

## IASB MEETING WITH WORLD STANDARD SETTERS

25 SEPTEMBER 2006

### "IFRS – A VIEW FROM A BIG 4 FIRM"

Samuel A. DiPiazza Jr.

Thank you very much for that introduction. I am extremely pleased to be here today. While I am honoured to serve as a Trustee of the Board of Trustees of the IASB, I am joining you here today in my capacity as Global CEO of PricewaterhouseCoopers.

So I am going to give you a view of our progress and our challenges from the perspective of the largest firm in the world, not of the Board of Trustees. While I think most of the accounting profession would agree with my thoughts and concerns, I would not want to presume so, and want to be clear I speak only on behalf of PwC.

Let me first thank each of you for being part of this symposium today. Our world today is a very challenging one. Your work as standard setters is critical in our journey together to build transparent and effective markets. This is an important meeting, a gathering of world standard setters at a critical time in this process, assessing what has been accomplished and anticipating what lies down the road.

The work of the International Accounting Standards Committee started in the early 1970s. Then it was visionary; today the IASB is a major force in the corporate reporting world -- driving tremendous progress, particularly over the last 3-5 years.

But together we do face many challenges:

- We find ourselves, **collectively**, being challenged by preparers, for the complexity of reporting standards.
- We find ourselves, **collectively**, being second guessed by regulators for inconsistent interpretations.
- We find ourselves, **collectively**, struggling with insuring that the corporate reporting model remains relevant to the investor, a primary stakeholder in this entire effort.

How we respond to these challenges will determine the future effectiveness of the capital markets.

This morning I want to share PwC's view on the significance of our drive to effective IFRS standards. I would also like to talk with you about the steps we are taking at PwC to ensure consistent implementation. In the process I will share our experiences during the first year and some of the challenges we see going forward.

I will keep these remarks brief -- hoping we will have some time for questions.

## 1. SIGNIFICANCE OF THE IFRS PROJECT

A few years ago, along with Bob Eccles, I wrote a book entitled Building Public Trust. In that book, we talked about what makes capital markets work. We used words like "integrity" and "accountability," we talked about the need for a different framework for financial reporting and the emergence of XBRL. We also said that without transparency, the markets do not have a chance to operate.

The markets are based on the presumption of the availability of financial information presented in a timely, clear, and understandable manner, according to standards that are logical and consistently applied. We said that in order to help facilitate the efficient movement of capital and labour between countries, we needed a common language, one set of consistently applied global standards for measuring and reporting on companies' financial results.

All of us in this room have all spent our lives dedicated to the commitment of efficient capital markets. That is why the IFRS effort is worth the battle. It is really about a framework of clear, understandable, relevant, and consistent financial information.

The pace of movement to a globalised and connected capital markets has accelerated, meaning our move to a single set of standards is more critical than ever. There are very few national markets. At a minimum we operate in regional markets, and almost always in global markets. So it should not surprise us that the investor expects that financial information in China could be interpreted just as information in Germany might be interpreted.

And in the past several years, because of your good work, we have come to realize that this might actually be possible -- through the implementation of IFRS.

Together we have made good progress, not easy, but clear progress. Our PwC survey research says that four in every five European fund managers believe the adoption of IFRS is a significant development for financial reporting. In some countries the figure was over 95%.

Transforming the standards in 100 countries (including the 25 EU member states) towards a single basic platform is not just a noisy "big bang" -- but a courageous leap -- towards global standards. Not French or German or UK standards... but global standards for global capital markets. For countries that already had a well established GAAP, this path to global standards was not without sacrifice.

Many of you here today made some very difficult decisions, and yielded a certain amount of authority, in order for all of us to reflect the reality of global capital markets. It took compromise, it took trust, it took hope.

The hope is that this movement toward a common principle based system will usher in greater transparency, lead to improved market confidence, and enhance attractiveness for investment.

Although it is still too early to conclude on 2005, most seem to agree that, all things considered, the transition went reasonably well.

But a **few key questions** remain:

- “Will we remain disciplined in developing principled based standards that reflect economic reality, not just accounting theory?”
- "Will companies and other market participants live up to an environment with broad principles but fewer detailed rules?"
- “Will the regulators accept judgments that might vary based on circumstances and backgrounds?”

We estimate that it will take several years for the market to become familiar with reporting under IFRS and to gain the necessary prior-year reporting experience to be able to undertake year-on-year comparability and benchmarking.

## **2. HOW PWC IS HELPING TO ENSURE CONSISTENT IMPLEMENTATION**

Ever since the decision was made in Europe to adopt IFRS, PricewaterhouseCoopers has been "warming up" our market for the change - through publications, training and general "awareness" building. Over the last five years our central team has distributed over 750,000 copies of IFRS publications and practice aids. As we neared 2005, our emphasis moved from education to developing the processes that promote consistent application of IFRS among our clients.

As a global accounting network, one of our roles is to help minimize differences in how different companies and different teams of auditors in different countries interpreted and applied the standards. I say "minimize" because the IFRS standards require judgment to apply them and, in some cases, allow for the use of alternatives. Two professionals exercising reasonable judgment might well come to two different but perfectly legitimate conclusions in relation to an issue. And every company has different facts and circumstances.

Consistency means an acceptable interpretation in every case -- what it does not mean is an identical application and interpretation in each case.

We looked at the challenge of thousands of clients converting to IFRS as an opportunity to re-configure the organization of our accounting technical and consulting activities around the world.

A new position in our organisation – Global Chief Accountant – was created to drive through the necessary management changes and set up the policies and protocols for how

our view is reached on client and engagement team technical consultations. This Global Chief Accountant, based here in London, oversees our advice on all IFRS and US GAAP issues.

We have over 100 of our partners around the world dedicated to consulting with our practices to insure a high quality of implementation across our network.

In addition to formalizing the infrastructure, we implemented a number of important practical steps to facilitate consistency:

- Encouraging discussion of accounting issues at an industry sector level (IFRS industry technical groups for banking, insurance, pharmaceuticals, telecoms, etc.);
- Identifying IFRS topic specialists who dialogue with their fellow specialists around the world on a regular basis (our global IFRS team includes specialists in business combinations, financial instruments, revenue recognition, pensions, etc.);
- Designating "accredited" IFRS specialist partners and senior staff around the world who can review the IFRS accounts of major listed clients; and,
- Cascading our centrally developed training materials. For example, this summer over 1200 of our people attended our central IFRS events run regionally in Europe, Asia, the Caribbean and the Americas. This training was then in turn rolled out to thousands of our people around the world.

The fact that IFRS is new and truly international means that finding answers takes more time, particularly as the people interpreting the standards come to the process from a variety of cultural, legal and educational backgrounds. Some technical answers are taking longer to research, discuss and respond to than we would ideally like. And, in truth, our clients are pushing us to improve our rate of response.

This is part of the learning process -- one that should ease as time progresses and key issues are settled.

### **3. CHALLENGES RELATED TO FIRST TIME ADOPTION OF IFRS**

Let me talk about some of the more significant challenges we witnessed relative to the first time adoption of IFRS. A number of challenges faced the preparer community. Let me mention just a few.

**Timing.** The 2005 requirement in Europe was both an advantage and a disadvantage. Some of the standards to be implemented in 2005 were not finalized until quite late. In Europe this was exacerbated by the time taken to endorse the IFRS standards for use in the EU - up to 8 months in the case of some standards. The European Commission has acknowledged that this has been an issue.

**Client preparedness and the underlying systems.** Our experience was that many companies managed to meet the 2005 deadline to publish their first IFRS financials only because they established dedicated project teams to work on the transition. In some cases

the objective was met by deploying "work-arounds" -- for example using spreadsheets to generate some numbers and disclosures. That worked for 2005, but the real challenge is to move from the project phase to "business as usual." IFRS is here to stay and companies need to have flexible and durable systems that generate IFRS-compliant data. IFRS needs to begin to migrate from the finance function to the business units in companies. Otherwise we will have financial reporting control issues, resulting in errors and restatements.

Use of non-GAAP information. We observed some companies publishing different sets of information for different constituencies. For instance, companies are now employing IFRS financial statements for statutory purposes and regulators, while compiling material containing financial indicators different from IFRS -- for Board members and analysts.

This is an issue with potential for confusion -- and it is something all participants in the corporate reporting process need to address.

There has been concern about certain areas of standards. Earlier this year PwC surveyed almost a 100 UK Finance Directors from FTSE 350 companies. We asked them to identify the specific areas that created the greatest additional work (and costs) for preparers of IFRS.

Not surprisingly, they identified areas such as

- financial instruments;
- share options;
- deferred tax; and
- identification and valuation of intangible assets.

Some of these areas require a much greater focus on valuation and the underlying economics than was perhaps the case under previous GAAP. As we embrace more standards that portray the underlying economics, we need to look at the skill sets needed by those working in all parts of the financial reporting supply chain, including preparers and the profession.

More than a third of the companies surveyed claimed they encountered surprises in terms of finding additional, unexpected differences in their IFRS accounts.

They also noted that, while internal personnel have largely taken the strain of the conversion work, nevertheless, costs have been incurred, and in some cases quite significant amounts.

Many Finance Directors also revealed that they are doubtful of the IFRS knowledge of their CEOs and other board members, as well as the IFRS understanding of fund managers and analysts.

Unfortunately, some see the standards as primarily a back-office book-keeping issue with limited implications for the fundamentals of the business.

It is clear that on-going work is required to embed IFRS.

One observation I found very disturbing was that a sizable proportion of Finance Directors are doubtful about the ability of the current standard-setting process to deliver high quality enforceable global standards in the future. They see the potential of what we think of as international standards developing into locally defined, different standards around the world. In effect, returning to whence we have come.

These findings represent one viewpoint.

They are in sharp contrast to the results of a similar PwC survey of European fund managers or, in other words, the investors. The fund managers contend they have a good understanding of the impact IFRS has on companies and say they find IFRS information useful. They also have more confidence in the future quality of global accounting standards, and say they see more advantages from the greater use of fair values.

So why the difference of view? The relative enthusiasm of investors may reflect the fact that they haven't had to bear the costs and are more likely to see immediate benefit from some of the increased disclosures and pan-European or global comparability. And I remind you that the investor is the most important stakeholder in this process.

But some of the real complexities of IFRS may also not yet be fully apparent to investors. Perhaps the most significant conclusion to draw from these opposing views is the need for more facilitated dialogue on financial reporting between the preparers and users of accounts. I will be interested to see how these opinions may change in Year 2.

#### **4. ITEMS THAT COULD DERAIL THIS EFFORT**

We must remember are still in the initial stages of this journey...and while we can see enormous progress...there remain a number of important items that could derail this effort.

Specifically:

- A lack of global consensus around consistency and judgement, and
- Concerns whether the reporting and regulatory cultures between the US and elsewhere can be aligned sufficiently to enable a satisfactory conclusion to the FASB/IASB roadmap. Many continue to ask the question: "Convergence, yes...but at what cost?"

Let me talk about each of these challenges.

As expected, the first time through the process, we are seeing accounts that still convey an obvious national identity. While we expect that different jurisdictions will travel different routes toward one set of global standards, our concern is that some countries may stop short of the ultimate destination – bowing to internal pressures such as legal frameworks, national mandates, and local business realities -- to create their own version of IFRS. Such

a scenario would risk undermining many of the potential benefits arising from the introduction of IFRS.

We also need to guard against individual countries or authorities publishing detailed application guidance on IFRS - as they did under their national GAAP. And that includes the SEC within the USA. If regulators find it absolutely necessary to issue implementation guidance, they should ensure that such guidance is consistent with global interpretations.

It is important that we involve international organizations such as IOSCO and the Basel Committee, and regulators at the national and international level, to ensure these instances are kept to a minimum. The goal is compatibility, equivalence and comparable results -- but not wholesale uniformity.

Management and auditors must have the ability to make reasonable judgments around GAAP. These judgments are necessary and should be respected by stakeholders in the financial reporting process. The test for the reasonableness of a judgment should be based on how well it conforms to the principles underlying the relevant standard.

Now we, in the profession, are a significant part of this problem. I understand the reality of the situation.

Preparers and auditors need to exercise greater restraint in calling for detailed interpretations of how IFRS and US GAAP should be applied in particular circumstances. Auditors must exercise their judgement -- and must be empowered to say "no" -- even if there is not a rule against a particular accounting treatment. For some preparers and auditors, this will require a change of mindset.

And regulators must provide for judgments that do not land in a very narrow space. Otherwise, we should simply create the rule book and we can remove all judgments.

We also have to acknowledge the crucial importance of the removal of the US GAAP reconciliation. The true convergence of US and global standards is a difficult feat. Even where they appear converged at 50,000 feet, the volumes of US implementation rules undermines any true convergence.

US investors, banks and other sources of capital are diversifying outside the US. As the rest of the world moves to using IFRS, US markets will increasingly have no choice but to begin to understand, and gain knowledge of the international standards.

## **5. PROGNOSIS FOR SUCCESS**

As we look to the future I believe we can be optimistic. Although the jury is still out on 2005, based on what we know so far -- the first hill -- the biggest hill -- has been successfully scaled. In one swift move we have witnessed a dramatic reduction in the number of financial reporting standards used around the world by listed companies -- a

great benefit to businesses and to investors.

The new IFRS standards are not perfect. Even the IASB does not claim that the standards are a finished product. The accounting standards, like business practices and processes, will evolve over time as circumstance and experience change.

While implementation has been generally successful, that has not yet translated into full understanding of the implications of the change. We can expect some uncertainty in the market about how to interpret the first sets of results, particularly for certain companies or specific sectors.

Also, as we look to the future, we anticipate that the IASB/FASB "roadmap" program will result in a number of new standards being effective from 2009. I believe the IASB has been very responsive to the cry for stability and time to incorporate new standards. The delay is good for all of us. But it is important that we educate the market that there will be a good deal of preparatory work in the run-up to those 2009 standards.

The IASB must continue to draft standards that are both responsive to the needs of the market and capable of practical implementation.

The IASB has developed a very thoughtful due process approach. They must live religiously to that process.

Preparers and others must be more fully involved in the debate as these next standards are developed, not waiting until late in the game to express their opinions.

To date, the preparer and investor communities have perhaps not made their voices heard as early as needed in the process.

We all have a responsibility to encourage the Board to promote an open dialogue and consider a wide range of viewpoints.

Inviting speakers representing different elements of the corporate reporting process, to share our thinking and experiences, is an obvious example of this.

I sincerely appreciate this opportunity to provide the PwC perspective.

I hope my observations have been helpful -- now I would welcome any comments or questions. Thank you.