japan might have been forced to accept such a proposal. The outcome, however, might have been different after the war and today. Prof. Uemura just shot out that question and left. Therefore, the question is that why in Canada did they decide not to use the Canadian standards for the listed companies? That would be the final question.

Prof. Karim Jamal

I think because of the very close integration between the Canadian economy and the US economy, the Canadian standard-setters had always been under tremendous pressure in Canada to be like the US. Historically, the pressure against the Canadian standard-setters came mainly from within Canada, where the largest companies, the most powerful companies, and the most influential companies being cross listed wanted to use US GAAP. Right from the start, in a

sense, the Canadian regulators had very little independence within Canada, because they were under tremendous pressure not to create differences with the US. So, by convincing the regulators to allow Canadian companies to elect to go with the US alleviated a lot of pressure off the Canadian regulators.

But, then the Canadian regulators came under a different kind of pressure, which came from much smaller companies, and particularly from their auditors. Private companies in the US are not required to follow GAAP, which is the case in Canada as well. So, what the private companies started doing is that they started dropping the audit. They just said we do not want GAAP, and we do not want to be audited because the only way to be audited was to follow the GAAP. The only way the auditor could offer an opinion is if the company was following GAAP. Therefore, the audit firms started to lose all their small clients, and the Canadian standard-setting board came under tremendous pressure to create a new set of standards for the small companies, where most of which were private. Accordingly, instead of looking at a size test, they made it a private-public test.

I think at the end of the day, they came under so much pressure from both sides that by allowing big companies to use the US GAAP, they effectively lost all of that side of the economy, and then they said maybe we should just start writing standards more for the smaller companies, public sector, and for the nonprofit entities, and to concentrate there. So, I think that is kind of where ultimately the political pressure kind of forced them. Otherwise, the pressure to follow US was just too strong. It is too strong and the economies are too integrated to move Canada away from the US.

Closing Remarks

Prof. Eiko Tsujiyama

Thank you. We were overwhelmed with so many questions. I wanted to ask each person who raised questions to give us some additional comments, but we made a decision to just read out the questions. In addition, we are about 10 minutes behind our official closing time. I want to thank you for joining us in this discussion over this long session.

I think it was a very fruitful symposium. That is my personal view, and that is because we had these two very prominent speakers with a lot of insight. I am very grateful to the two professors. With that great appreciation, we shall end this session. Thank you very much.

Prof. Masaki Yoneyama

Thank you. And with that we close our symposium. One request, as we said at the outset the simultaneous interpretation receivers should be returned at the exit, there is a box at the exit. Please put the receiver in the box when you leave. That is all. So thank you very much.