Keeping capitalism honest: comments by Hans Hoogervorst, 2014 IOSCO conference
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First of all, I would like to say how pleased I am to be here in Rio de Janeiro. It is always a pleasure to be in the Cidade Maravilhosa, where I spent time as a student of Brazilian modern history. At the time, 30 years ago, I could never have imagined coming back to Rio in the role of accounting standard-setter!

It is also a great pleasure to see so many friends and former colleagues from the International Organization of Securities Commissions (IOSCO). Last year we agreed a joint Statement of Protocols with IOSCO and we recently had a very successful meeting with IOSCO Committee 1 in Tokyo. Securities regulators and the IASB have the common objective of protecting investors and that makes us natural allies.

Today I would like to discuss the essential role accounting standards have in strengthening corporate governance. The financial crisis has made perfectly clear that the global economy has to reduce its dependence on bank financing. The banking system is fragile and fraught with moral hazard. The United States was able to exit the crisis quicker than the rest of the world because it is less reliant on bank financing. So we need more market financing, especially in the emerging economies and in Europe. In fact, the new European Commission will make the development of an integrated Capital Markets Union one of its central goals.

Yet the capital markets are not immune to moral hazard either. Since publicly listed companies are working with other people's money, there is the classical principal-agent conflict between management and the shareholder.

Company management is under huge pressure from what some call 'Quarterly Capitalism'. The pressure to deliver short-term profits is tremendous and may jeopardise long-term results. Since remuneration is often tied to earnings, management may also have strong financial incentives for short-termism. Knowing how subjective some aspects of accounting and financial reporting can be, this is sometimes a truly frightening thought.

The investor is not in a very strong position to be an effective counterweight. With the increasing complexity and globalisation of the economy, the distance between investor and investee has increased dramatically. As a result, it is very difficult for investors to keep a close eye on the companies they have entrusted their money to. Corporate governance is constantly struggling to contain conflicts of interest between management and the investor.

The IASB plays an essential role in strengthening the corporate governance of the capital markets. Our job as an accounting standard-setter is to provide transparency and to keep

capitalism honest. Our Standards help to close the financial knowledge gap between management and the market.

So what have we done and what more can we do? The shared vision of the IASB and IOSCO is to provide investors with a single set of high quality accounting standards. Indeed, you gave us that goal at the Sydney IOSCO meeting in May 2000. Some 14 years on, we are close to achieving this goal.

We have just published a survey on the use of IFRS around the world. Of the 138 jurisdictions in the survey, 114 have adopted IFRS, while 12 more allow the use of IFRS.

The dynamics of IFRS-adoption are still very strong. The voluntary use of IFRS by Japanese companies is expected to increase to 25% of market cap in the next year or two. More than 250 of China's largest companies use IFRS for their dual listings in Hong Kong. Even in the United States, 500 foreign companies are listed using IFRS. Chair Mary Jo White of the SEC has repeatedly said IFRS remains an important priority.

So, globalisation of investment has finally been met by globalisation of IFRS as a global standard. Investors in Brazil are now able to monitor the performance of companies in Korea and vice versa. Many studies show that the spread of IFRS has indeed contributed to lowering the costs of raising capital around the world. All this represents tremendous progress to investors and it could not have been achieved without the help of securities regulators.

But our job is not finished. In some areas, investors are still not able to get a complete view of economic reality. One of those areas is leases. We are about to finish a new leases Standard and when it comes, it will not be one day too soon.

Currently, most leases are not reported on a lessee's balance sheet. For many companies, such as transportation, telecommunication and retail companies, the leverage caused by unreported leases can be quite substantial.

Let me just give a clear example of how misleading the off-balance sheet treatment of leases can be. Recently, we analysed five retail chains that went into liquidation during the financial crisis. We compared the debt reported in their balance sheets to their off-balance-sheet lease commitments. The reported debt of these companies was 7 to 90 times lower than the debt which was hidden in their leases.

Retailer	Operating lease commitments (undiscounted)[4]	Reported debt[4]	Operating lease commitments as % of reported debt
Circuit City (US)	$4,537m	$50m	9074%
Borders (US)	$2,796m	$379m	738%
Woolworths (UK)	£2,432m	£147m	1654%
HMV (UK)	£1,016m	£115m	883%
Clinton Cards (UK)	£652m	£58m	1124%

The bankruptcy of Borders, the US book store, shows clearly how fatal lease liabilities can be. Borders reported debt of $379 million when it also had off-balance-sheet lease commitments of $2.8 billion, more than 7 times as big. According to some, this company had not needed to go bankrupt, since half of its stores were still profitable. Its problem was that it could not get rid of its lease commitments for its lossmaking stores. It just goes to show that a lease is not much different from debt in its classical form.

For the investor, it was hard to see how indebted the company had truly become. For investors to be able to hold management to account, lease liabilities need to be on the balance sheet. Information in the notes is simply not enough.

Our upcoming leases Standard will do the job and will provide investors with the information they need to obtain insight in the true leverage of companies in the economic sectors that are significantly affected by it. But, predictably, resistance against the Standard is very strong. We still face an uphill battle to get the Standard done and then to get it accepted around the world. So, we need all the help of securities regulators that we can get. So we count on you!

The leases Standard is also a clear example how instrumental accounting standards are for investors to hold management to account. Good accounting standards are a bedrock for good corporate governance. We look forward to continue working with you to further strengthen corporate governance in the capital markets.

Thank you.