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What IFRS means for executives

Rules changing

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Starting in 2010 and in full swing from 2011, International Financial Reporting Standards are coming to Canada for all publicly accountable enterprises, which includes financial institutions, companies listed on the stock exchanges and some government-owned businesses. To an unfamiliar observer, it sounds like another dull initiative of interest to corporate accountants and nobody else.

Yet IFRS introduction represents a significant change in the accountability and responsibilities of all C-level executives and an increase in corporate financial transparency. Some experts believe certain IFRS regulatory requirements might even be more demanding than that of the high impact Sarbanes-Oxley Act in the United States. Others stress that under IFRS, legal liability might shift from accountants to the CEO and other corporate non-financial executives. Almost all agree that with the IFRS takeover from Generally Accepted Accounting Principles, many a senior executive might be facing unexpected and unpleasant surprises.

Although IFRS is branded as a financial reporting framework, many of its long-term outcomes are likely to be nonfinancial -- exposing future projections and risks and enhancing corporate effectiveness. IFRS stipulates much greater detail and volume of financial statement disclosures than does the outgoing accounting method, making extensive use of cost/asset and revenue details, estimates, valuations, probabilities and assumptions. The supporting notes and text within financial statements take on significant additional importance.

A good deal of detailed information relevant to understanding financial performance is required to highlight cash flow, dividend policies, incentive arrangements, executive compensation, bonuses and profit sharing. Alongside IFRS, many countries are instituting the electronic tagging of statements using XBRL (eXtensible Business Reporting Language) and placing financial statements on the Internet. XBRL simplifies indexing and retrieval of particular disclosures, exposing previously obscure details in financial and performance statements.

Under IFRS, it is the enterprise management rather than the CFO that has the primary responsibility for presenting financial statements, affirming strategic and operational corporate plans, and ascertaining expected performance and risk threats. Compared to the old GAAP, the new system demands extra management reviews, professional judgments, formal signing of input statements by the CEOs and other non-financial executives, use of intricate risk estimation models and more accurate forecasts. It also affects the ways corporate stakeholders perceive how C-level executives discharge their responsibilities.

Corporate boards are required to approve IFRS-defined business programs, while providing strategic input and guidance to executive management. Top corporate executives and board members become liable for inadequate disclosure, misrepresentations contained in disclosure documents and failure to disclose material changes in a timely fashion. Due to IFRS's volatile financial reporting principles, the boards might question the adequacy of liability insurance for the directors, corporate officers and internal auditors.

When converting to IFRS from GAAP, what could at first glance seem like a small accounting difference might have significant impact on the company's bottom line. IFRS might impose the renegotiation of critical contracts, including loan agreements, credit line arrangements and executive compensation, and dedication of significant effort to investor/external stakeholder relations.

IFRS obliges corporate executives and boards to regularly review and certify, without reservations, financial input information for all substantive financial and risk data such as compensation of key management, not just the output financial statements as in the past. Although always recommended, many comprehensive accountability requirements were not formally prescribed under the old GAAP.

With its healthy stress on granular accountability and better informed shareholders, IFRS demands much higher accountability from directors and executives, opening the doors to new challenges and disputes. Under pressure from their stakeholders, top corporate executives and board members might find to their surprise (and sometimes years later), that they are personally accountable for certain past financial statement certification.

Members of the board of directors, facing the heightened expectations of corporate stakeholders, might more forcefully insist on radical improvement in the effectiveness of corporate management and accounting information systems. Gaps discovered in collecting and certifying of IFRS information could trigger the need for corporate investment in re-engineering business processes in order to improve performance and reduce risk. New more reliable process controls have to be defined and implemented.

Overall, IFRS introduction means both better protection of stakeholder rights but also increased corporate reporting and legal hurdles. Fasten your executive seat belt.

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