

The maturing of IFRS

Ian Mackintosh, November 2014

Ladies and gentlemen, it is a pleasure to be with you this morning. I would like to thank the hosts, Ernst and Young, for staging this important discussion on the outlook for financial reporting. Back in 2001, when the IASB began its work, the outlook for financial reporting was different in pretty much every country in the world. Today, IFRS means that the outlook for financial reporting is the same for most countries in the world. Accounting is on the cusp of becoming the world's first global profession, largely thanks to IFRS. This is remarkable progress in little more than a decade. We should all be proud.

In previous speeches this year I have addressed two specific themes.

First, I shared my view on the [inevitability of global accounting standards](#). How the demand-side of economic globalisation and international business has been satisfied by the supply-side of IFRS as the globally consistent language of financial reporting.

Second, I have talked about the success of the IFRS model. How moving from convergence in national standards to adoption of the same global standard has revolutionised the financial reporting landscape around the world.

Today, I will talk about the 'maturing of IFRS'. How the first decade of frenetic change in financial reporting around the world will I hope, for many of us, be followed by a period of relative calm. For Europe and many other parts of the world, IFRS is a decade-old news story. The cost and burden of transition is behind you. The convergence projects, and some really substantial improvements to our Standards, are largely complete. Perhaps we are moving from the build-out phase of global standards, to a period where the focus is on the maintenance of those standards and working with others to encourage their consistent implementation.

To a large extent the fulfilment of this vision is in your hands. Next year we will have an agenda consultation and you, our constituents,

will tell us how you would like to see the next few years play out. In the last agenda consultation, many pleaded for a period of calm, but then they had a few favourite projects they would like to see progressed, and, of course, we had the convergence projects to complete. Let's see what next year's consultation tells us.

The same is true of the IFRS Foundation as a whole. Four strategic and constitutional reviews have transformed the organisation from a young upstart into a mature international organisation, highly consultative with sophisticated processes and high levels of accountability. We will have another of these reviews next year.

A decade of IFRS

In a few weeks' time, it will be ten years since the European Union adopted IFRS. On 1 January 2005, the then 25 Member States simultaneously made the transition to IFRS from different and generally incompatible sets of national accounting standards. IFRS provided Europe with an off-the-shelf, high quality set of accounting standards for use across the European Union.

Australia, New Zealand, Hong Kong and South Africa quickly followed in adopting IFRS. Those decisions provided the necessary legitimacy and momentum for most of the major economies of Africa, Asia and the Americas to also begin their transitions to IFRS.

Research that we recently conducted shows that 114 countries of 138 countries we surveyed require the use of IFRS for all or most publicly listed companies. In other words, four-fifths of the countries that we researched are now mandating the use of IFRS. On top of that, IFRS is the predominant reporting language for most global industry sectors, while far more Global Fortune 500 companies use IFRS than any other reporting language—52 per cent use IFRS, while the next closest is US GAAP at 29 per cent.

Of course, we cannot ignore the fact that the remaining one-fifth of countries includes some very large economies, such as China, India, Japan and the United States. However, even here we continue to see good progress towards IFRS and global standards.

You may be aware that China has already made the transition to Chinese Accounting Standards, which are similar to IFRS. However, you may not know that Chinese companies that represent more than 30 per cent of the total domestic market capitalisation in China also report using full IFRS for the purpose of their dual listings in Hong Kong. Hong Kong has itself been fully on board with IFRS since the beginning.

India is about to make the transition to an entirely new set of Indian accounting standards that are based on IFRS. At present, Indian companies are able to apply full IFRS if they wish and we are hopeful that this will continue. We are working with the Indian authorities to minimise the differences between these new Indian standards and IFRS.

Japan is perhaps the most interesting case study for IFRS adoption. In 2009, the Japanese authorities allowed domestic companies to voluntarily apply IFRS. This approach has allowed Japan's largest, most internationally oriented companies to benefit from IFRS adoption, without imposing the burden of transition on smaller Japanese companies that see less benefit from an immediate transition.

As of today, 46 domestic Japanese companies with a combined market capitalisation of 63 trillion Yen have adopted full IFRS or announced plans to adopt it. According to the annual reports of these companies, the top three reasons for making the transition to full IFRS were, first, comparability with global competitors, second, the spread of their shareholder base and third, for management efficiency.

Use of full IFRS is also one of the determining factors for Japanese companies to qualify for to be included in the recently launched JPX-Nikkei 400 Index—an index that, according to a recent article in the *Financial Times*, has become very popular with international investors.¹

¹ 'Japan groups take a shine to JPX-Nikkei 400 Index', *Financial Times*, 15 June 2014, www.ft.com.

In the US, SEC Chairman Mary Jo White signalled earlier this year her desire to provide some clarity about whether and how the SEC will move forward on IFRS. We look forward to working with the incoming SEC Chief Accountant Jim Schnurr on this important topic.

However, we should not forget that the US already has a significant interest in IFRS. The SEC oversees the IFRS-compliant filings of almost 500 foreign companies listed on US markets. Those 500 companies have a combined market capitalisation that runs into trillions of dollars.

High quality standards

Widespread use of our Standards is only half the story. Those Standards must be of high quality, and capable of being applied on a globally consistent basis.

When the IASB began its work in 2001, we inherited a set of International Accounting Standards, or IASs, developed by our predecessor body, the part-time International Accounting Standards Committee, or IASC. While the IASC had done much good work, its standards were not required for use by any major economies. Those standards needed significant upgrading in time for use by the European Union and others in 2005.

At the same time, the United States was going through what Paul Volcker, the legendary former Chairman of the Federal Reserve, called a 'crisis in accounting'—caused by the failures of WorldCom and Enron.

It made perfect sense for the IASB and our US counterpart, the FASB, to work together to improve our respective sets of standards, and in doing so bring about their convergence.

That was the beginning of the convergence project, known as the Norwalk Agreement. After more than 12 years of effort, we are approaching the end of that programme.

The convergence programme has had many successes, as well as several challenges. We have achieved converged outcomes in many

areas, such as segment reporting, business combinations, fair value measurement and, most recently, revenue recognition.

However, convergence has been more elusive in areas such as financial instruments accounting.

Nevertheless, it is clear that the convergence programme has significantly contributed to the quality of financial reporting globally, even if the model does not always deliver the perfect outcome. The last of the convergence projects is lease accounting. We are working hard to achieve convergence in this project. We should issue a Standard in the first half of next year and time will show what degree of convergence we will have achieved.

The quality of financial information produced by IFRS is very high, thanks to the work of the IASB, but also to the convergence project with the United States. And a decade of use by both advanced and developing economies has shown that our mission of a single set of high global accounting standards is desirable, achievable and in my view, inevitable.

What next?

So, what next? What should you expect from the IASB in the coming decade?

Standard-setting

So, back to our 'period of calm'. I am sure that most people here in the room would hope that, after a decade of almost continuous change in financial reporting, we could have some relative calm. For companies here in Europe, the upheaval of making the transition to IFRS is well behind you, and the major convergence projects of the last decade are now largely complete.

Lease accounting and Insurance Contracts are the two big projects to be completed, which we hope to do next year. The *Conceptual Framework* is also being finalised, but that is unlikely to lead to significant revisions to our Standards.

I am not suggesting here that the IASB is planning to shut up shop, or that our existing Standards are perfect.

As I mentioned earlier, we have an agenda consultation next year and we are very keen to hear what you say. If we wanted to continue the same frantic pace as the last ten years, it would be easy to do so.

Our present research includes topics like business combinations under common control, equity/liability, equity method, foreign exchange, extractive activities, income taxes, pensions and share-based payments. All of these have the potential to become very major projects if we were to go back to basics.

What do you think we should do? Do you have other projects on your list? Should we be really serious about a period of calm?

We could see more stability in our Standards: more targeted improvements, less wholesale change.

A good example of targeted improvements is our Disclosure Initiative. This important project will seek to achieve improvements to the usefulness of financial disclosures through a series of targeted improvements to our Standards, such as amendments to IAS 1 and IAS 7. Through our research programme we will also consider whether further guidance on materiality is needed. We will also look at the possibility of developing a set of principles for disclosure in IFRS.

Implementation

Whether we have a period of calm or not, we need to prioritise consistent implementation across IFRS users.

Even in a single IFRS jurisdiction, such as Europe, the consistency of IFRS implementation can vary. Indeed, a 2013 study by Cass University and supported by Ernst and Young made this very point². It is incumbent on standard-setters, regulators and the accounting firms to work together to improve consistency in the implementation of our standards.

From the IASB's perspective, there are various steps that we are taking to enhance consistency of implementation.

² Amiraslani, Latridis & Pope (2013), *Accounting for asset impairment: a test for IFRS compliance across Europe*, www.cass.city.ac.uk

First, when we are developing Standards, we have various mechanisms in place to ensure that our Standards are capable of being applied on a globally consistent basis. We consult publicly at each stage of the process and proactively seek out feedback from relevant parties.

We work in close co-operation with national and regional accounting standard-setting groups, to seek their advice on the best way to draft our Standards in such a way that they can be applied in a diverse range of economic environments. We also tightly manage the translations process, to ensure that each of the 40+ languages that IFRS is translated into are consistent with the authoritative English version.

We have an Emerging Economies Group that looks at the challenges of applying IFRS in countries without deep and liquid capital markets. We have also recently formed an Islamic Finance consultative group to consider the challenges of applying IFRS for Shariah-compliant transactions. These are just some of the ways by which we ensure that IFRS are capable of being applied on a consistent basis.

Second, we have reformed the IFRS Interpretations Committee, to provide it with a much broader range of tools to address divergence in practice, where it occurs. For example, the Interpretations Committee may ask the IASB to take on targeted, narrow-scope amendments that do not fall within the scope of our annual improvements process, or it may ask the IASB for additional illustrative examples to be added to the Standards.

Third, we have formalised our working arrangements with IOSCO, the international network of securities regulators, through the creation of a Statement of Protocols. That statement describes the steps that they and we will undertake to enhance consistency in the implementation of IFRS. For example, we will share information on the implementation of IFRS around the world, and collaborate more closely in the development of Standards where consistent implementation may prove challenging. We have also agreed a

similar arrangement with ESMA, the European Securities and Markets Authority.

Finally, our Education Initiative has for the last few years worked in close co-operation with the international development agencies and others to run conferences around the world on IFRS, and to train the next generation of accountants in applying principle-based Standards. This has been a very important part of our work, if even if it has not been the most visible to the outside world. We intend to develop our education activities further in the coming years to help achieve consistent implementation.

Close

Ladies and gentlemen, I will now draw to a close. I have talked about how the last decade has seen a dramatic change in the financial reporting landscape through adoption of IFRS and improvements to those Standards.

I have shared with you my thoughts on what the next few years hold, Some of this is in your hands through our agenda consultation. Regardless what we do with our Standards we will have a greater focus on working with others to encourage consistent implementation of those Standards. IFRS has had a challenging, sometimes difficult, but successful 10 years. Let's build on that strong foundation. I welcome your comments and look forward to a lively question and answer session.